VAT UPDATE
APRIL 2009

Covering material from January – March 2009

Notes prepared by Mike Thexton MA FCA CTA

No responsibility for anyone acting upon or refraining from acting upon these notes can be accepted by the course presenter or author of the notes.

VAT Update April 2009

Contents

1. INTRODUCTION ... 1
 1.1 Appeals pending ... 1
2. OUTPUTS ... 3
 2.1 Scope of VAT: linking supplies to consideration ... 3
 2.2 Disbursements ... 4
 2.3 Exemptions ... 4
 2.4 Zero-rating ... 10
 2.5 Lower rate ... 11
 2.6 Computational matters ... 12
 2.7 Discounts, rebates and gifts ... 15
 2.8 Compound and multiple ... 18
 2.9 Agency ... 20
 2.10 Second hand goods ... 23
 2.11 Charities and clubs ... 23
 2.12 Other supply problems ... 23
3. LAND AND PROPERTY ... 25
 3.1 Exemption ... 25
 3.2 Option to tax ... 25
 3.3 Developers and builders ... 26
 3.4 Input tax claims on land ... 26
 3.5 Other land problems ... 27
4. INTERNATIONAL SUPPLIES ... 28
 4.1 E-commerce ... 28
 4.2 Where is a supply of services? ... 28
 4.3 International supplies of goods ... 32
 4.4 European rules ... 34
 4.5 Eighth Directive reclaims ... 38
5. INPUTS ... 39
 5.1 Economic activity ... 39
 5.2 Who receives the supply? ... 39
 5.3 Partial exemption ... 40
 5.4 Cars ... 44
 5.5 Business entertainment ... 45
 5.6 Non-business use of supplies ... 46
 5.7 Bad debt relief ... 48
 5.8 Other input tax problems ... 50
6. ADMINISTRATION AND PENALTIES ... 57
 6.1 Group registration ... 57
 6.2 Other registration rules ... 57
 6.3 Payments and returns ... 59
 6.4 Repayment claims ... 63
 6.5 Timing issues ... 65
 6.6 Records ... 66
 6.7 Assessments ... 67
 6.8 Penalties and appeals ... 68
 6.9 Other administration issues ... 79

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:

Note that the HMRC website now includes some 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.*"

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

Awaiting the ECJ:

- *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*: whether a promotion scheme created recoverable input tax for the company using the scheme on the cost of goods supplied to participating plumbers (this appeal will be heard with *Loyalty Management UK*, below)
- *EMI Group plc*: whether the UK's rules on business gifts are in accordance with EU law (questions for reference covered in this appeal)

- *Loyalty Management UK Ltd*: whether the promoters of the Nectar scheme were entitled to deduct input tax on “redemption services” supplied by participating retailers (HMRC were granted leave to appeal to the House of Lords in April 2008; R&C Brief in this update concerning the treatment of similar transactions by affected traders: points out that the Lords have decided to refer questions to the ECJ)

UK appeals awaiting hearing:

- *Premier Food (Holdings) Ltd*: remitted to Tribunal following HC’s explanation of errors of law in applying the definition of “confectionery”
- *RBS Deutschland Holdings GmbH*: effectiveness of scheme to avoid charging VAT on cars leased to UK customers (HMRC appeal to Court of Session, hearing 11 – 12 November 2008).
- *Scottish Equitable plc*: effectiveness of capping provisions (it has been reported that the Court of Session has decided to refer questions to the ECJ, although HMRC’s list of appeals still shows this as awaiting the Court of Session)
- *The Rank Group plc*: whether mechanised cash bingo and gaming machines are exempt (HMRC have announced intention to appeal the Tribunal’s decisions in favour of the company to the High Court)
- *Weald Leasing Ltd*: artificial leasing arrangements and abuse of rights (HMRC’s appeal to the CA to be heard w/c 24/11/08)
- *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 from previous lists:

- *Boots Co plc*: treatment of “voupons” (HMRC’s appeal to the HC – High Court found for HMRC)
- *JD Wetherspoon plc*: whether the taxpayer is entitled to round the VAT on individual sales down (ECJ confirmed that UK’s administrative practice on rounding is not discriminatory)
- *BMW AG*: HMRC’s decision to align return periods where a cash flow advantage accrued to an exporting company (HMRC’s appeal allowed by the CA)
- *Livewire Telecom Ltd*: whether a person involved in “contra-trading” was entitled to input tax recovery (HMRC’s appeal dismissed by the HC)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Council parking charges

The High Court has considered the ECJ's judgment in the *Isle of Wight Borough Council* case and has remitted it to the Tribunal for further findings of fact.

The Tribunal has considered the case twice before. On the first occasion, it decided that the provision on which HMRC chose to rely – the risk of distortion of competition – was not in the UK law, and HMRC could not rely on the direct effect of the Directive. The High Court considered that to be flawed because the Council was relying on direct effect, and had to take the burden with the benefit. On the second occasion, the Tribunal decided that there was no significant risk of distortion of competition, based on a consideration of the particular circumstances of the four councils involved in the case.

That decision was also flawed, because the ECJ has held that distortion of competition must be considered on a national basis in relation to the activities concerned, not on a local basis. However, because the Tribunal was considering the question in the wrong way, it did not gather or record the evidence on which a conclusion could be based in accordance with the ECJ's explanation of the principles. The judge therefore had to remit it to the Tribunal for further consideration of the evidence in the light of the ECJ's judgment.

This must give considerable hope to the councils, because the Tribunal has so far found in their favour twice.

High Court: *HMRC v Isle of Wight Borough Council and others*

2.1.2 VAT issues for the recession

There is a useful article in *Taxation*, 5 February 2009, which brings together a number of VAT issues which are of particular relevance in a recession. These include:

- bad debt relief;
- cash accounting;
- the use of pro-forma invoices;
- online filing;
- annual accounting;
- deregistration where sales are falling;
- sales of assets, including the charge on deregistration;
- VAT on expenses related to working from home;
- disallowance of input tax if the expense is not paid for within six months.

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Debt collection

The negotiation of credit is an exempt supply, and the Tribunal held that renegotiation of an existing debt was exempt in *Debt Management Associates* (17,880). Customs accepted that decision in Business Brief 30/2003 and said they would apply it. A bank appealed against a decision that supplies to it by sub-contracted debt agencies were taxable (it appears that the bank sought to recover VAT on its expenditure following the *DMA* decision, which would have involved the co-operation of the suppliers, but it was the bank that appealed to the Tribunal).

The bank argued that the agencies were given the authority to vary the debts and agree repayment schedules, which constituted negotiation as an intermediary and ought to be exempt. The Tribunal agreed with Customs that the overriding purpose of the supply was the recovery of money, and any negotiation element was ancillary to that.

The negotiation of the debt was not an aim in itself for the bank, and the effect was the delegation of a function rather than the creation of a true intermediary supply – the agencies were not acting independently of the bank, and were therefore not truly "negotiating".

The Tribunal suggested to the parties that they could consider an apportionment, but they agreed with each other that this would be artificial: there was a single supply which would either be wholly taxable or wholly exempt. The Tribunal decided that the essential supply was debt collection, not debt negotiation, and it was taxable.

There are important differences between this situation and *DMA*: in particular, in *DMA* the debtor engaged the negotiator and paid for the service, and the company made an offer of the renegotiated settlement to the creditors for the creditors to accept or reject. It was much less "delegated".

The Court of Session upheld the Tribunal's decision, finding that the essential aim or dominant purpose of the service supplied was debt recovery, which did not qualify for exemption.

Court of Session: *HBOS plc v HMRC*

2.3.2 Marketing not intermediation

A company described its business on VAT 1 as "the provision of telecommunication and data services in order to provide a facility for the trading of loan and insurance leads". The company used software to enable insurance brokers to buy and sell leads in an open market. It argued that its services to the insurance brokers should be exempt as intermediary services.

The Tribunal considered that the supply did not qualify for exemption. The company had no relationship with either the insured or the insurer; it

was not concerned with the needs of the consumer or whether insurance contracts were concluded, only collecting information in order to make the lead more marketable. It was not an insurance broker or agent, and its supplied did not qualify for exemption under any heading.

VAT Tribunal (20,904): *LEADX*

2.3.3 Online guidance

HMRC have amended the *Finance Manual* in their VAT series of online guidance manuals. It has been updated in relation to exemptions for the management of special investment funds and open-ended and close-ended collective investment schemes; the meaning of 'management'; fund management and input tax; nominee accounts, fund supermarkets, wraps and wrappers; the description of ISAs, CTFs, PEPs and SIPPs; and collective investment undertakings.

www.hmrc.gov.uk/manuals/vatfinmanual/Index.htm

2.3.4 Public postal services

The Advocate-General has given an opinion in the case about the extent of the exemption for the "public postal services". A commercial provider applied for judicial review of the UK legislation, which limits the scope of the exemption to the Post Office company itself. It argued that this exemption may have made sense when the legislation was written, because there was a statutory monopoly at the time; but now that the market for postal services has been liberalised, it represents an unfair distortion of competition.

The Advocate-General has given an opinion on the extent to which she believes postal services should qualify for the exemption. She observed that, in the UK, the Post Office company has been entrusted 'with responsibility for guaranteeing the universal service and by imposing appropriate conditions in the licence granted for that purpose. Those conditions of the universal service licence differ significantly from the conditions under which other postal service providers operate in the United Kingdom'. The Post Office company performs 'a task in the public interest' and is therefore 'subject to specific State control'. She held that 'public postal services' within Article 13A1(a) were 'the public postal service providers which guarantee the universal service'. This appears to confirm that there are justifiable reasons for the Post Office company to enjoy exemption on services while other providers do not.

However, the exemption does not apply to any service supplied by the Post Office company. Only 'universal services provided in the public interest' are exempt from VAT. Services which are 'provided on individually negotiated terms' and which were 'not subject to the requirements of the universal service' did not qualify for exemption. Presumably that covers many of the contracts entered into by commercial providers, but will also cover some of the supplies that the Post Office company makes in competition with them.

In countries where there is no single licensed provider of the universal service, it appears that all providers who undertake to fulfil the requirements of the Postal Directive may be regarded as "the public postal services" and enjoy the exemption.

ECJ (A-G) (Case C-357/07): *R (oao TNT Post UK Ltd) v HMRC*

2.3.5 HMRC go for double or quits

HMRC have announced that they intend to appeal the Tribunal's decisions in favour of *The Rank Group plc* to the High Court. The Tribunal was persuaded that mechanised cash bingo (20,688) and supplies by gaming machines (20,777) were exempt because they were indistinguishable from other supplies that were definitely exempt as a matter of law; accordingly, the ECJ's decision in *Linneweber* applied the exemption to all the supplies.

HMRC have not expanded on the case that they propose to put to the High Court. They have simply stated their position as follows:

VAT: Our view of the law remains unchanged in that VAT is and always has been properly due on supplies of MCB and on the takings of gaming machines. Therefore, businesses should continue to account for VAT on such supplies.

VAT Tribunal decisions are only binding on the specific case heard, as it is only the facts of that specific case that are considered in full. In line with HMRC's normal policy, as we continue to maintain that our view of the law is correct, no other businesses are affected by the decisions and therefore no claims for alleged overpayments of VAT by other operators can be considered until the conclusion of this litigation.

Bingo Duty: In order to protect our position in law, 'protective assessments' of bingo duty will be raised to safeguard revenue. These assessments will be issued to reflect the fact that if there is no VAT to deduct from bingo receipts, then additional bingo duty is due. These assessments will not be enforced unless HMRC loses on the substantive VAT liability issue.

R & C Brief 63/08

2.3.6 Examination services?

"Examination services" are exempt within Sch.9 Group 6 as long as they are provided to an eligible body (e.g. a university), even if they are provided by a non-eligible body. Most other education related services are only exempt if provided by an eligible body. Note 4 states that examination services include "the setting and marking of examinations, the setting of vocational or training standards, the making of assessments, and other services provided with a view to ensuring educational and training standards are maintained".

A company was engaged by the Oxford Cambridge and RSA examination board (OCR) and other examining bodies to design software for use in marking examinations online. It argued that the supply of the software was exempt within Group 6. HMRC disagreed.

The Tribunal heard evidence about the advantages which the software provided to the examiners: it enabled them to carry out the assessment of candidates in a way that was fairer and more thorough, as well as more efficient. The company argued that it was providing an educational service that was exempt either within the general wording of the 6th Directive or within the more detailed UK provision.

The Tribunal observed that exemptions must be strictly construed. In that light, the appellant provided a series of complex bespoke software packages that enabled the examining bodies to carry out their functions, but they were still software packages: they were not themselves examination services. The appeal was dismissed.

VAT Tribunal (20,911): *RM Education plc*

2.3.7 Medical care?

A company collected, tested, processed and stored umbilical cord blood stem cells for future therapeutic use. HMRC initially accepted that the services qualified for exemption under VATA 1994 Sch.9 Group 7 Item 8 (supplies of human tissue for therapeutic purposes). However, they later withdrew this ruling on the grounds that the company was not supplying the tissue: the customer supplied the tissue, and the company's services were the processing and storage of it.

The company argued that it should qualify for exemption under the VAT Directive, art.132(1)(b) or (c):

(b) *hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable with those applicable to bodies governed by public law, by hospitals, centres for medical treatment or diagnosis and other duly recognised establishments of a similar nature;*

(c) *the provision of medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned;*

The Tribunal decided that questions should be referred to the ECJ to clarify the extent of these exemptions. As the medical care in this case is at some point in the future – it is not clear whether there is even any clear indication at the time the service is supplied that the therapy will be needed or even possible – it will be interesting to see whether the ECJ will hold that the exemption extends that far.

VAT Tribunal (20,963): *Future Health Technologies Ltd*

There is a useful article reviewing the healthcare exemption in *Taxation*, 12 February 2009. The writer considers a number of borderline areas such as fees for the issue of various types of certificate; educational, expert witness and insurance-related services; fulfilling statutory duties; and the problems of apportioning income in order to determine recovery of input tax.

2.3.8 Leisure trusts

HMRC have announced a change in their policy in relation to supplies by eligible bodies which make a single charge to customers in respect of a mixture of available sporting and other facilities. Following the decision of the Tribunal and Court of Session in *The Highland Council*, HMRC's policy had been that a single charge for the use of mixed facilities could not qualify for exemption. The supply was "the right to use the facilities"; exemptions have to be strictly construed; as those facilities were not wholly exempt, the supply of the general right could not qualify.

HMRC have received representations from the leisure industry following the Court of Appeal's decision in *Weight Watchers (UK) Ltd*. Although the relevance of that case is not immediately apparent, the decision turned on the principle that the nature of the supply depends on what the typical customer believes it to be. In that case, the typical customer believed that the supply consisted of a service which would assist in losing weight, and any printed matter was incidental to that: it would therefore have been artificial to divide up the supply and give a separate zero-rated liability to the printed matter.

HMRC have been persuaded that the same principle applies to the single charge made by leisure trusts. In general, the typical customer will believe that the supply is of the sporting services on offer, and any taxable services (e.g. sauna facilities) are likely to be incidental to that. As a result, HMRC will now accept that where the predominant reason for purchasing an all-inclusive ticket is to use sporting facilities, the whole price of the ticket will be exempt.

The change will take effect from 1 April 2009, and there is no need to make adjustments to periods before that date. However, eligible bodies can do so if they wish, subject to the usual rules on repayment claims. If a repayment is claimed on the grounds that standard rated turnover has become exempt, it will also be necessary to recalculate input tax accordingly.

The Brief contains an interesting comment about the operation of the Capital Goods Scheme, which reflects the same policy as applied when London Zoo won exemption for eligible cultural bodies which had previously believed themselves to be VATable. CGS adjustments are calculated on the difference between the actual taxable use in the first year and the actual taxable use in later periods. If input tax was recovered in year 1 on the mistaken belief that supplies were taxable when they were in fact exempt, there has been no change in the extent of exempt supplies and no CGS adjustment arises. As the change of policy only applies from 1 April 2009, HMRC will not attempt to claw back the past input tax claim, even if it was made within the last 3 years – unless, presumably, the trader attempts to recover the output tax accounted for in the past.

Where the business has been acquired in a TOGC from someone who was genuinely entitled to recover the VAT in the first period (e.g. a non-eligible body), then the change to treating supplies as exempt will require a CGS adjustment.

R &C Brief 13/09

2.3.9 Civic aims or essential for sport?

The British Association for Shooting and Conservation (BASC) has grown out of the merger of a number of different associations, the oldest dating from 1908. It was incorporated under the Industrial and Provident Societies Act in 1997. It has a number of aims relating to the sport of shooting, including representing the interests of its members in promoting the right to hunt.

HMRC accepted that some of its subscription income is zero-rated as relating to the issue of a magazine, and some is exempt as relating to insurance. HMRC had ruled in 1994 that the balance was exempt, but in 1996 they issued a new decision that it should be taxable at the standard rate. BASC disagreed and continued to treat the income as exempt, and appealed against the resulting assessment of £397,551 for the year 2006.

The Tribunal had to consider whether the income could be exempt within:

- Group 9 item 1(e) as income of a body which has objects which are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature; or
- Group 10 item 3 as consideration for the supply by an eligible body to an individual, except, where the body operates a membership scheme, an individual who is not a member, of services closely linked with and essential to sport or physical education in which the individual is taking part.

The Tribunal decided that BASC’s objects and activities were too wide to fall within the “civic aims” or “political” exemption.

In relation to Group 10, the chairman held that the supplies were not sufficiently closely related to sporting activities to qualify for exemption, even if it was accepted that the UK’s addition of the expression “essential to sport” was a departure from the 6th Directive. The Directive’s expression “to persons taking part in sport” suggested to the chairman a supply that had a direct link with actual participation. “*None of BASC's supplies is in that category: it does not provide to its members the land on which they may shoot, the game they may shoot at or the guns with which they may shoot it.*”

BASC appealed to the High Court on both parts of the decision. The judge ruled that the Tribunal had reached the right decision for the right reasons in relation to the civic aims issue: it had considered both the constitution of the association and what it actually did. However, the ECJ’s recent judgment in *Canterbury Hockey Club* suggested that the Tribunal had “set the bar too high” in relation to the sporting exemption. If subscriptions to a national hockey association could be “related to sport” in the view of the ECJ, it was possible that BASC’s subscriptions would also qualify. There was insufficient evidence in the Tribunal’s decision for the judge to conclude on this, so he remitted it to the Tribunal for further consideration in the light of the ECJ judgment.

High Court: *The British Association For Shooting And Conservation Ltd v HMRC*

2.3.10 Online guidance

HMRC have added the *Trade Unions and Professional Bodies Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vtupbmanual/Index.htm

HMRC have added the *Investment Gold Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vgoldmanual/Index.htm

2.4 Zero-rating

2.4.1 No biscuit

A company marketed a product named “Crunchy Granola Bars”. The main ingredients were oats and sugar. The Commissioners issued a ruling that they were within the definition of confectionery, and thus were standard-rated. The company appealed, contending that they should be classified as biscuits, and as zero-rated. The Tribunal rejected this contention and dismissed the company’s appeal, observing that “*the bars did not contain flour which was regarded as an essential ingredient for a biscuit*”.

VAT Tribunal (20,905): *General Mills UK Ltd*

2.4.2 Not catering

A company operated three Subway franchised kiosks in shopping centres in Manchester. All were adjacent to a seating area or food court where customers could sit to eat their food, and many (though not all) did so. HMRC ruled that food eaten in the seating area was supplied “for consumption on the premises on which it is supplied”, and was therefore standard rated as catering.

The Tribunal chairman disagreed. He examined the layout of all the sites and considered that “the premises” were the kiosks themselves for this test rather than the food courts. The food courts were operated by the shopping centre, not by the Subway franchisees. The chairman considered that this was consistent with the Court of Appeal’s decision in the *Compass Contract Services* case.

