VAT UPDATE
JULY 2009

Covering material from April – June 2009

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

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

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

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

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

Awaiting the ECJ:

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

- *EMI Group plc*: whether the UK's rules on business gifts are in accordance with EU law (referred by the UK Tribunal)
- *Future Health Technologies Ltd*: whether the supply of services relating to the processing and storage of stem cells qualifies for exemption as "healthcare" (questions for reference covered in this update)
- *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)
- *Weald Leasing Ltd*: artificial leasing arrangements and abuse of rights (Court of Appeal has referred questions to the ECJ in HMRC's appeal against the High Court decision)

UK appeals awaiting hearing:

- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of ECJ's ruling on how "risk of distortion of competition" is to be applied
- *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).
- *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:

- *The Rank Group plc*: whether mechanised cash bingo and gaming machines are exempt (HMRC lost in the High Court, although there are also further matters to be heard by the Tribunal)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Scope of tax on public authorities

German law only allows the option to tax land and buildings where the supply is made to a business. A German company constructed a building and leased it to a body governed by public law, which used some of it for its own purposes and some of it for sub-letting to traders. The tax authorities refused to accept an option to tax in respect of both the head-lease and the sub-letting. The company appealed, and questions were referred to the ECJ.

The ECJ ruled in favour of the company, holding that the German tax authorities' interpretation of their own law was not in accordance with the Directive. Treating the main lessee (a Chamber of Commerce) as "not in business" in respect of all its activities would require an explicit provision of German law: "*Member States must lay down an express provision in order to be able to rely on the option provided for in the fourth subparagraph of Article 4(5) ... according to which specific activities of bodies governed by public law that are exempt under Article 13 or Article 28 of that directive are considered as activities of public authorities.*" As there was no such explicit provision, the German authorities could not rely on the Directive itself to render the body a "non-business".

The ECJ also held that the second subparagraph of art.4(5) 6th Directive "*must be interpreted as meaning that bodies governed by public law are to be considered taxable persons in respect of activities or transactions in which they engage as public authorities not only where their treatment as non-taxable persons under the first or fourth subparagraphs of that provision would lead to significant distortions of competition to the detriment of their private competitors, but also where it would lead to such distortions to their own detriment*". Treating the whole of the head-lease and the sub-letting as exempt without the option would cause a distortion of competition, because it would prevent input tax deduction where there was no overriding reason or need for it. The direct disadvantage of treating the lessee as outside the scope fell on it, but this would indirectly cause a distortion of competition for the property company as well. It followed that the public body should be treated as taxable in these circumstances.

ECJ (Case C-102/08): *Finanzamt Düsseldorf-Süd v SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG*

2.1.2 Isle of Wight Council: correction

The ECJ has issued a correction to the judgment in the Isle of Wight Council case. It originally said:

Article 4(5) 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 is to be interpreted as meaning that the significant distortions of competition, to which the treatment as non-taxable persons of bodies governed by private law acting as public authorities would lead, must be evaluated by reference to the activity in question, as such, without such evaluation relating to any local market in particular.

We now know that it should have said:

The second subparagraph of Article 4(5) 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 is to be interpreted as meaning that the significant distortions of competition, to which the treatment as non-taxable persons of bodies governed by public law acting as public authorities would lead, must be evaluated by reference to the activity in question, as such, without such evaluation relating to any local market in particular.

It seems that the correction is only concerned to specify which part of Article 4(5) was under consideration.

ECJ (Order) (Case C-288/07): *HMRC v Isle of Wight Council, Mid-Suffolk District Council, South Tyneside Metropolitan Borough Council, West Berkshire District Council*

2.1.3 Public bodies study

Meanwhile, the Commission has begun a detailed examination of the VAT rules applicable to public bodies, in order to determine whether the Directive needs to be changed. The first step is an open invitation to tender to carry out the study. Detailed specifications for the study can be found on the internet. Other related documents include the invitation letter and five annexes.

http://ec.europa.eu/taxation_customs/resources/documents/common/tenders_grants/tenders/AO-2009-03/Tech_specs_en.pdf

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Transfer of reinsurance contracts

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

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

The opinion also proposed that the transaction should not be regarded as an insurance transaction within Article 9(2)(e) 5th indent, so the place of supply would not shift to where the customer belonged.

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

2.3.2 Comparison websites

In late 2007 and 2008, the Tribunal came to apparently contradictory conclusions about the VAT liability of commissions earned by insurance comparison websites. The two cases were *Insurancewide.com Services Ltd* (20,394) (held not to be exempt as an insurance intermediary service) and *Trader Media Group Ltd* (20,671) (held to be exempt). Following the first case, HMRC commented on the scope of the exemption in R&C Brief 69/07: they believed that a comparison website was merely an introducer and was not acting as an insurance intermediary.

The High Court has now heard appeals by the taxpayer in the first case and HMRC in the second, taking the two cases together as they were clearly related. The judgment covers the preliminary issue of whether it is possible for the type of supplies made by a comparison website to constitute insurance intermediary services. The judge ruled that it was possible, but there is the possibility of a further hearing on the application of that principle.

The principal points of law on each side for the court to consider were:

- for the traders, whether the act of introduction was sufficient to:
  1. render a trader, an insurance agent and/or insurance broker and/or intermediary within the meaning of either art 13B of the Directive and/or Sch.9 Group 2 Item 4 VATA 1994; and
  2. to constitute one or more of the services described in Sch.9 Group2 Note1.
- for HMRC, whether:
  1. what the taxpayers were doing in maintaining a website through which customers could access insurers amounted only to advertising specifically excluded from exemption by Note 7(a) of Item 4 Sch.9 VATA 1994; and
  2. that a mere introducer did not have the necessary relationship with both the customer and the insurer so as to constitute itself an intermediary.

The judge considered the difference between introduction, which related to a specific potential customer, and advertising, which disseminated information to potential customers in general. He ruled that "it is not necessary [for exemption to apply] for the introducer to have a direct relationship with both customer and insurer as long as he is part of a chain of introduction communicating between customer and insurer".

Insurancewide appeared to lose before the Tribunal largely because the website stated that the company was not an insurance agent (probably for regulatory reasons, and only for a specific period). The judge commented that whether or not an individual seeking exemption was entitled to it depended upon what that individual was actually doing and not how he might describe himself or be described.

It therefore appears that the traders won this stage of the appeal and HMRC lost, although it is not clear whether HMRC will now agree to concede or whether they will come back with further arguments.

High Court: *Insurancewide.com Services Ltd v HMRC; Trader Media Group Ltd v HMRC*

2.3.3 Fee, not insurance

A company acted as an insurance intermediary, packaging products for homeowners who took out insurance against various home emergencies. The company charged an administration fee to the insured under a contract which was separate from the contract of insurance between the insured and the insurance company. In effect, the contracts established that the normal situation – in which the insurer pays the intermediary a commission for arranging the insurance – did not apply, and instead the insured paid for the arrangement.

HMRC ruled that the "normal arrangement" was the reality here, and the amount paid to the intermediary was liable to insurance premium tax. The VAT and Duties Tribunal upheld this decision, but the High Court has overturned it. FA 1994 s.72(1A)(b) provided conditions for such an arrangement to escape a charge to IPT, and the Tribunal had erred in finding that those conditions were not met. A "separate" contract meant no more than a legally distinct one: it did not have to be completely disassociated from the contract of insurance.

High Court: *Homeserve Membership Limited v HMRC*

2.3.4 Public postal services

The ECJ has confirmed the Advocate-General's opinion in the case about the extent of the exemption for the "public postal services".

The Post Office Company is "the public postal services" in the UK because it is subject to a substantially different legal regime from that which applies to operators such as the applicant, TNT Post. Its universal service obligation is in the public interest and it is justifiable that it should enjoy an exemption when other providers do not.

However, the exemption does not apply to every service supplied by the Post Office company. Services which are 'provided on individually negotiated terms' and which are 'not subject to the requirements of the universal service' should not qualify for exemption.

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

2.3.5 Rank keep winning

The UK VAT law drew a distinction between:

- games of bingo played under s.14 and s.21 of the Gaming Act;
- slot machines where the element of chance was provided by the machine itself, or provided in some other way.

The games were in practice indistinguishable from each other. The taxpayer argued that treating one game as exempt and another identical game as taxable infringed the principal of fiscal neutrality as set out in the ECJ's decision in *Linneweber*. The Tribunal agreed, and HMRC appealed to the High Court.

The core issue in the bingo appeal was whether the taxpayer had the burden of proving not only that there had been a difference in VAT treatment between similar (and apparently competing) products but also that that difference affected competition. The judge ruled that the Tribunal had considered the correct legal tests and had come to the right decision. The question of competition had to be considered in the context of the services concerned, not the suppliers of those services, and in relation to a notional national market, not an actual local one. It was for HMRC to show that a distinction in VAT treatment was justified, not for the trader to prove that there was no possible difference between the two supplies or that consumers were affected.

The core issues in the slot machines appeal were:

- whether there was in law a difference in treatment between similar supplies (which involved a consideration of the meaning of the word "'machine" in the phrase "the element of chance in the game is provided by the machine");
- if not, whether the evidence established that there was in practice (if not in law) a difference in treatment; and
- if the above questions were answered affirmatively, then whether it was necessary for the taxpayer to establish, on the evidence, actual competition between similar supplies.

