VAT UPDATE
JANUARY 2010

Covering material from October – December 2009

Notes prepared by Mike Thexton MA FCA CTA

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1. INTRODUCTION

These notes contain a brief summary of some of the main VAT developments in the last three months – Tribunal and Court decisions, changes in legislation, Customs announcements. They are divided as follows:

- outputs generally;
- land and property;
- international matters;
- inputs generally;
- administration.

The same main headings will be used each quarter. If nothing has happened under a particular heading in a particular quarter, that heading will be omitted – but all headings will still carry the same number. That is why some headings are included with "nothing to report".

1.1 Appeals pending

It is not possible to compile a comprehensive list of cases under appeal, and some of those which are thought to be still "live" may be dropped without a hearing. The following is compiled from several sources, and is just an approximate guide to some of the arguments that do not appear yet to have been finally settled:

For some years the HMRC website has included information about pending appeals, described as follows:

"*This section is aimed primarily at Tax Practitioners and has been introduced to highlight HMRC VAT appeals in respect of Tribunal decisions, and appeals by either party in respect of decisions in the High Court or above. The VAT Appeal Updates document will be updated on a monthly basis and finalised cases will be retained for viewing for two months before their removal.*"

Unfortunately the list does not appear to have been updated since June 2008, so it no longer provides any useful information.

VAT Appeals Update on www.hmrc.gov.uk/library.htm

Awaiting the ECJ:

- *AstraZeneca UK Ltd*: whether an employer is entitled to deduct input tax on the cost of buying face-value vouchers which are given to employees as part of their remuneration (referred by the Tribunal)
- *Axa (UK) plc*: whether charges for a payment plan for dentists included an exempt amount for collecting the payments (referred by the Court of Appeal; HMRC are appealing against decisions in the taxpayer's favour by the Tribunal and High Court)
- *Baxi Group plc* and *Loyalty Management UK Ltd*: whether promotion schemes created recoverable input tax for the company using the scheme on the cost of goods supplied to participating plumbers or loyalty card holders (given the reference numbers C-55/09 and C-57/09)

- *EMI Group plc*: whether the UK's rules on business gifts are in accordance with EU law (referred by the UK Tribunal)
- *Future Health Technologies Ltd*: whether the supply of services relating to the processing and storage of stem cells qualifies for exemption as "healthcare" (questions for reference covered in this update)
- *Macdonald Resorts Ltd*: nature of supplies where timeshares are sold for "points" (Court of Session has referred questions to the ECJ in taxpayer's appeal against the Tribunal decision)
- *T-Mobile Ltd*: whether additional charges for paying by cheque could be exempt (High Court has referred questions to the ECJ in taxpayer's appeal against the Tribunal decision)
- *RBS Deutschland GmbH*: whether arrangements exploiting differences between UK and German law on car leasing constituted an abuse of rights (Court of Session has referred questions to the ECJ in HMRC's appeal against the Tribunal decision)
- *Weald Leasing Ltd*: artificial leasing arrangements and abuse of rights (Court of Appeal has referred questions to the ECJ in HMRC's appeal against the High Court decision)

UK appeals awaiting hearing:

- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of ECJ's ruling on how "risk of distortion of competition" is to be applied
- *Pendragon plc*: HMRC will appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive"
- *Premier Food (Holdings) Ltd*: remitted to Tribunal following HC's explanation of errors of law in applying the definition of "confectionery"
- *WHA Ltd/Viscount Reinsurance Co Ltd*: whether the "offshore loop" plan was an abuse of rights (taxpayer has been granted leave to appeal to the House of Lords; Lords have stood the appeal over pending a potentially relevant infringement case in the ECJ)

In this update there are a number of appeals from decisions of lower courts, including *Oxfam*, *A1 Lofts*, *Boots plc* and several carousel cases. However, as HMRC no longer update their list, it is harder to know in advance that these cases are under appeal.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Political organisation not a taxable person

An Austrian political party incurred expenditure on advertising and recharged it to local branches. It also organised an annual party ball. It declared output tax in relation to the recharges and reclaimed input tax on the external costs of buying in the advertising. The Austrian authorities refused the claim, and the ECJ has confirmed their view. A political party which organises central expenditure and recharges it to branches is not acting in the capacity of a taxable person. It is not comparable to a commercial advertising agency.

In addition, certain subsidies paid to the party from public funds did not constitute "economic advantages" which would turn its transactions into economic activity subject to VAT.

ECJ (Case C-267/08): *Sozialdemokratische Partei Österreichs Landesorganisation Kärnten v Finanzamt Klagenfurt*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Transfer of reinsurance contracts

A German company transferred 195 reinsurance contracts to an associated Swiss company. The tax authority charged VAT on the transfer, and the company appealed. The case was referred to the ECJ.

The ECJ has agreed with the Advocate-General's opinion that a transfer of reinsurance contracts is a supply of services which is not an insurance transaction for the purposes of Article 13B 6th Directive, and it therefore does not qualify for exemption.

The court also ruled that the transaction cannot be regarded as an insurance transaction within Article 9(2)(e) 5th indent, so the place of supply does not shift to where the customer belongs.

The exemption for supplies of goods on which input tax was blocked on purchase (Art.13B(c)) also did not apply. VAT was therefore chargeable.

ECJ (Case C-242/08): *Swiss Re Germany Holding GmbH v Finanzamt München für Körperschaften*

Under the new place of supply rules from 1 January 2010, presumably a sale of the same type will become outside the scope of EU VAT. However, a transfer between member states will trigger a reverse charge in the recipient company, which will presumably not give rise to recoverable input tax as the business use is exempt.

2.3.2 Discretionary management

Investment management is a taxable activity unless provided to a special investment fund. Some discretionary investment managers currently charge separately a management fee (taxable) and execution fees for carrying out transactions (exempt). It has been reported that HMRC have been considering whether to challenge this split treatment, but have decided to take no action for the time being.

2.3.3 Payment processing?

The *T-Mobile* case is being referred to the ECJ. The Tribunal found against the company's claim for exemption of payment charges in early 2008. The company levied extra charges on customers who paid by cheque, in order to encourage them to pay by direct debit. Initially it accounted for output tax on the whole amount received from customers, but then it submitted a voluntary disclosure claiming a repayment of over £4m in respect of these charges for handling payments.

The Tribunal upheld HMRC's refusal (and policy in this area) in all respects. There was no separate supply of payment handling services: the company was simply collecting its debts, even if it purported to make a separate charge for doing so. If the Tribunal was wrong and there was a separate supply, it was incidental and ancillary to the main supply of telecommunications services, so it would take the same liability under *Card Protection Plan*.

The service that the company claimed to provide could be distinguished from that of *Bookit Ltd* and *FDR* (both held by the Court of Appeal to be exempt as involved in payments and transfers) because the company did not collect or transmit authorisation codes for payments – that was done for it by its bank. This effectively approves HMRC's policy on payment charges as explained in Business Brief 18/06 following the *Bookit* decision. Customs explained there that the Court of Appeal found for *Bookit* because its services included all of the following elements:

- obtaining the card information with the necessary security information from the customer;
- transmitting that information to the card issuers;
- receiving the authorisation codes from the card issuers; and
- transmitting the card information with the necessary security information and the card issuers' authorisation codes to Girobank.

The first three elements would be taxable on their own, but the fourth element was fundamental to the supply and made the whole thing exempt. Accordingly, Customs accept that card handling charges are exempt if they include the fourth element, but not if they do not. In particular, if a trader simply requires someone to pay more for goods or services because they are using a credit card to pay, that will not constitute separate consideration for an exempt supply of services. It will be additional consideration for the goods or services themselves.

That is the view that the Tribunal has accepted in this case. The High Court has now decided to refer the following questions to the ECJ:

1. What are the characteristics of an exempt service that has "the effect of transferring funds and entail[s] changes in the legal and financial situation"?

In particular:

a. *Is the exemption applicable to services which would not otherwise have to be performed by any of the financial institutions which (i) make a debit to one account, (ii) make a corresponding credit to another account, or (iii) perform an intervening task between (i) or (ii)?*

b. *Is the exemption applicable to services which do not include the carrying out of tasks of making a debit to one account and a corresponding credit to another account, but which may, where a transfer of funds results, be seen in retrospect as having been the cause of that transfer?*

2. Does the exemption in Article 13B(d)(3) of the Sixth Directive for "transactions concerning payments [or] transfers" apply to a service of obtaining and processing payments by credit and debit cards, such as those performed by the taxpayer in the present case? In particular, where the transmission of settlement files at the end of each day by the taxpayer has the effect of automatically causing the customer's account to be debited and the taxpayer's account to be credited, will those services fall within the scope of Article 13B(d)(3)?

3. Does the answer to Question 2 depend on whether the taxpayer itself obtains authorisation codes for onward transmission or obtains those codes through the agency of its acquiring bank?

4. Does the exemption in Article 13B(d)(l) of the Sixth Directive for "the negotiation of credit" apply to services such as those offered by the taxpayer in the present case in relation to credit card payments, whereby as a result of those services the customer's credit card account is debited with further amounts of credit?

5. Does the exemption for "transactions concerning payments [or] transfers" apply to services of accepting and processing payments made using third party agents, such as those offered by the taxpayer through the Post Office and PayPoint in the present case?

6. Does the exemption for "transactions concerning payments [or] transfers" apply to services of obtaining and processing payments made by cheque sent to the taxpayer or his agent, which payments have to be processed by the taxpayer and its bank?

7. Does the exemption for "transactions concerning payments [or] transfers" apply to services, such as those offered by the taxpayer in the present case, of receiving and processing payments made over the counter at a bank for credit, through the banking system, to the taxpayer's bank account?

8. What particular factors have to be taken into account when deciding whether a charge (such as the payment handling charge in the present case) that is applied by a taxpayer to its customer in respect of the customer's choice to make payment to the taxpayer using a particular payment method, and which is individually identified in the contractual document and separately itemised in invoices issued to customers, is a separate supply for VAT purposes?

ECJ (reference) (Case C-276/09): *T-Mobile Ltd v HMRC*

2.3.4 Financial intermediation

A company acted as a loan broker (arranging domestic property remortgages – an exempt service). Applicants who were turned down for loans were referred to an associated company which provided debt management services (also exempt). Both companies were separately registered for VAT. The debt management company paid for the referrals, and HMRC ruled that this represented consideration for a taxable supply.

The Tribunal agreed that the broker was providing intermediary services in relation to financial services and was therefore exempt within Group 5 Item 5 Sch.9 VATA 1994. The situation was considered in detail and was distinguished from *LeadX* (20,904) in which a trader was held to be carrying on a standard rated business of “selling leads” rather than acting as an insurance intermediary. Here, there was a much more focused intention to provide financial services – if the customer did not meet the criteria for a loan, he would be referred to the associated company for debt management. There was no attempt to make sale of leads in the open market.

First Tier Tribunal (TC00196): *Friendly Loans Ltd*

2.3.5 Gradual withdrawal

HMRC have now accepted that the *Rank* decision applies to more forms of bingo than those described in R&C Brief 40/09. HMRC will now consider claims relating to other forms of bingo which are played under the same sections of the Gaming Act as mechanised cash bingo. Their new Brief points out that this will have a consequence for bingo duty (discussed in R&C Brief 55/09) and also for direct tax.

R&C Brief 75/09

2.3.6 Electronic lottery terminals

HMRC have issued a Brief commenting on the marketing of “electronic lottery terminals” which are supposed to be exempt from VAT and Amusement Machine Licence Duty (AMLD). HMRC do not accept that these machines qualify for exemption, and advise those operating them to obtain licences and pay VAT. Anyone who disagrees should ask HMRC to issue a default licence and assessment so that they can appeal.

R&C Brief 70/09

HMRC have also publicised their attitude to "amusement machines offering games which are designed to look like recognised games of chance" such as roulette, bingo or poker. Apparently some such machines are being marketed as representing in fact games of skill (subject to VAT but exempt from Amusement Machine Licence Duty). HMRC believe that a game which looks like a game of chance should be taxed as a game of chance, and AMLD cannot be avoided by this means.

Joint release: HMRC and Gambling Commission, 14 December 2009

2.3.7 Going postal

Following the ECJ decision in *TNT Post UK Ltd*, HMRC have announced that some Royal Mail services are to be made standard rated rather than exempt. These are services which do not constitute "the public post" and for which terms are individually negotiated or which are not subject to regulatory control.

HMRC are currently in negotiations with Royal Mail to decide which services are affected and will issue further information when those discussions are complete.

R&C Brief 64/09

Meanwhile, the European Council has noted the following conclusion at its 2 December ECOFIN meeting:

The Council notes that the third Postal Directive will enter into force 1 January 2011 (1 January 2013 in some Member States).

Bearing this in mind, the Council stresses the importance of taking all necessary measures to solve the political problems originating from the VAT treatment of postal services before the third Postal Directive will enter into force and the liberalisation of the postal market is a fact.

Taking the previous into account and taking account of existing tax arrangements in Member States, the Council invites the Spanish and Belgian Presidencies to explore and examine all options in order to make steps forward in this respect and to report the progress made at the Ecofin council in December 2010 at latest.

www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111706.pdf

2.3.8 Education ineligible

A company provided training in IT. It did not register for VAT, and appealed against a notice of compulsory registration on the grounds that its supplies ought to be treated as exempt within Group 6 Sch.9 VATA 1994. The Tribunal agreed with HMRC that it was not an eligible body within Note 1(e) which requires that a body is only eligible if it (i) is precluded from distributing and does not distribute any profit it makes; and (ii) applies any profits made from supplies of a description within this Group to the continuance or improvement of such supplies.

The company's constitution prohibited the distribution of a profit, but it made a substantial amount of money which was paid to the directors (who were also shareholders) as remuneration. The Tribunal concluded that it was therefore a commercial organisation whose purpose was to make a "profit" that would be distributed as pay rather than as dividends. The appeal was dismissed.

First Tier Tribunal (TC00192): *Trans Medium Ltd (t/a Connectivity)*

2.3.9 Welfare concession to go

As part of the ongoing revision of ESCs, the current concessionary arrangement which allows welfare agencies to exempt their supplies while not yet state-regulated (i.e. while their registration is being processed) will be withdrawn with effect from 9 December 2010.

www.hmrc.gov.uk/pbr2009/withdrawal-extra-stat-con-5325.pdf

2.3.10 Dismantling for Uncle Sam

A company carried out the service of dismantling ships for the US Navy. HMRC ruled that this was subject to UK VAT, and the company appealed. It argued that Art.151(c) of the 2006 VAT Directive required that such supplies should be exempt. The article states:

1. Member States shall exempt the following transactions:

(c) the supply of goods or services within a Member State which is a party to the North Atlantic Treaty, intended either for the armed forces of other States party to that Treaty for the use of those forces, or of the civilian staff accompanying them, or for supplying their messes or canteens when such forces take part in the common defence effort;

HMRC believed that the exemption should only apply where the visiting forces were stationed in the member state. The company argued that such a restriction would require specific wording in the article, which was more naturally read as conferring a general exemption for supplies to any NATO customer.

HMRC argued that the purpose of the exemption was to prevent a member state from enjoying a fiscal advantage by taxing NATO forces which were stationed within it. The Tribunal accepted that fiscal neutrality was part of the system of VAT, but did not agree that this was the sole purpose of the exemption, nor that HMRC's construction of the words of the article was correct. It appeared that the dismantling services fell within the article and should be exempt.

First Tier Tribunal (TC00266): *Able UK Ltd*

2.4 Zero-rating

2.4.1 Flapjacks

A store sold a product described as a “flapjack bar”. Traditionally flapjacks have been regarded as “cakes” and zero-rated, while very similar cereal bars are treated as confectionery and standard rated. HMRC ruled that this product was confectionery, and the store appealed.

The product had been designed by an ex-professional wrestler who entered a national competition run by Asda to create new products. He had invented the recipe because he wanted something interesting to eat containing seeds, which he considered important to his diet.

The Tribunal heard evidence from the designer and considered the HMRC guidance on the difference between flapjacks and cakes. It concluded that the bars were confectionery, in that they did not contain several of the ingredients of a traditional flapjack (such as brown sugar, butter or margarine, and golden syrup), and were “sweetened prepared food normally eaten with the fingers”.

First Tier Tribunal (TC00211): *Asda Stores Ltd*

2.4.2 Prescribing

A new statutory instrument extends the range of “appropriate practitioners” who can make zero-rated prescriptions of medicines to individuals for personal use (Group 12 Sch.8 VATA 1994). These will now be:

(a) a registered medical practitioner;

(b) a person registered in the dentists' register under the Dentists Act 1984;

(c) a community practitioner nurse prescriber;

(d) a nurse independent prescriber;

(e) an optometrist independent prescriber;

(f) a pharmacist independent prescriber;

(g) a supplementary prescriber.

This is part of the ongoing review of ESCs following the *Wilkinson* case.

SI 2009/2972

2.4.3 Decking

An individual purchased materials so that he could install decking throughout the interior of his house to enable his disabled wife to move around by wheelchair. He claimed that the supply of these materials should have been zero-rated, so he claimed the VAT back from HMRC.

The Tribunal examined the provisions of VATA 1994 Sch.8 Group 12 Item 2 and could not find that the supply fitted any of the descriptions. The appeal was dismissed.

First Tier Tribunal (TC00265): *Andras Bokor*

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Rate change

2.6.1.1 Guidance

HMRC have published a detailed guide to the rules on changing the VAT rate. It covers general principles and a number of detailed aspects, including:

- special rules which apply to supplies which span the change in rate;
- accounting requirements;
- the impact on special accounting schemes;
- the effect on particular business categories and particular types of transactions; and
- anti-forestalling legislation.

http://www.hmrc.gov.uk/vat/forms-rates/rates/rate-rise-guidance.pdf

2.6.1.2 Anti-forestalling

They have also published a detailed guide to the anti-forestalling legislation itself. One point which has been discussed is whether the £100,000 limit for prepayments applies to single supplies or to the total turnover of a business. This is relevant for traders who bill annually and who might normally receive their 2010 income in January, but who advance everything into December 2009: if the total exceeds £100,000 but each individual payment is below that limit, do the rules bite? The law refers to the supply and "related supplies", which are made under "the same scheme". The guidance appears to suggest that this will only be triggered if the customer is the same or is connected:

"Scheme" includes any arrangements, transaction or series of transactions. This covers the situation where a supplier (or business associated with the supplier) makes a series of supplies to the same customer (or business associated with the customer) each of which is below the £100,000 limit but which in aggregate exceed it.

http://www.hmrc.gov.uk/vat/forms-rates/rates/anti-forestall-guidance.pdf

One late relaxation of the anti-forestalling rules has been implemented by statutory instrument. The charge will not be triggered by commercial hire purchase agreements which last over 6 months, even though the delivery of the goods before 31 December will create a tax point and the consideration will not be paid for the period referred to in the original legislation.

The relaxation applies if the only anti-forestalling condition met is the non-payment for 6 months, and the invoice is issued in accordance with normal commercial practice in relation to a supply made under a hire-purchase, conditional sale or credit sale agreement.

The online guidance was revised in mid-December to reflect this late change to the rules.