VAT Tribunal (20,959): *Made to Order Ltd*

2.4.3 Online guidance

HMRC have added the *Food Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vfoodmanual/index.htm

2.5 Lower rate

2.5.1 Education business

Cambridge University applied for a certificate under VATA 1994 Sch.7A Group 1 to certify that it was entitled to pay the reduced rate of VAT on supplies of electricity made to it.

The colleges of the University can receive some of their electricity at the lower rate because it will be used in residential accommodation for students, which is explicitly included in "domestic use" in Group 1. The University itself does not provide much accommodation, so it was arguing that it was a charity using the power otherwise than in the course or furtherance of a business. The specific claim related to power used in a new building for the faculty of education.

HMRC refused, and the University appealed. The Tribunal upheld the ruling, holding that the University was not a "body governed by public law" and was using the electricity for the purposes of its educational business.

The University appealed further to the High Court. It argued that it was governed by the Universities of Oxford and Cambridge Act 1923 and the secondary and tertiary legislation made under that statute, and was therefore a "body governed by public law". It should therefore be regarded as outside the scope of VAT, even if it supplied services for a consideration. It was accepted by both sides that the University was carrying on a business – although its funding comes from a number of sources, including grants, investments and donations, it was clear that its only ground for succeeding was the "public body" argument.

The judge ruled that the concept of a "body governed by public law" was European, not British. ECJ decisions had consistently restricted the expression to parts of the public administration of a member state. The fact that the UK happened to have passed some specific statute law which related to a particular body could not override the European concept. The University of Cambridge was not a "public body" in the European sense, and HMRC were correct to refuse the lower rate.

High Court: *The Chancellor, Master and Scholars of the University of Cambridge v HMRC*

2.5.2 The wrong claim

An individual arranged for building contractors to convert a barn into two holiday lettings. The builder charged 17.5% VAT, but the individual decided that the lower rate should apply. She had made previous claims for similar projects under s.35 (DIY builders' scheme), but was advised by HMRC that no such claim would be possible here because the holiday lets were for business use. HMRC suggested that only 5% would be due. The individual paid the full rate of VAT to the builders and claimed the balance back from HMRC under the DIY scheme.

The Tribunal agreed with HMRC's refusal of this claim. It was necessary for the claimant to agree a refund from the contractors; there was no direct right to go to HMRC for the money if it had been overcharged. The chairman expressed his sympathy for the claimant:

"*The appropriate rate is a matter for negotiation with the contractor. At this stage pursuing partial repayments from the various contractors bristles with difficulties. For practical purposes these are probably insuperable. It is unfortunate in that the Respondents have been enriched by the amount of the excess tax paid. Their advice was seriously inadequate in my view in as much as the taxpayer should have been forewarned of the somewhat exceptional need to confirm the reduced rate of tax with the contractors. This Tribunal cannot, however, grant any equitable remedy in the circumstances.*"

VAT Tribunal (20,964): *C Legge*

2.5.3 Online guidance

HMRC have added the *Fuel and Power Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vfupmanual/Index.htm

2.6 Computational matters

2.6.1 More on the rate change

HMRC have added to the guidance on their website in relation to the change in the standard rate of VAT on 1 December 2008. The extra guidance gives further detail on:

1. Electronic Cash Registers
2. Refunds
3. Treatment of tickets to events (theatre, football season tickets)
4. Extension to the normal time limit for raising VAT invoices
5. Flat Rate Scheme and the change in the standard rate
6. Credit Notes and the change in the standard rate
7. Guarantees for Import VAT
8. Importation of works of art, antiques and collectors' items eligible for reduced valuation.
9. VAT Rate Change 2008: TOMS calculation

One of the more interesting additional comments relates to refunds:

I received payment before 1 December 2008 for goods and services to be delivered after that date. Do I have to refund the difference in VAT to my customer?

If you have received a payment or issued an invoice using the old 17.5% rate before 1 December 2008 for goods that will be provided (or services delivered) after 1 December 2008, you have a choice. You can choose either to leave the VAT charged to your customers at 17.5% and account for that to HM Revenue & Customs (HMRC), or to account for VAT at the new rate of 15% on the amounts already received or invoiced.

If you issued a VAT invoice you will have to issue a credit note to your customer and refund the difference between the 17.5% and 15% rates.

If you have not issued a VAT invoice (because you are a retailer for example) you can account to HMRC for VAT at the 15% rate. In these circumstances you are not obliged to issue a credit note to your customer and the VAT legislation does not require you to refund the difference between the rates to your customer. However, you may be required to make a refund under the terms of the contract between you and your customer or by consumer protection legislation. HMRC cannot provide advice on these issues.

HMRC also state that the sale of tickets to a concert is not eligible for adjustment under s.88 VATA 1994, even if the money is received before 1 December and the concert happens afterwards. The reason is that the supply is of the right to attend the concert, and that right was supplied when the ticket was sold – not when the concert takes place.

HMRC have now published the following updated guidance:

Since the above guidance was published on 8 December 2008 it has become clear that a number of businesses were not aware of HMRC's view of the correct VAT treatment of tickets to events. Some have assumed that where a ticket was sold prior to 1 December 2008 for an event due to take place on or after that date that the 15% rate should apply.

Where a business has mistakenly refunded its customers the difference between the 17.5% VAT originally charged on ticket sales and the 15% rate, HMRC will operate a light touch and will not seek to recover the VAT that has been refunded. This treatment applies to refunds that were made up to the date of the publication of this update.

HMR&C Release 21 January 2009

2.6.2 Anti-forestalling

A draft of the anti-forestalling legislation that will apply at 1 January 2010 was published on 1 April. The details will be covered in the next update, but the basic principle is as expected: the difference between 15% and 17.5% will be charged as an additional output tax amount where it appears that there has been an artificial attempt to trigger the tax point early on a supply where the customer cannot recover the VAT as input tax.

There will be a de minimis level of £100,000.

2.6.3 Rounding

The ECJ has confirmed the Advocate-General's opinion in the *Wetherspoons* case. This concerned the issue of rounding in retail sales calculations, which had been considered only last year in *Ahold*, but with the additional argument in favour of the taxpayer: HMRC in the UK permit traders who calculate prices in net terms to round VAT amounts down on their VAT invoices, even if the precise calculation results in 0.5p or more. The company argued that this constituted a discriminatory and unfair practice, and retailers who priced in gross terms should also be allowed to round down.

The ECJ disagreed. The answers to the questions were:

1. Community law, as it currently stands, contains no specific requirement concerning the method of rounding amounts of value added tax. In the absence of specific Community legislation, it is for Member States to decide on the rules and methods for rounding amounts of value added tax, although those States must, when so deciding, observe the principles underpinning the common system of that tax, particularly the principles of fiscal neutrality and proportionality. In particular, Community law, first, does not preclude the application of a national rule which requires an amount of value added tax to be rounded up whenever the fraction of the smallest unit of currency concerned is at or above 0.50, and, second, does not require that taxable persons be allowed to round down any amount of value added tax which includes a fraction of the smallest unit of national currency.

2. In a sale at a price inclusive of value added tax, in the absence of specific Community legislation, each Member State is obliged to determine, within the limits of Community law, in particular in compliance with the principles of fiscal neutrality and proportionality, the level at which the rounding of an amount of value added tax which includes a fraction of the smallest unit of national currency may or must occur.

3. In view of the fact that traders who calculate the price of their sales of goods and services inclusive of value added tax are in a different situation to those effecting that same type of transactions at prices exclusive of value added tax, the former cannot invoke the principle of fiscal neutrality in order to claim the right also to round down, at line level and basket level, the amounts of value added tax due.

There was no unlawful discrimination because the circumstances of traders pricing in gross and net terms were sufficiently different for different treatments to be justifiable.

ECJ (Case C-302/07): *JD Wetherspoon plc v HMRC*

There is an article about the *Wetherspoons* case in *Taxation*, 15 January 2009.

2.7 *Discounts, rebates and gifts*

2.7.1 Questions about samples

The Tribunal has finally agreed the questions to be referred to the ECJ in the *EMI Group plc* case. The company is claiming repayment of output tax accounted for on deemed supplies which arose when it gave "free" records and CDs to disc jockeys. These did not qualify as "business samples" under the restrictive rules of Sch.4 para.5 VATA 1994; the company is arguing that HMRC's interpretation of the rules is not in accordance with EU law. The matter was debated before the Tribunal several times in 2007, and it has taken a very long time to agree that the ECJ should consider the following questions:

(a) How is the last sentence of Article 5.6 of the Sixth Directive to be interpreted in the context of the circumstances of the present case?

(b) In particular, what are the essential characteristics of a "sample" within the meaning of the last sentence of Article 5.6 of the Sixth Directive?

(c) Is a Member State permitted to limit the interpretation of "sample" in the last sentence of Article 5.6 of the Sixth Directive to-

> *(i) an industrial sample in a form not ordinarily available for sale to the public given to an actual or potential customer of the business (until 1993),*
>
> *(ii) only one, or only the first of a number of samples given by the same person to the same recipient where those samples are identical or do not differ in any material respect from each other (from 1993)?*

(d) Is a Member State permitted to limit the interpretation of "gifts of small value" in the last sentence of Article 5.6 of the Sixth Directive in such a way as to exclude –

> *(i) a gift of goods forming part of a series or succession of gifts made to the same person from time to time (to October 2003),*
>
> *(ii) any business gifts made to the same person in any 12-month period where the total cost exceeds £50 (October 2003 onwards)?*

(e) If the answer to question (c)(ii) above or any part of question (d) above is "yes", where a taxable person gives a similar or identical gift of recorded music to two or more different individuals because of their personal qualities in being able to influence the level of exposure the artist in question receives, is the Member Stale permitted to treat those items as given to the same person solely because those individuals are employed by the same person?

(f) Would the answers to questions (a) to (e) above be affected by the recipient being, or being employed by, a fully taxable person, who would be (or would have been) able to deduct any input tax payable on the provision of the goods consisting of the sample?

ECJ (reference) (Case C-581/08): *EMI Group plc v HMRC*

2.7.2 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.

High Court: *HMRC v The Boots Company plc*

2.7.3 Leisure passes

A company supplied a pass which entitled the holder to visit a number of attractions in London over a set period. The passes were like credit cards with an electronic chip which could be read by a machine at the attraction. Entry to some of the participating venues would be exempt, others would be taxable.

The company tried to argue that the cards qualified as "face value vouchers" within VATA 1994 Sch.10A. Holders could visit each attraction once only during the validity of the pass, so the theoretical "face value" was the total entry price of one visit to each of the attractions.

The Tribunal and High Court ruled that the passes in their original form did not qualify as "face value vouchers" within Sch.10A, because they did not display a face value. They expired by effluxion of time, not by consumption of a monetary value.

The company subsequently changed the design of the passes to include a face value, £70 for a single day or £420 for a six day pass. The Tribunal accepted that this brought the passes within Sch.10A. The effect was that the company would make a VAT-free profit of the difference between what it collected from the tourists and what it paid to the attractions, but that was within the nature of the legislation.

VAT Tribunal (20,910): *Leisure Pass Group Ltd (no.2)*

2.8 Compound and multiple

2.8.1 Compound services, not mixed food and services

The High Court has overturned the Tribunal's decision in a case dealing with a franchisee selling dietary food packs with dietary advice.

The appellant company was one of some 300 franchisees whose business would be affected by the decision. The franchisor operates under the name "LighterLife". The programme offers rapid weight loss to the seriously overweight, and is supposed to work by a combination of replacement of other food by dietary LighterLife food packs and counselling and advice in weekly group sessions run by the franchisee. The customers pay for the food packs but make no specific payment for the support services. It was accepted that the food packs would, on their own, be zero-rated.

The Tribunal examined a number of arguments about the relationship between the parts of the supply and decided that it was not possible to regard the advisory services either as supplied "free" – there was a clear understanding that they were included in the price the customer paid – or as being "incidental" to the food. They were a significant supply in their own right, and the consideration should be apportioned between zero-rated food and standard rated services.

HMRC appealed to the High Court, which held that the Tribunal had erred in deciding that there was a mixed supply. Precedent case law has established that the question of whether supplies are mixed or compound has to be settled by considering the standpoint of the consumer, not the supplier, and deciding whether it is artificial to split the elements into separate supplies. It was artificial to split this transaction into food packs and support services, because on the primary facts as found by the Tribunal, the typical customer was buying the combination of the two. The two elements reinforced each other. From an economic point of view, it did not make sense for the supplier to charge, or for the customer to pay, separately for the elements of food packs and support services.

As the Tribunal had commented in considering the correct answer if it was wrong on the question of mixed supplies, the result had to be wholly standard rated. If it did not have a separate element which was food, the single overall supply could not be described as simply a supply of food. The compound supply therefore did not fall within Group 1 Sch.8 VATA 1994.

High Court: *HMRC v David Baxendale Ltd*

2.8.2 Membership organisations

ESC 3.35 permits non-profit making membership bodies that supply a single package of benefits to their members to apportion their subscriptions to reflect the value and VAT liability of the individual benefits, without regard to whether there is one principal benefit.

A practical example is where the principal benefit of a membership subscription is standard-rated, but there are ancillary benefits which, if supplied in their own right, would be zero-rated and/or exempt. In such a case, the body may apportion the subscription to reflect the different elements, rather than treating the whole subscription as standard-rated. This is almost certainly contrary to the true legal position, where the benefits are likely to be a single compound supply that have only one liability – the body would then lose out on the benefit of either zero-rating or exemption.

HMRC say that some bodies have been using the ESC to rework previously submitted VAT returns, and have submitted claims for 'overpaid' VAT. In their view, the ESC may not be used to make retrospective adjustments, as such returns were correct in law. HMRC will therefore reject any such claims.

In some cases the claims have alleged 100% zero-rating, due to the principal benefit being zero-rated. Such cases will be given due consideration by HMRC, provided the claim is based on the application of the law, as opposed to retrospective use of the ESC. This means that a successful claim could lead to a repayment for past periods, but it would have to be based on the principles of the *Card Protection Plan* case, not the ESC.

R&C Brief 06/09

2.9 Agency

2.9.1 Withdrawal of the staff hire concession

HMRC have issued a Brief and an Information Sheet reminding affected businesses of the withdrawal of the staff hire concession with effect from 1 April 2009, as well as clarifying the treatment that should be applied from that date.

The correct VAT treatment following withdrawal is explained as follows:

If you act as a principal (eg employment business) in making a supply of staff using either:

- *your own employees (which includes a director of your company) engaged under a contract of services*
- *self-employed workers who make their supplies to you under a contract for services*

then VAT will be due on the full value of the supply (not just the profit margin).

If you act as an agent in providing introductory services of finding employment for workers or workers for your client and the workers enter into a direct contractual relationship with the client, who pays them, then VAT is due on your intermediary service only (based on your commission received). Such supplies are unaffected by the Staff Hire Concession and so will be unaffected by its withdrawal.

If you are making a supply of services other than staff, for example, supplies of care services, then your supply may qualify for exemption from VAT. See Notice 701/57 Health professionals for more information and the qualifying criteria. If your supply is of services other than staff it is unaffected by the Staff Hire Concession and so will be unaffected by its withdrawal.

Those seconding their staff for no profit and those placing disabled workers under the sheltered placement (or similar) schemes are subject to the treatment in parts B and C of the Statement of Practice in Notice 700/34 *Staff*. These sections have not been withdrawn, so these suppliers are not affected by the change on 1 April 2009.

The Information Sheet attempts to explain why the concession has been withdrawn, in particular the fact that the Conduct of Employment Agencies and Employment Businesses Regulations 2003 required employment agencies to act either as agents or principals in respect of different supplies of staff. HMRC believe that there is now no possibility that a similar service could be supplied by agents and principals: they cannot compete with each other. There is therefore no longer the distortion of competition that the concession was introduced to prevent.

R & C Brief 08/09, Information Sheet 03/09

Officers of a number of important representative bodies wrote to *The Times* to warn that the withdrawal of the staff hire concession on 1 April 2009 would have a serious and detrimental effect on UK employment. Plainly this has had no effect.

The Times 26 February 2009

2.9.2 Supply of staff?

In the case of *Helping Hand Asset Management Ltd* (20,408), the Tribunal had to consider an argument by HMRC that a company was providing administrative services to people supplying staff, rather than itself supplying those staff to customers. It decided that the company was supplying the staff as principal, and there was no supply of services to the "fixers" who provided the workers.

Now the Tribunal has considered a similar argument in relation to a different company, and come to the opposite conclusion. The company raised invoices to end users for the services of workers and accounted for VAT as if it was supplying them with staff. HMRC examined the arrangements and concluded that this was incorrect: in reality the employment agencies were supplying the staff directly to the end users, and there was no supply of staff by the company.

The Tribunal examined the evidence in detail and concluded that HMRC were correct. It is interesting to note that HMRC suggested in correspondence that there should be no significant overall effect on the total amount of VAT collected, but they were concerned to make sure that it was collected from the right person; if that is the case, presumably the parties should now be passing money around to rectify their accounting records with no overall loss.

The decision is complex, considering not only *Helping Hand* but a number of other precedents, including *Reed Personnel Services*, and also a judicial review application which the present appellant had made in an earlier dispute with HMRC on the Construction Industry Scheme rules for deduction of direct tax from payments to sub-contractors.

The Tribunal also rejected a separate argument that the company was receiving and making supplies as an agent within s.47(3) VATA 1994. This would have meant that they were "buying in" the staff from the employment agencies and selling them on, and could be deemed to be a principal. Apart from anything else, this subsection depends on the words "the Commissioners may, if they think fit", so it is hard to establish a right to be treated as a principal; but the Tribunal did not believe that the contracts represented a supply that was bought in and sold on in any case, but rather an outsourcing of administrative functions.

VAT Tribunal (20,930): *Oriel Support Ltd*

2.9.3 Sauna services

A company ran a sauna at which customers paid for admission; they then made separate payments to prostitutes for sexual services on the premises. HMRC argued that the whole amount paid by the customer was the company's VATable turnover, but the Tribunal agreed with the company that the prostitutes were acting as independent principals in providing their services.

The company argued that the Tribunal should "*distinguish between the legal services provided by the appellants and services which it would be illegal for the appellants to provide*", making the point that was thought important by the Tribunal in the case of *Polok*: prostitution is not illegal, but living off immoral earnings is. However, the illegality issue was not

considered by the Tribunal – only the "VAT technical" issue of who was contracting with whom.

Customers paid "door money" on a sliding scale: £20 for 30 minutes; £25 for 45 minutes, and £35 for 60 minutes. The company retained £5 as its "own charge"; it retained half the balance as "a charge made to the relevant hostess for use of the facilities", and gave half the balance to the hostess. It argued that only the £5 it retained should be regarded as a charge it made to the customer.

The Court of Session agreed with the Tribunal that the full amount of the "door money" constituted a taxable charge for admission by the company. It was for entry to the premises and the right to enjoy the facilities inside, including the opportunity to negotiate for further services with the women present. Those further payments were not the company's turnover, in line with the decision of the High Court in *Spearmint Rhino*, but the whole of the door money belonged to it.

Court of Session: *Joppa Enterprises Ltd v HMRC*

2.9.4 Taxis

The Tribunal had to consider the common question of whether a taxi firm was supplying services as principal or as agent. If it is a principal, the whole amount paid by the customer is its taxable turnover; if it is an agent, the fare is turnover of the driver (who is usually below the registration threshold), and only the amount paid over to the firm is its turnover (normally for a supply of radio services and possibly the car itself).

The drivers paid a £92 weekly fee in respect of cash customers, and HMRC accepted that this was the limit of the VATable turnover for that part of the business. Account customers were invoiced on a monthly basis; the firm kept 10% and remitted the remainder to the relevant driver. The director of the firm argued that there was no significant difference between the two types of work: as HMRC had accepted that the firm was an agent in respect of cash customers, it should also be treated as an agent for account customers.