The judge again confirmed the Tribunal's decision. There was no legal definition of "machine" which compelled the Tribunal to conclude that any particular part of the operation was "the machine". The evidence before the Tribunal justified the conclusion that there were different "machines" which were treated differently for VAT, that the supplies were identical, and that there was no justification for a difference in VAT treatment.

High Court: *HMRC v The Rank Group plc*

2.3.6 Gaming exemption

The Budget has extended the exemptions for bingo and gaming with effect from 27 April 2009. There will be no VAT on participation fees for playing bingo and other games of chance (fees that a gaming operator makes to customers for participating in gaming). There are related changes to the rules on prize money, and an increase in the rates of bingo duty and gaming duty.

BN73

2.3.7 Revised Notice

HMRC have reissued their Notice on *Finance* following the change of rules for the VAT exemption to the management of Special Investment Funds on 1 October 2008.

Notice 701/49

2.3.8 Cosmetic not healthcare

A trader ran a health and beauty clinic. She claimed that the permanent removal of unwanted hair by the application of intense pulse light (IPL) treatments was exempt from VAT under item 4 group 7 Sch.9 VATA 1994. HMRC disagreed, and the Tribunal upheld the assessment.

The exemption applies to "The provision of care or medical or surgical treatment and in connection with it, the supply of any goods, in any hospital or state regulated institution". HMRC accepted that the clinic was a "state regulated institution" because it was registered as a private clinic with the Healthcare Commission. The Tribunal accepted that the IPL treatment did not constitute "medical care or treatment".

The trader also claimed that this infringed fiscal neutrality because a doctor would be able to provide the same treatment within the exemption. The Tribunal disagreed: a doctor would only enjoy the exemption for IPL if it formed part of a course of care or treatment, and would not do so in circumstances that were similar to those of the supplies made by the clinic.

The trader argued that she was treating excessive hair growth which arose from medical conditions. She denied that she did it for cosmetic reasons. However, her patients were not referred to her by doctors, and there was no evidence to support her assertion that the treatment was in the medical interests of the patients. Similarly, her assertions that doctors were able to provide similar treatments without charging VAT were unsupported by convincing evidence.

First Tier Tribunal (TC0055): *Joan Burke*

2.3.9 Stem cells

The Tribunal has referred the following questions to the ECJ in the Future Health Technologies case about stem cell processing and storage:

1. In circumstances where a Member State accepts that services are carried out by an establishment falling to be treated as a duly recognised establishment of a similar nature to a hospital or a centre for medical treatment or diagnosis within Article 132.1(b) of the Principal VAT Directive, is the expression “hospital and medical care” in Article 132.1(b) to be interpreted as including the aggregate of or, alternatively, one or more of (and if so which) services of the following descriptions (as more fully described in the Agreed Statement of Facts):

   (a) The provision to the parents of an unborn child of a kit of the necessary medical equipment to enable an independent medical professional attending the birth to collect blood from the umbilical cord of the child shortly after birth;

   (b) The testing of the blood thereby collected at a purpose-built facility for the purpose of ensuring that it is not contaminated with any medical condition that could be transmitted via the blood or via an extract of stem cells from the blood in the event of the therapeutic use of the stem cells (with similar testing occurring again after 6 months)

   (c) The processing of the said blood by and under the supervision of suitably-qualified medical professionals to extract a sample of stem cells suitable for therapeutic medical use;

   (d) The storing of the blood and stem cells in scientifically controlled conditions designed to maintain and preserve the blood and stem cells in perfect condition; and/or

   (e) The releasing of the blood on request of the parents (until the child is 18 years old) for use in medical treatment?

2. Alternatively, should the concept of activities that are “closely related” to hospital and medical care in Article 132.1(b) of the Principal VAT Directive be interpreted so as to include all or any (and if so which) of the above services?

3. In circumstances where a Member State accepts that the said services are carried out by or under the supervision of one or more suitably-qualified medical professionals, is the expression “the provision of medical care” in Article 132.1(c) of the Principal VAT Directive to be interpreted as including the aggregate of or, alternatively, one or more of (and if so which) services of the following descriptions (as more fully described in the Agreed Statement of Facts):

   (f) The provision to the parents of an unborn child of a kit of the necessary medical equipment to enable an independent medical professional attending the birth to collect blood from the umbilical cord of the child shortly after birth;

(g) The testing of the blood thereby collected at a purpose-built facility for the purpose of ensuring that it is not contaminated with any medical condition that could be transmitted via the blood or via an extract of stem cells from the blood in the event of the therapeutic use of the stem cells (with similar testing occurring again after 6 months)

(h) The processing of the said blood by and under the supervision of suitably-qualified medical professionals to extract a sample of stem cells suitable for therapeutic medical use;

(i) The storing of the blood and stem cells in scientifically controlled conditions designed to maintain and preserve the blood and stem cells in perfect condition; and/or

(j) The releasing of the blood on request of the parents (until the child is 18 years old) for use in medical treatment?

ECJ (reference) (Case C-86/09): *Future Health Technologies Ltd v HMRC*

2.3.10 Not an eligible body

A students' union claimed that it should be treated as an "eligible body" under note 2 group 13 Sch.13 VATA 1994 and therefore able to exempt admission charges for entertainments. It would have to meet the following three conditions to qualify:

- precluded from distributing, and does not distribute any profit it makes;
- applies any profits made from supplies of a description falling within item 2 to the continuance or improvement of the facilities made available by means of the supplies; and
- managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities.

The Tribunal examined its constitution and activities and decided that it met the first two conditions. It had a turnover of about £2m, but made a surplus of only a few thousand pounds that was applied to the costs of services provided to members.

However, the management decisions were taken by five sabbatical officers elected by the student body. They were paid salaries of a little over £15,000. Although these salaries were not profit-related and were not excessive, they nevertheless were more than a nominal amount and meant that the management was not provided on a voluntary basis.

First Tier Tribunal (TC0082): *Keele University Students Union*

2.3.11 Investment gold coins

HMRC have published an updated (June 2009) version of Notice 701/21A, which cancels and replaces the Februrary 2007 version. It provides revised lists of investment gold coins whose supply is exempt from VAT. The lists are valid for the year 2009.

Notice 701/21A

2.4 Zero-rating

2.4.1 Pringles

Most "potato products" are standard rated as exceptions to Group 1 of Schedule 8. Pringles crisps have traditionally been so treated. In Tribunal 18,381, the manufacturers argued that a new, thicker "dipping Pringle" which was only 36% made of potato should be zero-rated like tortilla chips, rather than standard rated like crisps.

Customs argued that they were too similar to the existing crisps to be treated differently. However, the Tribunal agreed with the taxpayer. The implication of the legislation was that potatoes had to be the majority ingredient, perhaps the overwhelming majority. The new product was at least as similar to a tortilla chip as it was to a potato crisp.

However, another Tribunal came to a different decision on "regular Pringles". These are made of a number of different types of flour (including rice flour, corn flour and wheat starch) together with fat and emulsifier. The potato content varies, but is likely to be around 42%. The company argued that the earlier decision, together with the fact that Pringles are not similar to crisps and are not called or marketed as crisps, meant that they should be zero-rated as well.

The definition of the excepted item is "*potato crisps, potato sticks, potato puffs and similar products made from the potato or from potato flour, or from potato starch*". The Tribunal chairman said that this created two separate tests: the item had to be a "similar product" to those listed, and it had to be made from potatoes. Tortilla chips might be quite similar to crisps, but they were not made of potatoes; there were also potato-based products that were not similar to crisps, and they also would not be excepted.

The Tribunal examined the background to the legislation in detail. It acknowledged that there is no logical basis for it now: it pre-dates VAT, having been introduced in 1969 to levy purchase tax on foodstuffs which were more likely to be bought at a confectioner's than at a grocer's. The market for such products has developed beyond recognition since then, but the law has stayed the same – taxing potato snacks, popcorn and peanuts, but leaving untaxed many other competing products. Given that the law was no longer logical, it was not particularly helpful to try to discern or apply the purpose of Parliament in passing it.

After considerable thought, the chairman decided that "made from potato flour" applied to a product whose largest single ingredient was potato flour; Pringles might be different from other crisps, but they were nevertheless similar to potato crisps. They therefore satisfied both parts of the exception. The appeal was dismissed.

The High Court judge allowed the company's appeal. The two limbs of the excepted item were not wholly separate but rather should be read together. The items which were "similar" in the second part of the test should be as much made from potato as those in the first part. A potato stick made from pure potato would have some other products in it, such as residual oils, but it would be predominantly potato. A stick made of potato flour would correspond to that; a stick made of flour that was half potato and half something else would not. On the basis of the Tribunal's

findings of fact about the constituents of Pringles, they were not "made of potato flour" within the meaning of the statute.

The Court of Appeal has unanimously overturned this decision and restored the Tribunal's ruling. The question "did not call for or justify over-elaborate, almost mind-numbing legal analysis, but rather it was a short practical question calling for a short practical answer." Mummery LJ observed that "the 'made from' question would probably be answered in a more relevant and sensible way by a child consumer of crisps than by a food scientist or a culinary pedant". Accordingly Pringles were excluded from zero-rating. Toulson LJ commented that there was no requirement that the products should be made wholly, or substantially wholly, from potato or potato derivative; and Parliament had not specified a minimum percentage for potato content.

Court of Appeal: *Procter & Gamble (UK) v HMRC*

HMRC have issued a Brief reminding traders to correct their VAT accounts if they stopped charging output tax on Pringles after the High Court's decision. This can be done without a voluntary disclosure if the figures are small enough (less than £10,000 or less than £50,000 and 1% of the Box 6 turnover), but will have to be separately disclosed if higher than these limits.