SI 2009/3127

2.6.1.3 Midnight chimes

HMRC have confirmed the ministerial statement made earlier during the year that pubs and clubs will not have to give effect to the rate change at midnight on 31 December. However, they set out detailed conditions and restrictions on this concession:

HMRC recognise that making the necessary changes to account for VAT at 17.5% may cause particular problems for certain businesses operating after midnight at what can be a particularly busy time of year. For example, it would not be practical for a pub, club, restaurant or hotel hosting a New Year's Eve celebration to stop serving customers at midnight in order to adjust their tills to account for VAT at 17.5% and to amend their prices accordingly.

In order to assist businesses in this position HMRC will allow them to account for VAT at 15% on takings received up to the earlier of:

- *the end of trading of the 31 December session or*
- *6am on the morning of 1 January 2010.*

This treatment is subject to the following conditions:

It is restricted to those businesses open at midnight on 31 December 2009 that account for VAT at the point of sale such as businesses on a retail scheme –- pubs, shops, restaurants etc. It will not apply to:

- *mail order or on-line retailers;*
- *businesses that account for VAT on the basis of VAT invoices issued; or*
- *pre-payments for supplies of goods or services to be provided after 6am on 1 January 2010.*

It will not apply to sales made through coin operated or similar machines (vending, amusement or gaming machines etc). In these cases businesses must follow the normal rate change rules … and account for VAT based on the date that the machine is used or by apportionment if the machine does not record the date of usage.

It will not apply to transactions made after midnight on 31 December that would have been caught by the rate change anti-forestalling legislation (Finance Act 2009, Schedule 3) had they been made before midnight. Any such supplies will be liable to VAT at 17.5%.

HMRC may withdraw or restrict the application of this treatment in individual cases.

Telecom providers are also allowed by concession to apply the 15% rate to calls and messages that take place and are billed by 6am on 1 January, because New Year's Eve is a very busy time for the telecoms industry.

HMRC Release 4 November 2009; R&C Brief 68/09

2.6.1.4 Light touch

HMRC also set out their policy on operating a "light touch" where businesses make mistakes on the change of rate. Officers are supposed to consider the difficulties that traders experience in carrying out such a major exercise and may ignore errors where there is no loss of VAT (e.g. where the customer can recover it). Where there is a loss of VAT, an assessment may be raised, but penalties will only be levied after considering the trader's circumstances sympathetically.

R&C Brief 68/09

2.6.1.5 Practical problems

In November the Department for Business, Innovation and Skills (BIS) consulted on a proposal that retailers should have 28 days rather than 14 days to comply with the rules on price marking of goods to reflect the change in the standard rate on 1 January 2010. This was given effect by statutory instrument. This provided that it would be acceptable to display a general notice saying that an adjustment will be made at the till, if traders wish to increase the price rather than absorb it until new prices can be displayed. This change is a temporary amendment to s 11(a) of the Price Marking Order 2004, SI 2004/102.

http://www.berr.gov.uk/files/file53309.pdf; SI 2009/3231

There is an article by Neil Warren in *Taxation*, 15 October 2009, discussing a number of the practical challenges on a change of rate and suggesting plans to get the maximum benefit.

2.7 Discounts, rebates and gifts

2.7.1 Retail scheme and vouchers

The Boots Company operates a bespoke retail scheme. Its detailed operation has never been formally documented, but a draft of the original proposal was produced to the Tribunal and evidence of correspondence dealing with different issues arising on an informal basis. The company was not entitled to use any of the "standard" retail schemes because its turnover was too great.

In 2002 and 2003 it ran several promotional schemes involving "voupons". These were "£5 off" vouchers which were given to anyone buying goods with a value of at least £15. Initially the company accounted for the full value of the goods on the first sale, and the discounted value of goods on the second sale.

In 2003 the company claimed that changes to the law in April 2003 showed that it should have accounted for the reduced value on the first sales and the full value on the second sales, and it asked for a repayment. Initially the Customs officer dealing with the company refused, but after referring the matter to the Retail Unit of Expertise, he allowed the claim on 28 November 2003, repaying over £3m to Boots. This related to four periods in which Boots had been a payment trader and one in which it had been a repayment trader.

The company continued to account for similar promotions in the same way, and later asked for a further repayment because it decided it was entitled to the more favourable treatment notwithstanding the change in the law in 2003. HMRC refused, and also decided that the repayment in 2003 had been based on a mistake. An assessment was raised in March 2005 to recover most of the repayment. No attempt was made to recover the repayment which had been made for the period in which Boots was a repayment trader.

Boots appealed against the assessment, arguing four points:

(1) on 28 November 2003 Customs had agreed a binding amendment to their retail scheme and could not amend that agreement retrospectively;

(2) the assessment was invalid because it should have been raised under s.73 VATA 1994 (and not under s.80(4A)) and did not comply with the time limits in s.73;

(3) the repayment made on 11 December 2003 reflected the true value of the qualifying supply; and

(4) the repayment made on 11 December 2003 accorded with the method of valuation in paragraph 7.18 of Notice 727/4 upon which the Appellant was entitled to rely.

The Tribunal decided to deal with these arguments in the order 3, 4, 1, 2.

True value of the supply

The Tribunal examined the issue of the voupons and decided that they were given away free for no consideration. The correct treatment of such vouchers had always been to treat them as an entitlement to a discount on redemption rather than allocating any of the consideration for the qualifying goods to the voucher. The original refusal of the repayment claim had been correct.

Notice 727/4

The retail schemes notice on the apportionment scheme contains a table which sets out the treatment of gift vouchers supplied with goods. Boots claimed that it applied to them because the vouchers could only be obtained if goods worth £15 were purchased. The Tribunal held that the vouchers were really given away for no consideration, so a different line in the table applied to them instead; and, in any case, Boots were not entitled to rely on a Notice which dealt with the operation of a standard retail scheme – they had a bespoke scheme.

Amendment to the retail scheme

HMRC argued that the repayment had arisen as a result of a mistake of law, not as part of an agreed amendment to the operation of the retail scheme. The correspondence had not identified it as an amendment to the scheme; the company had not changed the way in which it accounted for similar items afterwards.

Nevertheless, the Tribunal chairman decided that it was such an agreed amendment, and HMRC could not resile from it retrospectively. They had agreed that voupons should be dealt with in the more favourable way for the periods in 2002 and 2003, and they could not change that later.

Validity of assessment

Because HMRC could not resile from the agreement, Boots had already won. In spite of that, the chairman expressed her view on the assessment question. She considered that the assessment had been validly raised under s.80 and the time limit ran for two years from the period in which the repayment had been made. If the company had not won the argument already, the assessment would have been valid.

It seems that HMRC themselves decided that different rules (s.73) applied to the period in which the company had been a repayment trader, and it was not possible for them to raise an assessment to recover that erroneous repayment in any case.

Appeal to the High Court

HMRC appealed to the High Court on the “agreed amendment” point. The judge decided that the evidence did not support the conclusion that HMRC had agreed to amend the retail scheme. All the correspondence had concerned the application of para.7.18 of Notice 727/4: the company had claimed that it was able to rely on it and HMRC had at first disagreed, then agreed, with that proposition. The repayment was in effect a stand-alone claim that did not reflect an amendment to the scheme.

Accordingly, the assessment was a valid reversal of the mistaken repayment.

Appeal to the Court of Appeal

The company appealed the decision further, but was not successful. The judge had been correct to interpret the correspondence in the way that he did, and the Tribunal had come to a conclusion that was not open to it on the evidence. The letters only meant that HMRC had initially accepted that the law meant something other than their previous interpretation, and repayment should follow; they were not intended to create a binding agreement.

Court of Appeal: *HMRC v The Boots Company plc*

2.8 Compound and multiple

2.8.1 Airport parking

Many years ago there was a standard plan for providers of airport parking: part of the fee was allocated to zero-rated transport in the bus to and from the car park. This was made ineffective by VATA 1994 Sch.8 Group 8 Note 4A(b) which provides that such transport cannot be a separate zero-rated supply.

Two companies accounted for tax on all income from parking from 1995 to 2006. They then submitted repayment claims, contending that the previous plan was effective, and that the change to the UK law was invalid under EC law because it breached the principle of fiscal neutrality.

The Tribunal rejected the companies arguments and dismissed the appeals. It held that the principles in *Card Protection Plan Ltd* meant that the companies were to be treated as making single supplies of parking facilities; the supplies of transport were incidental to those standard rated supplies.

The Tribunal specifically declined to follow the 1984 decision in *Courtlands Car Services Ltd* (1,778), on the grounds that that decision was inconsistent with the subsequent ECJ decision in *Card Protection Plan Ltd*. The Tribunal also commented that "*the notion of saying that unfair competition is discernable between airport park-and-ride treatment, and the slightly far-fetched notion of a car driver parking in Reigate or Redhill and taking the local train, or the public bus, to Gatwick is far-fetched*". There was no realistic possibility of distortion of competition between the services offered by the companies and alternative ways of achieving the same result.

First Tier Tribunal (TC00118): *Purple Parking Ltd*

2.8.2 Children's parties

An individual provided children's parties for a single price. Originally she accounted for output tax on the whole amount received. She then made a voluntary disclosure, claiming that she was making a supply of exempt land (rental of a hall) and incidental taxable refreshments. As part of her turnover should have been treated as exempt, she had overpaid output tax. HMRC refused to make any repayment, and she appealed to the First Tier Tribunal.

The premises resembled a sports hall. It was used during the week as a nursery for very young children, and those supplies were agreed to be standard rated. For weekend parties, customers paid a fee "for 75 minutes' use of the play barn" with a simple buffet meal afterwards. Only one member of staff was present: after greeting the customers and admitting them to the hall, the staff member retired to the kitchen to prepare the food.

The appellant's representative argued that there was a single supply of a licence to occupy, with the catering and use of play equipment being incidental to that within the terms of *Card Protection Plan*. The supply should therefore be wholly exempt. HMRC also believed that there was a single supply, but that it was standard rated as "a children's party" rather than being a licence to occupy land. This was supported by earlier decisions about the provision of a room in conjunction with a wedding reception in *Willerby Manor Hotels Ltd* (16,673) and *Chewton Glen Hotels Ltd* (20,686).

The Tribunal considered the two aspects of Card Protection Plan carefully: first, whether there is a single supply which it would be artificial to divide; and second, whether any of the remaining separate supplies might take on the liability of a principal supply to which they are ancillary. The conclusion was as follows:

44. We identify the elements or components of what is supplied are as follows:

- *The use of the Hall;*
- *The use of (or opportunity to use) tables and chairs in the Hall;*
- *The use of (or opportunity to use) play equipment in the Hall;*
- *The provision of refreshments;*
- *The service of member(s) of staff in receiving customers and their guests and in preparing refreshments and preparing the Hall and the café room before use/cleaning them up after use;*
- *The non-exclusive use of (or opportunity to use) the toilet and changing facilities in the building.*

45. On the evidence we regard the second and third of these components as ancillary to the first and the fifth and sixth of these components as ancillary to the first and fourth. That is, we regard, from an economic point of view, the use of the Hall and the provision of refreshments as the main or principal components of what was supplied by the Appellant to customers, and that it would be artificial, and distortive to split out for VAT purposes the second, third, fifth and sixth of the listed components.

The Tribunal went on to consider whether the supply of the use of the hall was an exempt licence to occupy, and concluded that it was: it was a relatively passive activity linked to the passage of time rather than to any value added provided. The provision of catering was a separate supply even though a single price was charged, and an apportionment of the consideration was necessary.

The appeal was therefore allowed in part, and the parties were invited to discuss and agree the apportionment.

First Tier Tribunal (TC00242): *Diana Bryce (t/a The Barn)*

2.9 Agency

2.9.1 Client account

A company appeared to have set up its whole business structure based on VAT advice. As the Tribunal confirmed assessments for more than £1.2m covering the periods July 2002 to November 2004, this advice appeared to have been flawed. However, the High Court has now remitted the case to the Tribunal for reconsideration.

It was common ground that a company which supplies "loft conversion services" to a customer must charge VAT on the whole of what the customer pays, when the customer pays it. The companies in this case argued that they provided "project management services". They received money from the customer and put it in a client account. It would then be taken out of the client account:

- to pay the project manager's fees, which were included in the companies' VAT returns, company accounts and corporation tax computations;
- to pay the costs of the project, which were regarded as disbursements of the client's money and therefore not part of the companies' accounts at all.

At the end of a project, some money was retained within the client account to cover the possible cost of claims under a ten-year guarantee. That part of the client's payment would not be subject to VAT until much later when it was released to the project manager.

The company director claimed that the company's contracts reflected the intended arrangements. The company arranged contracts between the various suppliers – designers, plumbers, electricians, plasterers, and so on – and the clients. The contracts should determine the nature of the supply unless they were a sham, which they were not.

The Tribunal took evidence from a number of witnesses, including a client and some tradesmen. Although the fine print attempted to create the contracts that the director contended for, it seemed unlikely that anyone else understood that to be the case. In particular, the client – who was a friend of the director and presumably was trying to support his case – did not believe that he had a contract with each of the individual tradesmen. If there had been a problem, he would have expected the company to put it right.

As a result, the Tribunal concluded that the company itself supplied the loft conversion service, and it was liable to output tax on all its receipts.

The company appealed to the High Court. Lewison J remitted the case for a rehearing by the Tribunal, holding that it had misdirected itself in law. It had considered that the precedent cases presented inconsistent approaches to the question of determining the VAT treatment of agency arrangements, and also that the present situation should be approached differently because the principal in the alleged agency was the consumer and not the supplier. The judge said that the Tribunal had adopted an "unstructured approach" and had "neither construed the contract, nor squarely addressed the question whether the contract, as construed, represented the real bargain between the parties". That must be unhappy reading for the Tribunal chairman and member who heard the case.

The Tribunal will now presumably reconsider the facts to find what the true nature of the contracts was; whether those contracts were a sham, or were replaced by different contracts; and on the basis of what the real agreement was between the parties, who supplied what to whom for VAT purposes.

High Court: *A1 Lofts Ltd & A1 Loft Conversions Ltd v HMRC*

The case is examined in an article in *Taxation* magazine, 10 December 2009.

2.9.2 New TOMS Notice

HMRC have published a new version of the TOMS Notice to include important changes to the rules and practice which come into effect on 1 January 2010. These were described in the last update.

The main changes relate to removal of the opt-in to the TOMS for wholesale supplies (previously detailed in section 3.2), removal of the opt-out for travel supplies consumed by businesses (previously detailed in section 3.3) and the introduction of a new market value calculation (annual adjustment), which is set out in a new section 8.

In addition to these changes the following sections have been changed:

- Section 4.15 has been amended to clarify the tax point rules under method 2;
- Section 4.20 has been amended to reflect the new invoicing regulations for TOMS supplies made to business customers after 1 October 2007;
- Section 6.1 has been amended to update what should be included in the total selling price for the annual calculations;
- Section 6.4 has been amended to add another typical example of overhead finance charges.

Notice 709/5

One of the changes discussed in the last update – withdrawal of the permission of tour operators to opt out of TOMS in respect of supplies of services to other businesses for their own consumption with effect from 1 January 2010 – has been given effect by statutory instrument.

SI 2009/3166

The transitional arrangements which apply to TOMS supplies straddling 1 January 2010 are described in a Revenue & Customs Brief. In effect, a supply with tax points either side of the change will be dealt with under two different sets of rules: for example, a trader who used the “normal rules” for a supply to another business which is now mandatorily within TOMS should:

- recover input tax on costs incurred up to 31 December 2009;
- not recover input tax on costs incurred after that date;
- not include in the calculation of the TOMS margin any costs on which input tax has been recovered.

R&C Brief 74/09

2.10 Second hand goods

2.10.1 Unfairness

A second hand car dealer appealed against an assessment on the basis that the UK's treatment of second hand cars was unfair and unreasonable. Surprisingly, the Tribunal considered this in some detail, referring to the Directive to make sure that the UK's rules are in accordance with it. The chairman considered that the problem was not so much with the rules as with the circumstances of the market in which the trader had to operate, which left him with very little margin (with or without the application of VAT).

First Tier Tribunal (TC00214): *Peter Benjamin Lyon*

2.10.2 New Notices

HMRC have issued three new notices on second-hand goods in order to make it easier for particular types of trader to find the information relevant to themselves. They are:

- Notice 718: The VAT Margin Scheme and global accounting
- Notice 718/1: The VAT Margin Scheme on second-hand cars and other vehicles
- Notice 718/2: The VAT Auctioneers' Scheme

The main point identified in "what's changed" is the declaration required on a margin scheme invoice (see paras.5.3 and 15.5 of Notice 718, para.5.3 of Notice 718/1 and section 4 of Notice 718/2).

2.11 Charities and clubs

2.11.1 Discussions between charities and HMRC

The Charity Finance Directors’ Group has met with HMRC to discuss tax problems suffered by charities. Several direct tax issues were raised, and one problem relating to VAT which HMRC promised to consider. In the current recession, some charities would like to cut costs by combining their “back-office functions”. However, this would create the normal outsourcing problem for any charity which used the services of another to process its paperwork – the processing charity would have to charge VAT, and the user charity could not recover it.

HMRC pointed out that they would be restricted by EU legislation, but would consider whether a solution could be found.

Notice 709/5

2.11.2 Article

There is a useful article on VAT and charities in *Tax Adviser*, December 2009. Neil Warren goes through a number of issues relevant to charities, but concentrates on the recent case of *Bath Festivals Trust* as offering a route for greater input tax recovery: if some of the charity’s income is in fact consideration for services supplied to a person who can recover VAT, rather than a mere grant, there is much greater scope for credit.

2.12 Other supply problems

Nothing to report.

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Sale of land with dilapidated building

The sale of a building is exempt subject to the option to tax under EU law. This is now in Art.135(k) of the VAT Directive, which exempts "the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1)". The definition in Art.12 is "any unimproved or improved land defined as such by the Member States".

A company purchased a plot of land with two dilapidated buildings on it. The vendor was responsible for demolishing these buildings, and had started to do so when the transfer took place. After the transfer, the authorities assessed land transfer duty on the purchaser, who appealed, arguing that the transfer was VATable and therefore exempt from transfer duty under Netherlands law. The Netherlands courts dismissed the appeal at first instance, but then referred questions to the ECJ.

The ECJ ruled that the demolition of the buildings had to be regarded as a part of the sale in these circumstances. The effect of the transaction was therefore not to supply the buildings, but to supply building land. The exemption did not apply.

ECJ (Case C-461/08): *Don Bosco Onroerend Goed BV v Staatssecretaris van Financien*

The UK's exemption for building land is based on Art.371 VAT Directive and Annex X part B item 9. This is a transitional saving for exemptions which the member states applied at 1 January 1978. The Commission has recently sent a reasoned opinion to France requesting a change of its rules, which exempt building land where the land is acquired by natural persons in order to construct buildings intended for residential use. Presumably this exemption is not protected by the transitional saving.

IP/09/1767

3.1.2 Charges for cleaning

Following the recent ECJ decision in *RLRE Tellmer Property sro v Finanční ředitelství v Ústí nad Labem*, HMRC have commented on the treatment of charges for cleaning services when supplied in conjunction with exempt letting. HMRC's current policy is that where the service charge arises as a condition under a lease and is to be provided by the lessor (or his agent) without the lessee having a choice, then the rent and the service charge are treated as consideration for a single supply which is either exempt or taxable according to the liability of the lease. HMRC regard this as the most common situation, and believe that the policy is in line with *Card Protection Plan*: it would be artificial to split the two elements of what is effectively a single supply.