The Tribunal did not agree. The account customers all had agreements with the firm, many of them dating from before the current owner had acquired it as a TOGC. There was a genuine difference between the relationships with cash and account customers. The firm bore the risk of bad debts in relation to accounts. All these factors indicated that it was acting as a principal, and the whole amounts paid by account customers were its turnover.

VAT Tribunal (20,974): *Bath Taxis (UK) Ltd*

2.10 *Second hand goods*

2.10.1 Online guidance

HMRC have added *VAT – The Margin Schemes Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vatmargmanual/index.htm

2.11 *Charities and clubs*

Nothing to report.

2.12 *Other supply problems*

2.12.1 Who makes the supply?

A company (AC) operated a commercial fitness club and charged VAT to its members. In 1996 another company was set up under common ownership (AH) in order to convert the supplies to members into the exempt supplies of a not-for-profit body. Under a standard planning arrangement in use at the time, revenue still accrued to AC through rent.

The law was changed with effect from 1 January 2000 to close down that version of the scheme. Another company (AAB), limited by guarantee, was set up to replace AH, and the scheme was operated much as before until 2006. HMRC ruled that the scheme was ineffective and AAB should account for VAT, but it did not do so. In 2006 AAB was put into liquidation and a new company was established (FAB). This company registered for VAT and accounts for output tax on the supplies made to members.

HMRC decided that AC continued to make the supplies of sporting services to its members throughout. If that was the case, it would be liable for output tax from 1996 onwards, or as far back as HMRC could assess. Neither the 1996 or 2000 versions of the plan would be effective. The argument was stated in terms of “abuse of rights”:

[HMRC] contend that the way in which the supplies should be re-characterised is that the abusive arrangements should be disregarded and the activities of carrying on the business of health club which are said to have been undertaken by AAB should be treated as having been undertaken by [AC] for VAT purposes. As such the transactions which AAB is said to have entered into in respect of the disputed supplies should be treated as having been entered into by [AC] and not AAB for VAT purposes. [HMRC] have accordingly raised assessments on [AC] which are intended to reflect this to the best of their judgement. The effect of the re-characterisation of the supplies is that [AC] is treated as having made the disputed supply and is hence liable for the underdeclared tax in accordance with the assessments. They have been formulated on the basis of the sales declarations of AAB. In addition credit has been given for output VAT wrongly accounted for by [AC] on supplies to AAB under the

arrangements. As aforesaid, [AC] is also entitled to deduct input tax which is attributable to the disputed supplies.

The Tribunal examined the arrangements from 1996 to 2000 involving AH. These were not the subject of the HMRC assessments, but the chairman (Sir Stephen Oliver) considered them to be relevant to the settlement of the current dispute. He decided that the establishment of the arrangement was an "abusive practice" within the *Halifax* principle, because it was an artificial arrangement which was entered into with the sole or main objective of obtaining the benefit of a VAT exemption. However, it was properly put into effect: the chairman was satisfied that the supplies to members were then made by AH, not by AC, and the payment of rent by AH to AC was properly for the supply of the land. AH was not acting as an agent of AC.

The present appeal was about assessments for VAT on the supplies made by AAB after 2000. HMRC had also assessed AAB, but it appears that they would prefer to collect the money from AC if possible as a continuing and presumably solvent company. Therefore they argued that AC should be treated as making the supplies instead.

The chairman accepted that the sole or main purpose of setting up the 2000 arrangements was to obtain a tax advantage, but it failed to do so. The scheme had not been properly implemented, and it appears that the chairman was not convinced that it worked anyway when examined in the light of the Court of Appeal's decision in *Messenger Leisure Developments Ltd* (CA 2005). As a result, the *Halifax* principle was not engaged. As in the *BUPA* case which was heard with *Halifax*, the scheme did not abuse any rights because it did not establish any rights.

AAB was properly liable for the VAT, but AC was not. So AC's appeal was allowed with costs.

VAT Tribunal (20,933): *The Atrium Club Ltd*

2.12.2 Continuous supplies

There is an article by Neil Warren in *Tax Adviser* (January 2009) on the issue of whether supplies by accountants should be treated as "continuous" or "discrete" for VAT purposes. The issue is particularly important in the context of a change in VAT rate, because s.88 VATA 1994 operates differently for continuous and discrete services (as covered in the last update).

3. LAND AND PROPERTY

3.1 Exemption

Nothing to report.

3.2 Option to tax

3.2.1 Belated option?

In 2004 a company purchased a commercial property, and reclaimed the input tax. The managing director realised a few days before completion that the vendor would add VAT to the price, and rang the VAT Advice Line to check that this could be recovered. Unfortunately there was no detailed record of the conversation he had with the officer, who had since left HMRC: he claimed that he had heard nothing to suggest that the VAT would not be recoverable, but it was not possible to be sure that he had explained the full circumstances to the officer.

The company did not occupy the property itself for its taxable business, but instead leased it to an associated partnership. It did not charge VAT on the rent or notify HMRC that it had opted to tax the property.

When HMRC later discovered this, they issued an assessment to recover the tax which the company had reclaimed on its purchase of the property. The company appealed, contending that it should be treated as having opted to tax the property even though it had not charged VAT on the rent.

A belated notification can be accepted by HMRC, provided that it reflects a genuine decision to opt that was made at the time. It is not possible for HMRC to accept a retrospective option where no such decision was taken. Unfortunately for the company, the director explained in his evidence that he had no knowledge of the procedure for opting to tax, or the importance of it, until the control visit at which HMRC raised the problem. The Tribunal concluded that he could not have decided to do something that he had never heard of, and dismissed the appeal.

The Tribunal chairman had sympathy with the appellant director, who he found to be a truthful and straightforward witness, and pointed out that it might be possible to recover some of the input tax under the Capital Goods Scheme. However, that would be a poor solution 5 years after the building was first used.

VAT Tribunal (20,976): *Cobol Ltd*

3.2.2 Unit moves

HMRC have announced that the National Option to Tax Unit is moving office. As from 4 February 2009, the new contact details are:

Option to Tax National Unit
Cotton House
7 Cochrane Street
Glasgow
G1 1GY

Tel: 0141 285 4174/4175
Fax: 0141 285 4454

3.3 Developers and builders

Nothing to report.

3.4 Input tax claims on land

3.4.1 Planning consent required?

An individual contracted with builders to carry out various works to a listed building, including two sewer connections. The local authority took some time to decide that no consent was required for one of the connections, because the works were underground, even though it was integral to works above ground that did require consent. Because of the delay, the owner did not apply for planning consent, and paid VAT to the builder. He subsequently argued that he should have been allowed to obtain the whole of the work zero-rated because the whole project required consent.

The Tribunal held that planning consent could not be obtained retrospectively. It was an objective condition for zero-rating building works that planning consent must be obtained before the work is carried out: whatever the difficulties that the owner had had with the local authority, there was no possibility of changing that. The work could not be zero-rated.

The second sewer connection had been zero-rated by the builder. It appeared that there was some question about whether this was appropriate because once again it was possible that consent was not required for underground work, but HMRC confirmed that they would not pursue the VAT on this supply.

VAT Tribunal (20,934): *Dr David Thomas Haigh*

3.4.2 Long running project

An individual bought a site in 1985, spent 9 years getting planning permission to construct a house on it, and finally occupied it 11 years after that in May 2005. A DIY builder's claim of £36,000 was restricted by HMRC to only £12,780. He appealed to the Tribunal, which agreed that the problem was that many of the invoices on which he claimed should have been zero-rated by the builders – they were for construction services with associated materials. It was not possible for the customer to claim back from HMRC VAT which should not have been claimed in the first place. The only recourse was to the builder.

This would of course present a problem for the builder, who could only adjust the VAT payable to HMRC in the last 3 years – although HMRC's representative pointed out that the builder could make a "*Fleming* claim" in respect of pre-1996 VAT if it was submitted by 31 March 2009.

VAT Tribunal (20,934): *Dermot O'Reilly*

3.4.3 Goods or services?

A similar problem, but with a more feasible solution, arose in another case. A couple building a house were required by planning regulations to install a sprinkler system on the ground floor. The installer charged VAT, and HMRC refused to repay it under the DIY scheme. The Tribunal agreed that the installation was a supply of services and should have been zero-rated; the couple would have to go back to the installer for a refund. As the installer company raised its invoice in January 2006, and the appeal was heard on 10 December 2008, there might just have been time within the three-year cap to sort out the VAT refund.

VAT Tribunal (20,948): *P & M Bates*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Special scheme

HMRC have issued an Information Sheet to announce that the VAT rate within Lithuania for the special scheme for non-EU businesses in relation to electronically supplied services increased from 18% to 19% on 1 January 2009. A further Information Sheet sets out the usual exchange rate information for those who use the scheme for the quarter to December 2008.

Information Sheets 01/09, 02/09

4.2 Where is a supply of services?

4.2.1 Advertising services

An Austrian company supplied advertising services to Austrian and German clients. In 1993 and 1994, before Austria joined the EU, it used a subsidiary established in Italy to buy advertising services there. These were supplied on to the holding company or to the clients. The Italian subsidiary was appointed as the holding company's tax representative in Italy.

The Italian company reclaimed the VAT under the 13th Directive. The Italian authorities later issued a tax adjustment (and a penalty) to recover the VAT repaid on this claim. Questions were referred to the ECJ to clarify the place of supply of services in such a situation.

The Italian authorities argued that their "use and enjoyment" rule was relevant: the advertising material was disseminated in Italy, and therefore the provision of the advertising services was used and enjoyed there and so chargeable to Italian VAT.

The Italian subsidiary had no economic status in the chain of supply – it incurred the VAT in Italy only as agent or representative of its holding company, rather than buying the services as principal and supplying them on. The Italian authorities considered relevant that the Italian subsidiary's status as the tax representative of the non-EU company could bring the supply of advertising services to the non-EU company's clients within the scope of Italian VAT under the "use and enjoyment" provisions.

The full answer of the ECJ to the questions raised is as follows:

"*With regard to advertising services, where the recipient of the services is established outside the European Community, the place of supply is, as a rule, according to Article 9(2)(e) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, as amended by Tenth Council Directive 84/386/EEC of 31 July 1984, defined as the place where that recipient has his principal place of business. However, Member States may exercise the option provided in Article 9(3)(b) of Sixth Directive 77/388, as amended, and*

define the place where the services in question are supplied, by way of derogation from that rule, as within the Member State concerned.

If the option available under Article 9(3)(b) of Sixth Directive 77/388, as amended, is exercised, advertising services provided by a supplier established in the European Community to a customer situated in a non-Member state, whether that customer is the final customer or an intermediate customer, are deemed to be supplied within the European Community, provided that the effective use and enjoyment of the services, within the meaning of Article 9(3)(b) of Sixth Directive 77/388, as amended, take place within the Member State concerned. That is the case, with regard to advertising services, where the advertising material being supplied is disseminated from the Member State concerned.

Advertising services provided by a supplier established outside the European Community for his own clients cannot be liable to VAT under Article 9(3)(b) of Sixth Directive 77/388, as amended, even where that supplier acted in the capacity of intermediate customer in respect of an earlier supply of services, since such a supply of services does not fall within the scope of Article 9(2)(e) of that directive or, in more general terms, Article 9 of the directive as a whole, those being provisions which are expressly referred to in Article 9(3)(b) of that directive.

The fact that the supply of services for the purpose of Article 9(3)(b) of Sixth Directive 77/388, as amended, is subject to value added tax does not preclude the taxable person's right to the refund of VAT where he satisfies the conditions laid down in Article 2 of Thirteenth Council Directive 86/560/EEC of 17 November 1986 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 Community territory.

Whether a tax representative is appointed does not, of itself, have any effect on whether the services received or provided by the represented person are liable to VAT."

What this means is that:

- it was open to the Italians to argue that supplies of advertising to the Austrian holding company by Italian advertisers were chargeable to VAT in Italy under the "use and enjoyment" rules, rather than outside the scope under the normal rules of art.9(2)(e) – so the VAT paid by the Italian subsidiary had been properly charged to it;
- the services remained "advertising services" whether they were supplied to the final advertiser or an intermediate supplier who sold them on;
- however, it was not possible for "use and enjoyment" to apply to supplies by a non-EU company to its clients who were not established in Italy – as the Italian subsidiary was only incurring the expenses as agent, the outputs were those of the Austrian company, and they could not be subject to Italian output tax;

- the fact that a company is a tax representative has no effect on the place of supply rules – if the Italian company's involvement was relevant at all, it could only be because it was a part of a supply chain itself;
- the fact that the company had a tax representative in Italy did not stop it making a 13th Directive claim to recover the VAT charged to it there on transactions which were eligible for such a claim.

Overall, it appears that the taxpayer has won.

ECJ (Case C-1/08): *Athesia Druck Srl v Ministero delle Finanze, Agenzia delle Entrate*

4.2.2 More on the VAT package

HMRC have commented on the adoption of Directives implementing changes to the rules on Sales Lists in accordance with the VAT Package measures adopted by the Commission. The Brief states the following:

On 16 December 2008, the EU Council adopted a Directive 2008/117/EC and a Regulation (37/2009) relating to EC Sales Lists (ESLs) and the time of supply of services subject to the reverse charge.

The implementation date for these new measures is 1 January 2010. This Revenue & Customs Brief gives some information about how these measures will be implemented in the United Kingdom. It should be read in conjunction with Revenue & Customs Brief 53/08.

The main changes relate to the submission of ESLs. In principle, the new Directive provides that these should normally be submitted monthly, but it allows Member States to offer their businesses certain options. The United Kingdom intends to implement these as follows:

- *ESLs relating to services may be submitted quarterly, relating to calendar quarters.*
- *From 1 January 2010, ESLs relating to goods may be submitted quarterly, relating to calendar quarters, provided that the value (excluding VAT) of supplies of goods to other Member States has not exceeded £70,000 in any of the previous 4 quarters.*
- *A business entitled to submit quarterly ESLs for goods can continue to do so unless the value of supplies of goods to other Member States exceeds £70,000 (excluding VAT) per quarter from 1 January 2010 to 31 December 2011 or £35,000 (excluding VAT) per quarter from 1 January 2012 onwards.*
- *If a business exceeds the quarterly goods threshold by the end of the first or second month in a quarter, an ESL must be submitted at the end of that month, covering the month or months in that quarter. Lists must be submitted monthly from then.*
- *Once a business is on a monthly cycle, because it has exceeded the threshold in any quarter, it must continue to submit monthly ESLs for goods until the value of its intra-Community trade in goods has been below the threshold for five consecutive quarters – it may then revert to quarterly submission if its trade remains below the threshold.*
- *A business required to submit monthly ESLs relating to goods may still submit ESLs relating to services quarterly.*

- *Any business may submit ESLs for goods and/or services monthly, if it wishes.*

The other change to ESLs is that the time, within which both UK businesses and then HM Revenue & Customs (HMRC) must carry out their respective ESL obligations, has been reduced from three months to one. We intend to discuss this issue with business to explore how implementation can balance the needs of business and HMRC. Our current thinking is that businesses that submit paper ESLs would have 14 days from the end of the (last) month to do so. This period would be extended to 21 days for electronic submission of ESLs.

Finally, the Directive makes changes to the time of supply of services rules for services supplied to businesses in another Member State where the customer has to account for VAT under the 'reverse charge'. The changes are:

- *the time of supply of such services will be the earlier of when the service is completed or when payment is made.*
- *for continuous supplies of services, the time of supply will be linked to the end of each billing or payment period, but where no invoice or other accounting document is issued or payment made during the year, the time of supply will be the end of each calendar year.*

These changes will determine not only when the customer has to account for VAT under the reverse charge when the service is received from a supplier in another Member State, but also when a supplier is required to include the transaction on an ESL.

We intend to discuss implementation of the new time of supply rules with businesses, to understand their current accounting practices and their concerns about the changes likely to be needed. Our objective in implementing the rules will be to do so in a way which is as easy as possible for businesses to apply, and minimises additional burdens, while remaining consistent with the provisions of the Directive.

A consultation document covering changes to the place of supply rules for services being phased in from 1 January 2010 and the introduction of a requirement to complete ESLs for reverse charge services was issued on 22 December 2008. The deadline for comments on the draft legislation contained in the consultation paper is 13 February 2009. We will be holding consultation seminars in Central London on 2 and 6 February 2009 and intend to cover the issues arising from the changes set out in this Brief at those events. If you are interested in attending please email vat.package@hmrc.gsi.gov.uk.

Revenue & Customs Brief 02/09

The VAT update in *Accountancy* magazine, April 2009, points out that it will not be straightforward to identify the services which are to be recorded on the ESL. For example, it will be those that are subject to a reverse charge in the other country: that may cause difficulties where there is a difference between the VAT rules of the UK and the customer’s country, because the UK supplier may think of the supply as something that is not VATable.

4.3 International supplies of goods

4.3.1 Online guidance

HMRC have updated the *Export of Goods from the UK Manual* in their VAT series of online guidance manuals. They have added a new section on assurance procedures and new pages on the basic conditions for zero-rating intra-EC supplies, customer's EC VAT numbers, the High Court decision in *JP Commodities Ltd* and the legal framework for zero-rating intra-EC supplies.

www.hmrc.gov.uk/manuals/vexpmanual/Index.htm

HMRC have added the *Retail Export Scheme Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vatresmanual/Index.htm

4.3.2 Traditional guidance

HMRC have issued a new version of the Intrastat General Guide, updated to January 2009. Changes include:

- details of changes to the exemption threshold from £260,000 to £270,000;
- details of changes to the delivery terms threshold from £14,500,000 to £16,000,000;
- amended address information; and
- the removal of references to joint Customs and Excise warehouses.

Notice 60

4.3.3 Concessions enacted

As part of the ongoing review and enactment of extra-statutory concessions, the importation valuation rules have been amended with effect from 6 April 2009. The rule in s.21(4) VATA 1994 reduces the value to be applied to certain works of art on importation to 2/7 of what they would otherwise be (creating an effective rate of VAT of 5%, where the standard rate is 17.5%).

There is a rule in s.21(6D) which disapplies subsection (4) if the works of art were exported from the UK in the 12 months before they are imported (presumably zero-rated). The change enacts a concession which limits the condition for the disapplication of subsection (4) to circumstances where a taxpayer has effected the arrangements in order to obtain the benefit of the reduced valuation provided for in that subsection.

SI 2009/730

Another concession has allowed the supply of goods for consumption on passenger transport by train within the EU (essentially Eurostar and any trains between Northern Ireland and Eire) to be treated as supplied outside the member states. This takes statutory force from 6 April 2009. This relief has existed for many years in relation to goods sold for consumption on ships and planes.

SI 2009/215

4.3.4 Who should pay?

A Dutch company supplied services to a German customer and charged VAT. The Dutch authorities pointed out that the company should not have charged VAT as the place of supply was Germany, and repaid the VAT to the Dutch company on the basis of an undertaking that the company would issue a credit note to its German customer. On discovering that this had not been done, the authorities assessed to recover the VAT again. The company appealed, contending that it could not be made liable for VAT that was not due.

Questions were referred to the ECJ, where the Advocate-General has given an opinion as follows:

(1) Article 21(1)(c)[1] of Sixth Directive 77/388/EEC, as amended by Directive 91/680/EEC, is to be interpreted as meaning that the issuer of an invoice is liable for the VAT of a Member State mentioned in the invoice in that State, even if the transaction was not actually taxable there.

(2) Community law does not prohibit Member States from making the correction of the tax erroneously invoiced and hence payable under Article 21(1)(c) of the Sixth Directive subject to the requirement that the taxable person subsequently issues a corrected invoice to his customer. This applies even if the recipient of the invoice is not entitled to deduct VAT.