R&C Brief 32/09

2.4.2 Direct needs of lifeboats

Art.148 VAT Directive provides for exemption with credit (zero-rating) for supplies which meet "the direct needs" of vessels used for rescue at sea. A dispute arose between RNLI and HMRC about costs of alterations or repair and maintenance services for lifeboat stations and other equipment. HMRC regarded these as too indirectly connected to the vessels themselves, and therefore subject to VAT.

The chairman commented on the principle that exemptions must be narrowly construed, and interpreted it as follows: "It seems to us that the principle of strict interpretation may be put thus: where the words admit more than one possible interpretation, that meaning should be adopted which provides the narrowest possible exemption which is consistent with the context (which may include the degree of detail of the words used to specify the exemptions) and purpose of the exemption."

The Tribunal considered a large number of ECJ precedents, and tried to address three questions:

(i) What is a need?

(ii) What is a direct need?

(iii) When is a need met?

Only supplies which met the direct operational needs of the boat would qualify for the exemption. These included dredging of a channel which was necessary for the boat to reach the water and also maintenance of a slipway, winches and hoists that enabled the speedy launching of the boat. Other costs were not directly linked to operation, and would be standard rated.

The Tribunal adjourned, expressing the hope that its decisions in principle would enable the parties to resolve their dispute about which particular costs were covered by the exemption.

First Tier Tribunal (TC0017): *Royal National Lifeboat Institution*

2.4.3 Aircraft

The Commission has sent a reasoned opinion to the UK to ask for a change to the legislation which gives relief for expenditure on aircraft. The Directive requires exemption for expenditure on aircraft which are "used by an airline operating for reward chiefly on international routes". In Case C-382/02 the ECJ ruled that the exemptions apply even for an aircraft operating on domestic routes, as long as it is used by such an airline.

However, the UK applies the exemptions according to different criteria, those of the weight of the aircraft and of its design. Any aircraft under 8,000kg is not exempted even where it is used by an airline meeting the relevant conditions. Conversely, aircraft of a weight over 8,000kg and not designed nor adapted for private pleasure flying is exempted, and that even where the aircraft is not used by an airline operating for reward chiefly on international routes.

The UK has been asked to revise its rules to comply with the Directive.

IP/09/1016

2.5 Lower rate

2.5.1 Children's car seat bases

Children's car seats have been eligible for the 5% VAT rate since May 2001. From 1 July 2009, this is extended to children's car seat bases, including the combination of a safety seat and a related wheeled framework, booster seats and booster cushions.

BN68; SI 2009/1359

2.6 Computational matters

2.6.1 Changing the standard rate

The Budget has confirmed that the standard rate will revert to 17.5% on 1 January 2010.

A new power is to be included in the law to allow for the standard rate to be varied by secondary legislation for periods of less than 12 months. The existing s.2 VATA 1994 allows for the standard rate to be varied by order for periods of exactly 12 months.

BN71

The Budget also confirmed the details of the anti-forestalling legislation that had previously been announced. Draft legislation has been published. The main features are as follows:

Where the legislation applies, there will be a supplementary output tax charge at 2.5%. This will restore the difference between the 15% that was charged by artificially advancing the tax point, and the 17.5% that "ought to be charged".

The legislation prevents forestalling by introducing a supplementary charge to VAT on the supply of goods or services (or the grant of the right to receive goods or services) where the customer cannot recover all the VAT on the supply and one of the following conditions is met:

- the supplier and customer are connected parties; or
- the supplier funds the purchase of the goods or services (or grant of right); or
- a VAT invoice is issued by the supplier where payment is not due for at least six months.

These provisions have effect on and after 25 November 2008.

A supplementary charge will also apply where a pre-payment of in excess of £100,000 is made before the rate rise in respect of goods or services (or in relation to the grant of the right to receive goods or services) to be provided on or after the date of the rate rise. However, it will not apply if the prepayment is in accordance with normal commercial practice in relation to such supplies when no VAT rate increase is expected.

This provision has effect on and after 31 March 2009.

BN72

The Financial Secretary to the Treasury has confirmed that pubs and clubs which are open after midnight on 31 December 2009 will be allowed a few hours' grace to continue charging 15% VAT rather than having to put the rate up at midnight.

www.parliamentonline.co.uk/hansard/hocw/90515w0021.htm

2.6.2 Retail scheme notices

HMRC have issued revised and updated versions of the retail scheme notices:

- Notice 727 Retail schemes
- Notice 727/2 Bespoke retail schemes
- Notice 727/3 How to work the Point of Sale scheme
- Notice 727/4 How to work the Apportionment schemes
- Notice 727/5 How to work the Direct Calculation schemes

Notice 727/2 explains that the legal basis for bespoke schemes are regs.66-75 SI 1995/2518. The notice explains how we will approach bespoke retail scheme agreements but is not in itself tertiary legislation under the regulations.

The significant current change to Notice 727/2 is the increase from £100m to £130m in the threshold for a bespoke scheme to be required.

Parts of the other notices have the force of law. There have been improvements in readability, but apart from incorporating the increase in the upper level at which a standard scheme can be used from the notices without entering a special arrangement with HMRC, the details have not changed from the 1997 versions.

www.hmrc.gov.uk

2.7 Discounts, rebates and gifts

2.7.1 Vouchers for future treatments

A company ran two spas. When customers bought a treatment, they received a voucher which entitled them to £15 off their next purchase. The company treated these as face-value vouchers and did not account for output tax on the £15 allocated to the sale of the vouchers. HMRC argued that there was a single supply of the treatment for a single consideration, and the voucher was simply an entitlement to a discount.

Not surprisingly, the Tribunal agreed with HMRC. Only 5% of the vouchers were redeemed, and there was nothing to distinguish this case from a number of precedents including *Boots* in the ECJ and *Tesco* in the UK Court of Appeal. Customers were not given a choice between buying the voucher or not doing so: it was not the subject of a separate contract on the first sale.

HMRC applied for, and were awarded, costs of the appeal.

VAT Tribunal (20,979): *Spa & Resort Operations Ltd*

2.8 Compound and multiple

2.8.1 Incidental to insurance

A company supplied car buyers with a chemical treatment which was supposed to preserve the paintwork and interior of the car in an "as new" condition. The treatment was marketed by the selling garage which also applied the treatments initially. The product was backed by an insurance policy held by the company: if the protection failed, after the customer had met various conditions, the company would claim under its own policy and pay for rectification.

It was agreed that the basic supply by the company was exempt as an insurance-related product. The dispute arose because the customers were required to use various chemical treatments to keep their insurance valid, and the first few bottles of those were provided as a "free gift" when they took out the policy. The company argued that it could recover the input tax on the cost of these chemicals because they were a separate supply.

The Tribunal held that the chemicals were ancillary to the insurance supply and would therefore be wholly attributable to exempt business. Even if they were a separate supply, it did not follow that the input tax was recoverable: it would fall to be apportioned under the partial exemption method in force, with the result that it would almost certainly be wholly irrecoverable.

The Tribunal chairman commented that it was difficult to establish the basic facts of the case – the various contractual relationships between the company, the garages, the customer and the supplier of the chemicals were not clear. He offered the appellant the opportunity to ask for a further hearing if the decision appeared to conflict with the facts.

He also noted that the company had later changed its business model and no longer sold an insurance-backed product – it now supplied the chemicals themselves as a routine standard-rated supply of goods. Apparently this was related to the discovery that the insurance-backed product would attract the higher rate of IPT. The chairman commented that it was peculiar that the company changed its name to include the word "insured" four months after it ceased to sell an insurance-related product.

First Tier Tribunal (TC0065): *Insured Vehicle Coatings Ltd*

2.9 *Agency*

2.9.1 Staff hire

A company supplied staff to a bank in respect of IT outsourcing. HMRC assessed for output tax on the full amount paid by the bank, but the company and the bank argued that the staff hire concession should apply. As HMRC refused to accept this, they applied for judicial review (no appeal can be made to the Tribunal about a concession).

The judge held that HMRC's refusal was reasonable and dismissed the application. The terms of the concession required that the staff should be under the control of the client, and the supplier should be an employment business within the meaning of s.13 Employment Agencies Act 1973. Neither condition was satisfied in respect of this IT outsourcing arrangement. On the evidence, the arrangements between the company and the bank were "a considerable distance from any situation likely to be regarded as deserving to benefit from the policy underlying the concession". The company "retained predominant control over its employees", and HMRC had been entitled to conclude that its supplies did not fall within the scope of the concession.

The judge commented that there was a "need for HMRC to avoid departing too far from the requirements of EU law on VAT, according to which VAT should be charged on the full amount of consideration in relation to the supply of staff, since departure from those requirements would tend to undermine the need for equal application of EU law throughout the EU Member States and could give rise to difficulties with the EU Commission". This offers support to HMRC's arguments which led to the abolition of the staff hire concession on 1 April 2009.

High Court: *Accenture Services Ltd v HMRC (and related applications)*

2.9.2 Changes to TOMS

HMRC have announced that certain aspects of TOMS were not implemented properly in accordance with EU law, so changes will be made to take effect from 1 January 2010. This is in order to comply with representations made to the UK by the Commission.

The three changes required are as follows:

- ending the concession which allowed TOMS operators who make occasional sales to businesses for onward sale to account for those supplies within TOMS rather than applying the normal rules of VAT. This was intended to simplify the accounting arrangements for the trader, but it is not in accordance with EU law, which only allows TOMS to be applied to supplies to "the traveller".