HMRC believe that the result was different in *Tellmer* because the Czech tenants had a genuine choice to use a different supplier for the cleaning services. HMRC would regard the supplies as separate on similar facts, although in restricted circumstances they would allow exemption by concession (ESC 3.18). HMRC are therefore satisfied that the policy is consistent with the ECJ decision.

R&C Brief 67/09

3.1.3 More timeshares

The *RCI Europe* case (C-37/08) dealt with the place of supply of services provided by a timeshare exchange club. Another case is now being referred by the Court of Session to consider the liability of supplies made by a timeshare club which operates on a points basis. The Tribunal decision (19,599) dates from the first half of 2006.

A company operated a “club” which enabled the owners of timeshares to obtain “points” which could be exchanged for hotel accommodation or the use of other timeshare properties. It argued that the supply of the points amounted to a supply of an interest in or right over land and was therefore exempt, but HMRC and the Tribunal disagreed.

The Tribunal expressly disapproved of the earlier Tribunal decision in *Finest Golf Clubs of the World* (19,347). In that case, it was held that the company could estimate the proportion of golf games that would be supplied outside the UK (about 90%) based on past experience; so, when it received subscriptions for future golf games, it was reasonable to suppose that 90% of them would also be outside the scope of UK VAT. This Tribunal held that the same principle could not be applied to this situation. At the time of supply, there was nothing that constituted a right over land under EU law. In particular, rights over land have to related to particular land. That was definitely not the case with these points. As exemptions must be strictly construed, these supplies had to be standard rated.

The questions now to be referred are as follows:

1. Where MRL, in accordance with the provisions of the Constitution of the Club and the contracts associated therewith, makes supplies of contractual rights (“Points Rights”) which entitle the purchaser to Points redeemable annually for the occupation and use of timeshare accommodation in MRL’s resorts, is that supply to be characterised:

a) as the leasing or letting of immovable property within the meaning of Article 13B(b) of the Sixth VAT Directive (now Article 135(1)(I) of Directive 2006/112); or

b) as membership of a club; or

c) in some other manner?

2. Does it affect the answer to question 1 that:

a) *In some cases the contractual rights are acquired in return for the customer depositing with MRL pre-existing rights of occupation held by the customer in timeshare accommodation at a particular place for one or more fixed weeks?*

b) *the customer may in any year decide not to redeem his or her Points entitlement for that year in whole or in part for any rights of occupation and may instead elect to augment his or her entitlement in the following year, or, subject to the contractual conditions of the scheme in any year, may augment that year's entitlement by "borrowing" from his or her entitlement to Points in the following year;*

c) *the properties comprising the pool of accommodation may change between the time when Points Rights are acquired and the time when Points are redeemed for the right to occupy a property;*

d) *the number of Points to which the customer is entitled each year may be varied by the supplier in accordance with the contractual conditions of the scheme;*

e) *The Appellant may from time to time arrange for persons holding Points Rights to have access to an external timeshare programme;*

f) *The Appellant may from time to time make arrangements for persons holding Points Rights to exchange their Points for accommodation in hotels operated by the Appellant or for other benefits provided by the Appellant?*

3. Where a taxable person makes supplies of the services described in questions 1 and 2 above,

a) *are these "services connected with immovable property" within the meaning of Article 9(2)(a) of the Sixth VAT Directive (now Article 45 of Directive 2006/112);*

b) *if the answer to question 3 a) is "Yes": in circumstances where Members of the Club may exercise their contractual rights by occupying timeshare accommodation in more than one Member State, and it is not known at the time of supply which accommodation will be so occupied, how is the place of supply to be determined?*

ECJ (reference) (Case C-270/09): *Macdonald Resorts Ltd v HMRC*

3.2 Option to tax

3.2.1 Pre-registration inputs

A company was incorporated in September 2006 with the intention of developing a retail site in Dundee. It registered for VAT with effect from 1 August 2007 and opted to tax the site in January 2008. It sought to recover all the input tax incurred in the pre-registration period, but was restricted by HMRC to services incurred in the 6 months before the EDR. The company tried to change the EDR but this was refused because HMRC had not made a mistake in giving effect to the date the company had applied for.

The company then attempted to rely on an ESC in Notice 742A which extends the reg.111 6 month period in some circumstances. As the Tribunal had no jurisdiction to hear an appeal on an ESC, it applied for judicial review to the Court of Session.

HMRC argued that the concession applied to traders who became registrable as a result of opting to tax and who would then be disadvantaged when compared to a trader who had incurred input tax in similar circumstances while registered throughout. That was because a trader who was registered and who decided to make taxable instead of exempt supplies could recover input tax under the payback rules of reg.109 – that had a 6 year time limit rather than a 6 month one.

The Court of Session refused the application, accepting HMRC’s argument that the company did not fall within the terms of the concession. The concession only applied to those traders who had to register as a result of making the option to tax. This company had already been registered before it exercised the option. The court did not consider that there was any policy reason, or any reason in fairness, to extend the concession to the company.

In effect, it fell between two possibilities:

- backdate EDR on original application in order to bring in all the input tax incurred from the start of the project;
- not register until the option to tax was exercised and fall within the concession.

The company may still be wondering why it should not benefit from either of these possibilities.

Court of Session: *Argyll Developments Ltd (petitioner)*

3.3 Developers and builders

3.3.1 Planning conditions

A company built 28 residential units subject to planning conditions that the buildings were to be used for holiday accommodation only and for no other purpose. Not surprisingly, HMRC ruled that the sales were standard rated.

The company appealed, pointing to the fact that the planning consent permitted 52-week occupation. There was therefore nothing in the consents that prohibited use as a principal private residence. The trader wanted to rely on the VAT Tribunal's decisions in *Livingstone Homes UK Ltd* (16,649) and *Tallington Lakes Ltd* (19,972).

The Tribunal did not agree. The buildings could be used throughout the year, but it was clear that they could only be used as holiday accommodation. The Tribunal pointed out that *Tallington Lakes* had been reversed by the High Court on appeal, and *Livingstone Homes* had been disapproved in a later decision of the Tribunal (*Loch Tay Highland Lodges Ltd*, 18,785).

First Tier Tribunal (TC00205): *Herling Ltd*

3.3.2 Extension

A company constructed a new building adjacent to an existing residential care home. HMRC ruled that the work was standard rated because the new building was an extension or annexe. The company appealed, arguing alternatively that it was not an extension, or that it created additional dwellings and should therefore in any case be zero-rated.

The Tribunal considered the appellant's arguments and precedent cases such as *Cantrell t/a Foxearth Nursing Home*. It concluded that the new building was similar to the existing one and served the same purpose. It was therefore appropriate to regard it as an extension.

The argument that additional dwellings were formed was fundamentally flawed. The rooms did not satisfy the conditions for dwellings, and the appellant's principal argument was that the building was used for a relevant residential purpose – that contradicted its secondary assertion.

The appeal was dismissed on both grounds.

First Tier Tribunal (TC00240): *Rebba Construction Ltd*

3.3.3 Separate or ancillary use?

The owner of a protected building obtained listed building consent for a cottage, within the curtilage of the protected building, to be converted into a five-bedroomed house. The planning permission provided that the house "shall only be used for purposes either incidental or ancillary to the residential use" of the protected building. HMRC issued a ruling that tax was chargeable on the work because it created an annexe. The owner appealed, contending that the work should be treated as a zero-rated approved alteration to a protected building.

The VAT Tribunal examined a number of precedent case on the question of “separate use”. It accepted the appellant’s argument that there was no “proposition of law that an incidental or ancillary use can never be a separate use”, so that the planning permission did not prohibit “separate use as such”. Accordingly the Tribunal held that the work satisfied the conditions of Note 2(c) Group 6 Sch.8 VATA 1994.

The appellant applied for indemnity costs on the basis that HMRC should have seen that the matter was determined by the earlier Tribunal decision in *Nicholson*, and HMRC had been very slow to engage in a proper argument. The Tribunal chairman commented that an award on the indemnity basis required that the Commissioners had acted “disgracefully”, and he did not believe this to be the case. Costs were awarded on the standard basis.

HMRC appealed to the Upper Tribunal (probably the first case to be heard by the Upper Tribunal acting as an appellate court). The Upper Tribunal disapproved the decision in *Nicholson* and upheld HMRC’s appeal, holding that the planning permission prohibited “separate use as such”. That was enough to deny zero-rating. The First Tier chairman had apparently interpreted “separate use” as meaning “use by a different household”, which was not prohibited; the Upper Tribunal preferred to interpret this as meaning “not ancillary use”, which was enough to rule out zero-rating.

Upper Tribunal (20,981): *Steven Lunn*

3.4 *Input tax claims on land*

3.4.1 50:50?

An individual, who was a professional lecturer in sustainable architecture, arranged for the construction of two dwellings. She intended to live in one and let the other. She claimed back the VAT under the DIY builders' scheme: HMRC allowed half and refused to repay the rest, on the grounds that the letting of the flat would constitute a business.

The appellant advanced two grounds both of which had to be dismissed by the Tribunal: that she had relied on misleading advice from an officer she had spoken to on the phone, and that the zero-rating of new dwellings was "within the spirit of the legislation".

However, the Tribunal accepted her third argument, that the letting was not a business activity. The building was partly an academic project, putting her theories on sustainable architecture into practice, and to be used for research purposes. The costs were substantially higher than they would be on a normal property, and if she had expected to make a profit, she would have located the building in a more desirable place.

The Tribunal considered that her motive could not determine whether the activity was a business or not, and recognised that renting of immovable property is usually considered an economic activity. Nevertheless, there are exceptions, for example *Yarburgh Children's Trust*. The chairman recited the tests of "business" as set out in *Lord Fisher*, and concluded that one of the most important was not satisfied: the project was not "conducted on sound and recognised business principles". It was more concerned with the environmental and sustainability issues than with those of commerce. Looked at as a whole, the project was not commercial, and the DIY claim should be allowed on the whole amount.

First Tier Tribunal (TC00224): *Paola Sassi*

3.4.2 The wrong claim

An individual submitted a DIY claim which included invoices for doors and windows which had been supplied in conjunction with zero-rated services. HMRC said that the goods should also have been zero-rated as "builders' materials" and refused to pay the DIY claim. The Tribunal agreed that the individual was not entitled to recover the money from HMRC: it had been overcharged by the builders.

First Tier Tribunal (TC00222): *Michael Roy Culverwell*

3.5 *Other land problems*

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Information sheets

HMRC have issued the usual Information Sheet to set out the exchange rates for traders registered under the special scheme for e-traders to use for the quarter to September 2009. A second sheet specifically reminds such traders that the VAT rate increases back to 17.5% on 1 January 2010.

Information Sheets 15/09, 16/09

4.2 Where is a supply of services?

4.2.1 VAT package: review

This section reviews the current position on the changes to international supplies that are being implemented from 1 January 2010. Although the changes affect both services and goods, they will be dealt with together. The connected change to the 8th Directive reclaim system has been covered in an earlier update.

The changes represent the implementation of the "VAT Package", a number of related measures that have been planned for several years and which are intended to simplify international trade. These include:

- changes to the place of supply of services rules which are expected to reduce the number of occasions when a business in one member state has to charge their own state's VAT to foreign business customers;
- changes to the system for reclaiming VAT incurred in foreign states using the 8th VAT Directive.

The law has been amended by a Statutory Instrument which covers these rules and also the alteration to the flat rates used by small businesses. Amendments have been made to the relevant parts of SI 1995/2518 which deal with reporting, time of supply and 8th Directive reclaims. The Explanatory Note to the SI contains a great deal of information about the European background to the changes and the purpose of the various measures.

SI 2009/3241

The idea of these two changes is that there will be fewer occasions on which foreign VAT is incurred, but when it is, it will be easier to recover.

Balanced against those improvements, measures have been added to the VAT Package to combat missing trader inter-community fraud, also known as "carousel fraud". This generally involves a domestic supply by trader X, subject to VAT, followed by an inter-community supply by trader Y. Trader Y claims back the domestic VAT charged by trader X, but trader X has disappeared with the money and never accounts for it to the authorities. In order to make this more difficult, the new rules require more detailed reporting of inter-community transactions, and much faster filing of reports. This will be a serious challenge to anyone who sells goods or services to business customers elsewhere in the EU.

4.2.1.1 Liability: goods

The changes on 1 January 2010 do not affect the VAT liabilities of people buying or selling goods internationally, or the conditions which must be satisfied to enjoy zero-rating of despatches and exports. It is only the reporting responsibilities of traders in goods that are affected.

4.2.1.2 Liability: services

The first important element of the VAT Package is a set of changes to the rules on "place of supply of services" for Business to Business (B2B) sales. These have previously been set out in s.7(10) and (11) VATA 1994, together with Sch. 5 VATA 1994 and SI 1992/3121 (the Place of Supply of Services Order). With effect from 1 January 2010, all these provisions are repealed and replaced with new rules:

- s.7A VATA 1994 sets out the basic rules on place of supply;
- Sch.4A lists the various types of supply which are affected by different exceptions to the basic rules.

The three possible treatments for VAT on international services supplied by a UK trader are:

- charge UK VAT, which the customer may be able to recover from HMRC;
- register for VAT in another member state and charge VAT there;
- charge no VAT, leaving the customer to account for VAT on a foreign VAT return (the "reverse charge" mechanism), subject to the rules in the customer's own country.

Of these, the ideal situation for both supplier and customer is the third. Strictly, such supplies are not "zero-rated" (as despatches and exports of goods are); they are "outside the scope of UK VAT" because the "place of supply" is outside the UK. The liability arises in the country in which the place of supply falls, and the customer is liable to pay the VAT in that country. The VAT Package is intended to increase the number of occasions on which the reverse charge (RC) is used and reduce the occasions on which either an 8th Directive reclaim (first possible treatment) or extra registration (second possible treatment) are required.

Up to 31 December 2009, the UK law on sales to foreign persons within the EU made the treatment dependent on whether the purchase was "for the purposes of a business carried on" by the customer. This meant that it was not enough to find out if the customer was VAT-registered: the supplier was also supposed to find out the use to which the customer put the supply. From 1 January 2010, the law will refer to the customer being a "relevant business person". This means someone who carries on a business activity anywhere in the world. If the customer is in business, the use to which the customer puts a supply of services will now be the customer's problem, not the supplier's.

In most intra-EU cases, the UK VAT treatment will depend on obtaining a valid VAT registration number for the customer with a two-letter country prefix. Although in the past it has been acceptable to obtain alternative evidence of business status and business use, the VRN will in future be required for reporting purposes, so it will be a good idea to obtain it to justify the treatment of the sale.

The following table sets out the main changes to the rules affecting supplies of services made by a UK business. It distinguishes between supplies to a "relevant business person" (B2B) and supplies to someone else, generally a consumer (B2C). The second table shows supplies that stay the same (although where the rules are has changed in all cases). It is not possible within this short summary of the most important points to give full definitions or explanations: please refer to the detailed guidance or the legislation for more information on any point which needs clarification.

Changes		To 31 December 2009	From 1 January 2010
Basic rule – if no exceptions apply	B2B	Where supplier belongs (UK VAT) – s.7(10) VATA 1994	Where customer belongs (reverse charge) – s.7A(2)(a) VATA 1994
Short-term hire of means of transport	B2B B2C	Where the supplier belongs (UK VAT) – s.7(10) VATA 1994 unless used and enjoyed outside the member states, in which case no VAT applies – SI 1992/3121 art.17	Where the vehicle is made available to the customer, unless used and enjoyed outside the member states, in which case no VAT applies – Sch.4A para.3
Long-term hire of means of transport (over 30 days for car hire)	B2B	Where the supplier belongs (UK VAT) – s.7(10) VATA 1994 unless used and enjoyed outside the member states, in which case no VAT applies – SI 1992/3121 art.17	Where customer belongs (reverse charge) – s.7A(2)(a) VATA 1994
Restaurant, catering in general	B2B B2C	Where supplier belongs (UK VAT) – s.7(10) VATA 1994	Where the services are physically carried out – Sch.4A para.5
Restaurant, catering on board EU transport	B2B B2C	Where supplier belongs (UK VAT) – s.7(10) VATA 1994	Where the journey departs from – Sch.4A para.6
Supplies of intermediaries	B2B	Where the main deal takes place – SI 1992/3121 art.13, unless the customer quotes a VRN to shift the place of supply/reverse charge – SI 1992/3121 art.14	Where customer belongs (reverse charge) – s.7A(2)(a) VATA 1994

Transport of goods within the EU	B2B	Where the transport begins – SI 1992/3121 art.10, unless the customer quotes a VRN to shift the place of supply/reverse charge – SI 1992/3121 art.14	Where customer belongs (reverse charge) – s.7A(2)(a) VATA 1994
Valuation of or carrying out of work on goods	B2B	Where the services are physically carried out – SI 1992/3121 art.15, unless the customer quotes a VRN to shift the place of supply/reverse charge – SI 1992/3121 art.14	Where customer belongs (reverse charge) – s.7A(2)(a) VATA 1994
Supplies of services formerly within Sch.5 VATA 1994*	B2B	If the customer belongs in another member state and uses the supply for the purposes of a business, outside the scope of UK VAT (reverse charge) – SI 1992/3121 art.16	Where customer belongs (reverse charge) as long as the customer is a "relevant business person", regardless of the use to which the supply is put – s.7A(2)(a) VATA 1994

* these include transfers and assignments of copyright, patents, licences, trademarks and similar rights; advertising services; services of consultants, engineers, consultancy bureaux, lawyers, accountants, and similar services, data processing and provision of information, other than any services relating to land; banking, financial and insurance services (including reinsurance), other than the provision of safe deposit facilities; the supply of staff; the letting on hire of goods other than means of transport; telecommunication services; radio and television broadcasting services; and electronically supplied services.

Significant categories of "basic rule services" which have previously been charged in the UK by UK suppliers even if the customer is a foreign business include:

- management services which do not fall within the "Sch.5 categories" listed above;
- call centre services which do not constitute advertising, the provision of information or financial services.