ECJ (A-G) (Case C-566/07): *Staatssecretaris van Financiën v Stadeco BV*

4.3.5 Art?

An article in *Taxation*, 5 March 2009, describes the difficulties experienced by someone importing an art "installation" that consisted of video images projected on flat screen televisions. HMRC argued that it had to be considered objectively at the point of importation – in its transit boxes, it was not a "sculpture". In the end, the Tribunal appears to have accepted the artist's word that it was a work of art, but only after considerable time and trouble.

4.4 European rules

4.4.1 International co-operation

The Commission has passed an amending Regulation and Directive to improve administrative co-operation to prevent VAT fraud in relation to international transactions. The new rules, which are intended to come into force in 2010, provide for information on international transactions to be provided more quickly than they are at present – they should be made available to the authorities within one month.

Council Reg 37/2009/EC of 16 December 2008 amending Council Reg 1798/2003/EC

Council Dir 2008/117/EC of 16 December 2008 amending Dir 2006/112/EC

In addition, further proposals have been adopted in relation to administrative co-operation and mutual assistance in the recovery of taxes. Member states will no longer be able to plead bank secrecy in order to resist a request for co-operation. The announcement contains the shocking comment that "the economic literature considers tax fraud to account for approximately 2 to 2.5% of GDP, i.e. between EURO 200 and 250 billion".

http://ec.europa.eu/taxation_customs/index_en.htm

4.4.2 Checking VRNs

HMRC has sought views of interested parties on the Commission's proposals for improving the online system for checking VAT registration numbers provided by customers in other Member States. Responses were required by 17 April 2009, but it is not easy to find the consultation document on HMRC's website.

HMRC were particularly interested in the views of business on:

- The level of service and greater legal certainty provided to businesses that wish to use the service (both EU businesses checking the status of a UK registration and UK businesses checking the status of their EU customer).
- Any concerns about the functioning of 'fuzzy matching' technology if that system is offered.
- Any concerns relating to the automatic disclosure of a business name and address if a correct VAT registration number is entered (Please note that under both Options 1 and 2, only the business name and address under which the business is VAT registered would be provided or confirmed and no other information).
- Whether the business should be required to submit its own VAT registration number to be able to rely on the information obtained. That would create a record of the enquiry, which makes abuse less likely and, if there were any, capable of being investigated.

- What concerns there would be if the system were open to an enquirer who did not need to identify himself. Such free access would not enable enquirers to trawl a database using name and address details because the enquirer would need to know the VAT registration number of the person whose details he was seeking. In any case the prospect of such abuse is limited because in most cases name and address information would be freely available by other means.
- Whether the system should provide businesses with the ability to undertake bulk checking of VAT Registration Numbers.

JCCC Consultation published 9 March 2009

4.4.3 Res judicata

The principle of res judicata is that a person is entitled to rely on a judicial decision once it has been given and not appealed further. It should not be possible for the other party to open the same dispute a second time.

An Italian company transferred the administration of a sports complex to a non-profit-making body in December 1985. The tax authority subsequently formed the opinion that this was designed to avoid VAT and was an "abusive practice". Assessments were raised on the company for 1988 to 1991. The company appealed, contending that the effect of a previous court decision relating to 1987 was that the transfer was effective for VAT purposes.

The case was referred to the ECJ for a ruling on the application of the res judicata principle which is laid down in Italian law.

The Advocate-General (Mazák) has given an opinion that Community law precludes the application of national legislation "which seeks to lay down the principle of res judicata, in so far as the application of that provision, as interpreted by the national courts, prevents a national court, in a dispute such as that before the referring court on the payment of VAT, from determining correctly and in compliance with Community law the existence of an abusive practice, where a decision on that issue is already contained in a final judgment drawn up by another court in relation to a different tax period".

This appears consistent with the principle as it would be understood in the UK: the 1987 liability was fixed by res judicata and could not be reopened, but that would not prevent the tax authority from raising the argument again in relation to a later year.

ECJ (A-G) (Case C-2/08): *Amministrazione dell'Economia e delle Finanze v Fallimento Olimpiclub Srl*

4.4.4 Finnish car tax

The ECJ has ruled that certain provisions of Finnish law are contrary to the VAT Directive. The reference by the Commission explained the underlying facts as follows:

A person liable for VAT who imports a vehicle into Finland has to pay VAT on car tax to the customs authorities in accordance with Finnish law. However, under another domestic provision, he can deduct the corresponding amount of VAT payable on the sale, so there is no VAT on

car tax left in the value of the vehicle. The VAT on car tax which has been deducted is not transferred to the amount the consumer has to pay.

If a private individual registers a vehicle for the first time in Finland he also has to pay VAT on car tax to the customs authorities but he cannot deduct it. That system, which distinguishes between sales by persons liable to VAT related to commercial activities at different stages of trade and acquisitions by final consumers from other Member States, means that the VAT on car tax that a private individual has to pay for a used vehicle obtained in another Member State and registered for the first time in Finland is probably higher than the residual VAT on car tax in the value of a similar used car which has already been registered in Finland when the person liable to car tax was also liable to VAT and the vehicle has been sold in connection with taxable commercial activities.

The Commission alleged an infringement of Article 90 of the EC Treaty arising from the fact that the value of the vehicle sold commercially does not include VAT on car tax because it has been deducted in its entirety.

The ECJ upheld most of the Commission's complaint, in particular ruling that allowing the deduction of the VAT on car tax, and applying the same taxable value for new cars and imported cars under three months, old were both breaches of the EC Treaty.

ECJ (Case C-10/08): *Commission v Republic of Finland*

4.4.5 Polish deductions

When Poland joined the EU, there was a blocking order in place in respect of some deductions of VAT on car fuel. A trader leased a car in March 2005 in circumstances in which the blocking rule did not apply; it was subsequently extended so that the company could no longer deduct the VAT on fuel as input tax. The trader appealed, contending that the extension of the blocking rule was contrary to the VAT Directive.

The ECJ ruled that such an extension would be contrary to the Directive, but it was for the domestic court to determine whether the provision complained of was indeed such an extension of a national rule that was in force when the Directive took effect in Poland. Only such national rules could be retained under the transitional provisions of art.17(6) 6th Directive.

ECJ (Case C-414/07): *Magoora sp. zoo v Dyrektor Izby Skarbowej w Krakowie*

4.4.6 Polish penalties

A Polish trader claimed input tax on certain second hand goods which were in fact exempt from VAT. The tax authorities assessed for the VAT and added an administrative penalty. The trader appealed, arguing that the penalty was contrary to the VAT Directive, presumably on the grounds that it was an additional amount of tax that was not VAT.

The ECJ rejected this contention and held that the EU law neither prohibited the imposition of such penalties nor required the member state to apply for a derogation in order to introduce them.

ECJ (Case C-502/07): *K-1 sp. z o.o. v Dyrektor Izby Skarbowej w Bydgoszczy*

4.4.7 Belgian time limits

The Belgian court has referred the following question to the ECJ for a ruling:

"*Does Article 10 of the [6th Directive] preclude an interpretation of national statutory provisions and an administrative practice which consist in fixing the starting point for an action for recovery of VAT, and therefore the date from which the limitation period for that action is to be calculated, as the date on which the VAT return is lodged in which the taxable person claims a right to deduct?*"

ECJ (Reference) (Case C-483/08): *Régie Communale Autonome du Stade Luc Varenne v Belgian State*

4.4.8 References

The Commission has made several new references to the ECJ in respect of failures by member states to fulfil their obligations:

- France (Case C-492/08), for applying a reduced rate of VAT to lawyers acting for legal aid funded clients;
- Greece, for failing to notify the Commission of the measures by which it adopted to transpose Directives 2006/69/EC (anti-fraud co-operation) and 2006/112/EC (the recast VAT Directive) into domestic law;
- Poland, for including car registration tax in the taxable base on which VAT is calculated for sales of cars (ruled incorrect by the ECJ in a Danish case, C-98/05));

The Commission has also issued a "reasoned opinion" to Italy, for using "objective" market value to calculate VAT on certain real property transactions, rather than valuing the consideration given by the parties (which, according to ECJ judgments, should be valued subjectively). If no satisfactory response is received, infringement proceedings will follow.

http://ec.europa.eu/community_law/eulaw/index_en.htm

4.4.9 MEPs like reduced rates

The European Parliament passed by a massive majority (636 for, 14 against, 18 abstentions) a resolution that member states should be allowed to reduce VAT rates on a new series of goods and services, such as restaurants, children's car seats, audio books and beauty treatments, and other locally supplied services if there is no distortion of competition in the EU Internal Market.

As usual, the European Parliament cannot take decisions about tax but only advise: the decision has to be unanimously reached by the Council.

European Parliament Press Release 19 February 2009

At the ECOFIN meeting on 10 March, ministers reached political agreement on a limited extension of the flexibility allowed to member states to introduce reduced rates. All Member States should have the option to apply reduced VAT rates on a permanent basis to the minor repairing of bicycles, shoes and leather goods, clothing and household linen, plus window cleaning, household cleaning, domestic care services, hairdressing, restaurant services, certain books and, with some restrictions,

the renovation and repair of private dwellings. These are currently subject to temporary measures which allow for member states to choose to apply a limited number of reduced rates.

Hansard, Col 42WS; EU Press Release 11 March 2009

4.4.10 Anti-fraud agreement

The Commission has announced the implementation of an anti-fraud agreement between the EU and Switzerland, covering VAT, excise duties, customs offences, corruption and money laundering (but excluding direct taxes). It contains provisions relating to administrative assistance and to mutual legal assistance in criminal matters for the protection of financial interests. Poland, Sweden, Romania, Bulgaria, France, Germany, Finland and the United Kingdom have agreed to implement the new policy: in the UK, it takes effect from 20 April 2009.

IP 19/02/2009

4.4.11 Two taxes?

It is a fundamental rule of VAT that member states are not allowed to impose turnover taxes in addition to VAT. A German individual purchased some land and contracted with a building company for the construction of a dwelling. Under German rules on connected party transactions, property transfer tax (similar to SDLT in the UK) was charged on the value of the future building works as well as the value of the land. The individual appealed, arguing that the transaction was already subject to VAT and the imposition of the property transfer tax on the future value was a double charge.

The ECJ ruled that the German tax was not similar to VAT, and it was therefore permissible for it to be levied on a transaction which was also subject to VAT.

ECJ (Case C-156/08): *Monika Vollkommer v Finanzamt Hannover-Land I*

4.5 Eighth Directive reclaims

4.5.1 Infringement proceedings

The ECJ has heard the Commission's application to rule unlawful the UK's rules which restrict 13th Directive claims in the circumstances highlighted by the *WHA Ltd* case (the so-called "offshore loop"). The UK changed the law after that case to provide that 13th Directive claims would not be valid if they depended on the provision of "specified services" to persons belonging outside the EU. Only taxable services, not those which were generally exempt within the EU, would justify a repayment claim. The Commission believes that this is incompatible with the UK's obligations under the 13th Directive.

Meanwhile, the Court of Appeal held that the offshore loop plan was an abuse of rights, but that will be reconsidered by the House of Lords.

ECJ (hearing) (Case C-582/08): *Commission v UK*

5. INPUTS

5.1 Economic activity

5.1.1 Sale of subsidiary

In a case referred by Sweden, the Advocate-General has given an opinion on the status of the disposal of a subsidiary company by a holding company. The Swedish court had decided that the 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 has disagreed. He believes 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 is 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 makes no difference whether the sales are in a single transaction or in a series.

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

5.2 Who receives the supply?

5.2.1 Services to director

A publishing company and its director were sued in the county court. The claim against the company was dismissed but that against the director was upheld, and he was ordered to pay the claimant's costs. He put the invoices through the company's books and claimed the VAT.

The Tribunal agreed with HMRC that there was no nexus between the costs and the business of the company. The costs were in any case the costs of the claimant and could not be inputs of the defendant; but they were also incurred by the director in his personal capacity, not on behalf of his company.

VAT Tribunal (20,973): *Zenith Publishing Ltd*

5.2.2 One partner, not the firm

A firm of three partners was dissolved, and one of them took legal action against the others. He claimed as input tax a significant sum in respect of the legal costs of the High Court action. In an earlier decision, the Tribunal held that there was no entitlement to input tax in respect of one part of the dispute which related to a farm property: that had nothing at all to do with his current VAT registered sole trade. The Tribunal recently considered further submissions in relation to another part of the dispute, which concerned the assets of the partnership business.

The partner argued that the costs in this dispute were incurred by him in his capacity as partner in the firm, and therefore the firm could recover the

VAT as input tax (presumably as a post-cessation expense). The Tribunal examined the evidence and concluded that, with one exception, the invoices had been addressed to the partner and his wife in their personal capacities and not to the firm. There was nothing in the documents or in the law of partnership to suggest that he was acting as agent for the firm in incurring these expenses. His appeal was dismissed.

VAT Tribunal (20,969): *Graham Langran*

5.3 Partial exemption

5.3.1 New standard method

Following the consultation on simplifying the rules of partial exemption that started in 2008, changes have been announced to the standard method to take effect from 1 April 2009. Given that the new rules are to apply to the first return period commencing after 31 March 2009, it is perhaps a little surprising that the changes were only announced on 1 April.

Consultation responses can be viewed on the HMRC website at http://tinyurl.com/dg8n54. The details of the changes to the scheme are set out in an Information Sheet.

The changes are:

- in-year provisional recovery rate;
- early annual adjustment;
- use-based option for new partly exempt businesses; and
- widening the scope of the standard method.

The first three are optional, and do not require any special permission from HMRC for businesses to start to use them; the fourth is compulsory.

In-year recovery rate

The new “default rule” is that a business will use the previous longer period’s overhead recovery rate during the following longer period rather than having to work out “T over T plus E” for each period. At the end of the year, it will make an annual adjustment by calculating the recovery rate for the current longer period and comparing it to the amount already recovered.

A business can continue to use the old procedure if it wishes. The only condition is that it must apply one procedure or the other consistently throughout the year.

The previous year’s percentage should still be used even if the business was in the end de minimis in that longer period. Presumably the recovery percentage would be so close to 100% that it would probably continue to be de minimis in the current period, but this will not necessarily follow.

If the standard method override applied in the previous period, the recovery percentage before the override should be used (because the override usually arises when unusual and unrepresentative events take place). The override will still have to be considered at the end of the current longer period.

Early annual adjustment

The annual adjustment has up to now been required to be entered on the VAT return for the period following the last return of the longer period. For longer periods ending on or after 30 April 2009, it will be possible for businesses to enter the annual adjustment on the final return of the longer period rather than waiting for the next return.

This will continue to be optional, so presumably a favourable adjustment will be routinely advanced, and an unfavourable adjustment will be routinely delayed.

Use-based option

HMRC have recognised that “T over T plus E” can be unrepresentative in the early years of a business, or when there is a change in activity so that exempt input tax is incurred for the first time. Businesses using the standard method will therefore be allowed to calculate input tax recovery according to the “use of the inputs” (in effect, using a “fair and reasonable” calculation rather than one based on turnover) in the following three situations:

- During its registration period. This is the period running from the date a business is first registered for VAT to the day before the start of its first tax year (normally, 31 March, 30 April or 31 May depending on the periods covered by the VAT returns).
- During its first tax year (normally the first period of 12 months commencing on 1 April, 1 May or 1 June following the end of the registration period), provided it did not incur input tax relating to exempt supplies during its registration period.
- During any tax year, provided it did not incur input tax relating to exempt supplies in its previous tax year.

The VAT manual at V1–15 provides in-depth discussion of how “the principles of use” can be applied. HMRC say that it is up to the business to choose a method, probably based on cost accounting principles; “provided this is logical, objective and transparent it will invariably form an ideal basis for a fair recovery of input tax”.

If the principles of use are used for individual returns within a longer period, the same method must be used to carry out the annual adjustment.

This will avoid the need for a business to apply for a special method where the standard turnover-based method gives an unfair result for a short period, but will be suitable in the longer term.

Widening the scope of the standard method

The old rules, which required a separate reg.103 calculation on the basis of use for making foreign and specified supplies, have been replaced. In effect, the decision in *Liverpool Institute of Performing Arts* has been overruled, and “outside the scope taxable supplies” will be treated as taxable supplies for the purpose of the overhead recovery percentage

calculation. However, it will remain necessary to calculate recoverable input tax on *financial* "specified supplies" (i.e. financial supplies that would normally be exempt) on the basis of use. The Information Sheet includes the following examples:

Example 1: A business provides consultancy services to customers within the UK and outside the UK. Under the current rules the business is required to calculate a recoverable amount of input tax relating to its services to customers outside the UK by way of a separate regulation 103 calculation or alternatively seek approval of a special method. The new rules simplify this by requiring residual input tax to be recovered by reference to the values-based calculation which includes the consultancy services irrespective of their place of supply.

Example 2: A business makes supplies of insurance, shares and bonds to customers located inside and outside the EU. Under the current rules, the business would be required to calculate input tax recoverable as attributable to these supplies to customers located outside the EU by way of a separate regulation 103 calculation. The new rules simplify this so that while input tax relating to shares and bonds, irrespective of their place of supply, must be recovered on the basis of use (for example on a transactions count basis), input tax relating to insurance can be recovered by reference to the values-based calculation which includes the supplies of insurance irrespective of their place of supply.

Example 3: A business makes supplies of management services from an establishment located within the UK and outside the UK. Under the current rules the business would be required to recover input tax relating to its supplies to customers outside the UK using a regulation 103 calculation. The remaining input tax would be recovered using the values-based calculation including supplies made to customers in the UK from the establishment located outside the UK, which could be distortive. To reduce this risk of distortion, the new rules require input tax relating to supplies made from establishments located outside the UK to be recovered on the basis of use. The remaining input tax is recovered using the values-based calculation (excluding supplies made from the establishment located outside the UK).

This new rule is compulsory for VAT return periods commencing on or after 1 April 2009. This means that traders will complete their last longer period (to 31 March, 30 April or 31 May 2009) using the old rules and will carry out an annual adjustment on the same basis; they will then be subject to the new rule for the next return.

SI 2009/820; Information Sheet 04/09; R & C Brief 19/09

5.3.2 Reg.109 claim

A registered housing association incurred input tax which it did not claim because there was an intention to use the costs in making exempt supplies (renting houses). Before the exempt supplies commenced, the land in question was transferred to a subsidiary and VAT was charged. The company made voluntary disclosures to recover a total of £458,000 by application of reg.109 SI 1995/2518. HMRC refused the claim, and the association appealed to the Tribunal in 2008.

The Tribunal decision reviewed the reasons for the VAT problems of housing associations and the possible solutions to them. These include the

use of "design and build" contracts with builders – the builder incurs the professional services and recovers the VAT, while the supply by the builder to the housing association is zero-rated. The problems with that approach are that the architect and other professionals become contractually responsible to the builder rather than to the end customer, and not all builders will enter into such a contract.

To deal with this problem, the housing association had set up a wholly owned subsidiary which would act as a property developer and would enter into design and build contracts with its holding company. The subsidiary could then enter into separate contracts for professional services with architects and construction services with builders, and could make a zero-rated supply of the finished building to the housing association after recovering all the input tax.

At the same time as this restructuring took place, the housing association took further action to respond to EU legislation about tendering. It decided that its subsidiary should carry on all future development activity, including the completion of all projects already in progress. Suppliers of services in relation to existing developments were told that the subsidiary would be completing the project, and they were asked to reinvoice the subsidiary. The holding company assigned the benefit of existing services to the subsidiary in return for payment. A director gave evidence explaining the company's belief that this would enable the subsidiary to sue for defective work supplied to the holding company. The Tribunal believed that this was a mistake, and the holding company (which received the services) would have to enforce warranties against the suppliers.