- ending the treatment which allows TOMS operators to "opt out" of TOMS for supplies to businesses for their own consumption, and to local authorities in relation to school trips. Taking these supplies out of TOMS has allowed the customers to reclaim the VAT charged. The Commission has pointed out that the "traveller" in this case is the customer, whether a business or corporate entity, and the supply falls within TOMS. This means that these customers will no longer be able to recover the VAT element from 1 January 2010.

- incorporating tertiary legislation to reflect the 2005 decision of the ECJ in MyTravel (C-291/03) on the use of market values to apportion package prices. At present the legislation still refers only to the use of a cost-based apportionment, although presumably HMRC will accept a values-based apportionment on a case by case basis.

Details of the market values rules are included in draft form as an appendix to the Brief.

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2.10 Second hand goods

2.10.1 Withdrawal of concession

Following the *Wilkinson* decision in the House of Lords, HMRC are reviewing the status of all their extra-statutory concessions and withdrawing or enacting them as they consider appropriate. One of the latest to come under review is ESC 3.08 *VAT: use of margin scheme for vehicle sales when incomplete records have been kept*.

HMRC explain the background to the concession and the change as follows:

The current concessionary arrangement which allows dealers in second-hand vehicles to account for VAT on either the purchase price, or half the selling price, of a vehicle for which they do not hold all the necessary margin scheme records will be withdrawn with effect from 1 April 2010.

This concession affects dealers in second-hand motor vehicles who fail to meet the record-keeping requirements of the VAT margin scheme for second-hand goods, works of art, antiques and collectors' items. It was introduced in January 1995 when the margin scheme was implemented across the EU under the EC 7th Directive. The treatment the concession allows had previously formed part of the provisions of the UK's margin scheme for cars.

Under Article 315 of the 2006 VAT Directive, the taxable amount in a margin scheme supply is the profit margin, and that profit margin is the difference between the selling price and the purchase price. The effect of this concession is to allow VAT to be calculated on either the purchase records alone or on the sales records alone.

The concession does not ensure that VAT is charged on the actual profit margin obtained by the dealer. Further, it provides an advantage to the motor trade sector which is not available for any other types of second-hand goods. The concession has no basis in UK or EU VAT law and must therefore be withdrawn.

Accordingly, where dealers in second-hand motor vehicles fail to retain evidence of both the purchase and selling price of a particular vehicle in future, VAT will be due on the full selling price of that vehicle. This is the legal requirement when margin scheme records have not been kept.

HMRC Technical Note 23 April 2009

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Who makes the supply (1)?

An individual identified a piece of land as having development potential. Using his experience in such matters, he looked for people to join in a project to develop the land and sell it at a profit. In due course he entered into various agreements with a development company; he had by this stage incorporated a company of his own as a vehicle for his part in the arrangement. He regarded the money paid to his company as a partnership profit share, outside the scope of VAT; HMRC believed that it was a consultancy fee and issued a notice of compulsory registration on the company.

The Tribunal reviewed the evidence in detail and upheld the notice and the assessment. Although the trader appeared honestly to believe his version of events, the documentary evidence was against him. He thought that the paperwork drawn up by the development company did not reflect the true facts, but the Tribunal could not find any evidence to support the assertion that a partnership had ever existed between him or his company and the developer. If there was no partnership, the money received could only be consideration for services rendered.

First Tier Tribunal (TC0038): *Private & Confidential Ltd*

2.12.2 Who makes the supply (2)?

A woman ran a proprietary golf club which had originally been set up by her late husband. In 2001 she and her daughter, now principals in the business, followed the advice of a VAT consultant and set up two not-for-profit companies to supply exempt sporting services – one to members of the golf club and one to visitors.

HMRC investigated and concluded that the arrangements did not work. They were intended to circumvent the rules on “commercial influence”, even though the mother and daughter still extracted money from the two companies in the form of rent and management charges; the directors of the not-for-profit companies were supposed to be independent of the owners. The officer investigating issued alternative decisions: his preferred view was that the golfing supplies continued to be made by the partners throughout, and as an alternative he regarded the establishment of the structure as an abuse of rights.

The Tribunal considered the facts and also the recent case of *The Atrium Club*, which had certain overall features in common. The chairman concluded that the facts were very different. Here, the supplies continued to be made by the partners and not by the separate companies. There was no question of abuse of rights, because the scheme did not confer any rights.

It was significant that in *Atrium Club*, the sporting supplies had been made by one non-profit subsidiary in the 1990s, then another in the early 2000s, then a third from 2005 onwards. The argument was about whether the holding company or the middle company had made supplies. It strengthened the holding company's case that the business had been transferred to the middle company and from the middle company by other companies – it had not been carried on by the holding company either before or after. In the present case, the business was "transferred" from the partnership to the two new companies in 2001: it was easier for HMRC to argue successfully that the partnership continued to carry the business on and the "transfer" was not real.

The decision is interesting for a detailed examination of the question "who makes the supply?" and how that question should be answered. It is considered under the following headings:

- Who is the person assumed to be making the supply from the viewpoint of the customer?
- Who is the Person who sets the price (or is entitled to set the price) for the supply?
- Whose assets are used to make the supply?
- Is the scale of the Operation such that it is unlikely to be operated in the Manner contended?
- To whom are payments made?
- Who would the customer claim against in the event of a default?
- How is the arrangement regarded for direct tax purposes?
- What degree of control does one party hold over another?
- Who has authority to make changes to the terms of a contract?

Although some of these questions could be answered in a way that suggested that the companies made the supplies, the overall evidence was very strongly in favour of the partners continuing to do so.

First Tier Tribunal (TC0087): *Mrs Phillida Barnett and Mrs Lara Read t/a Burghill Valley Golf Club*

2.12.3 Phone cards

A retailer failed to account for VAT on sales of phone top-up cards. HMRC assessed for underpaid output tax of £43,289 covering the period from 1 May 2003 to 31 January 2005.

On appeal in 2008, the Tribunal first considered the argument that sale of the phone cards constituted an exempt supply of credit, and dismissed it. That left the argument that under the vouchers rules in Sch.10A VATA 1994 the sales should be disregarded. The Tribunal held that:

- some of the sales were "credit vouchers", on which VAT must be accounted for if the supplier of the service fails to account for output tax on redemption of the voucher;
- some of the sales were "retailer vouchers", on which VAT is generally due on supplies by intermediaries.

Given that the supplies were vouchers, there was then a further argument about the place of supply. The Tribunal held that the place of supply of a voucher was the same as the place of the eventual telecommunications service. As the customers buying phone cards would almost invariably be individuals rather than businesses, this would be:

- the UK, where the telecom supplier was based in the UK;
- the UK, where the telecom supplier was based outside the EU – under the "use and enjoyment rules", the place of supply would be shifted from the supplier's place of belonging to the place where the service was used and enjoyed, i.e. the UK;
- elsewhere in the EU, where the telecom supplier was based in the EU but not in the UK (supply of Sch.5 service to a non-taxable person in another member state – a "basic rule" supply).

The Tribunal analysed the effect of the rules as follows:

86. On this basis, Mr Arachchige's supply of phone cards will be a VATable supply in the UK:

(i) to the extent the cards are credit vouchers if:

(a) the supplier fails to account for VAT (here or elsewhere in the EU); and

(b) the supplier of the telecoms service belongs in the UK or outside the EU;

(ii) to the extent the cards are retail vouchers, if the supplier of the telecoms service belongs in the UK or outside the EU.

In either case a non-UK but EU supplier of the telecoms service will mean that the supply of the card is not VATable because it will not be a supply made in the UK.

To the extent that the vouchers were for supplies in the third category, the assessment to UK VAT should be reduced. To the extent that the vouchers were for the first or second category, the assessment was confirmed.

The High Court has now allowed HMRC's appeal against the Tribunal's conclusion on place of supply. The judge ruled that "avoidance of non-taxation" is a fundamental principle of the VAT Directive, and domestic legislation should be interpreted in accordance with that principle if that is possible. As the trader would clearly not account for output tax in any other member state, the conclusion that some of the supplies were not subject to UK tax would mean that the sales would not be taxed anywhere. It was possible to avoid this undesirable effect by making the place of supply the UK in all cases. The basic place of supply rule in s.7(10) put the trader's supplies in the UK, and it was not so clear that it was overridden by SI 1992/3121 that non-taxation was the inevitable result.

High Court: *HMRC v Arachchige*

2.12.4 Fuel scale rates

The fuel scale rates reduce very slightly for the first return period commencing on or after 1 May 2009. As before, the charges are linked to the CO_2 emissions rating of the car, but the progression is not mathematical and the exact figures have to be looked up in the full table. The rates will change again on 1 January 2010 when the standard rate of VAT reverts to 17.5%.

BN69; SI 2009/1030

2.12.5 Car scale rates

HMRC have issued a new edition of the simplified scale rates that have been agreed between the Department and trade bodies so that traders in the motor business do not have to carry out individual detailed calculations for private use of cars on which input tax is eligible for deduction (e.g. demonstrator vehicles in retailers). The new rates apply from 1 May 2009.

Information Sheet 07/09

2.12.6 Selling a business

There is an article by Neil Warren in *Taxation* (28 May 2009) discussing the VAT issues when a business is bought or sold.