No change		To 31 December 2009	From 1 January 2010
Basic rule – if no exceptions apply	B2C	Where supplier belongs (UK VAT) – s.7(10) VATA 1994	Where supplier belongs (UK VAT) – s.7A(2)(b) VATA 1994
Long-term hire of means of transport (over 30 days for car hire)	B2C	Where the supplier belongs (UK VAT) – s.7(10) VATA 1994 unless used and enjoyed outside the member states, in which case no VAT applies – SI 1992/3121 art.17	Where the supplier belongs (UK VAT) – s.7A(2)(b) VATA 1994unless used and enjoyed outside the member states, in which case no VAT applies – Sch.4A para.3

Supplies relating to land	B2B B2C	Where the land is situated – SI 1992/3121 art.5	Where the land is situated – Sch.4A para.1
Supplies of passenger transport	B2B B2C	Where the transport takes place – SI 1992/3121 art.6	Where the transport takes place – Sch.4A para.2
Cultural, educational, entertainment services*	B2B B2C	Where the services are physically carried out – SI 1992/3121 art.15	Where the services are physically carried out – Sch.4A para.4
Hiring of goods	B2B B2C	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – SI 1992/3121 art.17	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – Sch.4A para.7
Telecommunications services	B2B B2C	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – SI 1992/3121 art.17	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – Sch.4A para.8
Electronically provided services (e.g. website supply, software)	B2B	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – SI 1992/3121 art.17	Where the rest of the rules would place the supply in the UK but the use and enjoyment is outside the EU, the supply is treated as outside the EU – Sch.4A para.9
Supplies of intermediaries	B2C	Where the main deal takes place – SI 1992/3121 art.13	Where the main deal takes place – Sch.4A para.10
Transport of goods within the EU	B2C	Where the transport begins – SI 1992/3121 art.10	Where the transport begins – Sch.4A para.12
Valuation of or carrying out of work on goods	B2C	Where the services are physically carried out – SI 1992/3121 art.15	Where the services are physically carried out – Sch.4A para.14
Supplies of services formerly within Sch.5 VATA 1994*	B2C	If the customer belongs outside the EU, outside the scope of UK VAT – SI 1992/3121 art.16	If the customer belongs outside the EU, outside the scope of UK VAT – Sch.4A para.16

* from 1 January 2010, most of these services will move to the reverse charge when supplied B2B; however, charges for admission to an event will continue to be charged where the event takes place.

A new version of the Place of Supply of Services Notice, now numbered 741A, has been issued to set out the rules from 1 January 2010 onwards.

Notice 741A

4.2.1.3 Reverse charges

For a UK business buying services from outside the UK (whether within the EU or not), the rules set out above will also determine whether the customer has to self-account for a reverse charge on the purchase of the services. The "basic rule" will now apply a reverse charge if none of the exceptions apply. Among the major categories of supply which are now automatically reverse charged if bought into the UK from outside are:

- management services;
- call centre services;
- long-term car leasing;
- all intermediary and transport services, and work on goods.

The option is preserved to allow a UK customer to account for a reverse charge as an alternative to the overseas supplier being required to register in the UK where:

- the place of supply is covered by Sch.4A Parts 1 and 2 (paras.1 – 9);
- the customer is already VAT-registered.

This is provided by s.8(2) VATA 1994. Where the place of supply is in the UK because of the new "basic rule" and the customer is not yet VAT-registered, the value of the reverse chargeable supply is included in the customer's turnover to determine whether the customer has a liability to register for VAT under Sch.1 VATA 1994.

4.2.1.4 Time of supply

The time of supply for international sales of services which are outside the scope has previously not been particularly important, because there was no liability to VAT and no specific reporting responsibility (although such sales were supposed to be included in Box 6 of the VAT return). For reverse charges, the rule in reg.82 SI 1995/2518 provided that the tax point was the date of payment.

Under the new regime, the time of supply becomes much more important, because it will be necessary to enter sales of services on an ESL. The time of supply for both sales (ESL) and purchases (reverse charge) will be the earlier of the completion of the service and the date on which it is paid for. Continuous supplies will be supplied at the end of each billing or payment period, or the date of payment if earlier. For continuous supplies that are not subject to billing or payment periods, the time of supply will be the end of the calendar year or the date of payment if earlier.

4.2.1.5 Paperwork: goods

The format of European Sales List or ESL for goods is not changing, but the frequency and deadlines are both being considerably tightened:

- monthly ESLs instead of quarterly reports will be required if the despatches of goods in the current quarter or any of the preceding four quarters exceeds £70,000;

- the first monthly ESL will be required as soon as the limit is exceeded, e.g. a trader who starts business on 1 January and makes £40,000 of despatches in January and the same in February must file an ESL covering January and February and will then file monthly ESLs from March onwards for at least the next year;
- the time limit for filing ESLs is reduced from 42 days from the end of the quarter to 14 days from the end of the relevant month (for paper returns) or 21 days (for electronic returns).

Clearly this is a tight time limit and traders need to make sure they are ready to meet it.

The transactions that have to be entered on the ESL do not change. ESLs include movements of own goods from the UK to a foreign branch; but they exclude distance sales, even if they are effectively treated as despatches to a foreign VAT registration of the same trader.

"Normal" despatches of goods will not require a special indicator on the ESL. "Triangular" sales of intermediaries which are disregarded using the simplification procedure under s.14(6) VATA 1994 are indicated by a code "2" on the ESL.

Zero-rated despatches are UK supplies, so they are entered in Box 6 of the return as well as in Box 8. A trader registered under the flat rate scheme has to account for flat rate VAT on despatches even though no VAT is charged to the customer – a considerable disadvantage of the FRS for such a trader.

4.2.1.6 Paperwork: services

The requirement to submit ESLs for services is completely new. The following points should be noted:

- only sales which are treated as outside the scope of UK VAT because the reverse charge will be applied by the customer should be shown on the ESL – it does not include exempt supplies or supplies which are sold to a foreign customer but charged to UK VAT;
- the ESL must show the value and the customer's VRN with two-digit country prefix;
- the services ESL is only required quarterly, but may be filed monthly if the trader wishes;
- the same time limits apply as for the goods ESL;
- supplies of services are indicated by a code "3";
- such supplies are supposed to be entered in Box 6 of the VAT return by a "normal" trader, but not by a flat rate trader (because no FRS VAT is due on such supplies);
- only supplies of goods are entered in Box 8 of the VAT return.

4.2.2 Article

There is a useful article on the change of rules in *Taxation*, 26 November 2009. Neil Warren uses a number of articles to highlight types of supply on which the place and liability change and on which they do not.

Taxation 26 November 2009

4.2.3 Implementing regulation

The Commission has announced a proposal for an implementing regulation to be issued in conjunction with the VAT package. The last implementing regulation was issued in 2005 and covered a number of borderline areas where there might be differences of interpretation between member states. The Commission proposes to update the regulation to clarify the application of the new rules following the introduction of the VAT package. Presumably the final implementing regulation will follow quite soon after the proposal, as the VAT package is already in force and it has been in preparation for a long time.

http://ec.europa.eu/taxation_customs/resources/documents/common/legislation/proposals/taxation/COM(2009)672_en.pdf

4.2.4 The old rules still apply

An Irish company demolished buildings and sent the waste material to a business in Northern Ireland for processing and disposal. The Northern Irish business did not charge VAT on the work done.

HMRC assessed for output tax and the trader appealed, arguing that the service should be outside the scope of UK VAT. The Tribunal agreed with HMRC that the work fell within SI 1992/3121 art.15(d) and was therefore situated where it was physically performed for VAT purposes. The appeal was dismissed, but the liability should disappear on 1 January 2010.

The decision is stated very briefly, and does not go into detail about the evidence or the arguments. However, it appears from the wording that the taxpayer argued that the service was situated in Ireland because it was a “demolition service”, i.e. connected to the land and therefore within art.5 SI 1992/3121. The Tribunal did not accept that the trader had any direct involvement in the demolition contract, and a sub-contractor was not supplying the same service as the main contractor.

First Tier Tribunal (TC00219): *G Kinney*

4.2.5 Reverse charge applied

The Medical Protection Society is a professional body which supports doctors and dentists when they are subject to legal action. It sometimes buys in legal advice from outside the UK, but has never accounted for reverse charges on this expenditure. Most of its income is exempt, so the reverse charge would be a cost.

In January 2008 HMRC raised an assessment for three years' worth of reverse charges (£5.8m). The company claimed that the misdirection concession should apply, as it had a ruling from 1998 that it did not have to account for VAT on these items. As HMRC's refusal to apply a concession was not appealable to the Tribunal, it applied for judicial review in the High Court.

The judge did not consider that the appellant had presented the full relevant facts in 1998. The disclosure letter in 1998 suggested that the society's members were "in the driving seat" when instructing lawyers to deal with claims, so they could be argued to receive the services directly. The society would not then be in receipt of the services and would not be liable for the reverse charge. When HMRC reviewed the society's guidelines on handling claims in 2006, it became clear that the society was "in the driving seat". The judge was satisfied that this was a material difference, and it had not been made clear in the 1998 letter. The concession was therefore not applicable and the application was dismissed.

High Court: *R (oao Medical Protection Society Ltd) v HMRC*

4.2.6 Not consultancy

A UK company offered "guardianship services" to the foreign resident parents of children boarding at UK schools. The services were described in a leaflet as "covering the care and guardianship of your child, educational guidance, practical and administrative support with travel and financial matters, plus a range of extras such as assistance with shopping for essential items, school uniform or musical instruments". The company argued that these services should not be VATable when supplied to persons belonging outside the EU.

There was some discussion of the relevance of different parts of the ECJ's decision in *Linthorst* (the case about the vets), but the Tribunal approved of a suggested working definition of consultancy as "Specialist and expert advice by someone with extensive experience/qualifications on a subject". On that basis, the Tribunal was not convinced that the services concerned were consultancy. They were rather administration and routine advice, and they were subject to VAT in the UK.

First Tier Tribunal (TC00268): *Gabbitas Educational Consultants Ltd*

4.2.7 Practical issues

The Readers' Queries in *Taxation* magazine, 3 December 2009, contain two interesting practical problems and some expert comment:

- a UK-based building contractor who has the opportunity to undertake a project in France;
- the auditor of a charity which is registered in the UK but which carries on all its activities outside the EU, which is where the auditor has to do the audit work.

4.3 International supplies of goods

4.3.1 New guides

HMRC have issued a new information pack to provide a basic guide to anyone wishing to import or export goods. It is intended as a guide to help anyone get started on importing and/or exporting, and to provide a better understanding of the procedures involved in these activities.

http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD_008051

HMRC have also issued a new guide to Simplified Import VAT Accounting (SIVA), explaining the system and the approval criteria that must be met to use it.

Notice SIVA 1

4.3.2 New Notice

HMRC have issued a new Notice 702/10/09 *Tax warehousing*. It gives information on the VAT treatment of goods in tax warehouses in the UK and of services associated with those goods.

www.hmrc.gov.uk

4.3.3 Intrastat thresholds

The Instrastat reporting threshold is being cut from annual despatches of £270,000 to £250,000 with effect from 1 January 2010. At the same time, the threshold for the arrivals Intrastat is being increased from annual acquisitions of £270,000 to £600,000. This is supposed to cover 97% of dispatches and 95% of arrivals.

R&C Brief 69/09; SI 2009/2974

4.3.4 Low values

The level below which VAT is not charged on postal imports remains £18. The de minimis level for customs duty rises from £120 to £135. The level below which customs duty will not be collected is duty of £9. The value of gifts between private individuals which will not be charged to VAT rises from £36 to £40. Goods with a value below £630 (up from £560) are subject to a flat duty rate of 2.5%, rather than applying the appropriate rate from the Tariff.

The general tax free allowances for goods accompanying travellers have been increased with effect from 1 January 2010. They are now £390 for arrivals by air and sea and £270 when travelling by other means (which includes private pleasure travel by air or sea). The limits for 2009 were £340 and £240. The increase arises because of a reconversion of the euro amounts in the Directive at current sterling exchange rates. This is required once a year.

SI 2009/3172

4.3.5 Sundry exemptions on import

The EU Council has adopted a Directive to codify the rules on sundry exemptions under Art.143(b) and (c) of the 2006 VAT Directive. This covers such varied categories as personal property on a change of residence or marriage, capital goods on the movement of a business, certain agricultural imports, and some goods imported for the benefit of charities and philanthropic organisations.

http://register.consilium.europa.eu/pdf/en/09/st12/st12820.en09.pdf

4.3.6 Proof of import

The last update included the First Tier Tribunal's decision (TC00169) in the case of *Peter Terence O'Neill*, who objected to paying import VAT on a postal package which had entered the UK from the USA via Germany. A similar argument arose in another case. The evidence showed that the goods had remained in a customs procedure in Germany, so they only entered free circulation when they arrived in the UK. VAT had been correctly charged on the importation.

First Tier Tribunal (TC00260): *Mrs S Sheftz*

4.4 European rules

4.4.1 Emissions allowances

At the ECOFIN meeting on 2 December 2009, the council of finance ministers agreed to a draft directive allowing member states to apply a reverse charge mechanism to emissions allowances and some other goods and services in order to prevent fraud. This extends the existing authorisation of reverse charge mechanisms for mobile phones and electronic equipment.

4.4.2 Reasoned opinions

The Commission has issued a number of reasoned opinions to different member states requiring reconsideration of their rules. These include:

- the exemption for certain fundraising activities in the Netherlands. which the Commission regards as too widely drawn – it allows exemption for organisations which raise funds for social recreational and cultural bodies, which effectively extends the exemption not only to those bodies but also to their suppliers;

  IP/09/1644

- the denial of input tax in Austria on mixed use buildings – those used partly for private and partly for business purposes, where the private use is regarded as a deemed exempt supply in contravention of the ECJ decision in *Seeling* (Case C-269/00);

  IP/09/1638

- the Polish rules on 8th Directive reclaims, which are subject to unacceptable delays and unfairly stringent conditions (e.g. if a query is not dealt with inside seven days, the right to refund is lost);

IP/09/1645

- the French rules on tax representatives, which allow non-established persons making supplies which under the Directive should be accounted for as reverse charges by the French customer to register in France and declare the output tax through a fiscal representative, apparently then offsetting the recovery that would be due to the customer;

IP/09/1642

- the Greek rules which allow a reduced rate of VAT to be applied to bowling when carried on by members of the Hellenic Bowling Federation, but require non-members to pay the standard rate.

IP/09/1641

4.4.3 German derogation

Germany has a derogation which permits the denial of input tax recovery on part private, part business assets which are used more than 90% for private purposes by a taxable person or his employees. The Council has approved an extension of this derogation until 31 December 2012.

http://register.consilium.europa.eu/pdf/en/09/st13/st13502.en09.pdf

4.4.4 Polish derogation

The Council approved a derogation to allow Poland to exempt taxable persons whose annual turnover is no higher than €30,000 with effect from 1 January 2010. The limit was previously €10,000.

http://register.consilium.europa.eu/pdf/en/09/st13/st13501.en09.pdf

4.4.5 Spanish land agents

In Spain, Land registrars are professionals appointed by the Spanish State and charged by it with the management of the land registers. They work on their own account, are free to organise their work, select their own staff and collect the payments which constitute their income themselves. Traditionally Spain regarded their activities as taxable, but an appeal decision in 2003 determined that certain of their work was carried out in the capacity of a public official. They have therefore been treated as outside the scope of VAT since then.

The Commission took infringement proceedings against Spain, and persuaded the ECJ that the appeal decision had been wrong. The court declared that treating these independent practitioners as public authorities was in contravention of the VAT Directive.

ECJ (Case C-154/08): *Commission v Spain*

4.4.6 Finnish lawyers

The Commission sought a declaration by the ECJ that Finland has failed to meet its obligations under the Directive by allowing public legal aid offices (part of the government's legal system) to supply legal advice to the public without charging VAT (where the member of the public is required to make a financial contribution). The Commission believed that this is an area in which the public authority competed directly with commercial lawyers, and failing to charge VAT therefore would lead to a significant distortion of competition.

The Advocate-General recommended that the application for an order should be rejected by the court. In his opinion, the legal aid activities of the public offices do not constitute "economic activity"; they are carried out in the capacity of public bodies, and should be outside the scope of VAT.

In the opinion of the Advocate-General, the Commission failed to demonstrate that a price differential of 22% (the VAT) is a significant factor in the choice exercised by people who use the services of the legal aid offices, and it therefore does not constitute a significant distortion of competition.

The full court dismissed the action, awarding costs against the Commission. However, it appeared to take the decision a stage further back from the Advocate-General's opinion – the Commission failed even to show that there was a supply of any sort. It was necessary to show that there was an economic activity before considering whether the public authority was a taxable person, and the court did not believe that there was one here. It was therefore not necessary to consider whether the offices acted in the capacity of a public authority, nor whether there was a significant risk of distortion of competition. The reasoning was that the link between the supply of services and the payment of a financial contribution was too tenuous to make the payment into "consideration for a supply of services". This was because the payment was more dependent on the level of the individual's income and assets than on the value of the services provided.

ECJ (Case C-246/08): *Commission v Republic of Finland*

4.4.7 Evasion and exemption

The German Supreme Court has referred a question to the ECJ about the availability of the exemption for despatches to someone who is deliberately attempting to exploit the VAT system for fraudulent purposes. In a string of previous decisions, the ECJ has consistently ruled that the legality or otherwise of a transaction should have no bearing on the VAT treatment, unless the prohibition on such transactions is so severe that there cannot be a legitimate market (e.g. counterfeit currency, outlawed narcotics); however, it seems that the court has not previously had to consider whether a direct attack on the VAT system itself might be treated differently.

The question referred is:

1. Must Article 28cA(a) of the Sixth Council Directive 77/388/EEC be interpreted as meaning that a supply of goods within the meaning of that provision is to be refused exemption from value added tax if the supply has actually been effected, but it is established on the basis of objective factors that the vendor, a taxable person,

(a) knew that, by his supply, he was participating in a transaction aimed at evading VAT, or

(b) took actions aimed at concealing the true identity of the person to whom the goods were supplied in order to enable the latter person or a third person to evade VAT?

ECJ (reference) (Case C-285/09): *Criminal proceedings against R*

A similar problem arises in a case referred by Italy. The activity in this case is money-lending at such exorbitant rates that the business is considered illegal under Italian domestic law. The question referred is:

In accordance with the Community law principles set out in the Sixth VAT Directive of the neutrality of VAT and exemption from VAT, under conditions laid down by the Member States, for transactions entailing the granting and the negotiation of credit and the management of credit by the person granting it, can exorbitant lending activities, which are a criminal offence under national law, be subject to VAT where, in economic terms, they may be envisaged as being in competition with the corresponding lawful activities of granting money loans, which fall within the scope of VAT under national law but are deemed exempt thereunder whenever they may be regarded as 'finance transactions'?

ECJ (reference) (Case C-381/09): *Gennaro Curia v Ministero dell'Economia e delle Finanze, Agenzia delle Entrate*

4.5 Eighth Directive reclaims

4.5.1 New refunds Notice

HMRC have issued new Notice 723A *VAT: EU refunds for agents and advisers*. It explains how tax agents and advisers can become authorised to submit claims for 8th Directive refunds on their clients' behalf.

The agent has to apply online to add "VAT EU refunds for agents" to the portfolio of authorised services on the HMRC website. After filling in some details, the agent then has to wait for an activation PIN to arrive in the post.

In order to be authorised for a particular client, the agent has to provide the following details in respect of the client:

- VAT registration number;
- principal place of business postcode;
- effective date of registration for VAT (the first three pieces of information can be found on the client's Certificate of Registration - VAT 4);
- final month of the last VAT Return submitted to HMRC;
- the box 5 figure on the last VAT Return submitted to HMRC.

The client will then receive a letter with an activation code which must be communicated to the agent before the agent can make claims on the client's behalf. Once the process is complete the agent should be able to submit claims within 24 hours.