HMRC relied on an earlier decision, *Pierhead Housing Associating* (18,713). In that case a housing association had sought to reduce the VAT cost of separate professional services by turning a project into "design and build" after the event: the contracts with the architect were novated and new contracts entered into between the architect and the builder. In that case it was held that the housing association could not recover input tax because it had not supplied anything to the builder. It seems that the novation did not result in the architect refunding money to the housing association (including the irrecoverable VAT) and reinvoicing the whole to the builder, who would have been able to recover it; nor did the builder pay the housing association for the benefit of the work done so far. The company in the present case sought to distinguish the facts on the basis that the subsidiary had specifically paid for a transfer of the benefit of the contracts.

The company presented arguments which would be relevant if HMRC were arguing abuse of rights, which they did not appear to use. The non-VAT benefits and reasons for the transaction were emphasised. It was part of a larger restructuring of the business and the supply of the benefit of the services to the subsidiary was an essential part of that.

The Tribunal dismissed the appeal. It appeared to hold that the transaction between the holding company and subsidiary did not constitute a supply at all (even though VAT was charged, and presumably had been accounted for as output tax by one and input tax by the other). The Tribunal did not accept that the subsidiary would be able to enforce contractual terms against the suppliers in respect of services that had been supplied before the subsidiary was even incorporated. In reality, the supplies had been made to the holding company; it was the holding company's intention to

use those supplies to make exempt rental supplies; that had not changed. Reg.109 did not apply.

The High Court has allowed the association's appeal against this decision. The Tribunal erred in failing to recognise the assignment of the development projects as a supply. Input tax was deductible if it was linked with a taxable supply, regardless of the overall or ultimate objective of the taxpayer. Given that the transaction between the association and its subsidiary was a supply, and that the value of that transaction was determined in accordance with the amounts of input incurred before the assignment, the association was entitled to the benefit of reg.109.

High Court: *Community Housing Association Ltd v HMRC*

5.4 Cars

5.4.1 Transport concession enacted

Normally a vehicle must be capable of seating 12 people in order to be treated as "not a motor car" and therefore eligible for input tax recovery. An extra-statutory concession has allowed this rule to be waived where the vehicle would seat that many but for adaptations to accommodate wheelchairs. Following the *Wilkinson* case, HMRC have been reviewing the status of many ESCs, and have made this one statutory by amending the Input Tax order accordingly. The amendment came into force on 6 April 2009, but would have been applied by concession before that date.

SI 2009/217

5.5 Business entertainment

5.5.1 HMRC comment on *Danfoss*

The *Danfoss* case highlighted the principle that input tax blocks on genuine business expenditure are only permissible if they were in force when the 6th Directive came into effect in the territory, or else a derogation has been granted. This was supposed to be a transitional rule while the member states agreed a final list of what should be blocked or not, but it is still there 22 years after the 6th Directive. The Danish rules were ineffective because their blocking rule was only an administrative practice, not a rule of law, when the Directive took effect in Denmark.

The UK rules contains a legal block on input tax on UK entertaining which pre-dates the 6th Directive, so that should be effective. The UK's problem is that it extended the block to cover entertaining foreign customers in the late 1980s: that is an extension of an input tax block without a derogation, and if the expenditure is genuinely for the business, it is not allowed.

HMRC have announced that they are reviewing the effects of the decision. A claim for input tax incurred before 1996 would have had to have been submitted by 31 March 2009. Claims can still be made for input tax incurred in the last three years at any time. HMRC's comment states that a claim will only be considered if it includes the following:

- Details of the overseas clients (NB overseas suppliers are not covered).
- The type of expenditure (eg meal, drinks, sporting event etc).
- The amount of VAT claimed.
- Evidence to support the fact that the VAT had not previously been deducted.

HMRC do not consider that this decision has any implications for the input tax block on expenditure on entertaining UK business clients. Nor does it have any impact on input tax that can be claimed on expenditure on meals and other entertainment provided to employees – businesses can continue to claim this input tax subject to the normal rules.

www.hmrc.gov.uk/news/ent-claim-input-tax.htm

5.5.2 Entertainment

An article in *Taxation*, 8 January 2009, reviews a number of tax rules on food, including the VAT provisions relating to entertainment of clients, staff and others.

5.6 Non-business use of supplies

5.6.1 Partial non-business use

The ECJ has come to a potentially far-reaching and radical decision on input tax which is incurred for mixed use, where part of that use is not for economic purposes.

The traditional understanding has been that use for non-economic purposes did not distinguish between "private use" (e.g. by a sole trader) and "use for activities which do not involve the making of taxable supplies" (e.g. the charitable activities of a charity). Both were regarded as "non-business use" that would not give rise to a right of input tax deduction, except using the *Lennartz* principle for capital expenditure. This provided that a taxpayer acquiring capital expenditure for mixed business and non-business use had a choice:

- full recovery of the input tax immediately, followed by output tax charges under what is now art.16 Directive 2006/112 EC to reflect the non-business use;
- partial recovery of the input tax immediately, followed by no output tax charges.

Art.16 provides: "*The application by a taxable person of goods forming part of his business assets for his private use or for that of his staff, or their disposal free of charge or, more generally, their application for purposes other than those of his business, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.*"

It has been held that the self-supply charge under art.16 does not on its own justify an initial input tax deduction: there must be some "external" economic use as well as the private use. However, a string of cases since *Lennartz* have held that the trader has an absolute right to allocate the whole of the asset purchased to the business and reflect the private use as an output of the business.

The new case was referred by the supreme court in the Netherlands. It appeared to feature a claim for art.16 and the *Lennartz* approach to apply to inputs other than capital expenditure, although it is not clear how this would benefit the trader – if the private use followed shortly after the input tax claim, it would appear that the effect of art.16 would be very similar to the disallowance of a proportion of input tax.

However, the ECJ has gone considerably further in its judgment. It has drawn a distinction between:

- "private use", which has nothing to do with the taxable purposes of the entity;
- "non-economic use within the purposes of the business" – activities which do not involve making taxable supplies, but which are central to the purposes of the taxable entity.

The second type of activity does not fall within art.16, because it cannot satisfy the words "*their application for purposes other than those of his business*". This means that there cannot be any output tax on a self-supply in such circumstances.

The corollary of this is that input tax incurred for mixed economic and non-economic use (in the new sense) cannot give rise to a full input tax deduction. The future non-economic use *within the purposes of the entity* must be taken into account at the time the input tax is incurred, and it denies the right of deduction at that time.

The ECJ comments that the situation in the present case, which featured general expenditure of a trade body which promoted the interests of its members, was quite different from that in cases where the *Lennartz* approach was confirmed: *P Charles and T S Charles-Tijmens v Staatssecretaris van Financiën* (Case C-434/03) and *Wollny v Finanzamt Landshut* (Case C-72/05). There, the expenditure was on immoveable property, and it was wholly allocated to the business before being partly used for private purposes. This appears to be a distinction which could have four aspects:

- timing: it might be possible to allocate expenditure wholly to the business as long as the non-economic use comes later (but it is not clear how much later);
- type of expenditure: the ECJ appear to accept that the *Lennartz* approach is more appropriate for immoveable property than for other types of expenditure;
- accounting treatment: the ECJ refer to the current taxpayer allocating all the expenditure concerned to "general expenses" in the accounts, rather than exclusively to the "economic" side of its activities;
- type of use: it appears that private use, wholly separate from the taxable activities of the trader, is now to be regarded as something quite different from "non-economic use" which falls within the natural activities of the trader.

At present it is not clear how far the ECJ's decision goes, but it seems at least to cover the fourth point. There are some important issues on which HMRC will need to issue clarification:

- whether the *Lennartz* approach can still be justified by one or more of the first three points on the list, even if the fourth point applies;
- what happens where the *Lennartz* approach has been applied in the past to something that now appears not to be eligible for it.

It may be that traders may now be able to argue that charges should not arise under Sch.4 para.5 in respect of "non-economic use", but where they have in the past claimed back the input tax on the expenditure it may be that the courts will insist that they cannot "have it both ways".

ECJ (Case C-515/07): *Vereniging Noordelijke Land- en Tuinbouw Organisatie (VNLTO) v Staatssecretaris van Financiën*

5.7 *Bad debt relief*

5.7.1 Credit note or bad debt?

A car dealership company (B) sold Ford cars. B had no corporate relationship with Ford. In 2002 B went into receivership. It held a number of cars for which it had not paid F. In accordance with the supply agreement between the two companies (which was terminated if either party went into an insolvency procedure), F reclaimed the cars and issued credit notes. The supply agreement contained a "retention of title" clause which was legally effective and which entitled F to recover its cars in priority to other creditors.

B's receivers needed to continue the business in order to try to sell it as a going concern, for which they needed stock. They agreed with F that, after the credit notes had been issued, F would re-sell the same cars to the receivers on the same terms. In effect, F exercised its rights under the supply agreement by issuing the credit notes, but then decided to carry on a new informal supply agreement with the receivers. The cars were not physically repossessed by F.

B's receivers subsequently submitted a claim for repayment of input tax in respect of these cars. The Commissioners rejected the claim and B appealed, contending that the credit notes should not have been treated as effective for VAT purposes (cancelling the input tax entitlement in the pre-insolvency period), and that F should have claimed bad debt relief instead. This would have benefited B because B would not have had to repay the input tax under the usual bad debt rules if an insolvency procedure commenced between the input tax claim and the six month deadline at which F would make its claim.

The Tribunal rejected this contention and dismissed B's appeal, holding that the credit notes had been correctly issued and that F could not have claimed bad debt relief since it had legally (if not physically) "recovered" the cars in accordance with the supply agreement. The original supply had been reversed, so there was no input tax for B to claim. However, it was not a straightforward case: the company's counsel had argued strongly from precedent cases that the supply did not cease to be a supply because of the retention of title clause, and the reclamation of the cars by F was not a supply either.

The High Court confirmed the Tribunal's decision. The parties had agreed that the first supply agreement had been rescinded, cancelling the original supplies, and the credit notes were validly issued on that basis.

The Court of Appeal has now remitted the case to the Tribunal for reconsideration. The credit notes would only have the effect of cancelling the original supply (and therefore cancelling the associated right to input tax) if there was a contractual agreement between B and F that the supply should be cancelled. The original Tribunal did not consider this question: it appeared to accept that the credit notes must be assumed to reflect such a contract, rather than questioning whether the credit notes did so.

As the Tribunal's primary findings of fact did not justify its conclusions, it should examine the case again. It was possible that it would come to the same answer, but it was also possible that it would accept the taxpayer's argument: F acted unilaterally in repossessing the cars and issuing the credit notes, and B accepted that conduct not because of a contractual

agreement but because it had neither the power nor the commercial incentive to do anything else.

Court of Appeal: *Brunel Motor Co Ltd v HMRC and another*

5.7.2 Accounting for bad debts

In the case of *Times Right Marketing Ltd* (20,611), the Tribunal held that bad debt relief was due where output tax on a bad debt had been "accounted for" to HMRC because it was covered by an input tax claim. It was not essential for the claimant to have paid money to HMRC representing the output tax on the bad debt.

HMRC have now changed their policy to reflect this decision. They have published some illustrative examples (which appear to contain an error – noted below).

The amount of BDR to be claimed is included in Box 4 of the supplier's VAT Return, in the VAT period which covers the date they fulfil the conditions to make a claim, or a later period, subject to the usual time limits. For illustrative purposes this figure is shown separately here. It is assumed that all other BDR conditions have been satisfied.

£120,000 is taken to be the amount of VAT on bad debts over six months old at the time of the 2009-08 return.

Example 1 – Supplier has not paid net tax due in any period

	03/08	*06/08*	*09/08*
Output tax	*200,000*	*250,000*	*225,000*
Input tax	*110,000*	*112,000*	*111,000*
BDR (in Box 4)			*30,000 **
Net tax due	*90,000*	*138,000*	*104,000*
Tax paid	*Nil*	*Nil*	*Nil*

**Allowable BDR in period 09/08 is £30,000 calculated as follows:*

VAT related to bad debts on supplies made in period 03/08 – £120,000

Less unpaid net tax due in period 03/08 £90,000

*Maximum 03/08 bad debts available for relief six months later in period 09/08 £30,000**

The amount of 03/08 BDR reclaimable in 09/08 has been restricted to the excess of input tax over output tax due on non-bad debt supplies, ie £110,000 input tax – £80,000 output tax.

Example 2 – Supplier has partly paid period 03/08 by the time of submitting their 09/08 return

	03/08	*06/08*	*09/08*
Output tax	*200,000*	*250,000*	*225,000*
Input tax	*110,000*	*112,000*	*111,000*
BDR (in Box 4)			*50,000 **
Net tax due	*90,000*	*138,000*	*84,000*
Tax paid	20,000 **	*Nil*	*Nil*

** this figure is omitted in the HMRC example, but it is surely supposed to be there!

**Allowable BDR claim in 09/08 is £50,000 calculated as follows:*

VAT related to bad debts on supplies made in period 03/08 £120,000

Less unpaid net tax in period 03/08 £70,000

*Maximum 03/08 bad debts available for relief six months later in period 09/08 £50,000**

The amount of 03/08 BDR reclaimable in 09/08 has been restricted to the excess of input tax over output tax due on non-bad debt supplies. £110,000 input tax – £60,000 (£80,000 – £20,000) output tax.

R & C Brief 18/09

5.8 Other input tax problems

5.8.1 Reverse charge extended

At the ECOFIN meeting on 10 March, ministers reached political agreement on a two-year extension of the UK's derogation to apply a reverse charge to domestic transactions in carousel-prone goods.

Hansard, Col 42WS

5.8.2 Contra-trading in the High Court

HMRC denied a company a repayment of over £2m on the basis that it knew or ought to have known that it was involved in MTIC fraud transactions. It had been trading in mobile phones from June 2003 onwards, and had not had a claim refused until April 2006. The company had been visited by Customs officers many times during that period for checking of records and discussion of the risks of MTIC fraud.

HMRC accepted that the supply chains in which the company was directly involved did not involve any missing trader fraud. The fraud was carried out by other traders in a different supply chain; the alleged role of the appellant company was as a "contra-trader", who would reclaim input tax

that was effectively offset against VAT due from one of the missing traders. The Tribunal chairman went into detail about how contra-trading works: there is a "clean chain" in which all transactions are genuine, and a "dirty chain" in which there is a missing trader – the idea is that the company that would normally claim a repayment from HMRC (and therefore be at risk of extended verification and denial of credit) nets off the input tax on "dirty chain" transactions against output tax on "clean chain" transactions, so that the trader claiming a repayment is entirely insulated from the fraudulent supply chain.

The trader argued that it was so far removed from any fraud that it neither knew, nor could have the means of knowing, that any of its transactions were tainted by fraud.

Before the Tribunal, the parties were not agreed on who had the onus of proof, nor whether the standard of proof should be the normal civil standard (balance of probabilities) or something higher because of the allegation of fraud. The Chairman (Dr Avery Jones) considered that he did not need to decide on either matter. As both parties had given substantial quantities of evidence he felt that he had enough to reach a decision without being concerned with who had to prove what; and he thought that the civil standard was what was required (HMRC's contention), but he still found for the appellant on that basis.

One feature which no doubt attracted HMRC's attention was the fact that the company banked with First Curacao International Bank, which is currently under investigation by the Netherlands authorities in connection with alleged money laundering, and which has been associated with traders involved in MTIC fraud before. The Tribunal was satisfied that at the time of the transactions the appellant company had no reason to suspect anything untoward about the bank, and there were genuine commercial reasons for using it.

The Tribunal also decided that the appellant's connection to the fraud was so tenuous that it neither knew nor had the means of knowing that its transactions were tainted by fraud. Its input tax claim therefore should be allowed.

VAT Tribunal (20,533): *Livewire Telecom Ltd*

A similar conclusion was reached for similar reasons in another case. HMRC failed to show that the appellant knew or ought to have known that the transactions were connected to fraud. The fact that the market in mobile phones was "beset with fraud" did not mean that the trader "ought to have known" that a particular supplier was acting in a fraudulent way: it could not know this without knowledge that was beyond the capacity of an individual trader.

VAT Tribunal (20,570): *Olympia Technology Ltd*

HMRC appealed both these decisions to the High Court. HMRC argued that, even if the traders did not have actual knowledge of the frauds, they had the means of knowing. The traders argued that HMRC's case in the Tribunals had been centred on actual knowledge: having failed once with that argument, they should not be allowed to change their line on appeal.

The court ruled that the way in which the case had been presented in the Tribunal did not prevent HMRC from advancing the argument differently on appeal. The "means of knowing" argument had been put to the Tribunal as well, and was not a wholly new line taken before the High Court.

The High Court decided that the Tribunal had used too restrictive a test in the *Olympia Technology* case. The chairman had decided that the knowledge would have to extend to both the existence of the missing trader in the dirty chain and the complicity of the contra-trader as well. The judge ruled that knowledge of fraud by the contra-trader would be enough to taint the claimant's right to repayment. However, the misstatement of the legal test did not determine the matter in HMRC's favour.

The judge ruled that the Tribunal had applied the correct test in the *Livewire* case and there was no evidence to suggest that it had reached the wrong conclusion. HMRC's appeal was accordingly dismissed. In the *Olympia Technology* case, the overstatement of the requirement of knowledge meant that it was not certain that the Tribunal had reached the right conclusion. The case should be remitted to the Tribunal for further consideration on the basis of the correct test.

High Court: *HMRC v Livewire Telecom Ltd; HMRC v Olympia Technology Ltd*

5.8.3 More carousels

HMRC refused a repayment of £1m in relation to trading in mobile phones. The claimant argued that it had carried out adequate due diligence on its suppliers. The Tribunal rejected this argument in a decision that runs to 236 numbered paragraphs. The warning to the trader is summed up as follows:

227. We consider that Mr Peters could have made much more comprehensive further enquiries in advance of BSG becoming committed to the transactions, rather than leaving some of the checking procedures to be dealt with after the event. Apart from the various matters which we have already referred to, it would have been appropriate for him to ask the following questions, and, depending on the answers, to ask yet further questions to satisfy himself as to the position:

(1) Why was BSG, a relatively small company with comparatively little history of dealing in mobile phones, approached with offers to buy and sell very substantial quantities of such phones?

(2) How likely in ordinary commercial circumstances would it be for a company in BSG's position to be requested to supply large quantities of particular types of mobile phone and to be able to find without difficulty a supplier able to provide exactly that type and quantity of phone?

(3) Was Infinity already making supplies direct to other EC countries? If so, he could have asked why Infinity was not making supplies direct, rather than selling to UK traders who in turn would sell to such other countries.

(4) Why are various people encouraging BSG to become involved in these transactions? What benefit might they be deriving by persuading BSG to do so? Why should they be inviting BSG to join in when they could do so instead and take the profit for themselves?

228. His failure to make full enquiries and investigations in advance meant that he did not discover information which ought to have led him into yet further investigations. In turn, the result was that BSG became committed, without sufficient protection, to enter into the transactions with Infinity linked by way of contra-trading to the other transactions derived from two traders established to be fraudulent, namely AS Genstar Ltd and Wade Tech Ltd. We think that if he had asked and obtained answers to the appropriate questions, he would have concluded that the uncommercial features of the deals being offered to BSG could only be explained by taking into account other transactions which Infinity was entering into, and that the most probable explanation was that those other transactions were connected in some way with fraud. Our conclusion is that BSG ought to have known that, by its purchases, it was participating in transactions connected with fraudulent evasion of VAT.