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Composite and artificial

A company, L, owned a plot of land with planning permission to build 575 homes with the condition that they were not to be occupied as a principal place of residence. It entered into arrangements with customers and a related company, C, under which:

- L granted a long lease over a plot of land to the customer, standard rated because of note 11 group 1 Sch.9 VATA 1994 (land with a right to build holiday accommodation on it);
- C sold construction services to the customer, purported to be zero-rated as construction of a dwelling.

HMRC ruled that there was a pre-planned series of transactions which together comprised the sale of a holiday home, which ought to be standard rated. The true interpretation of the arrangements was either that L sold the completed holiday home (effectively subcontracting the cost of construction to C), or L and C together sold the completed holiday home and were liable for output tax on their proportion of the consideration paid. As an alternative argument, the arrangement was abusive within the *Halifax* principle (being similar also to the case of *Part Service* C-425/06).

In respect of the main argument, the Tribunal held that it was not possible for supplies by two different companies to be treated as a single composite supply, nor as a joint supply of a holiday home by the two companies together. The decision of the Court of Appeal in *Telewest* was followed.

The company argued that *Halifax* should not apply because there were various commercial advantages to the arrangement from the companies' point of view – the effect was not only favourable for VAT. By selling the land first and the construction services afterwards, L generated cash income much earlier than it would have been received under what HMRC said was the "normal" transaction. Also, people who bought the land were not bound to use C for the construction services, and they were not bound to a particular timetable. The two transactions were spread over a long period in most cases, and could be spread over even longer. They should not be looked at as a single pre-planned arrangement.

Nevertheless, the Tribunal found for HMRC. Looking at the transactions and the relationship between the parties and the supplies in detail, it appeared that the conditions for *Halifax* to apply were satisfied. The transactions were artificial in that they had (in the Tribunal's view) been arranged specially to create a VAT effect; they were contrary to the purpose of the VAT law because they would benefit from exemption and zero-rating when in reality what was being supplied was something that ought to be standard rated. That had the potential to distort competition, which was contrary to the purpose of the law. The trader's appeal was dismissed. It seems likely that there will be a further appeal.

First Tier Tribunal (TC0016): *Lower Mill Estate Ltd*

3.1.2 Not composite and not zero-rated

A company built apartments and granted 125-year leases to tenants. There were insufficient parking spaces for each apartment to have one, so the available spaces were sold separately. The parking space leases were for the same length of time as the apartment leases, and were subject to a condition that they should not be assigned to anyone who did not also own an apartment. HMRC ruled that the price paid for parking spaces was standard rated, and the company appealed.

The Tribunal agreed with HMRC that it was not possible to regard the grant of the lease and the lease of a parking space as a single economic transaction. There was too little legal or economic connection between them: someone who took a lease of an apartment was not guaranteed a parking space, and was given a separate choice of applying for and paying for one. The company's appeal against HMRC's ruling was dismissed.

First Tier Tribunal (TC0070): *Civilscent Ltd*

3.1.3 Composite and exempt

Three individuals involved in insurance set up a self-invested pension plan (SIPP) which bought a commercial property. As trustees, they signed a lease for 20 years over the property in favour of four companies which they ran, and opted to tax in order to recover the input tax on the purchase of the property. HMRC disapplied the option on the basis that they had financed the purchase of the property and would occupy it for exempt business purposes. They argued that they supplied the facilities of using the building, rather than something that would be exempt, pointing to HMRC guidance which suggests that joint occupation rules out the existence of a licence to occupy.

The Tribunal pointed out that this argument was flawed. There was a lease, not a licence. There was no question that the SIPP had supplied an interest in the land which was within Sch.9 Group 1, and it was exempt subject to the option to tax. Other arguments which sought to show that the supply comprised facilities rather than land were also dismissed.

First Tier Tribunal (TC0060): *Trustees of the Lyndon David Hollinshead and Others*

3.1.4 Cleaning and rent

A Czech residential landlord invoiced tenants separately for rent and the cleaning of the common areas of the building. The landlord believed that the whole supply was indivisible and should all be exempt. The authorities ruled that the two supplies were separate and the cleaning services were VATable.

The Advocate-General gave an opinion supporting the authorities:

1. Articles 6 and 13 of the Sixth Directive must be interpreted as meaning that residential tenancy (or, possibly, tenancy of spaces which are used for purposes other than those for dwelling), on one hand, and the cleaning of common areas which is associated, on the other hand, is to be regarded as autonomous and separable activities.

It is a matter of national courts to determine whether the provisions of the tenancy agreement, the rules of procedure of the building and the legal practice in effect in the state concerned exceptionally allow a different interpretation.

2. In situations where the national court held that the tenancy and the associated cleaning of common areas can not exceptionally be regarded as autonomous and separate operations, the cleaning of common areas must be regarded as a part of "letting of immovable property" under art. 13B(b) of the Sixth Directive and the amount paid in relation to that activity is exempt from VAT.

The ECJ has confirmed this, ruling that "*the letting of immovable property and the cleaning service of the common parts of the latter must, in circumstances such as those at issue in the main proceedings, be regarded as independent, mutually divisible operations, so that the said service does not fall within that provision*".

ECJ (Case C-572/07): *RLRE Tellmer Property s.r.o. v Finanční ředitelství v Ústí nad Labem*

3.2 Option to tax

3.2.1 Change of view on occupation

HMRC have announced a change of their view following the judgment of the House of Lords in the *Newnham College* case.

The case concerned whether Newnham was "in occupation"of the college library which had been leased to a subsidiary company for the purpose of a zero-rated business supplying books. If the college was in occupation, its option to tax the library would be disapplied because the occupation would be for the purpose of making supplies of exempt education. The VAT incurred on the rebuilding and refurbishment of the library would be then be irrecoverable because the lease to the subsidiary would be exempt rather than taxable. The House of Lords upheld the judgment of the Court of Appeal and found in Newnham's favour. They concluded that Newnham was not in occupation and, as a result, that the option to tax was not disapplied.

HMRC now accept that physical presence alone is not the correct test of occupation for the purposes of what is now VATA 1994 Schedule 10 Paragraphs 12 to 17 (the "anti-avoidance test"). Following the House of Lords judgment, a person is considered to be "in occupation" if, in addition to physical presence which occupation normally entails, they have the right to occupy the property as if they are the owner and to exclude others from enjoyment of such a right. This means a person must have actual possession of the land along with a degree of permanence and control. Such a right will normally result from the grant of a legal interest or licence to occupy. Occupation could also, however, be by agreement or de facto; it is therefore necessary to take account of the day to day arrangements, particularly where these differ from the contractual terms. An exclusive right of occupation is not a requirement; an agreement might, for example, allow for joint occupation. Equally, it is not necessary for a

person to be utilising all of the land for all of the time for them to be considered as occupying it.

A person whose interest in land is subject to an inferior interest, which prevents him from having rights of occupation for the time being, is not "in occupation" for the purposes of the anti-avoidance test until the inferior interest expires. It should be noted, however, that an important feature of the test is that it is forward-looking and takes account of the intended or expected occupation of the building at any time during the Capital Goods Scheme (CGS) adjustment period. As a result, a person who has granted an inferior interest but intends during that adjustment period to occupy the land himself would intend to be "in occupation" for the purposes of the anti-avoidance test and so must consider whether his intended occupation was for eligible purposes.

However, a person can ignore the following types of occupation for the purposes of the test:

1. Occupation which is purely for the purpose of making his rental supplies under the grant, since those are the very supplies whose liability he is trying to determine by applying the test. For example:
   (a) occupation by the grantor between the date of the grant and the start of occupation by the tenant which is for the purpose of undertaking refurbishment or repairs;
   (b) occupation by maintenance, security or reception staff (or similar), unless it is for the purpose of providing ongoing services separate from the letting itself.
2. Occupation at a future date, but within the CGS adjustment period, which is solely for the purpose of re-letting the property or making a fresh grant.

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3.2.2 Simplifying the option to tax

The Budget included the announcement that HMRC would "simplify" the procedure for opting to tax a building which has been used to make exempt supplies by replacing one of the automatic permission conditions and two extra statutory concessions, one of which will be regularised in the law.

The new automatic permission condition will take effect on 1 May 2009 and is explained in an Information Sheet as follows:

Taxpayers who wish to opt to tax land and buildings, but have made previous exempt supplies of them, are required to seek the prior permission of HMRC unless they meet the terms of any one of the four APCs published in notice 742A Opting to tax land and buildings. If a taxpayer meets the terms of any one of the four conditions, that taxpayer is able to opt to tax simply by notifying that option to HMRC, without the need to formally apply for permission.

With effect from 1 May 2009, the new APC (at Annex A) replaces the previous condition 3 and has force of law. The other APCs (1, 2 & 4) remain unchanged.

NEW AUTOMATIC PERMISSION CONDITION ("APC")

It is hoped that many more taxpayers will now be able to use the APCs than in the past and that the number of formal requests for permission will, as a result, be reduced. However, it has been necessary to write the new APC in a legally precise form and ensure that it cannot be used for tax avoidance purposes. This means that the new APC is longer than the other APCs. The following flow diagram has been designed to assist taxpayers in understanding the circumstances in which the new APC can be used.

The new condition consists of two requirements. In order to be entitled to automatic permission under the new condition you must satisfy the first requirement and if the second requirement is applicable to your situation that second requirement must also be satisfied. The first requirement relates to outputs and looks at supplies that you intend or expect to make. The second requirement relates to inputs and looks at VAT you incur on your costs or purchases. Following the flowchart is a series of notes that clarify some of the terms used. The notes are referred to in the flowchart, where appropriate. It is important to note, however, that the flowchart and notes do not form part of the automatic permission condition and do not themselves have legal force, they are provided as an introduction to and overview of the operation of the new condition.