Notice 723A

Meanwhile, the Commission has issued an implementing regulation in relation to the new refund procedure. This provides for some specific details of the application procedure and presumably is relevant to how HMRC design and operate the electronic portal.

eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:314:0050:0059:EN:PDF

4.5.2 Shortening time limits

Although the new refunds procedure has extended the time limit for making 8th Directive claims in many countries, in Belgium it has shortened it substantially. Belgium used to allow claims for VAT up to the end of the third year following the year in which the VAT was incurred; now this will be 30 September following the year in which the VAT was incurred. Claims for 2006, 2007 and 2008 had to be submitted before 1 January 2010 to take advantage of the old time limit, because the new procedure will be the only claims mechanism available in 2010 (i.e. only claims for 2009 will be possible).

4.5.3 Article

There is a useful article by Neil Warren on the change of 8th Directive claims procedure in *Taxation*, 5 November 2009.

Taxation 5 November 2009

4.5.4 Signing a claim

A Netherlands-based company submitted an 8th Directive claim to the German authorities, who refused it because it was not signed "personally" by the trader. A lawyer who was authorised to act as the company's agent in all matters relating to VAT had signed it instead. After an appeal in Germany, questions were referred to the ECJ, which ruled:

'Signature' of an application for a refund of value added tax, as referred to in the specimen form set out in Annex A to the Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes – Arrangements for the refund of value added tax to taxable persons not established in the territory of the country, is a Community law notion which must be interpreted uniformly to the effect that such a refund application need not necessarily be signed by the taxable person in person and that the signature of an agent may be sufficient for those purposes.

ECJ (Case C-433/08): *Yaesu Europe BV v Bundeszentralamt für Steuern*

5. INPUTS

5.1 Economic activity

5.1.1 Sale of subsidiary

In a case referred by Sweden, the ECJ has given a ruling in principle on the status of the disposal of a subsidiary company by a holding company. However, the application of that judgment will be left to the national courts, and it is not entirely clear how it will be applied.

The Swedish court had decided that a holding company should be entitled to recover input tax on expenses associated with disposing of such a shareholding, because the acquisition of a subsidiary was treated as relating to an economic activity and justifying input tax credit.

The Advocate-General disagreed. His opinion was that the sale of shares in a subsidiary constitutes an exempt supply within art.135(1)(f) Directive 2006/112/EC. The sale is an economic activity, and because it involves shares it is covered by the exemption. There should be no right of deduction of input tax, even if the purpose underlying the transaction is a restructuring of the industrial (and therefore presumably taxable) activities of the company. It should make no difference whether the sales are in a single transaction or in a series (one of the question for reference concerned the sale of shares which were in a company that had once been a subsidiary but which no longer was controlled by the vendor, presumably because of a sale in several tranches).

The ECJ's full judgment is different again. It starts by confirming that the sale of shares in a subsidiary is an economic activity and within the scope of VAT. That suggests that it is likely to be an exempt supply. However, the judges stated that it could be regarded as the sale of a "totality of assets" (i.e. a transfer of going concern); if so, it would be disregarded and treated as neither a supply of goods nor a supply of services.

This is a surprising outcome, given the legal difference between selling shares and selling assets. The judges have apparently based their conclusion on the principles of equal treatment – if a transaction could be structured as a sale of shares or as a sale of assets, with an essentially similar economic result, they should be treated the same for VAT. However, it is then for the national courts to decide when to apply TOGC treatment to particular transactions. It would be particularly sensible, for example, to do so where a VAT-grouped subsidiary was being sold, because its assets would have been regarded as "part of" the selling group up to that point; but the judgment may also extend to sales of subsidiaries that have been separately registered.

The judgment went on to rule that the transaction itself is an exempt supply if it is not a TOGC, but held out the possibility – again for the national court to determine – that there could be "*a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person*". If this is the case, the *Kretztechnik* principle would apply – the costs would be residual, and a fully taxable trader would be able to recover all the input tax (as the exempt supply of the shares would be an incidental financial transaction).

To decide the issue, the ECJ states: "*It is for the referring court to take account of all the circumstances surrounding the transactions at issue in the main proceedings and to determine whether the costs incurred are likely to be incorporated in the price of the shares sold, or if they are among only the cost components of transactions within the scope of the taxable person's economic activities*." It seems unlikely that the incidental costs of selling a subsidiary are "incorporated in the price of the shares sold" in the same way that the cost of labour is incorporated in the price of a manufactured product; that may indicate that the costs should generally be regarded as overhead.

ECJ (Case C-29/08): *Skatteverket v AB SKF*

Under current UK practice, supported by the case of *BLP Group plc* (Case C-4/94), the sale of shares in a subsidiary has been regarded as an exempt business supply which leads to the blocking of input tax on directly related costs under the normal rules of partial exemption. Many people who have had input tax blocked on costs of sale will be looking at both of the possible routes outlined by the ECJ in the current case to claim a repayment of past input tax.

5.1.2 Abuse of rights?

In late 2007, a scheme exploiting a discrepancy between the VAT rules in the UK and in Germany was held to work (and not to be an abuse of rights) by the VAT Tribunal. It will now be referred to the ECJ by the Court of Session.

A UK bank established a subsidiary in Germany. That company purchased cars in the UK and leased them to a customer as company cars. Under UK VAT rules, it was treated as making a supply of a "basic rule service" (leasing of a means of transport) which was therefore made in Germany. It was entitled to reclaim VAT on the purchase of the cars under the 8th Directive, but would not have to account for output tax.

Under German VAT rules, however, the supply of the cars was treated as a supply of goods. As the goods were never in Germany, no output tax was due in Germany either.

If the customer leased cars in the UK from someone who had to charge UK VAT, only 50% of that VAT would be recoverable under UK rules.

HMRC issued a ruling denying input tax recovery on the purchase of the cars in 2003, but the case has only now come before the Tribunal. The *Halifax* decision was an important factor arising in between the ruling and the hearing.

HMRC's main argument for refusing the input tax claim was that the effect of the scheme was to remove the onward supply from any charge to output tax. If there was no output tax anywhere in the EU, there should be no input tax. The Tribunal rejected this argument: the activity was clearly taxable. There would at the very least be a taxable sale of the cars at the end of the leases, and output tax charged at that point; the failure to charge any output tax in Germany in the intervening period was really a problem for the German authorities, not for HMRC.

HMRC's secondary argument, that the scheme was an abuse of rights, was also rejected. The Tribunal considered that the old UK direct tax decisions of *WT Ramsay Ltd* and *Furniss v Dawson* were relevant in deciding what was an "artificial" scheme, even though the *Halifax* decision was 20/30 years later, in a different court and under a different legislative basis altogether; the Tribunal therefore believed that it was necessary to identify an "inserted step" in a series of transactions before there could be artificial tax avoidance. As the transactions between the German company and its customers were direct contractual supplies with nothing inserted, it was not possible (in the Tribunal's view) for the arrangements to be regarded as abusive. The Tribunal quoted the following extract from the ECJ judgment:

"*Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the highest amount of VAT. On the contrary … taxpayers may choose to structure their business so as to limit their tax liability.*"

The Court of Session has decided to refer the following questions for a ruling by the ECJ:

In circumstances such as those of the present case, where:

a) *a German subsidiary of a United Kingdom bank purchased cars in the United Kingdom with a view to leasing them to an unconnected company in the United Kingdom and paid value added tax on these purchases;*

b) *under the relevant United Kingdom legislation the supplies consisting of the rental of cars were treated as supplies of services made in Germany and accordingly not subject to value added tax in the United Kingdom. Under German law these supplies were treated as supplies of goods made in the United Kingdom and accordingly not subject to value added tax in Germany. The consequence was that no output tax was charged on these supplies in either member state;*

c) *the United Kingdom bank selected its German subsidiary as lessor and determined the duration of the leasing arrangements with a view to obtaining the tax advantage of no VAT being chargeable on the rental payments:*

1. Is Article 17(3)(a) of the Sixth Directive (now Article 169(a) of the Principal VAT Directive) to be interpreted as entitling the United Kingdom tax authorities to refuse to allow the German subsidiary to deduct VAT which it paid in the United Kingdom in respect of the purchase of the cars?

2. In determining the answer to the first question, is it necessary for the national court to extend its analysis to consider the possible application of the principle of prohibiting abusive practices?

3. If the answer to Question 2 is yes, would the deduction of input tax on the purchase of the cars be contrary to the purpose of the relevant provisions of the Sixth Directive and thus satisfy the first requirement for an abusive practice as described in paragraph 74 of the decision of the Court in Halifax plc and Others v Customs & Excise Commissioners (Case C-255/02) having regard among other principles to the principle of the neutrality of taxation?

4. Again if the answer to Question 2 is yes, should the court consider that the essential aim of the transactions is to obtain a tax advantage, so that the second requirement for an abusive practice as described in paragraph 75 of the said decision of the Court is satisfied, in circumstances where in a commercial transaction between parties operating at arm's length, the choice of a German subsidiary to lease the cars to a United Kingdom customer, and of the terms of the leases, are made with a view to obtaining the tax advantage of no output tax being charged on the rental payments?

ECJ (reference) (Case C-277/09): *RBS Deutschland Holdings GmbH v HMRC*

5.1.3 More abuse (or not)

A group of companies entered into a complex avoidance scheme devised by a firm of accountants which had the effect of allowing them to account for output tax only on the margin achieved on sales of demonstrator vehicles rather than on their full sale price. HMRC raised assessments and misdeclaration penalties on the grounds that the arrangements were an abuse of rights within the *Halifax* principle.

The scheme worked as follows:

- four associated dealership companies sold their demonstrator cars to three associated captive leasing companies under sale and leaseback agreements;
- the captive lessors assigned the benefit of these agreements to a Jersey bank in return for a 45-day loan facility;
- within that period, another associated company acquired the Jersey bank’s car business in a transfer of going concern, outside the scope of VAT, and then sold the cars under the second-hand margin scheme.

HMRC’s view of what ought to have happened gives further explanation of how the scheme worked:

In the Commissioners’ view the Dealership Companies:

- *Should not have accounted for output VAT on selling the cars to the Captive Leasing Companies.*
- *Should not have deducted any VAT on the leaseback transactions either before or after the assignment of the agreements.*
- *Should have accounted for any output VAT on the full value of the sales they made as agent of PDS.*
- *Should have accounted for output VAT on any private use of the “stock in trade” cars on which input VAT has been recovered.*

The Captive Leasing Companies

In the Commissioners' view the Captive Leasing Companies:

- *Should not have deducted any VAT on the purchase of the cars from the Dealership Companies.*
- *Should not have charged any VAT on the leaseback transactions.*

PDS (the company that eventually sold the cars)

In the Commissioners' view PDS should not have accounted for any VAT on the sale of the cars "to customers".

HMRC were convinced that the arrangement was an abusive VAT scheme because of the involvement of the accountants. However, the Tribunal decided that this was not conclusive. It believed that the principal objective was the obtaining of finance rather than obtaining the VAT advantage, and it allowed the appeal. The concept of abuse and the current state of the doctrine is discussed in detail, and is likely (depending on the final outcome of the litigation) to become an important point of reference for future appeals in this area (until there is further guidance from the ECJ).

HMRC will appeal to the Upper Tribunal.

First Tier Tribunal (TC00147): *Pendragon plc*

5.1.4 A yacht business?

In Revenue & Customs Brief 56/09, HMRC commented on attempts to recover input tax on pleasure craft by registering for VAT as a "yacht chartering business". The Brief set out the tests for such an activity to be considered a business, and also highlights a number of factors which might indicate that such an arrangement was abusive even if it did entitle the owner to register. Now the Tribunal has heard a case on this issue and allowed the taxpayer's appeal against HMRC's refusal to register the business.

A yacht was purchased by a company and leased to the directors and employees of the company and its associates, and also to third parties through an agent. A market rate was charged for the chartering, but the company made losses.

The Tribunal examined the background to the acquisition of the yacht and applied the tests of "business" in *Lord Fisher* and in *Enkler,* as well as comparing the case to precedents such as *Coleman* and *Three H Aircraft Hire*. It concluded that the hiring was "quite a serious undertaking moderately earnestly pursued"; overall, it satisfied the tests of being a business, and the appeal was allowed.

However, the Tribunal complained that much of the hearing was taken up with an examination of the company's accounting records in an attempt to establish what had happened when, and the witnesses did not have a clear understanding of the records or the events. Much of this could have been dealt with in advance and might have avoided the need for the hearing. The taxpayer was awarded only 40% of the costs of the hearing (under the transitional rules – if the appeal had commenced after 1 April 2009, the appellant would not have been awarded anything).

First Tier Tribunal (TC00249): *Heath House Charter Ltd*

5.2 Who receives the supply?

5.2.1 For the creditors?

A company was in financial difficulties and appointed an accountancy firm to liaise with its banks, bondholders and other creditors. It paid the fees and reclaimed input tax on them. HMRC assessed to disallow the tax, arguing that the firm's supplies were made to the creditors, not to the company.

The Tribunal examined the engagement letters, which appeared to support HMRC's position: they were addressed to the engaging institutions, and stated that the report was solely for the use of the engaging institutions. However, even HMRC accepted that the appellant was a party to the contracts – they were tripartite agreements. HMRC relied on the Tribunal decisions in *Telent plc* (19,967) and *Birmingham City Football Club* (20,151) to support the contention that the person who pays for services does not necessarily have the right to deduct the VAT.

The Tribunal quoted the *Redrow plc* decision of the House of Lords at length. It concluded that there was a supply made to the company as well as to the lenders; it was then obvious that the supply was used for the purposes of its business, and it was entitled to the deduction.

First Tier Tribunal (TC00201): *Airtours Holiday Transport Ltd*

5.3 Partial exemption

5.3.1 Incidental real estate transactions

In calculating the overhead recovery proportion, EU law (represented in the UK by SI 1995/2518 reg.101(3)(b)) requires the exclusion of "incidental real estate transactions" from the fraction. A case was referred to the ECJ by the Danish courts to consider what could be regarded as "incidental" in this context.

The company concerned was involved in construction. Its main business was carrying out projects for customers, but it also built some properties for its own use. When it sold such buildings, Danish law regarded the sale as exempt, requiring the company to apply the rules of partial exemption. It argued that the sale of these buildings were "incidental real estate transactions", because they were not part of the main business of the company. The Danish authorities disagreed, requiring a proportion of overhead expenditure to be disallowed.

The ECJ ruled that such an activity could not be regarded as incidental where it constituted the direct, permanent and necessary extension of its business. It would not offend against the principle of fiscal neutrality for some of the overhead input tax to be disallowed, even if there had been a self-supply charge on the construction of buildings for the company's own use, because the law regarded the sale of such buildings as exempt.

The court also considered that it was not necessary to consider the extent to which overhead input tax was actually consumed in making the sales of these buildings – in effect, that would entail applying a special method "fair" recovery rather than the standard method proportional approach. The court's ruling requires the straightforward application of the standard method.

ECJ (Case C-174/08): *NCC Construction Danmark A/S v Skatteministeriet*

5.3.2 Special method

A company sold furniture but also made exempt supplies of arranging insurance for commissions. In 1986 it agreed a special method with Customs, under which overheads were to be apportioned using a turnover-based proportion (this was not the standard method at the time, but became standard on a change of regulations in 1992).

The special method was not operated as agreed. Overheads were not apportioned, and the resulting exempt input tax was de minimis. It was possibly for this reason that HMRC did not challenge the recovery of input tax until 2006, when they issued assessments on the basis that input tax should have been disallowed.

The company argued that it was operating a "de facto method" because its returns and records had been examined by control officers who must have noticed the levels of exempt income and who had not raised any objections. The control officer who dealt with most of the visits was not a partial exemption expert and clearly regarded the company as "low risk" – unlikely to be involved in anything dishonest or in complex avoidance schemes. However, he did not appear to have considered the possibility that it would simply apply an incorrect or muddled understanding of an agreed method. He confirmed after various visits that he had found no errors. He also had to examine voluntary disclosures after the *Primback* decision which led to adjustments and highlighted the insurance income.

The Tribunal accepted the company's argument that the officer had effectively approved the special method in use and allowed that part of the appeal. The decision goes into considerable detail about the basis for allowing a "de facto agreement" to constitute approval.

The Tribunal also held that the company's advertisements were exclusively incurred in the taxable part of its business and therefore 100% recoverable. The precedent cases were considered in detail, and the Tribunal decided that the principle was to establish a direct and immediate link between the expenditure and the supplies. There was such a link with the sale of sofas, but not with the insurance intermediation. There was an important distinction between this situation and that in *Dial-a-Phone*: this company's adverts did not mention insurance at all, while Dial-a-Phone's mentioned three months' free insurance which was offered as an incentive to take up "paid for" insurance.

The Tribunal also found that inputs relating to the stores, factories and head office were all residual. They were not cost components of particular sales – there was no direct and immediate link between the cost of lighting and the supply of a sofa. The same personnel sold sofas and insurance. The overheads were therefore not directly linked to exempt supplies, but they were also not linked to taxable supplies. They were therefore residual.

First Tier Tribunal (TC00157): *DFS Furniture Co Ltd*

There is a commentary on this case in ICAEW *Accountancy*, November 2009 p.80. Graham Elliott comments that the Tribunal appeared unwilling to allow HMRC to change a treatment that had not been challenged over a long period in which on average HMRC officers were inspecting the records for 29 days a year. He notes that traders often believe that a VAT visit means that everything is agreed and settled up to that date, and that a future visit will not go back further than the earlier one: while that is not the strict legal position, this Tribunal seems to have thought that the alternative was not acceptable.

5.3.3 Special method override

In 2001 HMRC agreed a floor-area based special partial exemption method with a chain of opticians' stores. In 2005 they issued an override notice under reg.102A SI 1995/2518, cancelling the special method and replacing it with "the extent to which the goods or services are used by him or are to be used by him in making taxable supplies". The company appealed against the issue of the notice.

The Tribunal agreed with the earlier criticisms of the Tribunal and High Court in *Optika* and *Banbury Visionplus*: the problem with a floor-area based method in an open-plan optician's shop was that very little of the space was used exclusively either to make taxable or exempt supplies. As a result, the special method did not represent a fair, or fairer, method of attributing and apportioning input tax. The override notice was properly issued, and was not ambiguously worded so as to make it invalid.

The Tribunal also dismissed an appeal against an assessment for input tax overclaimed by the company. The Tribunal considered only matters of principle in relation to this assessment: it did not consider the assessment in detail, but as it arose from the issue of the override notice, it was valid in principle.

The Tribunal made the following comment about what might be an acceptable special method:

"*We have already indicated that we think it unlikely that a floor area-based method could ever be suitable. We heard some evidence about the calculations, referred to as a "full cost apportionment", VEUK makes in order to determine the taxable and exempt proportions of the charge it makes for dispensed spectacles and the slightly different calculation it makes in respect of contact lenses. We are aware that the Commissioners have misgivings about the calculations, but as we understood the matter, their misgivings relate to the details of the calculation, rather than to the principle. The more we heard evidence on the matter, the more it seemed to us clear that a method which satisfactorily calculates VEUK's output tax liabilities is as likely, perhaps with adjustment for special factors, to represent a suitable method for calculating the input tax for which it is entitled to credit. We did not understand how an expense which is a cost component of a mixed supply must be treated in one way when calculating the output tax liability, and in another when calculating the input tax credit. In short, it appeared to us that the Commissioners were right to* *conclude that, in relation to the retail business taken alone, the standard method, perhaps with some small adjustment, was appropriate.*"

The company appealed to the High Court, but the judge upheld the Tribunal's decision on all points. First, there were findings of fact which the company could not overturn; second, it was clear that the Tribunal's conclusion from the facts was the correct one. There was no error in law and the override notice should stand.