VAT Tribunal (20,901): *Blue Sphere Global Ltd*

By contrast, another appellant persuaded the Tribunal that it had taken all reasonable steps. The hearings took place over 1 – 5, 8 – 12 October and 6 – 7 December 2007 and 22 – 23 January 2008, the main decision runs to 484 numbered paragraphs, and there are several appendices. The Chairman summarised the decision as follows:

482 To reiterate we have found:

(a) The particular chains of transactions in question have been established with the exception of the chains noted above;

(b) The transactions in question form part of a chain in which there was a tax loss with the exception of the chains noted above;

(c) That tax loss attributable to fraud in the chain in question has been established with the exception of the chains noted above;

(d) OCL/Mr Dar did not know or ought to have known or have the means of knowing of their participation in transactions connected with fraudulent evasion of VAT. In particular OCL had taken all available proportionate steps taken to ensure on the balance of probabilities that there was no connection with persons or transactions involved in VAT fraud. This is the case in respect of all the chains concerned in this appeal...

VAT Tribunal (20,903): *Our Communications Ltd*

The Tribunal had to consider a preliminary argument raised by a taxpayer that it had been discriminated against by HMRC choosing to subject its input tax claims to extended verification. This was based on the requirements of art.22(8) 6th Directive:

"*Member States may impose other obligations which they deem necessary for the correct collection of the tax and for the prevention of evasion, subject to the requirement of equal treatment for domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.*

The option provided for in the first subparagraph [i.e. in the text cited above] cannot be used to impose additional obligations over and above those laid down in paragraph 3 [requirements for the issue of invoices, etc.]."

The company argued that only intra-EU transactions were picked for extended verification. As a result, HMRC's refusal of its claim was based on unlawful grounds, and the claim should be paid.

The Tribunal examined the policy of HMRC with regard to extended verification and decided that it did not discriminate against intra-Community traders just because that was what they were; rather, MTIC fraudsters would of necessity be intra-Community traders, and HMRC carried out extended verification on those intra-Community traders who appeared after initial consideration to pose a significant risk of fraud. There was no discrimination. No questions would be referred to the ECJ at this point: it would be necessary to proceed to a substantive hearing to consider the arguments, based on *Kittel*, about whether the trader "knew or ought to have known" that the transactions were connected with fraud.

VAT Tribunal (20,931): *4 Distribution Ltd*

5.8.4 No evidence

A trader claimed input tax in respect of the purchase of a boat. He was a business development consultant, but the visiting officer did not disallow the VAT on the basis that the boat was not connected with the business: rather, she said that there was no supporting evidence. The trader said that the invoice had been blown overboard in a strong wind, but the seller had appeared very respectable and would surely not have done anything improper. The seller could not now be traced.

The Tribunal agreed with HMRC that there was no reason to accept alternative evidence to support an input tax claim. Although there was no doubt that the boat existed, there was nothing to confirm that VAT had been paid to the seller.

VAT Tribunal (20,909): *Fryer*

5.8.5 No supply

A company claimed to have "outsourced its payroll" by employing several directors through another company. The other company paid the directors and recharged the cost to the first company with the addition of VAT. It went into liquidation without paying the VAT to HMRC, who sought to disallow a deduction of the VAT in the first company.

The Tribunal agreed that there was no evidence that any supply had been made between the two companies. There was no documentation reflecting the agreements that were claimed to be in place, apart from a flurry of invoices at the last minute. The evidence lacked any credibility, and the appeal was dismissed.

VAT Tribunal (20,949): *Bodyguard Workwear Ltd*

5.8.6 Two strikes

An individual registered for VAT and claimed a repayment of input tax on purchases of fuel which he said had been supplied to domestic customers and were therefore charged at the lower rate. HMRC investigated and

contacted a number of the customers recorded in his books, all of whom denied ever having received supplies of fuel from him. In addition, HMRC discovered that the supplier of the fuel was not registered for VAT. They therefore refused to repay any input tax.

The Tribunal confirmed these decisions. The trader did not appear at the hearing, and costs were awarded against him.

VAT Tribunal (20,935): *L Davidson t/a Hillside Fuels*

5.8.7 Novation again

Another trader has fallen foul of the problem which arises when connected companies try to rearrange hire purchase contracts with the hirer. The idea is to keep the goods and to keep paying for them; the contracts are "novated", so the original hirer is no longer obliged to pay, and the connected company takes over the assets and the obligations. The original hirer will then probably go into liquidation.

HMRC argued that there were several reasons to disallow input tax to the acquiring company:

- it did not receive a supply of goods from the transferor company, but rather took over financial obligations in a novation, which carries no VAT;
- it acquired the assets as part of a TOGC, so no VAT was due;
- it had not paid the amounts due to the transferor, so it would not be entitled to claim input tax.

HMRC identified two parts of the transaction as not relating to a novation transaction between the connected companies, but rather:

- in one case, an assignment rather than a novation, on which HMRC accepted that input tax was claimable;
- in the other case, transactions directly between the "transferee" and third party hirers, which were therefore claimable under the normal rules.

To this extent, the Tribunal allowed the company's appeal, but agreed with HMRC that the rest of the input tax claimed was disallowed because of the "novation" argument.

VAT Tribunal (20,924): *Scotts Group Ltd*

5.8.8 Unusual route of appeal

A Bulgarian trader claimed input tax in respect of a purchase of goods. The tax authorities discovered that the supplier had not paid over the VAT as output tax, and sought to disallow the deduction. Surprisingly, the claimant went to the European Court of Human Rights rather than the ECJ, but was equally successful. As it had complied with the requirements of the VAT law, it was entitled to a deduction. The Bulgarian rules "*amounted to an excessive individual burden on the applicant company which upset the fair balance that must be maintained between the demands of the general interest of the community and the requirements of the protection of the right of property*".

ECHR (Case 3991/03): *Bulves AD v Bulgaria*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Date of deregistration

A trader applied to be deregistered on 24 September 2007. HMRC accepted that his turnover was below the threshold and agreed, on 5 February 2008, to deregister him from the date they had received the letter, 26 September 2007. By that time, he had sent another letter asking to be deregistered retrospectively from the beginning of his 2007 financial year. HMRC refused, stating that the deregistration provisions only allowed them to deregister a trader from the date of application or a later date.

He appealed, arguing that the *Marks & Spencer* case indicated that he should be repaid VAT that had been "wrongly paid" to HMRC. The Tribunal chairman interpreted the parts of that case that he sought to rely on differently: she said they meant that the trader was entitled to rely on the proper application of national law and European law. HMRC's interpretation of Sch.1 para.13 VATA 1994 was correct, and there was no reason to regard the VAT collected by the trader up to 26 September 2007 as "wrongly paid".

VAT Tribunal (20,972): *Keith Savidge (KCS t/a Car Spa)*

6.2.2 Cancellation of registration

An individual appealed against decisions of HMRC to deregister his business and to refuse a claim for substantial amounts of input tax. The Tribunal chairman explained that the claims were completely spurious, but the trader appeared to have suffered a nervous breakdown and should be treated with sympathy and understanding. The decision recorded the chairman's view that HMRC's officers had behaved impeccably, in case the trader carried out his threat of writing to various MPs to complain about HMRC's conduct in the matter.

Given that the following arguments were the main basis of the claim, it might be considered that the Tribunal was excessively understanding:

Four additional and different lines of argument were advanced, either in dialogue with HMRC before the hearing or before us, as follows:-

- *a BBC television programme had made some references to Sir Richard Branson's companies having received favourable VAT treatment, and implicitly a number of high-profile businessmen had also received such treatment so that the Appellant should do likewise;*

- *HMRC were stupid not to appreciate what was meant by "constructive accounting" and such accounting was readily accepted by all the large firms of accountants, and that was all that he had done in the present case;*
- *the Appellant was only asking for the small sum of approximately £190,000, and if HMRC would not give it to him, or at least make a down payment of £100,000, he would not be able to take up some critical course on computers at Oxford University; and that*
- *since the government had recently given billions to the banks in the City, it was absurd that HMRC was wasting its time, and his time (that they ought to be paying for at £500 an hour) in debating this minor claim.*

VAT Tribunal (20,956): *Kulwant Ajay Singh t/a Borealis*

6.2.3 Compulsory registration

A company provided domestic care services to the public. It employed its workers under contracts of employment, but argued that this was not effective for VAT purposes because it exercised very little control over them. The status of the workers was a by-product of the regulations which prohibited agencies from using self-employed people.

HMRC prepared for a hearing of the appeal, but at the last minute discovered that the trader did not intend to attend or be represented. The chairman decided to hear the evidence rather than striking the appeal out. He concluded that HMRC were correct on technical grounds, and confirmed the compulsory registration. Costs of the hearing were awarded to HMRC.

VAT Tribunal (20,947): *Westbourne Domestic Care Agency Ltd*

HMRC concluded from a market trader's self-assessment income tax returns that he had exceeded the registration threshold in 2000. They issued a notice of compulsory registration backdated to that time, together with an assessment for over £50,000 and a late registration penalty. His representative appealed on the grounds that it was improper for HMRC to take information from self-assessment returns and use it to assess VAT.

The Tribunal rejected this, observing that the FA 1972 contained the following provision:

No obligation of secrecy or other restriction upon the disclosure of information imposed by statute or otherwise shall prevent either–

a: the Commissioners of Inland revenue or an authorised officer of those Commissioners; or

b: the Commissioners of Customs and Excise or an authorised officer of those Commissioners;

from disclosing information to the other Commissioners or an authorised officer of the other Commissioners for the purpose of assisting them in the performance of their duties.

This section was repealed with effect from 18 April 2005 by the Commissioners for Revenue and Customs Act 2005, which explicitly allows HMRC to cross-reference information but not to contravene the Data Protection Act.

The Tribunal considered that the use of the data did not contravene the DPA, and was essential for the Commissioners to carry out their functions. The appeal was dismissed.

VAT Tribunal (20,912): *Webster Shrowder*

6.2.4 Online guidance

HMRC have added the *Agricultural Flat Rate Scheme Manual* to their VAT series of online guidance manuals.

www.hmrc.gov.uk/manuals/vatafrsmanual/Index.htm

6.3 Payments and returns

6.3.1 Monthly returns

Traders who expect to make regular repayment claims are generally allowed to file monthly returns. This has led to the standard VAT planning manoeuvre of separately registering a zero-rated company (e.g. an exporter) within a group of companies so that it can file monthly repayment returns while the rest of the group accounts for output tax quarterly, including output tax on supplies to the zero-rated company. This creates a significant cash flow benefit.

In Business Brief 12/05, HMRC warned traders that they might require associated businesses to align their return periods if they suspected manipulation of returns to achieve cash flow benefits. This power would be exercised under SI 1995/2518 reg.25, under which there is no right of appeal to the Tribunal. When BMW received such a ruling in 2006, it therefore had to apply for judicial review, contending that the decision was not rational or reasonable.

The High Court held that the benefit actually enjoyed by virtue of the arrangement in this case was substantially equivalent to the benefit that the manufacturing company would enjoy if it was the direct exporter. The group as a whole enjoyed no new benefit from the arrangement, so denying it was not rational. It appears that the decision letter simply assumed that there was a VAT planning motive behind the arrangements, and no questions were asked by HMRC about possible other motives or administrative advantages of making monthly returns.

As a matter of principle, it was reasonable for HMRC to treat differently an exporter that was associated with its suppliers and one which was not, particularly if the associated exporter was deliberately manipulating the stagger groupings to obtain an unfair cash advantage. However, the High Court judge did not believe that this applied in this circumstance.

The Court of Appeal has overturned this ruling and allowed HMRC's appeal. As the judge had accepted the lawfulness and reasonableness of the overall policy of requiring traders to align their return periods, it was unreasonable of him then not to apply it.

HMRC had the power to determine return periods under reg.25 SI 1995/2518 and art.252 Directive 2006/112/EC. If that power was applied differently to different taxpayers, that might be discriminatory unless it could be shown that there were valid reasons for the distinction which were objectively justified in the exercise of the powers of tax management. HMRC had put forward valid reasons (the cash flow advantage enjoyed where the supplier and customer were associated) and it was not for the court to overturn HMRC's judgement, unless it was manifestly unreasonable.

HMRC were not required by the law to consider whether there would be a different benefit in different circumstances. There was a cash flow benefit from the use of different accounting periods, at the expense of the Exchequer; the policy of denying such a benefit was rational; the application of that policy to these companies was therefore lawful.

Court of Appeal: *R (oao BMW AG and others) v HMRC*

6.3.2 Flat rate scheme

As announced in the Pre-Budget Report, the Flat Rate Scheme has been amended with effect from 1 April 2009 so that:

- there will be only one entry test, based on net value of taxable supplies being no more than £150,000 in the last 12 months (removing the second test of gross income being no more than £187,500);
- the exit test, which must be considered on each anniversary of joining the scheme, will be measured using whichever method (e.g. cash received) the trader uses to calculate turnover for the VAT return. Previously HMRC ruled that the amounts invoiced in the year had to be used, even if a different figure was used to calculate the VAT. The level at which the trader must leave the scheme (gross income of £225,000) remains unchanged.

A new version of Notice 733 has been issued. It says that the following points have changed:

- a new paragraph on what to do if you leave the scheme because you deregister – paragraph 12.4
- a new paragraph on how florists account for VAT under the scheme – paragraph 10.7
- a description of how barristers chambers can use Method 3 with the scheme – section 13 and
- a new section on how to claim input tax outside the scheme when you buy capital expenditure goods that cost £2,000 or more – section 15.

There is at least one more change: "interest on a business bank account" is now given as an example of exempt business income that must be included in the turnover which is chargeable to the flat rate. This confirms HMRC's view that such interest income is not "outside the scope investment income", which may be excluded.

Not everyone accepts that HMRC are correct in this, and it is likely that a challenge may be mounted.

SI 2009/586; Notice 733

Taxation magazine (12 March 2009) contains an article which outlines some potential areas of difficulty in operating the scheme, as raised by Neil Warren and Mike Thexton in a meeting with HMRC officers in January. The points raised are:

- exempt income is subject to the FRS if it is received by the registered person – sole traders may not realise that this extends to buy-to-let rental income and even the sale proceeds of a buy-to-let property, and traders in general may not realise that they should account for FRS VAT on the sale of a business car;
- HMRC believe that interest received on a business bank account is included in FRS turnover (now clarified in the new Notice 733). An unincorporated trader can transfer funds easily to a private account which will be outside the scope of VAT, but this is more difficult for a company. It is likely that this point will be disputed with HMRC to establish whether a small company's interest income really constitutes "exempt turnover" or should properly be regarded as "outside the scope".

At the meeting, the HMRC officers accepted that it would be very harsh to apply the FRS to the sale proceeds of a buy-to-let property when the trader did not appreciate that it would be a good idea to leave the scheme before making the sale. In that circumstance, on the grounds of proportionality, they would allow the trader to leave the scheme retrospectively. The trader would be permitted to recalculate VAT on the basis of the "normal rules" from before the sale of the property, and would have to stay outside the FRS for at least 12 months.

6.3.3 Flat rate dispute

A publican applied to use the flat-rate scheme. HMRC rejected his application on the grounds that he constituted a risk to the revenue, as he had failed to register for VAT on time and had also underdeclared takings. Despite not having received authorisation, the publican submitted returns based on the scheme.

HMRC issued assessments to recover the additional VAT that would have been due if he had applied the standard method for calculating VAT rather than the FRS. He appealed against the assessments and against HMRC's refusal to authorise him to use the scheme.

The Tribunal dismissed his appeals, holding that HMRC's decision to refuse authorisation had been reasonable. The Tribunal commented that the publican had shown a "*blatant disregard of his responsibilities in respect of income tax and VAT*", and an "*inclination to remain below the respondents' radar until found out by formal enquiries into his tax affairs*".

VAT Tribunal (20,929): *PT Genrey*

6.3.4 Paper returns to go

VAT Notes 4/2008 has confirmed that one of the proposals of the Carter Review will be implemented from April 2010 – the phasing out of paper VAT returns. From that time onwards all newly registered traders, and all traders with an annual turnover of over £100,000, will be required to file online and make payments electronically.

Paper returns will remain an option for the remainder of traders, but this will be reviewed by 2012.

VAT Notes 4/2008

6.3.5 Changing banks

HMRC have announced that they are changing their banking arrangements during 2009. Instead of the Bank of England holding HMRC's accounts, the business will be transferred to Royal Bank of Scotland and Citi. Traders who make direct electronic payments will have to change the account numbers and sort codes that they use, but this information will be provided when it is needed – there is no need to take any action until then.

www.hmrc.gov.uk

6.3.6 Time to pay

Help from HMRC with "time to pay" was launched by the Chancellor of the Exchequer at the PBR in November 2008. HMRC have announced that 60,000 businesses have agreed "time to pay" arrangements with the Business Payment Support Service, representing a deferral of one billion pounds of tax due. The following points are included in the announcement:

The Business Payment Support Service (BPSS) offers enhanced support to businesses finding it difficult to make tax payments on time, including corporation tax, VAT, PAYE, income tax and national insurance contributions.

The majority of businesses have agreed repayment timetables spread across 3 to 6 months.

The service is supporting those businesses hardest hit by the economic circumstances. Construction firms account for a quarter of those benefiting from these new arrangements, with many retailers and manufacturers also agreeing payment schedules they can afford.

Businesses can call HMRC and in the majority of cases get a decision within 10 minutes on the help they can receive.

The BPSS is open to all businesses in temporary financial difficulties and can be used to spread tax due now over a period which reflects the business' circumstances.

Businesses that have already entered into a time to pay arrangement, but whose circumstances change for the worse, should contact HMRC. In many cases HMRC will be able to revise or extend the time to pay arrangements, depending on individual circumstances.

An earlier announcement, on 14 January, stated the figures at 20,000 businesses and £350 million.

www.hmrc.gov.uk/pbr2008/business-payment.htm ; HMRC Press Release 16 February 2009

An article in *Taxation*, 8 January 2009, points out the crucial confirmation that agreeing a "time to pay" arrangement will avoid default surcharges (as long as the trader then sticks to the terms of the agreement). This is not the usual rule: normally, a trader who agrees to pay VAT late has only put off the arrival of the bailiffs, and is still subject to surcharges.

6.4 Repayment claims

6.4.1 Putting the cap on *Marks & Spencer…*

After the ECJ found comprehensively in favour of the taxpayer's version of the arguments about the five questions referred to it on the introduction of the 3-year cap, it was inevitable that Marks & Spencer would at last receive the repayments that were denied to them by the Court of Appeal following the first reference to the ECJ in 2002. The House of Lords, in re-hearing the case after it was returned by the ECJ this time, commented that the answers to the third and fifth questions had raised the possibility of further issues having to be decided by the national court. However, after 13 years of litigation, HMRC had decided that they did not wish to pursue those matters, so the matter could be disposed of by allowing the appeal at last.

House of Lords: *Marks and Spencer plc v HMRC*

6.4.2 …and recognising the principle

HMRC have published a Revenue & Customs Brief accepting the finding of the ECJ that it was unacceptably discriminatory to apply the unjust enrichment rule to payment traders but not to repayment traders. This was a defect in the law up to 26 May 2005, when it was corrected.

Claims made before 26 May 2005 that were refused by HMRC on the grounds of unjust enrichment and have still not been settled will now be paid, subject to verification. Claims where the unjust enrichment defence was not challenged or was upheld, in the courts, may be resubmitted for consideration, subject to the relevant time limits.

R&C Brief 05/09

6.4.3 Direct tax on repayments

HMRC have issued a Brief to explain their views on the direct tax treatment of VAT repayments arising under "Fleming claims" (and, by extension, other claims). Apparently some have suggested that a VAT repayment is outside the scope of corporation tax.

HMRC say that they do not accept this. VAT originally overpaid and recovered would in the earlier period have been excluded from turnover: customers would have paid it to the trader but it would have been treated as not belonging to the business. If it is recovered from HMRC, it becomes turnover, and is taxable accordingly. The Brief does not say when the recovery should be treated as taxable – the normal principle for

timing of such receipts is that the accounting policy of the company is followed, which would put the receipt in the period in which it became reasonably certain that the money would be recovered. Although there may be an ingenious argument in favour of excluding such receipts from direct tax, HMRC's position seems very strong.