The Information Sheet also explains changes to a concessionary treatment as follows:

EXISTING CONCESSIONARY TREATMENT

HMRC have been operating two informal concessions that allow VAT recovery by taxpayers who have opted to tax and would otherwise be unable to recover VAT on certain types of capital expenditure on their property.

The two concessions apply as follows:

i) VAT incurred prior to registration

The first concession applies if you register for VAT as a result of making an option to tax. Special rules already apply under which you may be entitled to claim relief for VAT incurred on supplies obtained before registration. If the rules apply, relief is restricted on supplies of goods to those received within the previous 3 years and on supplies of services, to those received not more than 6 months before your registration.

This restriction may lead to inequitable treatment compared with a business carrying out similar activities that was already VAT registered when the tax was incurred and so could make a deduction, for instance, under the Capital Goods Scheme (CGS). If you consider you have suffered because of this you should write to the Option to Tax National Unit (Annex B shows how you may contact them) and explain your circumstances.

In all cases relief for VAT incurred before registration is restricted to tax which is attributable to supplies that will become taxable as a result of the option to tax. If you incurred VAT before registration that was attributable both to exempt supplies before registration as well as taxable supplies after registration, the relief will be restricted proportionately.

ii) VAT incurred prior to an option to tax in relation to land and buildings falling outside the scope of the Capital Goods Scheme (CGS)

*The second concession applies to VAT registered taxpayers who require permission to opt to tax (but see * under "Future changes" below) and have incurred expenditure of a capital nature but of insufficient value to fall within the Capital Goods Scheme (CGS). Usually, there is no legal basis for recovering input tax on such expenditure, by virtue of the option to tax, unless the 'Payback' rules apply (see section 11.9, Notice 706 Partial Exemption). However, as a concession, we normally allow recovery of that part of the input tax which doesn't fall within the CGS, to the extent to which it will be used in making taxable supplies.*

In this situation, a fair and reasonable recovery of input tax needs to be agreed on capital expenditure which will be used in whole or in part in making future taxable supplies. This will be calculated over a ten-year period to ensure consistency with the CGS, although recovery will be through a one-off credit on the first return following the option to tax.

FUTURE CHANGES TO THE CONCESSIONARY TREATMENT

The two informal concessions extend the scope of VAT recovery but their operation complicates the procedure for opting to tax. We have reviewed the concessions to see whether they can be simplified and regularised.

*Both of the concessions will be retained for a 12 month period in their current form until 30 April 2010. *Those taxpayers who meet the new APC but would have required formal permission prior to 1 May 2009 can continue to claim under the second concession above during this period by writing to the Option to Tax National Unit at the address shown in Annex B.*

We consider that it is possible to legislate for the effect of the first concession above where its use mirrors the CGS. However, it does not make sense to do so ahead of a planned review of the CGS, which is scheduled to take place in 2010/11. From 1 May 2010, the part of the concession that mirrors the CGS will be retained. The future of the concession will be considered as part of the review.

We consider that the remainder of the first concession and the second concession above have no vires in UK law and there are no plans to legislate for them in the future. These concessions will therefore be withdrawn with effect from 1 May 2010.

The new condition, which has the force of law, is set out in Annex A:

Annex A New Automatic Permission Condition

You may opt to tax if you satisfy the first (outputs) requirement and (if applicable) the second (inputs) requirement.

Definitions

For the purposes of this condition:

'property' includes land, buildings and civil engineering works.

the question of whether a person is connected with another person is to be decided in accordance with section 839 of the Taxes Act 1988.

'permissible exempt supplies' means the following exempt supplies arising from a grant in relation to the land:

a) Supplies for which the consideration solely represents legal and/or valuation costs reimbursed under the agreement for the grant; or

b) Supplies where:

i. the consideration is provided by way of regular rents and/or service charges; and

ii. the consideration relates to a period of occupation of the property and that period ends no later than 12 months from the date on which the option first takes effect; and

iii. no opted supply, other than an opted supply relating solely to the same period of occupation as an exempt supply under point (ii) above, will be reduced in value as a result of the consideration payable for these exempt supplies.

First (outputs) requirement

You do not intend or expect that any supply which will be taxable as a result of you making your option to tax will either

1 be made to a person connected with you; or

2 arise from an agreement under which you or another person has made or will make an exempt supply in respect of a right to occupy the property, where the right begins or continues after the date on which the option takes effect.

Application of the first (outputs) requirement

You may disregard paragraph 1 of the requirement if the person connected with you is expected to be entitled to credit or refund of at least 80% of the VAT chargeable on the supply.

For the purposes of paragraph 2 of the requirement you may ignore permissible exempt supplies.

Second (inputs) requirement

1 This requirement applies if you have been or expect to be entitled to credit for any part of the input tax incurred on your capital expenditure on the property as being wholly or partly attributable to supplies that are taxable supplies by virtue of your option to tax.

2 Where this requirement applies you must not intend or expect to use any part of the capital expenditure for either of the following purposes:

a. making exempt supplies which do not confer a right to credit for input tax pursuant to section 26(2)(c) of the Value Added Tax Act 1994;

b. for private or non-business purposes, other than purposes giving rise to a right to a refund of VAT on the supplies under sections 33, 33A or 41(3) of the Value Added Tax Act 1994.

Application of the second (inputs) requirement

For the purposes of the requirement, your capital expenditure is your expenditure on goods or services used in connection with the acquisition of, building works on, construction works on or the fitting out of, the property. Capital expenditure does not include expenditure on routine repairs and maintenance.

For the purposes of the requirement, "entitled to credit" includes a deduction or credit arising as a result of the application of Regulation 109 or Part XV of the VAT Regulations 1995 (SI 1995/2518).

You may disregard paragraph 2a of the requirement if any of paragraphs a), b) or c) below apply:

a) all the exempt supplies concerned are supplies which fulfil any of the following descriptions:

i. supplies within Paragraphs 5 to 11 of Schedule 10 to the Value Added Tax Act 1994 and made to a person who is not connected to you;

ii. permissible exempt supplies;

iii. supplies within Group 5 of Schedule 9 to the Value Added Tax Act 1994 which are incidental to one or more of your business activities;

b) you make exempt supplies, but intend or expect the input tax incurred on your capital expenditure on the property that is attributed to those exempt supplies, including any subsequent adjustments to initial input tax deduction, will not exceed £5,000;

c) you expect to be entitled to full credit for all the input tax incurred on your capital expenditure on the property as a result of the application of section 33(2) of the Value Added Tax Act 1994.

BN67; Information Sheet 06/09

3.2.3 Revocation

There is an article about the practicalities of revoking an option to tax by Neil Warren in ICAEW *Taxline*, July 2009.

3.3 Developers and builders

3.3.1 Annexe

A builder was engaged by a professional architect to construct a building which was physically attached to the architect's house. It was larger than the original dwelling, and could operate independently as a dwelling. The builder zero-rated the work. HMRC asked to see the planning permission and plans, and discovered that there were a number of discrepancies between the drawings that the architect had shown to the builder and those that the architect had submitted for planning approval. The building appeared to be an annexe to an existing dwelling, and the work could not qualify for zero-rating.

The builder's main defence to an assessment was that he ought to be entitled to rely on the instructions of a professional architect. He also

believed that there was no explicit provision in the planning permission to prohibit the separate use or disposal of the new annexe.

The Tribunal had some sympathy with his predicament, but it held that the prohibition did exist at the time of the construction work. There was also internal access between the two parts of the building – the builder had constructed the doorway himself. As a result, the work could not qualify for zero-rating.

First Tier Tribunal (TC0022): *Keith Lamming*

3.3.2 Separate or ancillary use?

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

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

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

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

3.3.3 Relevant charitable purpose

The rules on zero-rating of a building "solely" for a charitable purpose will change with effect from 1 July 2010. In the meantime, there is a transitional period of one year in which charities can use either the old extra-statutory treatment or a new interpretation of the word "solely" in the legislation.

ESC 3.29 permitted charities to issue a certificate that they intended to use the building solely for non-business purposes provided that 90% of the building was to be so used, based on time, floor space or headcount. This will be withdrawn (as part of the ongoing review of the status of all HMRC concessions) and replaced by a requirement that "solely" means that at least 95% of the use of the building is intended to be non-business. There are no defined measures for this test: the charity must carry out its own review and be prepared to justify its conclusion as fair and reasonable if challenged.

The change of use charge will not arise where zero-rating was granted on the basis of the concession and the use of the building has not changed. Under the new interpretation, a change of use charge can arise if the conditions on which zero-rating were claimed cease to apply.

ESC 3.29 can be applied to new projects as long as there is a meaningful start to construction, or the payment of a meaningful deposit, no later than 30 June 2010.

R&C Brief 39/09; Information Sheet 08/09

3.4 Input tax claims on land

3.4.1 Reduced rate

A DIY builder reclaimed some £17,000 in VAT after converting a derelict cottage for himself to live in. HMRC repaid about £13,000 but refused the rest, stating that the builders should have charged only 5% VAT. The individual appealed to the Tribunal, apparently relying on a reading of the legislation that led him to the conclusion that only "relevant residential use" could qualify for the lower rate.