High Court: *Vision Express (UK) Ltd v HMRC*

5.3.4 Theatre production costs

Following the case of *Garsington Opera* (TC00045), HMRC have issued a Brief to explain their policy on theatre production costs and the circumstances in which they can be treated as residual. The first version of this Brief (62/09) contained a formatting error and was replaced by a corrected version (65/09).

The new policy is as follows:

It is an established principle of partial exemption that input tax is residual if the costs are 'used or intended to be used' to make both taxable and exempt supplies. Costs are used if they have a direct and immediate link to supplies. Production costs will always be directly and immediately linked to exempt admissions to the show. Production costs only become partly deductible (residual) if there is a firm intention to make taxable as well as exempt supplies when the costs are incurred. Production costs are not 'overhead costs' which are treated as residual because they relate to the organisation as a whole. Production costs only become residual if they relate to specific taxable supplies as well as exempt admissions. Examples of when production costs relate to taxable supplies include if a theatre has contracted to or intends to:

- *Secure sponsorship - the sponsorship must relate to an event or a clearly defined run of events over a clearly defined time. Putting on the shows must be a condition of the sponsorship so that production costs become cost components of the sponsorship income. The intention may be evidenced by way of clear financial commitment.*
- *Tour the production - once again the intention may be evidenced by way of clear financial commitment.*
- *Record the show for later sale on CD or other media.*

Production costs remain residual if an intention to make taxable supplies is frustrated. For example if production costs were treated as residual because of an intention to tour the show, the costs remain residual if the intended tour is later cancelled.

The Brief points out the distinction between this situation and that in Mayflower Theatre Trust: inputs do not become residual because of an indirect link to taxable supplies, but only if there is a direct link. For example, corporate sponsorship on its own, or the use of photographs in taxable programmes, are not enough to make the production costs residual.

The Brief also points out the possible need for a "use-based calculation" to check whether the standard method override will apply. This is explained as follows:

A 'use-based' calculation is any calculation that fairly reflects how costs are used in making supplies. Calculations should be as simple as is possible whilst achieving a fair result. A fair calculation could be:

Recoverable input tax on production costs incurred in the tax year = A ÷ (A + B) × C

Where:

A = Value of supplies in the year (such as sponsorship or touring) with a direct and immediate link from the production costs of any show.

B = Value of all box office sales in the year; and

C = Residual input tax incurred on production costs in the tax year.

Theatres operating the standard method where the SMO is likely to be triggered on a regular basis may wish to seek approval for a special method.

R&C Brief 65/09

5.3.5 Manual updated

HMRC have updated their Partial Exemption Manual to include:

- additional text stating the requirement to notify local TAPE teams on receipt of a special method application; and
- an amendment to the special method example paragraph, regarding longer period adjustments, to reflect Budget 2009 changes.

www.hmrc.gov.uk

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Charity fundraising

Charities have to divide the VAT on their expenses into:

- business and non-business;
- taxable business and exempt business.

Until the case of *Church of England Children's Society* (High Court 2005), VAT relating to fundraising was generally regarded as wholly irrecoverable because fundraising was not a business activity. That case established that the *Kretztechnik* principle could apply: general fundraising supported the whole of an entity's activities, and the VAT in relation to it was therefore an overhead of the whole of those activities. Some of it could therefore be recovered, to the extent that it was used to make taxable supplies.

In 1995, Oxfam had agreed a method of apportioning VAT between business and non-business on a costs basis. Those costs (VAT-exclusive) which were exclusively used in business activities and those costs which were exclusively used in non-business activities were expressed as a percentage ("B over B plus non-B") and this was applied to expenses which were partly for business and partly for non-business purposes. The method was put on a formal basis by the issue of a direction from Customs in 2000.

Following the *CofE* case, HMRC accepted that Oxfam were entitled to apply the formula to fundraising costs as well as the other costs already treated as "pot". Some £2.5m was repaid to the charity as a result. However, Oxfam argued that there was a further effect of the decision which HMRC had not taken into account. Previously, the expenditure on fundraising had been included in "non-B" in the formula: now it should be excluded altogether, producing a higher percentage to be applied to a larger residual amount of VAT. The business proportion would rise from about 75% to 85% or 90%.

HMRC argued that this no longer produced a fair and reasonable result, and they said that they were entitled to revisit the formula. The agreed method included the proviso that the agreement would not apply if there was a significant change in the way the business operated, and HMRC contended that this significant change in the understanding of the law triggered that get-out. In May 2006 HMRC issued a notice withdrawing approval of the agreed method, and no replacement had yet been agreed by the time of the Tribunal hearing in 2008.

Oxfam argued that the approved method, formally agreed by HMRC in a document, constituted a binding contract from which HMRC could not retrospectively resile. Now that a proper understanding had been established of the way in which the rules ought to operate, the method should be merely mechanical. This was the result in a number of other cases such as *GUS Merchandising Corporation* in respect of retail schemes and *The Labour Party* in respect of partial exemption methods.

The Tribunal discussed this proposition in great detail, and drew an important distinction. Retail schemes and partial exemption are provided for in statute. There is no statutory detail on the business/non-business split. The situations are therefore not comparable, and it is not right to assume that Oxfam's agreement was binding in the same way as it was for *GUS* and *Labour*. The negotiations which led to the formal document in 2000 did not appear to be the agreement of a contract but rather the ratification of an existing practice. In short, the Tribunal agreed with HMRC that they were entitled to consider the voluntary disclosure as a new claim which was subject to the principles of being fair and reasonable, rather than being required to make a repayment on the basis of a mechanical formula.

The Tribunal was not satisfied that the repayment claim was fair and reasonable. It would appear to create a recovery of some 85% of the VAT on fundraising expenditure, which appeared inconsistent with statements in the annual report that 80% of donated income was used for the relief of poverty (generally involving non-business activities). The appeal was therefore dismissed.

The charity appealed to the High Court, but the judge believed that the Tribunal's decision was justified. There was no abuse of power by the public authority in modifying the assurance earlier given, and no irrationality in that modification either.

The charity had also commenced judicial review proceedings on the basis of a "legitimate expectation". This was held over pending the result of the Tribunal hearing. The judge commented that he believed the legitimate expectation point was one that could be argued before the Tribunal; but this was in his view an extension of the traditional understanding of the Tribunal's jurisdiction in such a matter, so it would be prudent for future appellants to take both routes of appeal as a protective measure until a higher authority settled the matter.

High Court: *Oxfam v HMRC*

5.6.2 Flat for directors' use

A company with a base in Aberdeen leased a flat in Edinburgh that was used by directors and employees while meeting clients in the capital. It reclaimed input tax in relation to the flat. HMRC issued an assessment to recover this, arguing that s.24(3) VATA 1994 blocked the input tax on accommodation provided for directors.

The Tribunal allowed the appeal in part. It held that an apportionment would be possible if some of the flat was used for business meetings, and left it to the parties to go away and agree an appropriate split.

The Tribunal also allowed some input tax which related to removal expenses of an employee from one residence to another, because it appeared that there was a genuine business purpose in securing the move. She was then closer to clients and more able to provide services to them. The Tribunal accepted that the subjective test of business purpose in *Ian Flockton Developments* was satisfied.

First Tier Tribunal (TC00252): *Robert Gunkel & Associates Ltd*

5.6.3 Article

There is a useful article on expenditure on houses in *Taxation*, 3 December 2009. John Newth points out that it is in some circumstances possible to claim VAT relief, and even income tax relief, where expenditure is incurred to enable a person to work from home.

5.7 Bad debt relief

5.7.1 Bad debt rules in detail

A company claimed bad debt relief on 12 March 2007 in respect of invoices dated 31 January and 6 March 2003. The amount claimed was over £44,000. The only issue was when payment was "due" on the invoices, which would determine whether the claim was made within the time limit of three years and six months from the due date for payment (reg.165A SI 1995/2518).

The general terms of business with the customer concerned specified that invoices were to be paid within 60 days, and invoices would cover all sales within the requisite month. This would set the time limit at 1 October and 5 November 2006, and the claims would be out of time. The customer went into liquidation on 13 February 2004. If that triggered the time limit, the claims were in time.

The company argued that there had been a variation of the original terms of trade in order to assist the customer to trade out of a cash flow problem. It had been documented in June 2003, but the officer of the company stated that this was simply a note of an agreement that had been reached earlier. He agreed with HMRC's counsel that it ought to have been more formally documented, but argued that such informality is normal in small companies.

The Tribunal chairman accepted the officer's evidence as reliable and honest, but interpreted the events differently. He did not believe that there had ever been a legally binding variation of the supply agreement; instead, the company had agreed to offer its customer "indulgence". The payments were still due, but enforcement action would not be taken. As a result, the bad debt relief time limits ran out when HMRC said they did.

First Tier Tribunal (TC00185): *Resteel Trading Ltd*

5.8 Other input tax problems

5.8.1 Carousels

In case VTD 20,900, the Tribunal examined the evidence in detail, then commented on "*…the sheer improbability of these trades being genuine. In particular we take account of the following:*

(i) the exponential increase in Red 12's turnover despite no capital and no assets;

(ii) by February 2006 Mr Singh, who had some previous commercial experience, had been operating in the field for long enough to know of the considerable risk of fraud and yet his checks on his suppliers were inadequate;

(iii) the inadequacy of the invoices;

(iv) the lack of any value added by Red 12;

(v) the length of the deal chains;

(vi) the volume of trade given Mr Taylor's evidence as to the availability of new telephones;

(vii) the peculiar circumstances of many of the deals, in particular Deal 25 (see paragraph 22(b));

(viii) Mr Singh's lack of credibility and lack of care with regard to his own terms and conditions, in particular in respect of potential liability."

The appeal was "allowed in part" by the Tribunal, because HMRC's grounds of assessment had been "missing trader intra-community fraud", and one of the deal chains was not proved to involve an intra-community transaction – it is not much of a victory to win because HMRC were alleging the wrong sort of fraud. Input tax was disallowed on the other 45 transactions.

The High Court dismissed the trader's appeal against this decision, holding that it was a finding of fact which the Tribunal was entitled to reach on the evidence.

High Court: *Red 12 Trading Ltd v HMRC*

Earlier in 2009 the VAT Tribunal (20,931) considered a preliminary issue in relation to a dispute over an alleged MTIC fraud. It ruled that HMRC's policy of extended verification was not unfairly discriminatory and was not ultra vires the VAT Directive. It has now proceeded to the substantive hearing and dismissed the company's appeal, holding that the purchases were connected with fraudulent evasion of VAT and the company actually knew that it was participating in such transactions.

The Tribunal considered in detail the level of knowledge of the director and decided that it was clearly not enough to represent "all that could be done" to ensure the bona fides of the customers and suppliers, and probably represented evidence that the directors were knowing participants in the fraud.

First Tier Tribunal (TC00191): *4Distribution Ltd*

A trader was involved in 47 transactions over 15 months in which goods including washing powder, soft drinks and confectionery were purportedly despatched from Northern Ireland to customers in Spain. The trader was unaware that the transactions were part of a missing trader fraud. The Tribunal considered that he had done enough due diligence to be allowed zero-rating on 4 of the transactions, but on the remainder he had not. There was insufficient evidence that the goods had left the UK, and the evidence on which he had relied was not sufficient to give him the protection of the principles in the *Teleos plc* case.

As usual in such cases, the Tribunal had to consider a great deal of evidence to try to establish what had actually happened, knowing that some of that evidence was likely to be misleading because some at least would be based on a fraud. Such case reports are always useful reading for anyone who is likely to be involved in such a dispute, because they show the difficulty of establishing the facts when the evidence is unreliable.

First Tier Tribunal (TC00248): *Brendan MacMahon t/a Irish Cottage Trading Co*

A trader in a long-running dispute over an alleged MTIC fraud made an application to the High Court to object to two procedural decisions of the Tribunal. HMRC had wanted to introduce an accountant from a major firm as a witness, and the Tribunal had allowed this; the appellant wanted to introduce evidence of French law, explaining how the French authorities interpreted the *Kittel* judgment of the ECJ.

Sir Andrew Park J rejected the appellant’s arguments on both points. The accountant was properly admitted as an expert witness; the French administrative practice could not be relevant to a UK Tribunal decision. It was permissible to introduce arguments based on the interpretation of an ECJ decision, including consideration of other language versions of that decision, but the view of a different administrative authority was not something which could be “legitimately prayed in aid”.

High Court: *Mobile Export Ltd v HMRC (no.3)*

The Tribunal had to consider assessments to over £23.5m dating from the years 2000 to 2003. The trader advanced a number of arguments to support claims to input tax, but these were all dismissed. A small amount of the assessment was cancelled because it wrongly related to underdeclared output tax, but £23m of overclaimed input tax was confirmed.

The Tribunal refused to award costs to HMRC because the case was subject to the transitional rules and it was not clear whether the old or new rules ought to be applied. If HMRC wished to pursue an application for costs, it would be necessary to have a further hearing.

First Tier Tribunal (TC00223): *Tariq*

In another carousel case, a company was held to have “known or had the means of knowing” that its transactions, all entered into with one supplier and generating a pre-ordained fixed profit of 6%, were connected with fraud. HMRC were therefore entitled to refuse its claims for input tax.

First Tier Tribunal (TC00281): *Life Enterprises Ltd*

5.8.2 Mind the gap

The European Commission has published a study on the gap between the amount of VAT due and the amount received in 25 Member States, and the evolution of these figures, over a period of 7 years.

The study comes up with an estimate VAT gap varying between € 90 billion and €113 billion in the period 2000 to 2006. The definition of the "VAT gap" is explained as follows:

2. We provide estimates of the VAT gap based on a comparison of accrued VAT receipts with a theoretical net VAT liability for the economy as a whole. We estimate the theoretical net liability by identifying the categories of expenditure that give rise to irrecoverable VAT and combining these with appropriate VAT rates.

3. The VAT gap is not a measure of VAT fraud. For example:

(a) The VAT gap might include VAT not paid as a result of legitimate tax avoidance measures.

(b) The VAT gap is estimated primarily on the basis of national accounts data, and therefore depends on the accuracy and the completeness of such data. Moreover, it does not take account of taxable activities that are outside the scope of national accounts.

(c) Due to lack of data, we do not adjust our estimates of the VAT gap to remove the VAT that is not collected due to insolvencies arising as a result of regular business activity, yet this portion of VAT that is not remitted is not due to VAT fraud.

4. The estimates presented in this report are of the VAT gap, as defined above, and not of VAT fraud.

Press Release IP/09/1655; http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/combating_tax_fraud/reckon_report_sep2009.pdf

5.8.3 Alternative evidence

A company acted as agent procuring customers for energy companies. It was paid commissions on contracts sold, and accounted for output tax on these. It was discovered that one of its salesmen had fraudulently forged customers' signatures on documentation in order to earn commission, and the energy company clawed back the commission. The company disputed this clawback, but eventually made a claim to reduce its output tax by an amount equivalent to the output tax on the clawed back commissions. Some time later HMRC inspected the records and disputed the entitlement to treat this amount as input tax.

By this time the original documentation concerning the clawback appeared to have been lost by the solicitors who had unsuccessfully attempted to resist the energy company's claim. A replacement summary of the clawback was provided to the appellant by an employee of the energy company, but it appeared that he had been made redundant and it was not clear whether the statement was produced by the energy company's system; it was also dated four months after the energy company had itself deregistered. HMRC refused to accept this as alternative evidence to support an input tax claim.

The hearing of the appeal was adjourned after one day, following which the company was given six months to provide further evidence. Nothing further was forthcoming, and the company was not represented when the hearing reconvened. As a result the appeal was dismissed and the costs of the appeal following the adjournment were awarded against the appellant (which had been held to have acted reasonably up to that adjournment).

First Tier Tribunal (TC00210): *Watt Power (UK) Ltd*

Another case on HMRC's discretion to accept alternative evidence appeared to be a domestic variation of a carousel fraud, although there was no suggestion that the appellant knew or ought to have known this. He bought £3.2m of goods over a three-month period from a business which provided invoices showing a "hijacked" VAT number. HMRC denied input tax deduction, and the appeal concerned whether they should have used their discretion to allow the credit on the basis that the transactions were genuine (in effect, transferring the problem of tracking the supplier to HMRC).

The Tribunal did not think that the trader had done enough to verify that the supplier was genuine, and in those circumstances it was reasonable for HMRC to refuse to exercise their discretion.

First Tier Tribunal (TC00270): *Mr Arash Razaie t/a Foodline Delivery Services*

5.8.4 TOGC

A trader acquired a bar, including fixtures and fittings, and claimed VAT as input tax. Initially HMRC disallowed this on the grounds that no VAT invoice had been produced. When the trader's accountants argued that alternative evidence should be accepted instead, they changed the reason to the fact that the purchase was a transfer of going concern and should have been outside the scope of VAT. They then modified the assertion again, after it was pointed out that the previous business had ceased some two years before the transfer of the fixtures concerned.

Unfortunately for the appellant, the previous owners had deregistered when the business ceased, and the sale of the fixtures was not enough to make them registrable again. The transaction was therefore outside the scope of VAT for a different reason, and there was no input tax to claim.

First Tier Tribunal (TC00253): *Shakeel Ali*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Commission rattles the sabre

As a follow-up to its July 2009 “position paper”, the Commission has now sent reasoned opinions to 8 member states, including the UK, concerning the application of their rules to VAT groups. The Commission’s objections are as follows:

Sweden: restricts VAT grouping to financial and insurance businesses. The Commission does not believe that the Directive allows such a limitation to a particular sector.

Finland: the same restriction applies as in Sweden, and non-taxable persons are allowed to join a VAT group.

Ireland, the Netherlands, Spain, the UK, Denmark and the Czech Republic allow non-taxable persons to join a VAT group.

The Netherlands are also alleged to have failed to notify changes in the grouping rules to the VAT Committee.

Grouping is based on Art.11 VAT Directive, which provides:

After consulting the advisory committee on value added tax (hereafter, the ‘VAT Committee’), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.

The member states have 2 months to change their rules or face infringement proceedings in the ECJ. It seems too obvious to point out that Art.11 does not appear to require the “persons” to be taxable persons.

IP/09/1768

6.2 Other registration rules

6.2.1 Withdrawing a VAT1

It is well known that an EDR cannot be changed once it has been validly applied for unless a mistake has been made by HMRC. This calls for extreme care in entering the date on the VAT1, or in filling in the same form online.

A company ran car rallies in Europe, charging entry fees. It was incorporated on 3 July 2006 and started trading in November 2006. After taking professional advice, the director anticipated that the first year’s sales would be £150,000 and that he would have to be registered from 1 March 2007.

He instructed his part-time book-keeper to register the company for VAT with effect from that date. He wanted to do this in advance so that the paperwork would be completed in good time, so she attempted to register using the online form. When she tried to enter 01/03/2007 as the date from which registration should take effect, the system did not permit her to enter this date. Instead, the current date – 29/11/2006 – appeared. Not apparently realising what she was doing, the book-keeper pressed "submit". No hard copy or soft copy was retained.