HMRC also state their view that interest paid on repayments of VAT is also chargeable to corporation tax. Although it does not arise on a "loan relationship", which is normally required for a charge to arise, it is deemed to do so by s.81 FA 1996. In this case, there is a specific reference to the timing of the charge and the relevance of Generally Accepted Accountancy Practice (GAAP – which most accountants think stands for Generally Accepted Accounting Principles).

The loan relationships rules do not apply to income tax traders. Perhaps someone will attempt to argue that interest paid by HMRC does not fall within the income tax provisions, although no-one has done so on previous occasions when repayments have been common (e.g. when opticians won their landmark case in 1995).

R&C Brief 14/09

6.4.4 Last minute advice

HMRC issued a note on their website on 27 March to clarify what was required by the 31 March deadline for a "Fleming claim" to be regarded as validly made in time. It is now too late to make such claims, but there may be disputes about whether something was "a claim made before the deadline" or not. This was their advice:

Your email should include the text "New Fleming Claim" in the email title.

Using email:

- *Attachments to emails should be no larger than 10 MB. Please don't send self-extracting zip files as HM Revenue & Customs (HMRC) software will block them.*
- *HMRC cannot guarantee the security of emails sent over the Internet. Any information you send by email is at your own risk.*
- *It is important that you have assessed the risks of using email to send information or to receive it.*
- *Information about market/price sensitive matters or well known individuals should not be sent by email.*
- *HMRC usually contact you by post to verify the claim. If you would like a reply by email, please state so and confirm that you understand and accept the risks involved in using email. HMRC will not always be able to reply by email.*
- *If you have any doubt about the authenticity of an email you receive which claims to come from the Fleming Claims Team, please call to check.*

Telephone enquiries in relation to the submission of claims or to claims that have already been submitted to the Claims Team may be made on Tel 0113 389 4432.

www.hmrc.gov.uk

6.4.5 Extended time limits

Reg.29 SI 1995/2518 has been amended so that a taxable person cannot make a claim for input tax until he holds the evidence which is required to substantiate that claim as well as having incurred it; it is also clarified that a taxable person can only deduct a specific amount of input tax once.

The capping rules have been amended so that the time limit for making claims becomes 4 years rather than 3 with effect from 1 April 2009, although the 3 year limit continues to apply to anything for which the operative date fell up to 31 March 2006. This mirrors the new time limit for assessments.

The time will not start to run towards the limit until the due date for the first return period in which the law allows the taxpayer to make the claim, i.e. now the period in which the trader holds the evidence which is required to substantiate it. Previously it would have been the due date for the period in which the input tax was charged by the supplier as output tax (i.e. the tax point for the supply).

Similar changes have been made to the time limits for:

- correcting errors in reg.34;
- claiming pre-registration input tax in reg.111;
- using a different return from the normal one for adjusting CGS input tax under reg.115;
- claiming bad debt relief under reg.165A (becomes 4 years and 6 months after the supply rather than 3 years and 6 months).

The time limit of 3 years which used to appear in reg.38 (adjustments in the course of business) has been removed altogether. Since the cap was introduced, it has become apparent that the adjustment of VAT following an adjustment of the price charged is a Community right and cannot be restricted by UK legislation.

SI 2009/586

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 New record-keeping requirements

Sch.37 FA 2008 introduced rules to bring the record-keeping requirements for income tax, corporation tax, capital gains tax and VAT within the same statutory framework. A Statutory Instrument has confirmed that the new rules come into force on 1 April 2009.

The general approach of Sch.37 is to allow HMRC to prescribe in primary and secondary legislation what is required to satisfy the law. The penalties for failure to meet statutory record-keeping obligations remain the same as before, but will be brought into a comprehensive framework in due course as part of the reform of penalties. The effect of the Appointed Day Order is to bring into effect amendments to paras. 6 and 6A Sch.11 VATA 1994, thereby removing certain details of the requirements for records to secondary legislation.

The time limits for retention of records may be shortened by statutory instrument under the new legislation, but they remain 6 years at present for the VAT records of a registered trader.

SI 2009/402

6.6.2 Proposals for invoicing

The Commission has adopted a proposal to change the VAT Directive in respect of the invoicing rules, and published a Communication on the technological developments in the field of electronic invoicing.

The aim of the proposal is to reduce burdens on business, promote small and medium sized enterprises (SMEs), increase the use of electronic invoicing and help Member States tackle fraud. The proposal simplifies, modernises and harmonises the VAT invoicing rules. In particular, it eliminates the current barriers to e-invoicing in the VAT Directive by treating paper and electronic invoices equally.

At the same time, the Commission has published Phase 3 of a study into the invoicing rules carried out by PWC. It contains recommendations aimed at harmonising, simplifying and modernising the invoicing obligations both for local and cross-border transactions.

http://ec.europa.eu/taxation_customs/taxation/vat/traders/invoicing_rules/index_en.htm#existingleg

6.7 Assessments

6.7.1 New time limits

Sch.39 FA 2008 introduced rules to bring the time limits for assessments and claims for income tax, corporation tax, capital gains tax and VAT within the same statutory framework. A Statutory Instrument has confirmed that the new rules come into force on 1 April 2009.

The overall time limit for most assessments and claims becomes 4 years rather than 3. The "later of 2 years from the accounting period and 1 year from knowledge of the facts" remains, as does the 20-year limit for assessments arising from the taxpayer's dishonesty.

Transitional rules provide that assessments and claims that went out of time on 31 March 2009 (i.e. those that relate to periods ending up to 31 March 2006) do not come back into time on 1 April because of the extension of the time limit. In effect, the new rules will become fully operational on 1 April 2010.

SI 2009/403

6.7.2 Period of assessment

The Tribunal has allocated an IPT number to a VAT case about the validity of an assessment. HMRC issued a notice of compulsory registration to a subsidiary of Prudential and assessed it for the period from 1 June 2004 to 30 April 2007. The holding company, as representative member of its VAT group, appealed, contending as a preliminary point that HMRC could not raise an assessment for a period exceeding a year.

The Tribunal disagreed: in circumstances of late registration, it was open to HMRC to specify a longer period for which VAT should be accounted for or an assessment could be raised.

VAT Tribunal (IPT 0015): *Prudential Assurance Co Ltd*

6.7.3 Suppression

The Tribunal considered a calculation of understated turnover raised on a coffee shop. The chairman confessed that he found it difficult to conclude on the evidence what exactly had happened: he was persuaded by the appellant's testimony that the suppression was not as great as HMRC suggested, but he was not convinced that the records were completely accurate. He allowed the appeal in part, and directed that the turnover should be recalculated on a different basis (which would affect the date on which the business would have to be registered for VAT).

VAT Tribunal (20,907): *The Coffee Denn Ltd*

The director of a public house did not keep all the underlying records, and was therefore unable to provide convincing evidence to displace an assessment on a mark-up basis by HMRC. The Tribunal considered the method adopted by HMRC in arriving at the assessment and concluded that it was entirely reasonable and was therefore "to best judgement". The assessment was confirmed.

VAT Tribunal (20,936): *Irish Inns Ltd*

A trader ran a shop which was open 24 hours a day. There was clearly evidence of suppression, and the trader had not produced evidence sufficient to displace the assessment to understated VAT which was made to the officer's best judgement. When investigated by HMRC in relation to underdeclarations of turnover, the owner said that it was only open between 0700 and 2300. This was sufficient evidence of dishonesty to confirm a s.60 penalty.

VAT Tribunal (20,946): *Agron Haxhija and Bujar Mustapha t/a Orsi Deli Foods*

The owner of a restaurant and takeaway was unaware that his brother-in-law, who helped to run it, kept a detailed diary of how many people visited the site each day. This was found and used by HMRC to raise an assessment, which was held to be "to best judgement" by the Tribunal because all the figures going in were supported by good evidence.

VAT Tribunal (20,950): *Mohammed Tariq t/a Shama Balti*

6.8 Penalties and appeals

6.8.1 New Tribunals

A Statutory Instrument has given effect to the changes in the law required to create the new First and Second Tier Tribunals which will hear appeals on tax matters and on a range of other issues such as tax credits. The following section of the Explanatory Memorandum covers the changes which are specifically concerned with VAT:

Part V of VATA is amended to reflect the transfer of functions to the new tribunals. References are updated and provisions which have been overtaken are repealed. In addition, provision is made for review of appealable decisions, and some additional administrative changes have been made.

Section 83A (Offer of review)

This section provides that HMRC must offer reviews of decisions which are appealable under section 83 when the decision is notified to a person (P). The section does not apply to the notification of the conclusions of a review.

Section 83B (Right to require review)

This section provides that any person (other than P) who has a right of appeal under section 83 against an HMRC decision may require a review or serve notice of appeal within 30 days of the date when that person becomes aware of the HMRC decision. Case law has determined that any person with sufficient interest in a VAT decision (such as the recipient of the supply in question) has the right to appeal that decision. This section provides for these parties to require a review and clarifies the process for doing so.

Section 83C (Review by HMRC)

This section provides that HMRC must review a decision if they have offered review under section 83A and the offer has been accepted within 30 days, and also when a review has been required under section 83B. HMRC are not required to review decisions where P, or another person, has appealed to the tribunal under section 83G: they are not required to conduct a review requested by someone other than the recipient of the decision if the recipient has accepted the offer of review.

Section 83D (Extensions of time)

This section provides for HMRC to notify an extension of time to appeal or ask for review if they are asked to do so within the review offer acceptance period (set out in section 83C(1)(b)) or the 30 day period provided for in section 83B. In such cases, the 30 day time limit for appealing or asking for review begins again on the date of the notice or from a date set out in the notice or a further notice. This section replaces the effect of SI 1986/590 Rule 4(2) for appeals (but by reference to a 30 day, rather than a 21 day, period) and extends the provision to cover reviews.

Section 83E (Review out of time)

This section provides that HMRC must review a decision after the review acceptance period or the period in section 83B if they are asked to do so and are satisfied that P or the person requiring a review under s 83B had a reasonable excuse for not accepting the offer within the period, and that P or the other person made the request without unreasonable delay after the excuse had ceased to apply.

HMRC are not required to review any matter where an appeal has been made in respect of the decision.

Section 83F (Nature of review etc)

This section provides for the nature and extent of the review. Subsections (1) to (6) mirror the provisions in TMA s 49E.

Where HMRC fail to give notice of the review conclusions within the time set out in (6) or any period subsequently agreed, the decision is to be treated as upheld (subsection (8)) and HMRC must notify the party who accepted the review offer or required review under 83B of this (subsection (9)).

This provision finalises the review in such cases, ensuring that the taxpayer may appeal to the tribunal once that period of time has passed, and provides a basis on which to do so. Section 83G(5) gives the time limit for making an appeal in such cases.

Section 83G (Bringing of appeals)

This section provides a time limit for making an appeal under section 83. Appeals may be made by notifying the tribunal within 30 days of the date of the decision to which the appeal relates or, in cases where a person other than the recipient of the decision is the appellant, within 30 days of the date when that person became aware of the decision. Where the time limit for appeal has been extended under section 83D an appeal may be made within the period provided for under that section (subsection (1)).

In cases where HMRC are required to undertake a review, an appeal may not be made until the conclusion date. In such cases any appeal is to be made within 30 days beginning with the conclusion date (subsection (3)).

In cases where HMRC are asked to undertake a review out of time under section 83E an appeal may not be made until HMRC have decided whether or not to undertake a review. If HMRC decide to undertake a review an appeal may not be made until the conclusion date. In such cases any appeal is to be made within 30 days beginning with the conclusion date. If HMRC decide not to undertake a review an appeal may be made from the date on which HMRC so decide (subsection (4)). The conclusion date is the date of the document notifying HMRC's conclusions (subsection (7)).

If HMRC do not notify their conclusions within the review time limit, the time limit for appealing starts at the end of the review time limit and ends 30 days after the conclusion date (subsection (5)).

An appeal may be made after the end of the period specified in subsection (1), (3)(b), (4)(b) or (5) if the tribunal gives permission to do so (subsection (6)).

Section 84 (further provisions relating to appeals) is consequentially amended to reflect the new tribunal structures and related changes.

Subsection (2) is omitted to remove the requirement to have made all the returns required under the Act and paid all the amounts shown as payable on those returns in order for an appeal to be entertained.

Subsections (3B) and (3C) are inserted to provide that applications not to pay amounts subject to appeal on grounds of hardship are made to HMRC in the first instance, and that HMRC may agree such applications if they are satisfied that the applicant would otherwise suffer hardship. If HMRC and the applicant cannot reach agreement on the issue of hardship the applicant may apply to the tribunal for a determination of that issue.

Subsection (8) is omitted and has been restated in revised form in section 85A.

Section 85(1) is amended to remove specific reference to costs. This now mirrors the equivalent provision in TMA (section 54).

New section 85A (Payment of tax on determination of appeal) restates section 84(8) with modifications. The modifications remove the power of the tribunal to decide the rate at which interest is payable on any amounts found to have been over- or underpaid on determination of the appeal and provide instead that interest will be payable at the normal statutory rates.

New section 85B (Payment of tax when there is a further appeal) provides that tax is payable or repayable in line with the tribunal determination notwithstanding any further appeal (subsection (1)).

If the amount payable or repayable is altered by the order or judgment of the Upper Tribunal or court on further appeal, overpaid tax or underpayments of credits shall be refunded with such interest, if any, as the Upper Tribunal or court may allow. Or, if too little tax has been charged or too much credit has been allowed, any amount determined to be due shall be payable at the end of the 30 day period beginning on the date HMRC issue notice of the amount payable (subsection (2)). Subsections (1) and (2) mirror the restated TMA section 56.

Pending determination of the further appeal HMRC may apply for permission to withhold any payment or repayment or to require adequate security before payment or repayment is made if they consider this necessary for the protection of the revenue (subsection (3)). In such cases the tribunal may give permission or require the provision of security.

P may apply to HMRC for permission not to make payments or repayments under subsection (1) pending the determination of the further appeal (subsection (4)).

If HMRC and P do not agree, P may apply to the tribunal or court from which permission or leave to appeal is sought for a determination of the issue (subsection (5)).

In considering an application under subsections (4) or (5) HMRC or the relevant tribunal or court, as appropriate, may decide how much, if any, of the disputed amount should be paid or repaid; or require the provision of adequate security; or stay the requirement to pay or repay under subsection (1) (subsection (6)).

Security shall be of such amount and given in such manner as the tribunal or court may determine (but, in the case of an application under subsection (4), HMRC may agree to accept such security as they consider adequate to protect the revenue) (subsection (9)(a) and (b)). An application under this section is to be made to the tribunal or court from which permission or leave to appeal is sought (subsection (8)).

SI 2009/56

There is an article in *Taxation*, 22 January 2009, discussing the results of a trial of the new "review" system in the North West and Midlands Appeals Unit of HMRC. There have been positive responses to the trial, but the writer considers that there is still a great deal of work to do before the whole country is ready for a changeover on 1 April.

There is a further article in *Taxation*, 26 February 2009, explaining the new appeals process and the new two-tier Tribunal structure.

Further statutory instruments have created the legal structure for the Tribunal and set out the rules of procedure of the new First-Tier Tribunal. Concern has been expressed that these rules have been established very late; HMRC would no doubt respond that this is because they have been the subject of extensive consultation, and they should therefore be the best possible rules as well as being free from unpleasant surprises.

There have also been changes to the rules for the Upper Tribunal (SI 2008/2698) which make minor amendments to correct and clarify the drafting.

SI 2009/196; SI 2009/273; SI 2009/274

HMRC have launched a training package for their own staff to help them understand the new appeals procedure. The following comment clarifies the relationship between the old system of reconsideration and the new review:

"*As now, the requirement to pay any disputed tax will be suspended during review. If the conclusion of the review is that tax is due, this must be paid before an appeal can be heard. However, if payment would cause the customer hardship, they may ask HMRC to agree to suspend the tax until*

the tribunal appeal is settled. If HMRC does not agree, the customer can ask the tribunal to decide the matter.

In Customs and Excise duties and the environmental taxes, the current mandatory review will become optional, so that customers will be offered a review when an appealable decision is made. They can then decide whether or not to accept the decision, accept the offer of review, or appeal to the tribunal. However the existing mandatory review process will continue for decisions about the restoration of seized goods.

Review is not the same as local reconsideration. Review is a statutory process with strict time limits. Queries about decisions, especially in cases where the taxpayer provides new information, are not to be treated as review requests unless the customer has specifically asked for a review. In many such cases we expect to be able to reach agreement and finalise cases without a review as now."

HMRC Press Release 20 February 2009

HMRC have also issued a Brief to explain the new rules and procedures. It does not contain any details but provides links (from the website version) to more detailed documents.

R & C Brief 10/09; www.hmrc.gov.uk/briefs/vat/brief1009.htm

6.8.2 Transitional rules

The old VAT Tribunal could award costs to a successful appellant in all cases. The new First-Tier Tribunal will not do so. For appeals made but not heard before 1 April 2009, the procedural rules of the First-tier Tax Chamber will apply. However, the new Tribunal has the discretion to continue to apply the rules of the existing Tribunals on a transitional basis.

For indirect tax appeals made before 1 April 2009, this means the Tribunal may continue to operate the existing costs rules in the VAT Tribunal. Where this happens the practice of HMRC not seek to costs from appellants in most cases will also continue to apply on a transitional basis.

The new provisions for optional statutory review apply to indirect tax decisions (other than restoration decisions) made on or after 1 April 2009.

Where HMRC issue a VAT decision before 1 April 2009, the old provisions for non-statutory reviews (reconsiderations) continue to apply.

Ministerial Statement 10 March 2009 Hansard Col 8WS;
www.hmrc.gov.uk/about/news.htm

6.8.3 New factsheet

HMRC have published a new Factsheet 1 which will presumably be issued with assessments and decisions from 1 April 2009. It sets out in outline the taxpayer's rights and options if the taxpayer disagrees with HMRC's decision.

Factsheet HMRC 01/09

6.8.4 More on the new penalties

HMRC have published a Q&A for the penalty regime for inaccuracies in returns and documents applies to returns due to be filed on or after 1 April 2009 in respect of the main taxes, and extended to other taxes and duties for returns due to be filed on or after 1 April 2010. The new failure to notify penalty regime applies to failures occurring on or after 1 April 2010 (CT accounting periods ending on or after 1 April 2009).

The Q&A relevant to VAT are as follows:

Q22. How will the new penalties affect the Error Correction Procedure customers can use for indirect taxes like VAT?

The VAT error correction procedure (previously the voluntary disclosure regime) corrects errors on past returns. No penalty was due if the taxpayer voluntarily disclosed the error to HMRC or if they had a 'reasonable excuse'.

Under the new regime customers are still expected to disclose errors. Most voluntary disclosures are of mistakes made despite taking reasonable care, so will still incur no penalty. If they are below the de minimis level they can be corrected on the next return. (The de minimis level was increased in the 2008 Budget, see Budget Note 75. (PDF 730K)

For careless errors, penalties can still be reduced to nil if a full unprompted disclosure is made. This means telling HMRC about the error, helping to determine the correct amount of tax due and allowing access to the figures to check the result. Simply correcting an error on the next return is not an unprompted disclosure.

If a business makes repeated disclosures of the same sort of errors then the question of whether this is failure to take reasonable care may have to be considered.

Q48. What are the VAT and Excise wrongdoing penalties?

From 1 April 2010, a new penalty regime will apply where a person:

- makes an unauthorised issue of an invoice showing VAT or an amount inclusive of VAT
- misuses a product like red diesel so that a higher rate of excise duty is due
- handles goods, such as alcohol or tobacco products, that are subject to unpaid duty

The legislation is contained in Schedule 41 of the 2008 Finance Act.

Q49. Who will they apply to?