The Tribunal agreed with HMRC's basic contention – the builders had charged too much, and HMRC were not able to refund any more than the VAT that should have been charged. However, the Tribunal also found that some of the invoices should have in any case been standard rated, so found for the appellant to a small extent.

First Tier Tribunal (TC0064): *Geoffrey Williams*

3.4.2 Not explicitly stated

A DIY claim is only permitted for a new dwelling, not for an alteration to an existing building. It is permitted to retain part of a previous structure only if it is required as a condition in the planning consent.

An individual discussed a project to convert two old farm buildings with the planning officer, and was told that it would be unlikely to be accepted unless the façade was retained. He therefore submitted plans that he thought would be accepted, and was granted permission that did not refer to the retention of the façade as a condition.

HMRC subsequently refused his DIY claim, and their decision was upheld by the Tribunal. The appellant submitted a letter from the planning officer stating that the application would probably have been refused if it had not retained the façades, but to satisfy the VAT law it had to be explicitly stated in the planning consent at the time.

First Tier Tribunal (TC0037): *Roland Hall*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Special scheme

An Information Sheet sets out the usual exchange rate information for those who use the scheme for the quarter to March 2009.

Information Sheet 05/09

4.2 Where is a supply of services?

4.2.1 VAT package to be implemented

The Budget included more details of the VAT package changes, covering place of supply, time of supply and the filing of ESLs. The proposals have been covered in past updates, but here is a summary of the Budget announcement.

Place of supply

From 1 January 2010, the “basic rule” for international business-to-business supplies changes from “where the supplier belongs” to “where the customer belongs”, and the reverse charge will be extended accordingly to more supplies. Supplies to non-business customers will still be taxed where the supplier belongs.

From 1 January 2010, valuation and work on goods will move to “where the customer belongs” if the customer is in business; most B2B cultural, artistic, sporting etc. services will also move to the reverse charge from 1 January 2011, although admission charges will still be taxed where the event takes place.

Land-related services remain where the land is. There is currently some doubt about where the services of booking hotel rooms should be: some member states are suggesting that it should move to where the land is, which would be inconvenient for travel agents established in other states. This is subject to discussion with the Commission.

From 1 January 2010, short-term hire of means of transport (30 days for most means, 90 days for vessels) moves to where the transport is put at the customer’s disposal. Long-term hire will fall under the new general rule (where the customer belongs for B2B, where the supplier belongs for B2C). From 1 January 2013, long-term hire to non-business customers will also move to where the customer is established.

From 1 January 2010, restaurant and catering services will be charged where they are physically performed. Where this is on an intra-EU journey, the place of supply will be the place of departure.

From 1 January 2010, supplies of intermediaries, transport of goods and ancillary transport services will move to the general rule. Transport and ancillary services for non-business customers will remain under the old rules (where physically performed, or point of departure for intra-EU transport of goods).

The place of supply of "schedule 5 services", passenger transport, supplies subject to the "use and enjoyment provisions" and electronically supplied services for non-business customers will remain unchanged.

BN74

The change to the time of supply rule for reverse charges will take effect on 1 January 2010. Instead of the tax point being triggered only by payment, it will be the earlier of the completion of the service and the date on which it is paid for. Continuous supplies will be supplied at the end of each billing or payment period, or the date of payment if earlier. For continuous supplies that are not subject to billing or payment periods, the supply will be the end of the calendar year or the date of payment if earlier.

BN75

ESLs will be required from 1 January 2010 to report supplies of services to business customers who will be required to account for a reverse charge. The returns will be filed for each calendar quarter and will have to show the VAT registration number of the customers and the total value of the supplies to each customer.

The time limit for submission will be 14 days for paper and 21 days for electronic submission.

BN76

On 1 May 2009 HMRC published further details of the new rules. A guidance statement on ESLs includes FAQs which confirm that the existing ESL penalty regime will continue for the time being (daily penalties of £5, £10 and £15 for non-submission, £100 for material inaccuracies). The document also notes that the threshold for quarterly submission of goods ESLs will fall from £70,000 to £35,000 on 1 January 2012.

www.hmrc.gov.uk/vat/ec-sales-lists.pdf

www.hmrc.gov.uk/vat/cross-border-changes-2010.htm

HMRC have also published a summary of responses to the consultation on the implementation of the VAT package. Responses were received from businesses, professional associations and firms of accountants and lawyers.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_029449

There is a two-part article about the VAT package in *Tax Adviser*, April and May 2009.

4.2.2 Timeshares

The VAT Tribunal referred questions to the ECJ to assist in determining whether services are "connected with" immovable property and would

therefore be treated as made where the property is situated under art.45 VAT Directive (old art.9(2)(a)). The company is a timeshare operator, so it collects money from people who want to stay in accommodation (normally for holidays) – but at the time they pay their fees, it may not be clear where they will actually be staying.

Separate fees are charged for:

- enrolling in the operator's "club" which enables the exchanging of timeshares with other owners;
- subscribing to the service on a regular basis;
- exchanging a timeshare with another owner.

Both the UK and the Spanish authorities claimed that the fees were chargeable to VAT in their jurisdictions where the property concerned was in Spain – the UK on the basis that this was a "basic rule supply" and the business was established in the UK, and the Spanish on the basis that it was connected to the immovable property which was in Spain.

The Advocate-General has now given an opinion on the questions referred by the Tribunal. The response to each question (in italics) is given below.

In the context of the services supplied by the Appellant for:

- *the enrolment fee;*
- *the subscription fee; and*
- *the exchange fee*

paid by members of the Appellant's Weeks Scheme, what are the factors to be considered when determining whether the services are "connected with" immovable property within the meaning of Article 9(2)(a) of the Sixth VAT Directive (now Article 45 of the Recast VAT Directive)?

The enrolment fee and the subscription fee are not directly connected with a supply of immovable property for the purposes of the VAT Directive. They are therefore consideration for "basic rule" supplies.

The exchange services could fall within TOMS if the business uses the supplies and services of other taxable persons in making its onward supplies. If so, the place of supply will again be where the supplier is established.

If any or all of the services supplied by the Appellant are "connected with" immovable property within the meaning of Article 9(2)(a) of the Sixth VAT Directive (now Article 45 of the Recast VAT Directive), is the immovable property with which each or all of the services are connected the immovable property deposited into the pool, or the immovable property requested in exchange for the deposited immovable property, or both of these properties?

If the supplies are not within TOMS, the Advocate-General considers that the exchange fees are related to the property and will therefore fall to be taxed where the property is situated.

If any of the services are "connected with" both immovable properties, how are the services to be classified under the Sixth VAT Directive (now the Recast VAT Directive)?

In light of the divergent solutions found by different Member States how does the Sixth VAT Directive (now the Recast VAT Directive) characterise the "exchange fee" income of a taxable person received for the following supplies:

- *facilitating the exchange of holiday usage rights held by one member of a scheme run by the taxable person for the holiday usage rights held by another member of that scheme; and / or*
- *supplying usage rights in accommodation purchased by the taxable person from taxable third parties to supplement the pool of accommodation available to members of that scheme.*

Although the Advocate-General's summary at the end of the opinion does not state which property is used to locate the supply of the exchange fees, it appears from the foregoing argument that it is the property where the payer of the fee takes the holiday that determines it. Presumably it is possible that someone with a timeshare in Greece swaps with someone else who has a timeshare in Spain, and each will pay a fee: the person who owns in Spain will pay Greek VAT, and the person who owns in Greece will pay Spanish VAT, in respect of the fees they pay to swap.

ECJ (A-G) (Case C-37/08): *RCI Europe v HMRC*

4.2.3 Management is not consultancy

The UK subsidiary of a Japanese bank supplied services to its holding company. It argued that these were outside the scope of UK VAT because they fell within "consultancy" in Sch.5 VATA 1994. HMRC ruled that they were general management services and were neither consultancy nor similar to consultancy.

The Tribunal considered the evidence, in particular explanations from the managing director of what the company did for its holding company. It did not accept many of the views he put forward, in particular that the management services he carried out could equally well be provided by an outside consultant. The work he did was central to the company's operations and was not within Sch.5. Sch.5 services were generally provided independently by advisers rather than forming part of the operations of the company.

One interesting note was that the taxpayer was invited to apply for an award of costs in spite of losing the appeal. The issue arose because HMRC's skeleton argument turned out to be very different from its statement of case. The Tribunal did not consider that there was any prejudice to the trader, so it was not appropriate to rule that the revised argument should not be admitted; but the fact that the company had prepared for one argument and then had to face a different one justified an application for costs.

First Tier Tribunal (TC0089): *Sumitomo Mitsui Banking Corporation Europe Ltd*

4.3 International supplies of goods

4.3.1 No triangulation

A UK wholesaler of soft drinks was approached by a company registered in Belize (S) to deliver goods to a customer in Poland (K). K was registered for VAT in Poland but S was not registered for VAT anywhere in the EU.

The wholesaler contacted HMRC and asked about the correct VAT treatment. According to the wholesaler's account of the conversation, the HMRC officer advised that the despatches could be zero-rated as long as K's VAT registration number was shown on the invoices. The wholesaler proceeded on this basis, believing that this was "a standard triangulation procedure" and that it had been approved by HMRC.

When HMRC carried out an inspection, they pointed out that triangulation was not possible because S was not registered in any member state, and raised an assessment for over £300,000 of underdeclared output tax. The company applied for judicial review on the basis that the advice received created a "legitimate expectation" that zero-rating would be available on the basis given. The application was refused: the judge commented that "the claimant's behaviour reflected a degree of wishful thinking in interpreting what had been said on the telephone". In all the circumstances, it had not been reasonable for the claimant to rely upon what the HMRC officer had said in a telephone conversation as the foundation for its treatment of the supplies as zero rated.