In January the director received an acknowledgement with a VRN and a certificate of registration showing the effective date of 29 November. He contacted his accountants immediately to investigate, because he had not been collecting VAT on receipts up to that point. The accountants wrote to HMRC to request a change in the EDR on 17 January 2007. This was refused, and this decision was appealed to the Tribunal.

The Tribunal discovered the reason that the online procedure created a difficulty: it will not accept an EDR more than 3 months ahead of the date of completion of the form. If the book-keeper had attempted to complete the form a few days later, the problem would not have arisen. Nevertheless, it appeared that the trader had applied for registration and had been validly registered in accordance with the application.

The Tribunal examined a precedent, *Homeforce* (17,948), in which the Tribunal had directed HMRC to treat a "request to change an EDR" as "a request to deregister the trader" (which could then be followed by a further registration application). Cancellation of registration was something that HMRC could do, even if they could not move the EDR, and this should have been explained in response to the letter of 17 January rather than simply refusing to change the date.

The Tribunal directed a different officer to reconsider the matter, taking into account the possibility of cancelling the registration from 17 January 2007 to 1 March 2007 and therefore refunding any VAT charged for that period.

This appears to ignore the problem that cancellation of registration (Sch.1 para.4 VATA 1994) requires that the Commissioners should be satisfied that taxable turnover in the next 12 months will not exceed the deregistration threshold. This company would not have satisfied that test at 17 January. The review may therefore not produce any success for the appellant.

First Tier Tribunal (TC00198): *Modified Gumball Rally Ltd*

6.2.2 Time limits

A trader received a series of letters from HMRC in 2008 pointing out that his declared turnover on his self-assessment returns appeared to be above the VAT registration threshold. After receiving no satisfactory response, HMRC issued a notice of compulsory registration with effect from 1 September 2003.

The taxpayer's representative argued before the Tribunal that HMRC were out of time under s.73(6) and s.77(1)(a) VATA 1994. Because they had had the self-assessment returns for some time, clearly showing the information they had used to come to their decision, they could not now issue an assessment.

The Tribunal pointed out that this argument was flawed. HMRC had not issued an assessment but a notice of compulsory registration. The time limits relied on did not apply to such a notice.

Although it was not mentioned in the decision, it is worth noting that the assessment that would follow from the notice would apply to the registration period, and the time limit would run from the end of that period – so HMRC would be in time to raise it even though the period started well before the three (or now four) year time limit.

First Tier Tribunal (TC00194): *Baljit Singh t/a BS Construction*

6.2.3 Farmer and wife

Taxation magazine (22 October 2009) includes a "reader's query" about an apparently concerted campaign by HMRC in the north-west to amalgamate bed and breakfast operations run on farms by the farmer's wife with the VAT-registered farming business.

HMRC may have a point in some cases, but in others they are on shaky ground and their attack should be resisted very strongly.

The first step is to establish the basis for the assessment. If HMRC are asking for back tax, it appears that they are asserting that the VAT-registered trader is carrying on the B&B trade – this is not a business-splitting direction under Sch.1 para.1A/2 VATA 1994 ("artificial business splitting"), because that can only have prospective effect. If the farm is a husband and wife partnership, and the B&B business is run in partnership, then HMRC are correct to issue the assessment, even if the activities are kept separate and keep separate accounts. All taxable activities of the same registered trader are caught by the registration.

If the B&B trade is run by the wife and the farm is not registered as a trade of the wife herself, HMRC are on much weaker ground. As long as the wife's accounts are kept separately and the proceeds are not enjoyed by the registered person (whether it is the husband or a partnership of husband and wife), then it is unlikely to be the case that there really is a single business that is omitting some of its income from the VAT returns.

HMRC are probably thinking of cases they have won against cafés and pubs where the two sides of the business are much more closely connected – for example, selling food and drink to the same customers can be more sensibly treated as a single activity carried on in partnership than can selling B&B to individuals and selling food to wholesalers or shops.

If HMRC are basing their argument on the use by the wife of "farming assets" which are not charged to her on an arm's length basis, it will be important to analyse what assets are actually used by her. HMRC's case will be strengthened if the wife's business uses anything on which the farm has recovered input tax, but even then it could be argued that there is a deemed supply of that item under Sch.4 para.5 VATA 1994 rather than the creation of a single business as a result.

If the assessment is based on Sch.1 para.2, it is surely completely misconceived. To start with, such a direction cannot be retrospective; to finish with, farming and B&B are not a "single activity" that has been "artificially split". They are commonly run in the same place, but they are quite different from each other and there may be many reasons other than avoiding VAT registration for the husband to keep his pigs separate from the wife's guests.

Taxation 22 October 2009

6.2.4 Double whammy

A taxi firm operator was investigated by the Inland Revenue in relation to possible understatement of income taxable profits. Customs & Excise became involved and in 2002 he registered for VAT with effect from 1 April 1996. He subsequently disputed an assessment raised by HMRC for VAT relating to a long "registration period" running from 1996 to August 2002, claiming that:

- he had already paid an agreed settlement for that period that covered everything;
- he had been cajoled into accepting various figures to settle his income tax liabilities, and then found that they were held against him to create further VAT liabilities.

The Tribunal found it difficult to establish exactly what had happened after such a long delay, but it appeared that the "settlement" of the initial VAT return had only related to agreement of a "time to pay" arrangement covering what were clearly estimated figures. HMRC had not accepted that the figures were final, nor that the liability was fully declared.

There was also no convincing evidence that the figures agreed with the Revenue were excessive or unrealistic. The assessment and registration date were confirmed.

First Tier Tribunal (TC00283): *Daniel John Currie*

6.2.5 Retired hurt?

Another case which turned on co-operation between the different sides of HMRC was described by the chairman as "a very unsatisfactory case because we have had to give our decision without having any clear understanding of what actually occurred". The trader had been a self-employed plumber up until 2001, when he deregistered for VAT (being over 70 years old). However, his income tax returns still showed the results of the business until 2004, with turnover marginally above the compulsory registration threshold. HMRC therefore argued that he should have continued to be registered and was now liable for some £19,000 of VAT plus a penalty on top.

The problem was that it was not clear why he had continued to include the income on his tax returns. He claimed to have sold the business in 2001 to a Mr Smith, and Mr Smith was then the proprietor and operator. In the absence of any explanation or evidence of how this arrangement operated, the Tribunal could only dismiss the appeal.

The chairman noted that the appellant was elderly, unwell and distressed, and urged HMRC to consider carefully before trying to collect the tax and penalty.

First Tier Tribunal (TC00258): *Peter Robert Balkwill*

6.2.6 Article

There is a useful article on problems of registration delays in *Tax Adviser*, November 2009. Neil Warren has discussed HMRC's targets and performance with senior officials and suggests that there is a great deal that applicants can do to make sure that their requests are processed as quickly as possible.

6.3 Payments and returns

6.3.1 Payments on account

HMRC have issued a revised (October 2009) version of Notice 700/60 *Payments on account*. It has been updated to reflect changes to HMRC's bank details and the replacement of reconsideration procedures with the statutory review after 1 April 2009.

There is no change to the requirement to make payments on account if the net VAT payable for 12 months exceeds £2m, or to the procedure whereby HMRC are supposed to notice this and notify the trader that they have entered the scheme.

Notice 700/60

6.3.2 Annual accounting

HMRC have issued a revised version of Notice 732 *Annual accounting*. It includes minor changes to improve clarity on how to make the balancing payment, leaving the scheme, the effect of deregistration and where to send the application form.

Notice 732

6.3.3 Online filing – consultation

HMRC have published a summary of responses to the consultation on compulsory online filing. The following comment is a warning to those who still believe that it is possible to do business without a computer:

Increasingly, businesses (or their agents) will need a computer in order to deal with Government as a whole and not just HMRC. This is all part of a wider drive to get business customers using computers in their dealings with Government. So far as tax is concerned, a business will need access to a computer to deliver on other tax responsibilities, such as filing an Employer Annual return, as well as starter and leaver forms online. And from April 2011, companies will be required to file Company Tax Returns online and pay any corporation tax electronically.

Although some of the respondents wanted a delay to the implementation of compulsory online filing and the penalties associated with it, HMRC believe that sufficient warning has been given and people should be ready.

HMRC also make the point that it is not necessary to prepare accounting records using a computer – the records are not affected at all by the new requirement. The filing of a VAT return should be a relatively simple exercise, and compares favourably with filling the figures in on a piece of paper.

www.hmrc.gov.uk

Meanwhile, regulations have been issued to amend the rules on filing in the General VAT Regulations to provide for electronic and paper returns in appropriate circumstances in line with the new policy.

SI 2009/2978

Practical issues for tax agents who want to file online VAT returns for their clients are considered in ICAEW *TAXline*, December 2009, and also in *Tax Adviser,* January 2010.

6.3.4 Tax paid by credit card

Regulations were introduced in 2008 to allow payment of tax over the telephone by credit card, subject to a fee of 0.91%. This has been increased to 1.25% from 14 December 2009 to reflect increased costs for HMRC.

SI 2009/3073

6.3.5 Tax paid on the never never

The Pre-Budget Report confirmed that the "time to pay" arrangements offered by the Business Payment Support Service would continue for the foreseeable future, "as long as required". However, businesses which apply for time to pay on liabilities of more than £1m will now have to provide an independent business review in support of the request, demonstrating that they need the time to pay and will be able to pay in due course.

6.3.6 New flat rates

When the VAT rate was cut from 17.5% to 15% on 1 December 2008, the flat rates were reduced as well. They have been increased again with effect from 1 January 2010, but not always to the same level that they were at before. The complete table is as follows:

Category of business	2010	2009	2008
Retailing food, confectionary, tobacco, newspapers or children's clothing	3.5	2	2
Post offices	4.5	2	2
Farming or agriculture that is not listed elsewhere	6	5.5	6
Pubs	6	5.5	5.5
Retailing vehicles or fuel	6	5.5	7
Wholesaling food	6.5	5	5.5
Retailing that is not listed elsewhere	6.5	5.5	6
Membership organisation	7	5.5	5.5
Wholesaling agricultural products	7	5.5	6
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	7	6	7
Sport or recreation	7.5	6	7
Wholesaling that is not listed elsewhere	7.5	6	7
Printing	7.5	6.5	7.5
Repairing vehicles	7.5	6.5	7.5
Manufacturing food	8	7	7.5
Manufacturing yarn, textiles or clothing	8	7.5	8.5
Packaging	8	7.5	8.5
General building or construction services*	8.5	7.5	8.5
Hiring or renting goods	8.5	7.5	8.5

Library, archive, museum or other cultural activity	8.5	7.5	7.5
Manufacturing that is not listed elsewhere	8.5	7.5	8.5
Repairing personal or household goods	9	7.5	8.5
Mining or quarrying	9	8	9
Transport or storage, including couriers, freight, removals and taxis	9	8	9
Forestry or fishing	9.5	8	9
Travel agency	9.5	8	9
Dealing in waste or scrap	9.5	8.5	9.5
Hotel or accommodation	9.5	8.5	9.5
Manufacturing fabricated metal products	9.5	8.5	10
Computer repair services	9.5	10	11
Agricultural services	10	7	7.5
Social work	10	8	8.5
Veterinary medicine	10	8	9.5
Advertising	10	8.5	9.5
Photography	10	8.5	9.5
Publishing	10	8.5	9.5
Any other activity not listed elsewhere	10.5	9	10
Investigation or security	10.5	9	10
Boarding or care of animals	10.5	9.5	10.5
Business services that are not listed elsewhere	10.5	9.5	11
Estate agency or property management services	10.5	9.5	11
Laundry or dry-cleaning services	10.5	9.5	11
Entertainment or journalism	11	9.5	11
Catering services including restaurants and takeaways	11	10.5	12
Film, radio, television or video production	11.5	9.5	10.5
Secretarial services	11.5	9.5	11
Hairdressing or other beauty treatment services	11.5	10.5	12
Financial services	12	10.5	11.5
Management consultancy	12.5	11	12.5
Real estate activity not listed elsewhere	12.5	11	12
Architect, civil and structural engineer or surveyor	13	11	12.5
Accountancy or book-keeping	13	11.5	13
Computer and IT consultancy or data processing	13	11.5	13
Labour-only building or construction services*	13	11.5	13.5
Lawyer or legal services	13	12	13

Some of the rates have risen substantially, but some have been reduced. It is up to the trader to notice that the rates have altered and apply the right rate – any overpayment through failing to notice a reduction will be capped if not spotted for over four years.

Naturally anyone whose rate has increased should reconsider whether the scheme benefits them, and weigh up the costs of extra administration against the increased VAT liability through using the FRS. HMRC expect that some traders will leave the FRS as a result of the changes, but it is impossible to estimate how many.

There will also be complications for those who use the cash basis under the FRS. If they have charged 15% to a customer on an invoice, they should apply the 2009 flat rate to the income, even if the money is received in January. That might be even more confusing where the tax point is in December but the invoice does not carry any VAT, for example because the supply is exempt or zero-rated. The tax point should fix the appropriate rate to use, and the tax point will not always be the same as the date of receipt.

PBRN 33; SI 2009/3241

6.4 Repayment claims

6.4.1 No exceptions to the cap

A trader used the flat rate scheme from 28 February 2003, applying the 13% rate appropriate for a takeaway food outlet. He failed to notice that the rate was reduced to 12% from 1 January 2004, and therefore overpaid VAT of £5,774 over a four-and-a-half year period. He claimed this back, but HMRC said that the cap applied.

The Tribunal held that there were no grounds to depart from the statutory limitation period. The decision was upheld.

First Tier Tribunal (TC00200): *Malcolm Hutchinson t/a Clifton Fisheries*

A similar decision was reached in a case involving a sandwich shop which had taken several years to realise that it could zero-rate sales of takeaway sandwiches. The trader stated that "*despite several calls to the Advice Centre, only one officer had been able to explain the law to him.. .the Appellant had been advised by at least three sets of accountants, none of whom had picked up the differentiation in tax treatment of hot and cold food*." These were surprising assertions but they were of no assistance against the clear provisions of the law.

First Tier Tribunal (TC00212): *Botanical Catering Ltd*

6.4.2 Bankruptcy and VAT debt

A trader was declared bankrupt in 1999. It appears that he paid some VAT in that year which he subsequently decided should have been part of his bankruptcy proceedings, so he claimed it back. HMRC asked for evidence that the liability had arisen before the bankruptcy; in the absence of such evidence they would only repay a proportion of the VAT, pro-rated to take account of the length of the period leading up to the bankruptcy order.

The trader appealed against the refusal to make a repayment. HMRC applied for the appeal to be struck out on the grounds that no appealable decision had been taken – the letter sent to the trader was simply a request for more evidence. The Tribunal ruled that it was not unreasonable to interpret the letter as a decision, given that the trader had told the officer by telephone that more evidence would not be forthcoming. It was then clear that HMRC would restrict the repayment in accordance with the terms of the letter.

On the other hand, the Tribunal agreed with HMRC that there was no appealable matter within s.83 VATA 1994. The repayment claim did not fall within any of the provisions of s.80, because it had at the time been VAT properly due to HMRC. The fact that it had been paid when it could have been included within the bankruptcy was not a matter that was referred to in s.83. Accordingly the appeal was struck out.

HMRC then applied for costs. They pointed to a history of largely unsuccessful litigation brought by the trader, including an appeal heard in September 2009 at which the Tribunal chairman had explained the provisions of s.83 at some length. The trader argued that the history of litigation was irrelevant, and the question of reasonableness must be considered only in relation to the current dispute.

The chairman disagreed with this proposition: it was necessary to take into account the context and history in deciding whether someone had acted reasonably. HMRC had a fair point in objecting to the apparent use by the trader of the Tribunal as the "first port of call" in any dispute about VAT. However, it did not appear that this particular appeal was unreasonable; the decision in September 2009 was only given long after this particular dispute was in train. No award for costs was made.

First Tier Tribunal (TC00209): *Barry O'Brien t/a Poster Sites (Southern)*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Updated guidance

HMRC have updated their guidance setting out the basic record-keeping and accounting requirements that traders are expected to comply with. Although it refers to computerised records, it is mainly written in the context of paper records.

http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_024429

6.7 Assessments

6.7.1 Proportion of sales

A trader ran a café and sandwich bar. He had difficulty filing VAT returns and eventually completed some with the assistance of a compliance officer, who estimated the proportion of standard rated sales to use at 45%. Subsequently the trader appealed against an assessment for the first return period and made a voluntary disclosure for later periods, in both cases disputing the proportion of standard rated sales. His MP wrote to the Paymaster General to represent the trader's concerns at being overcharged VAT, and the Paymaster General suggested that he should appeal to the Tribunal.

The trader did not appear at the hearing. The Tribunal considered the evidence provided by HMRC and found that there was nothing wrong with it. With the onus of proof on the taxpayer, and no evidence provided in support of his contentions that HMRC's figures were unfair, the appeal could only be dismissed.

First Tier Tribunal (TC00189): *Barry Triscott*

6.7.2 Suppression

A trader running an Indian restaurant appealed against an assessment for underdeclared VAT of £49,000 and a s.60 penalty on the same figure (mitigated by 10% to £44,700).

It is interesting to note that the "test purchase visits" on 16 February, 28 April, 15 August and 20 September 2001 involved 10 meals bought by HMRC officers on each occasion (11 on the last). The officers visited the restaurant in five groups of two. Part of the trader's defence was that the HMRC visitors were a very high proportion of the meals sold on the days in question, and these were therefore exceptionally busy nights and not a good basis for extrapolation. The officers apparently also bought meals that were on average £5 more expensive than "normal customers".

This argument was accepted by the Tribunal: although the Tribunal did not believe the trader's protestations that the assessments were wildly excessive and therefore not to best judgement, HMRC were directed to recalculate the assessment and the penalty using new calculations that excluded the distortive effect of the officers' meals.

The trader claimed that his staff must have stolen the takings, and therefore he should not suffer the s.60 penalty. The Tribunal did not accept this. Costs were awarded to HMRC at 80% of the total, to reflect the fact that the appeal had been successful to a small extent.

First Tier Tribunal (TC00193): *Makhisur Rahman t/a The Viceroy Indian Restaurant*

Another case concerning a restaurant also included disputes about the significance of the officers' meals. This time it was the fact that HMRC could not produce the receipts or expense claims to support the meals that they claimed their officers had eaten. The trader's representative regarded this as "sinister". He also raised a number of other arguments in defence, and introduced a professional statistician as an expert witness to attack

HMRC's use of just 2 dates as the basis for their extrapolation. However, none of the restaurant's management or staff gave evidence.

The Tribunal examined the various arguments and dismissed them all. As the burden of proof was on the appellant to show that the assessment was not to the best of the officers' judgement, an absence of any evidence from the staff – once there was an indication of suppression – made it difficult to support any other figure than that which HMRC had produced. The basis of that figure was logical and had not been directly undermined by alternative suggestions. The appeal was dismissed.

First Tier Tribunal (TC00244): *Queenspice Ltd*

6.7.3 Two tills

A trader objected to an assessment based on estimates and mark-ups. HMRC argued that they had evidence that he was operating two tills in his pub when his records only reflected receipts from one. The Tribunal accepted that the assessment was made to best judgement and dismissed the appeal.