The wrongdoing penalties can apply to any person, who is not registered, but should be registered to pay VAT or Excise Duties. They can also apply to members of the general public, who are not required to be registered to pay VAT or Excise Duties.

The penalties provide another sanction for the department to use for fraud against VAT and Excise Duties.

Q50. Why are additional penalties for VAT and Excise Duties needed?

VAT and the Excise Duties on alcohol, oil and tobacco products are subject to persistent and widespread fraud.

The wrongdoing penalties will sit alongside the range of other sanctions used against the non-compliant, including those involved in deliberate fraud. These sanctions include the forfeiture of goods, vehicles, disruption, criminal prosecutions or revoking registration.

They will enable HMRC to make a more proportionate response in some situations than at present.

Q51. What is the unauthorised issue of an invoice showing VAT?

Most commonly, this occurs when someone who is not registered for VAT or who doesn't work for a VAT registered business, issues an invoice that includes VAT.

Q54. What is reasonable excuse?

A person won't be liable to a penalty for a non deliberate wrongdoing if they can show that they have a reasonable excuse.

Supplying products knowing that they will be misused is a deliberate act. Consequently there can be no reasonable excuse for this type of wrongdoing.

Reasonable excuse is not defined in law, and what is reasonable will differ from person to person depending on their particular circumstances. It is likely to be an exceptional and unforeseen event beyond the person's control.

For example an individual detected running on red diesel may have done so unwittingly because they had that day bought a car from a third party and so could not reasonably have known how it was fuelled.

See also the examples given in Question 44 about reasonable excuse in the failure to notify penalty.

Q55. How is the penalty calculated?

The penalty will be based on the amount shown as VAT on an unauthorised invoice, or the amount of Excise Duty unpaid because of the wrongdoing. This unpaid tax or duty is the potential lost revenue.

The penalty is calculated by applying an appropriate percentage to the potential lost revenue.

The penalty is the appropriate percentage of the potential lost revenue and depends on whether the wrongdoing was:

- deliberate and concealed – maximum penalty 100 per cent, minimum penalty 30 per cent

- deliberate but not concealed – maximum penalty 70 per cent, minimum 20 per cent
- non-deliberate – maximum penalty 30 per cent, minimum 10 per cent.

The penalty is reduced if the person tells HMRC about the wrongdoing. As with the other penalties the amount of reduction depends on whether the disclosure is unprompted or prompted, and how much help the person gives to establish the correct amount of tax that is due.

Q57. When must a wrongdoing penalty be paid?

A VAT or Excise wrongdoing penalty must be paid within 30 days. The 30 days begins on the date the penalty assessment is issued.

www.hmrc.gov.uk/about/new-penalties/faqs.htm

6.8.5 Successful default appeals

A large trader was partly successful in appealing against default surcharges arising on two balancing payments under the payments on account regime. It had put forward three excuses:

- it did not believe that it had received the surcharge liability notice – non-delivery of the SLN renders subsequent defaults invalid;
- it was not aware that the 7-day extension of time does not apply to payments under the POA regime;
- it had suffered an internet connection breakdown which caused one of the returns and the related payment to be delayed from 4pm in the afternoon to 7.30am the following morning.

The Tribunal thought that it was more likely that the company had mislaid the SLN. The failure to know the rules was not an excuse. HMRC argued that the breakdown in the internet connection was not an excuse because the company should not have left filing so late in the day; however, the Tribunal considered that the previous reliability of the connection meant that the trader had acted reasonably in expecting it to work without problem. The surcharges were reduced to reflect the effect of striking out this default.

VAT Tribunal (20,938): *LVG Ltd*

The Tribunal came to the rescue of a trader who offered three different defences against a default surcharge at 15%: he claimed that his son was told on the telephone that even if part of the VAT was paid on time the surcharge would be based on the full amount. His next ground was that the surcharge was disproportionate and against the principles of the Human Rights Act. His third ground was that he had not been advised of the cash accounting scheme.

All of these defences were rejected, but the Tribunal still found a reasonable excuse. There was an acrimonious dispute between the trader and a Customs officer over what had been said in a conversation with the helpline; the officer's notes did not refer to the issue of a default surcharge being raised, while the trader was adamant that it had been specifically discussed. However, the record did show that the officer had mentioned the date on which a BACS transfer would have to be initiated, without explaining that a CHAPS payment two days later would solve the

problem. In the circumstances, this constituted a reasonable excuse for the trader.

VAT Tribunal (20,902): *Mediaid Training Services Ltd*

6.8.6 Unsuccessful default appeals

The Tribunal dismissed an appeal against a default surcharge at the 15% rate in circumstances in which the trader might have expected to succeed. The VAT return was filed on time, and a payment was attempted using the Lloydslink electronic payment system on the 7-day extended deadline. The system failed for reasons which could not be identified; in spite of repeated calls to the bank's helpline, it could not be rectified in time for a payment to be made that day.

The Tribunal considered that the trader had not done all that a reasonable trader would do to make the payment. There had apparently been problems with the Lloydslink system the previous day, which might have put the trader on notice that the VAT payment should be attempted earlier than about 90 minutes before the deadline for same-day CHAPS transfers; similarly, its history of defaults – leading to the 15% rate applying – should have led to greater efforts being made. The penalty was confirmed at £32,365.

VAT Tribunal (20,971): *Datapoint Global Services Ltd (Formerly Touchbase Communications Ltd)*

A restaurant business claimed that it had suffered "unforeseeable and inescapable" cash flow difficulties because its general manager had left and the new general manager had over-ordered stock. The Tribunal held that this was not unforeseeable: the directors had experience of the business and should have given more guidance to the new manager.

VAT Tribunal (20,975): *Ricecooker Ltd t/a Liquorish*

A solicitor claimed a reasonable excuse for late payment of VAT on the grounds that HMRC had been late paying him an income tax refund arising from an investment in a film partnership. The Tribunal held that the income tax matter was wholly unconnected with the taxable trade; it was not clear whether the repayment should in fact have been made earlier than it was, but even if it was late, the trader should have made sure that he had sufficient funds to pay his VAT on time. He was using the cash accounting scheme and therefore only had to pay VAT to HMRC when he had received it from his clients.

VAT Tribunal (20,937): *D Walker*

A trader tried to convince the Tribunal that the failure to pay VAT on time arose because his financial officer had unnecessarily paid other creditors early, leaving insufficient funds to pay the VAT. If the other creditors – who had agreed not to press for payment – had not been paid, it would have been possible to pay the VAT.

The Tribunal did not accept that it would have been possible, even if the surprising account of the financial officer's actions was true. The numbers and dates did not show that the VAT liability could have been paid on time: there was a shortage of funds, and that could not be a reasonable excuse without a more convincing explanation.

VAT Tribunal (20,939): *City AM Ltd*

A trader was late paying two successive quarters' VAT, and received surcharges at 10% and 15% as a result. In respect of the first quarter, it had notified HMRC that it would be adversely affected by a postal strike which would delay receipts from its customers. However, the Tribunal considered that the effect was unlikely to be significant as the strike started on 4 October and the VAT was due on 7 October.

In respect of the next quarter, the trader's bank had changed the payment arrangements offered to the customer. It had previously accepted faxed CHAPS instructions; now the customer was required to use online banking to give BACS instructions, and a limit of £30,000 was placed on such payments. The company sent a fax anyway, and when it discovered that this was no longer accepted, it was too late for the BACS transfer (and the £4,000 cheque, as the total liability was £34,000) to arrive in time. The Tribunal did not accept that this confusion constituted a reasonable excuse.

In deciding whether the trader acted reasonably, the Tribunal may have been influenced by the fact that the trader did not turn up to the hearing; on being contacted by telephone, the responsible employee said that she had received notice of the hearing and had intended to attend, but had forgotten all about it.

VAT Tribunal (20,932): *UCS Building Division Ltd*

A trader gave instructions to his bank to transfer funds to HMRC on 4 April and 4 July, but as these were BACS transfers the money only arrived on 8 April and 8 July. His appeal against the resulting surcharges appeared mainly to be a complaint that he had paid the money, so where was it before it got to HMRC? The Tribunal was unable to answer this mystery, but confirmed that he needed to pay by CHAPS to achieve same day transfer.

VAT Tribunal (20,954): *Wolfe Ware Ltd*

6.8.7 Costs

A university claimed a VAT repayment of more than £2,000,000 relating to the building of a laboratory. HMRC rejected the claim on the grounds that the effect of VATA 1994 Sch.4 para.5(4A) (which was subsequently repealed by FA 2007) was that the tax was not reclaimable. This was the attempt by the Government to rule out the application of the Lennartz principle to buildings, introduced by FA 2003 and almost immediately shown to be ineffective by the cases of *Seeling* and *Charles-Tijmens* in the ECJ.

The university appealed, contending that Sch.4 para.5(4A) was invalid under EC law. Shortly before the hearing of the appeal, HMRC accepted the university's claim. The university applied for costs on the indemnity basis.

The Tribunal rejected this application, holding that HMRC's conduct of the case had not been "so unreasonable as to warrant a direction for

indemnity costs". Accordingly costs should be awarded on the standard basis.

VAT Tribunal (20,960): *Queen Mary University of London*

A company provided security personnel to the Saudi Arabian military attaché. In 2003 HMRC issued an assessment charging tax on the supplies. S appealed, contending that the supplies were within SI 1992/3121 art.16, so that for VAT purposes they were made where the recipient belonged. The Commissioners did not accept this contention until 2006, when they withdrew the assessment shortly before the hearing of the appeal.

S applied for costs on the indemnity basis, contending that there had been a "significant level of unreasonableness" in HMRC's conduct, and that it had been "objectively hopeless to resist the appeal". The Tribunal chairman observed that HMRC's stance had been "clearly wrong and it is surprising to put it at its lowest that it was maintained for so long". However although HMRC's stance had been "unreasonable in that it was lacking in common sense", it had not been "unreasonable to such a high degree as to justify an order for indemnity costs".

VAT Tribunal (20,966): *Seymour Limousines Ltd*

A sole trader was involved in a long-running dispute with HMRC (the first hearing was in 2002). The circumstances are not fully described in the present case, but it is apparent that HMRC pursued a number of demands for VAT and for security, and this appears to have had a detrimental effect on the trader's health; eventually all the demands were dropped, for no reason that the Tribunal chairman was aware of. The trader was awarded the costs that she had paid to a barrister and accountants to represent her, less an amount that she had to contribute to HMRC's wasted costs of a hearing which she failed to attend.

She then made a claim for nearly a quarter of a million pounds in respect of her own costs as a litigant in person, for the time spent during the periods when she was unrepresented. The Tribunal chairman examined the arguments in detail, and concluded that her contentions that it was now possible for a litigant in person to claim time costs in the VAT Tribunal was not correct. He dismissed the application.

HMRC had asked for costs of the current hearing if successful. The chairman said that he was minded not to make an award, partly because the point was an important one that was worthy of further legal consideration, and partly because of HMRC's unexplained withdrawal of the various decisions which had been the cause of the original dispute. He ruled that the parties could make further representations about the costs of the current hearing within the next 28 days if they wished.

VAT Tribunal (20,906): *Melina Serpes*

6.8.8 Out of time

A company was refused a repayment of £33m of input tax in a decision dated 29 November 2007. It lodged an appeal on 20 May 2008. HMRC resisted an application to be allowed to appeal out of time; the Tribunal made a number of directions to the trader and its representatives to produce documents and other information, but they did not. When finally a hearing was set for 6 January 2009 to consider the extension of time, the representative did not attend, pleading an attack of norovirus (but without a medical certificate).

The Tribunal saw no reason to extend time and dismissed the appeal.

VAT Tribunal (20,914): *Pan Euro Ventures Ltd*

6.9 Other administration issues

6.9.1 New inspection powers

Sch.36 FA 2008 introduced rules to bring the powers of HMRC to require information and to carry out inspections within the same statutory framework for income tax, corporation tax, capital gains tax and VAT. A Statutory Instrument has confirmed that the new rules come into force on 1 April 2009.

It remains to be seen how much practical difference this will make, in particular for VAT where HMRC’s powers in Sch.11 VATA 1994 were already more extensive than they were for the other taxes. There remain the rights of entry to premises where a business is carried on and inspection of goods and records, and the restriction on searching to situations in which a warrant has been applied for and granted.

SI 2009/404

HMRC have issued a press release commenting on the new rules. Acting Chairman Dave Hartnett is quoted as follows:

“This new approach to compliance checks will improve HMRC’s ability to ensure that the right tax is paid at the right time. We have consulted with taxpayers and their agents to make very sure that HMRC achieves the right balance between obtaining the information we need and appropriate use of our powers.”

More information about the new checks is available in several forms:

- a podcast can be download from the HMRC podcast pages at http://www.hmrc.gov.uk/podcasts;
- a narrative explanation, with links to a number of resources including the responses to the consultation, is given on the HMRC website at http://www.hmrc.gov.uk/about/new-compliance-checks.htm;
- questions and comments can be submitted by e-mail to compliance.checks@hmrc.gsi.gov.uk.

HMRC Press Release 3 March 2009

6.9.2 Farewell to Sheldon

HMRC have announced the withdrawal of ESC 3.5 *Misdirection* with effect from 1 April 2009. They believe that it is no longer relevant as it has been replaced by other statements which confirm when taxpayers are entitled to rely on assurances from HMRC officers (found on the website at www.hmrc.gov.uk/pdfs/info-hmrc.htm). The main provisions of the current statement echo those of the old concession:

There may be a small number of cases where we provide information or advice that is incorrect in law. Where this happens, we will be bound by such advice provided that it is clear, unequivocal and explicit and you can demonstrate that:

- *you reasonably relied on the advice*
- *where appropriate, you made full disclosure of all the relevant facts*
- *the application of the statute would result in your financial detriment*

Where this is the case, to apply the statute may be so unfair that it could amount to an abuse of power. But, where we have given incorrect information or advice, our primary duty will always remain to collect the correct amount of tax as required by the law and therefore there will be some circumstances where we will not be bound by the advice we have given.

Where we provide you with erroneous advice that is binding on us and subsequently notify you that it is incorrect, the established legal position is that you will only be required to start accounting for tax on the correct basis from the date of notification. All cases will be subject to any statutory time limits.

Misunderstanding

There may be certain circumstances where you have misunderstood the law and applied the wrong tax treatment when carrying out a transaction or providing information or payment to HMRC. In these circumstances, the wrong amount of tax has been collected. As HMRC has a duty to collect the correct amount of tax as required by law, the situation must be rectified for the past and for the future in order to ensure that the law is applied correctly. However, in rectifying the situation, HMRC will be bound by considerations of public law for example to treat taxpayers fairly.

R & C Brief 15/09

6.9.3 Investigation procedures

HMRC have issued a new Notice explaining how enquiries into serious indirect tax fraud will be handled. The procedures relate to suspected missing trader or carousel fraud where HMRC have reason to believe that the person under investigation has acted dishonestly.

Notice 161

6.9.4 New compliance checks

HMRC have issued Frequently Asked Questions on the new compliance check procedures which came into effect on 1 April 2009. They cover:

- General
- Exercise of powers
- Authorisations
- Information powers
- Inspection powers
- Time limits
- Record keeping

www.hmrc.gov.uk/compliance/faqs.html

HMRC have also launched a new e-learning package to help agents and others to understand the new rules. It can be accessed from the HMRC website. These new administrative rules will be considered in more detail in the next quarterly update.

www.hmrc.gov.uk/e-learning/compliance-checks/Externalmodule/HTML/Externalmodule_menu.html

There are separate e-learning packages about the new information and inspection powers.

www.hmrc.gov.uk/e-learning/Compliance_Checks_External/Information_power_ex/HTML/Information_power_ex_menu.html

www.hmrc.gov.uk/e-learning/Compliance_Checks_External/Inspection_powers_ex/HTML/Inspection_powers_ex_menu.html

6.9.5 All change for compliance

1 April 2009 has been set as the appointed day for the following provision to take effect:

- FA 2008 Sch.37 (new record-keeping requirements); *SI 2009/402*
- FA 2008 Sch.39 (new time limits for assessments and claims – although some provisions are deferred until 1 April 2010); *SI 2009/403*
- FA 2008 Sch.36 (powers of HMRC officers to call for information and carry out inspections); *SI 2009/404*
- FA 2008 Sch.40 (changes to penalties for incorrect returns). *SI 2009/571*

Some of these provisions are examined elsewhere in this update, and some will be examined in more detail in the next update when there will be more opportunity to assess the changes.

1 April 2010 has been set as the appointed day for the following provision to take effect:

- FA 2008 Sch.41 (single penalty regime for failing to notify chargeability to tax or to register for tax, or issuing an unauthorised VAT invoice). *SI 2009/511*

This repeals s.60, s.61 and s.67(1)(b) VATA 1994 only to the extent that the penalties there relate to dishonesty which is now penalised under Sch.41 FA 2008.

There have been numerous complaints that the changes to all the compliance procedures have been rushed through too quickly, particularly as they all take place at once: many people suspect that HMRC will find it difficult to cope with the new rules, and taxpayers and advisers will as well. There are articles by Neil Warren in *Tax Adviser* on the new penalties (February 2009) and the new rules for VAT visits (March 2009).

6.9.6 New online help

HMRC have launched a new series of short online videos which provide useful information for new and small businesses on a range of tax issues.

http://www.businesslink.gov.uk/taxhelp; HMRC Press Release 23 February 2009

HMRC have also updated their online guidance on civil penalties to reflect the decision in *Greengate Furniture Ltd* (18,280). This confirmed that, while a lack of a power to mitigate default surcharges was regrettable, it did not contravene European law.

http://www.businesslink.gov.uk/taxhelp; HMRC Press Release 23 February 2009

6.9.7 Security

As usual, there have been a number of traders who have appealed against notices of requirement to deposit security, and as usual, none of them have succeeded in persuading the Tribunal that HMRC have acted unreasonably in issuing the notice. There seems to have been a rise in the number of cases going to the Tribunal, which may reflect the economic difficulties of the country in general.

The only benefit of appealing is to defer the moment at which security must be deposited, because HMRC generously regard the appeal as suspending the requirement. In each case HMRC could show either current non-compliance that showed a revenue risk, or non-compliance by associated and predecessor businesses. The argument that "if we deposit security we will have to go out of business" only serves to prove that the requirement is reasonable from HMRC's point of view – if the business is that precarious, it represents a clear revenue risk.

VAT Tribunal (20,913): *Kent Cabling Contractors Ltd*; (20,908): *J & W Waste Services Ltd*; (20,944): *Christopher John Wraith*; (20,925): *Economy Car Group Ltd*; (20,943): *LED Screen Hire Europe Ltd*; (20,953): *Vanquip Ltd*; (20,955): *Construction Solutions (Southern) Ltd*; (20,968): *Stephens Joinery Ltd*; (20,965): *Mark William Mummery*; (20,967): *Isajen Ltd*; (20,958): *Edward Thomas t/a Abacus Construction*; (20,961): *Elizabeth Rodgers Resourcing Ltd*

6.9.8 Online guidance

HMRC have added the *Joint and Several Liability* to their VAT series of online guidance manuals. It covers the rules which were introduced to tackle missing trader fraud.

www.hmrc.gov.uk/manuals/jslmanual/JSL1000.htm

HMRC have also added the *Compliance Handbook* to the online guidance manuals. This has been updated for the new compliance checks introduced by FA 2008 Sch.36 and covered elsewhere in this update.

www.hmrc.gov.uk/manuals/chmanual/CH10000.htm

HMRC have amended their guidance in the *Debt Management and Banking Manual* in relation to direct debit, CTD, tax credits, foreign cases, enforcement action, transfers to EIS (selection criteria), revenue losses (automatic remission) and time to pay.

www.hmrc.gov.uk/manuals/dmbmanual/Index.htm