First Tier Tribunal (TC00285): *Robert Walsh*

6.7.4 No receipts

A trader operated as a building contractor. HMRC identified payments to him by other registered traders that did not appear to be included within his VAT returns, and assessed him on an apparent underdeclaration of £127,000. He argued that the person preparing the returns had incorrectly netted off income from main contractors against amounts paid to VATable sub-contractors, with the result that the gross figures on the return were wrong but the net liability would be about the same.

The Tribunal examined the evidence for this and found it unconvincing. If sub-contractors had been used, it was likely that they were not VAT registered and there was no entitlement to offset. The appeal was dismissed.

First Tier Tribunal (TC00254): *John Sloan*

6.8 Penalties and appeals

6.8.1 Late registration

A company was incorporated with the assistance of a firm of accountants which was then supposed to effect a VAT registration. It appears that they did not do so; some time later, a new accountant was appointed, and shortly afterwards the registration was completed. HMRC levied a penalty at 10%, mitigated by 25% for voluntary disclosure. The company appealed to the Tribunal to increase the mitigation.

The Tribunal noted that the reliance on the first accountant could not be a reasonable excuse. However, it could give rise to mitigation. Although the company could have been more diligent in following up its own accountants, the Tribunal was mindful that the 10% penalty had been triggered by just one day – if the notification had arrived one day earlier, the rate would only have been 5%. In these circumstances, the Tribunal added further mitigation of half the difference, reducing the assessed amount from £2,515 to £1,886.

First Tier Tribunal (TC00183): *ALH Interiors Ltd*

6.8.2 The *Steptoe* argument

A company received about 99% of its income from a single customer, which was persistently slow in paying. The company was in default in most periods, and pleaded reasonable excuse on the grounds that its circumstances were similar to those considered by the Court of Appeal to constitute a reasonable excuse in the *Steptoe* case.

The Tribunal disagreed. It appeared that the company did have enough cash at most times to pay its outstanding VAT, and it had misunderstood the obligation to make payments on the basis of invoices rather than receipts. It is not clear why the company was not using cash accounting, which would surely have solved its problems.

It is interesting to note that the Tribunal discussed at length the difference of opinion between the appeal judges in *Steptoe* – the taxpayer only won on a majority decision, and the Tribunal appeared to regard this as indicating that the principle should be applied with caution.

First Tier Tribunal (TC00184): *Pillars Property Cleaning and Maintenance Ltd*

In a different case, the Tribunal appears to have been readier to accept and apply *Steptoe*. The company's argument appeared to be based on "the normal hazards of trade":

"*…the decline in the Company's business as a result of the recession which was unexpected and unforeseen, the loss of a major customer, the effect that redundancies had on the business lowering staff morale and diverting attention from seeking new customers, the early payment of salaries before the Christmas 2008 shutdown, the late payment by customers and the necessity of the Company to pay its suppliers on time to remain in business…*" all leading to an insufficiency of funds within *Steptoe*.

The Tribunal chairman commented:

"*…we find that that the underlying cause of the default was a combination of the loss of a major client, the effect of the redundancies and the late payment by the Company's customers as a result of the current recession coupled with the necessity for prompt payment of its suppliers.*

16. In deciding whether these reasons amount to a reasonable excuse we must consider what the reasonable competent businessman (taken for comparison purposes) exercising due diligence and a proper regard to his tax obligations, who must be taken to have exercised reasonable foresight, would have done in a similar situation.

17. We are of the view that such a businessman, in circumstances similar to that of the Company, would not have avoided the insufficiency of funds that led to the default."

Given the economic difficulties suffered by many traders at the moment, that is a relatively sympathetic interpretation.

First Tier Tribunal (TC00250): *Mediaclash Ltd*

Yet another Tribunal was less sympathetic. The company produced correspondence with a debtor (referred to as a "creditor" in the decision) which explained that it was late paying invoices because it was awaiting a VAT repayment from HMRC. The Tribunal considered that this was too remote from the late payment of VAT by the appellant. There was no evidence to show that it was this late payment that caused the default, or to show that the late receipt was such a high percentage of turnover that it could constitute a reasonable excuse. It appeared rather that the shortage of funds was part of the normal hazards of trade.

First Tier Tribunal (TC00251): *YSL Video Wall Hire Ltd*

6.8.3 Reliance on another

The employee responsible for a trader's VAT returns was dismissed on 3 November 2008. As a result, the managing director had to initiate a BACS payment for the October VAT return. He was aware that the company was in a surcharge period, but he was involved in business meetings in early December, and made a payment after close of business on 3 December which only arrived on 8 December. If he had made an "urgent" transfer the following day, it would have arrived in time.

The director argued first that the July 2008 return, which had led to an extension of the liability period, had been filed in time. The Tribunal found that there was insufficient evidence to support this assertion. In relation to the October return, the loss of the key employee occurred too long before the due date for it to constitute a reasonable excuse. The director said that a freelancer who was assisting with accounting had told him that receipt by 8 December would be acceptable, but even he admitted that he had doubts about the accuracy of that. If anything, it constituted "reliance on another", and that could not be a reasonable excuse.

The appeal was dismissed.

First Tier Tribunal (TC00182): *J Z Machtech Ltd*

A trader had a history of paying his VAT liability in two tranches, £10,000 and the balance. He entered the surcharge regime after a late payment, but the first surcharges were below the de minimis threshold and were not corrected. He then used a new book-keeper who was not aware of the rules, and both tranches were paid late. He appealed against a surcharge of £790.

The Tribunal found no reasonable excuse. If anything, the appeal was based on "reliance on another", which could not succeed.

First Tier Tribunal (TC00218): *David Low t/a Low's Traditional Fish & Chips*

6.8.4 Oops

A substantial company was subject to the payments on account regime. The balancing payment for June 2007 was paid late, triggering the surcharge regime. The instalment due on 30 June 2008 was paid late due to staff illness, extending the period to June 2009 and raising the rate to 5%. The December 2008 return was then submitted late, and the 5% surcharge based on the outstanding balance amounted to £91,393.60. The company argued that this was excessive, and offered interest of £7,358.29 instead.

The Tribunal examined the circumstances and could find no reasonable excuse in any of the late payments. There was no power to mitigate or reduce a surcharge, which was therefore confirmed as due.

First Tier Tribunal (TC00237): *Beresford Blake Thomas Ltd*

6.8.5 New Notice

HMRC have issued a revised version of the Notice on default surcharges. Changes include new information on deferring payments for the payment on account scheme, concessions for small businesses, late "nil" or repayment returns. There is also clearer advice on how to avoid a default when a due date falls on a weekend or bank holiday.

Unfortunately, most people who appear to plead reasonable excuse before the Tribunal do so because they have not yet read the Notice, rather than because the information in it was unclear.

Notice 700/50

6.8.6 Offer refused

A company distributed video games. It was in default for four successive periods, culminating in surcharges at 10% (£200) and 15% (over £5,000). The very large surcharge appears to have alerted the company to the importance of submitting VAT returns on time, and it appealed against the surcharges on the grounds of insufficiency of funds. It offered to pay interest instead of surcharge in respect of the late payment.

The Tribunal could find no reason to cancel the penalty. There was no power to mitigate a surcharge or to replace it with interest.

First Tier Tribunal (TC00241): *Click Distribution Ltd*

6.8.7 Misdeclaration

A trader claimed input tax on a number of invoices which HMRC decided were falsified. A misdeclaration penalty was raised. The trader's representative asked repeatedly for copies of invoices held by HMRC which they alleged showed that the trader's purchase invoices, purporting to be from a particular company, were "hijacked" forgeries. HMRC only produced these after many requests, including a direction from the Tribunal. When he saw the evidence, the representative advised that the appeals against those parts of the penalty should be dropped.

The hearing was then about whether the trader should be regarded as an innocent dupe who could not have known that the invoices were bogus. The transactions took place, and he believed that he was dealing with honest traders. The Tribunal disagreed: the discrepancies and inadequacies of the invoices were such that a conscientious trader would have carried out more checks, and those checks would have revealed the problem.

The representative also made a claim for some of the costs which were incurred as a result of HMRC's delay in providing the evidence which showed that part of the appeal could not succeed. The Tribunal rejected this argument. Although there was no excuse for HMRC's failure to provide the documents, the result of that production was that the representative carried out the checks that the trader should have done much earlier. Realising that the claim was ill-founded was not something that could justifiably be charged to HMRC.

First Tier Tribunal (TC00225): *Sarwar & Sons Knitwear Ltd*

6.8.8 Consultation

HMRC are consulting on draft clauses to complete the modernisation and alignment of penalties for late filing of tax returns and late payment of tax. The idea is to have a unified system for late filing and late payment, as there now is (since April 2009) for errors in returns. An impact assessment is available at www.hmrc.gov.uk/budget2009/interest-penalties-2410.pdf.

The proposals appear at present to be:

- the introduction of penalties for late filing of £100 to £400 per return, depending on how many previous defaults there have been in a penalty liability period;
- the introduction of penalties for late payment of between 1% and 4% of the tax outstanding, depending on how many previous defaults there have been.

This appears likely to be a much milder regime than default surcharge, unless there are hidden catches not at present obvious. It is harsher for other returns such as PAYE which do not have an equivalent of default surcharge at present.

www.hmrc.gov.uk

6.9 Other administration issues

6.9.1 HMRC Charter

HMRC have issued a new Customer Charter, called "Your Charter". HMRC explain:

The Charter has a lot of benefits for businesses and individuals who deal with HMRC. It clarifies expectations and sets out what customers can expect in their dealings with us such as :

- *being treated with courtesy and consideration;*
- *providing information that helps customers understand what they have to do and by when;*
- *considering any financial difficulties they may be having;*
- *letting them know how appeals, investigations or complaints are progressing.*

The Charter is discussed in ICAEW *TAXline*, December 2009.

6.9.2 More consultation

In the December Pre-Budget Report package, there was a further consultation document in the programme dealing with HMRC's Review of Powers, Deterrents and Safeguards. It is entitled "How HMRC interacts with tax agents to ensure that their clients' returns and claims are correct when submitted." The document can be viewed on the HMRC website and an impact assessment is available separately at www.hmrc.gov.uk/better-regulation/ia.htm.

The following points are made as a result of responses to the previous consultation:

- Tax Avoidance: The first consultation included an overview of changes affecting the tax profession which included some discussion of tax avoidance. This consultation process is not intended to make changes to the law relating to tax avoidance, nor to the way HMRC addresses it.
- Regulation of Agents: The first consultation also canvassed views on the registration or regulation of tax agents, albeit HMRC considered there were significant downsides to the latter. In the light of the responses HMRC does not propose taking either idea forward.
- Mistakes: Some read the first consultation document as suggesting that HMRC was proposing to routinely question agents in respect of individual errors or to seek to penalise tax agents in respect of them. That is not HMRC's intention and would run counter to the behavioural principles that underpin the new penalty regimes. This consultation is about serious shortcomings in tax agents' work.
- Persistent error: HMRC does however consider it is right to examine the position of an agent whose clients' tax returns reveal persistent errors, or a lack of care or technical competence. In such cases HMRC would approach the agent in the first instance to discuss the evidence and, if it was accepted that there was a problem, what might be done to put matters right for the future.

- Disclosure: HMRC raised the question of disclosure to representative bodies in the first consultation. Chapter 4 of this document discusses how disclosure of persistent errors, or a lack of care or technical competence would enable a body to offer help and assistance to a member as thought necessary. Whilst no additional legislation is needed, it is right that HMRC should work in partnership with representative bodies in implementing the existing powers effectively.
- Deliberate wrongdoing: Where there is evidence to suggest that any tax agent has been involved in deliberate wrongdoing HMRC will always treat the matter as one of extreme seriousness. Chapters 5 to 9 of this document consider the adequacy of the powers available to HMRC in this context.
- High volume agents: Chapter 10 of this document considers the particular risk caused by some agents who submit a high volume of incorrect claims or returns that have little or no merit, and proposes a specific remedy. HMRC recognises that this requires a balance between repaying what it owes and tackling the abuse, and clearly distinguishing the problem cases from the majority of claims it deals with.
- Extension of powers into unintended areas: As acknowledged in the previous consultation HMRC fully recognises the important role agents play in protecting the interests of their clients. Any existing or new powers would not be used against agents who were simply defending or advancing their clients’ interests, and there would be strong safeguards preventing this.
- Unaffiliated tax agents: HMRC believes that there should be a regime that does not differentiate in principle between tax agents who are affiliated to a professional body and those who are unaffiliated. However, membership of such bodies gives HMRC reassurance that robust procedures will be in place, and monitored independently. It also offers a wider range of options and safeguards for those few cases where further action is needed. For instance, where a tax agent is unaffiliated and discussion had failed to reach agreement as to whether or not there was a persistence of error, it may be that the only option available to HMRC would be to consider further sanctions.

The new document covers the following matters:

- changes relating to public interest disclosure;
- changes relating to deliberate wrongdoing;
- changes to access to working papers;
- what a suitable penalty for deliberate wrongdoing might be;
- publishing the names of tax agents involved in deliberate wrongdoing;
- changes relating to high volume agents.

www.hmrc.gov.uk

An article in *Tax Adviser*, January 2010, discusses a number of matters of concern with the new proposals, while welcoming the dropping of many of the earlier suggestions as a result of the first consultation.

6.9.3 Security – appeal allowed!

It is a very long time since a trader won an appeal against an notice to deposit security (apart from a single success in a case where HMRC had issued the notice to the wrong company). An individual applied for registration in respect of a company which would retail CDs. He had been a director of a previous company which had gone into liquidation owing HMRC £1.1m, so HMRC issued a notice requiring security of £22,000 (quarterly returns) or £14,600 (monthly returns).

Sir Stephen Oliver considered that the notice satisfied the first of the two tests set out in the case of *John Dee Ltd*: it was not a decision that no reasonable panel of Commissioners could have reached. However, it was also necessary to consider whether they had taken into account irrelevant information, or failed to take into account relevant information; and if so, whether their decision would have inevitably been the same if they had taken into account the correct information.

The Tribunal found it difficult to establish exactly what had happened to the previous company, but it was apparent that its circumstances were very different to those of the present company. It had turnover of £58m against less than £1m; it had gone into liquidation after a sudden and unexpected slashing of the credit terms allowed to it by its suppliers. These factors were relevant, and had not been taken into account: the decision had been based solely on the fact that the owner of the second company had been a director of the first. As HMRC had appointed the receiver of the first company, they must have been able to obtain the relevant information.

Sir Stephen did not think that the decision would have been inevitably the same if HMRC had considered all the facts. He therefore allowed the appeal against the requirement to deposit security.

First Tier Tribunal (TC00199): *Dada Records Ltd*

There is a commentary on this case in ICAEW *Accountancy*, December 2009 p.80. Graham Elliott comments that the HMRC officers concerned seemed to take account only of the amount due to HMRC in the earlier insolvency, without considering any of the commercial factors or the differences between the two businesses.

6.9.4 Security – normal service resumed

Other cases on security notices produced the normal result – the appeals were dismissed because the Tribunal could not find any fault with the "reasonableness" of HMRC's procedures in issuing the notices. Perhaps the most interesting case was one involving a solicitor who put forward a number of legal arguments to try to defeat the security notice – the chairman, perhaps wary of the possible response from a lawyer, took great care to explain in detail why he considered that it was reasonable for HMRC to regard the trader as a risk to the revenue.

In another case the trade had a long list of associated companies, many of which were in arrears with their VAT payments. No-one appeared at the hearing to represent the trader, but the chairman went through the circumstances leading to the issue of the notice in great detail to ensure that there could be no allegation of unfairness; he noted that this was an additional requirement for security because an earlier deposit had had to be applied to the payment of VAT due.

First Tier Tribunal (TC00267): *Galleria Italia Ltd*; (TC00257): *Paul Maurice Roche*; (TC00259): *J&W Waste Services Ltd*

6.9.5 Mind the UK gap

HMRC have published their latest estimates of "tax gaps" in the taxes they administer. The total gap is about £40bn, or 8% of the total tax liability. VAT contributes £11.5bn. This includes the effect of legitimate tax avoidance as well as evasion and other forms of fraud. The document describes the approach to the estimate as follows:

The aim is to measure the total level of VAT losses by comparing the net theoretical tax yield with actual VAT receipts. The difference between these amounts is known as the VAT gap.

This 'top-down' approach employs a gap analysis, which involves:

- *assessing the total amount of expenditure in the economy that is theoretically liable for VAT*
- *estimating the tax liability on that expenditure based on commodity breakdowns of the expenditure data*
- *estimating the value of tax on the VAT-able expenditure, to derive the gross VAT theoretical tax liability (VTTL)*
- *subtracting any legitimate refunds (deductions), occurring through schemes and reliefs, to arrive at the net VTTL*
- *subtracting actual VAT receipts from the net VTTL and*
- *assuming that the residual element, the gap, is the total VAT Gap, including all losses, for any cause.*

The VAT gap for the last 7 years is presented as follows:

Table 2.1: VTTL, VAT receipts and revenue losses

	02/03	03/04	04/05	05/06	06/07	07/08	08/09
Net VTTL (£bn)	75.5	78.7	82.5	86.2	89.5	93.5	94.2
Net VAT receipts (£bn)	63.7	69.1	72.8	73	77.6	81.9	79.8
Revenue loss (£bn)	11.9	9.5	9.8	13.3	11.9	11.5	14.4
VAT gap (per cent)	15.7%	12.1%	11.8%	15.4%	13.3%	12.3%	15.3%

The effect of MTIC fraud is now placed at between £1bn and £2.5bn a year, down from £4.5bn to £5.5bn in 2005/06.

www.hmrc.gov.uk/stats/measuring-tax-gaps.pdf

6.9.6 Prison sentences

HMRC announced the conviction of 4 of a gang of 11 fraudsters (7 had previously pleaded guilty; another 3 people tried at the same time were acquitted by the jury) who had set up a string of bogus companies to exploit the VAT system. It appears that this was a domestic VAT fraud, making repayment claims in relation to expenses, rather than a MTIC operation.

The investigation of the businesses started in 2005 but arrests were not made until 2008. The amounted stolen appeared to be about £1.9m. The sentences ranged from six years to 240 hours of unpaid work. The individuals involved were from Merseyside, Cheshire, Derbyshire, Leicestershire and Scotland. Three of them were self-employed financial advisers who had facilitated the fraud by helping to set up bank accounts for the bogus companies.

HMRC Release 22 October 2009

An individual was accused of involvement in a carousel fraud. He entered a plea of not guilty but absented himself from the trial, remaining in contact with his legal representatives from an unknown location by e-mail. The judge ruled that he should be tried in his absence, and he was convicted and sentenced to 10 years.

He now appealed against conviction and sentence on the grounds that the trial had been unfair, both because of his absence and because material which should have been disclosed to the defence was not disclosed. He also argued that he should have been charged with a statutory offence of conspiracy which carries a maximum seven-year sentence, rather than the common law offence of conspiracy to cheat the revenue.

The appeal court held that the material would not have helped his defence, and the way in which he was able to give instructions to his counsel by e-mail did not prejudice the trial. The conviction was safe.

There was also no reason why he should have been charged with the statutory offence rather than the common law one; however, it now appeared that his role in the fraud had been lesser than had been represented at the trial, so the sentence was reduced to eight years less the time spent on remand.

Court of Appeal: *R v Pomfrett*