High Court: *Corktech Ltd v HMRC*

4.3.2 Reasonable refusal

A trader applied to be able to use Simplified Import VAT Accounting, which permits import VAT (but not duty) to be deferred without financial security. HMRC have a number of criteria on which they judge an application to use SIVA, one of which is the strength of the applicant's balance sheet. In this case the trader did not have sufficient assets for HMRC's test, and the application was refused.

The company appealed, arguing that HMRC could not be at risk because the company was always a repayment trader. It imported some goods from outside the EU – and was therefore liable for import VAT – but it then exported or despatched nearly everything, which meant that it was only ever in a repayment position. HMRC argued that this was irrelevant because the import VAT was regarded as a duty of customs and was considered separately from domestic VAT accounting.

The Tribunal believed that the officer had not properly addressed the relationship between the import VAT liability and the domestic VAT position, but nevertheless her decision could not be held to be unreasonable. Although the company had fixed assets and debtors in excess of the monthly import VAT liability, HMRC's rules for valuing such assets (50% of the fixed assets and nothing for the debtors) meant that the security was not great enough. SIVA was denied.

First Tier Tribunal (TC0018): *I C Blue Ltd*

4.3.3 No despatches

A trader based in Northern Ireland zero-rated several sales of vehicles because he believed that they qualified as despatches to customers in the Irish Republic. HMRC did not accept that he had the appropriate documentation, and further investigations with the Irish authorities suggested that some of the customers did not agree that they had purchased vehicles from the trader.

The Tribunal examined such evidence as could be produced, and commented as follows:

"*On a careful review of the documentation which was submitted to us, there is no doubt that the information which the Appellant has produced is scant. It was suggested to us by Miss. Lynch, the Appellant's Counsel, that Notice 725 and the correspondence from Customs was confusing and that the Appellant could not be expected to comply with it strictly. With respect that is not an argument which we find convincing. The rules (which have the force of law) applicable to one trader are applicable to all, and we see no reason why they should be relaxed in the particular instance of this case.*"

The assessment was held to have been issued to the best of HMRC's judgement.

First Tier Tribunal (TC0079): *Enda McNulty*

4.3.4 No export

A UK resident individual bought a house in Mauritius. He purchased furniture and other items, which were delivered to his house in Sussex. He then left with his family to live full-time in Mauritius, and claimed that the furniture should be zero-rated because he took it with him.

The Tribunal upheld HMRC's refusal of his claim. The regulations clearly required that an export had to be a sale to a person who belonged outside the member states. At the time of the supply, the purchaser was resident in the UK.

First Tier Tribunal (TC0067): *T D Martin-Jenkins*

4.3.5 Time limits

The Swedish court has referred questions to the ECJ about the imposition of time limits on goods leaving the country as part of the conditions for zero-rating despatches within the EU. The questions referred are as follows:

Are Articles 138 and 20 of Council Directive [2006/112/EC] on the common system of value added tax to be interpreted as meaning that the transport out of the territory of the State of origin must begin within a certain period of time for the sale to be exempt from tax and for there to be an intra-Community acquisition?

Similarly, are those Articles to be interpreted as meaning that the transport must end in the country of destination within a certain period of time for the sale to be exempt from tax and for there to be an intra-Community acquisition?

Would the answers to questions 1 and 2 be affected if that which is acquired is a new means of transport and the person acquiring the goods is

an individual who intends ultimately to use the means of transport in a particular Member State?

ECJ (Reference) (Case C-84/09): *X v Skatterverket*

4.3.6 New Notice

HMRC have issued a new version of Notice 101 *Deferring duty, VAT and other charges*. It explains the Duty Deferment Scheme and how to apply for a Deferment Approval Number.

Notice 101

4.3.7 Updated manual

HMRC have moved their online manual on *VAT supplies in warehouse and fiscal warehousing* to the main list of VAT manuals.

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

4.3.8 Tightening of rules

The European Council has reached political agreement at its June meeting on a directive tightening the rules for the exemption from VAT upon importation which is currently subject of abuse through fraud (10430/09). It restricts the circumstances in which an importation can be exempt from VAT because the goods are directly despatched to a customer in another member state. The new conditions to be imposed are that the importer must provide to the competent authorities in its own member state:

- the VAT identification number of the importer issued in the member state of importation;
- the VAT identification number of the customer, to whom the goods are supplied, issued in another member state, or his own VAT identification number issued in the member state in which the dispatch or transport of the goods ends;
- the evidence that the imported goods are intended to be transported or dispatched from the member state of importation to another member state.

The new directive forms part of a Commission proposal on two anti-fraud measures linked to cross-border transactions. The second part of the proposed measures, on which negotiations are ongoing, concerns joint and several liability.

www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/108392.pdf; http://register.consilium.europa.eu/pdf/en/09/st10/st10689.en09.pdf

4.4 European rules

4.4.1 Optional reduced rates made permanent

The European Council has adopted a directive which makes extends and makes permanent the optional use of reduced rates of VAT for certain labour-intensive local services. This option has existed for some years and has been extended in time before, but it will now be allowed indefinitely and will cover restaurant services. There is a condition that there must be no risk of unfair competition between service providers in different member states.

Adoption of the directive follows political agreement reached at the Economic and Financial Affairs (ECOFIN) Council's meeting on 10 March 2009, after the extension of reduced rates was identified as part of the economic recovery strategy approved by the European Council in December 2008.

Under the directive adopted by the Council, member states that so wish may apply reduced VAT rates, on a permanent basis: to the following:

- labour-intensive local services comprising:
    - minor repairs of bicycles, shoes and leather goods, clothing and household linen (including mending and alteration);
    - window cleaning and cleaning in private households;
    - domestic care services such as home help and care of the young, elderly, sick or disabled;
    - hairdressing;
    - the renovation and repair of private dwellings, excluding materials which account for a significant part of the value of the service supplied;
- restaurant and catering services;
- books on all physical means of support.

In addition, Portugal may apply a reduced VAT rate to tolls on bridges in the Lisbon area; Cyprus is allowed to apply a reduced VAT rate to the supply of liquid petroleum gas in cylinders; and Malta may maintain a zero VAT rate for the supply of foodstuffs and pharmaceuticals.

The Directive entered into force on 1 June 2009.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/council_pr_9458-09_en.pdf

4.4.2 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 Court has agreed with the recent Advocate-General's opinion as follows:

"[The VAT Directive] must be interpreted as meaning that turnover tax is due, in accordance with that provision, to the Member State to which the VAT mentioned on an invoice or other document serving as invoice relates, even if the transaction in question was not taxable in that Member State. It is for the national court to ascertain, taking into account all the relevant circumstances of the case, to which Member State the VAT mentioned on the invoice in question is due. In particular, the rate mentioned, the currency in which the amount to be paid is expressed, the language in which the invoice was drawn up, the content and context of the invoice at issue, the place of establishment of the issuer of that invoice and the beneficiary of the services performed, as well as their behaviour, can be relevant in that regard. The principle of fiscal neutrality does not generally preclude Member States from making the refund of VAT due in that Member State merely because it was erroneously mentioned on the invoice subject to the requirement that the taxable person have [sic] sent the beneficiary of the services performed a corrected invoice not mentioning that VAT, if the taxable person has not completely eliminated in sufficient time the risk of the loss of tax revenue."

The last sentence is hard to follow, but it appears that it is supposed to mean that the member state can impose a condition on the taxpayer before refunding the tax. Earlier in the judgment the following appears: "In such circumstances, it must be held that making the refund of the VAT mentioned on an invoice subject to the requirement that that invoice be corrected, does not in principle go beyond what is necessary to achieve the objective of completely eliminating all risk of loss of tax revenue."

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

4.4.3 Not a turnover tax

Member states are not permitted to impose "turnover taxes" which are similar to VAT. A Spanish business objected to a levy on "documented legal transactions in real property" on the basis that it was a turnover tax.

The ECJ ruled that it was not. The duty complained of does not apply to all transactions of goods and services but only to transactions subject to be registered in the public registry; it is not levied in the context of a production or distribution process but only when an immovable property is transferred to the ownership of the buyer; and it is not calculated on the added value of the property but on the value of that property. It seems that it is similar to the UK's stamp duty land tax, and is equally valid under EU law.

ECJ (Case C-151/08): *N.N. Renta SA v Tribunal Económico-Administrativo Regional de Cataluña (TEARC), Generalidad de Cataluña*

A Lithuanian levy which funds the country's road-building programme was referred to the ECJ for a ruling on whether it infringes the prohibition on turnover taxes which compete with VAT. The ECJ ruled that it did not contravene the rules. It was not comprehensive and it was not proportional to the price paid for goods or services, and so was not sufficiently similar to VAT to be unlawful.

ECJ (Case C-119/08): *Mechel Nemunas UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*

4.4.4 Polish transport

The Commission has decided to refer Poland to the ECJ in respect of a "VAT" charge the country has introduced on passengers crossing the Polish border in certain buses which are registered in other countries. The Commission sent a reasoned opinion to Poland in 2008 arguing that this contravened the treaty and the directive, but Poland has not changed its rules.

The Polish rule is supposed to tax the part of the passenger transport taxable in Poland, but it involves:

- the bus driver having to pay the tax in a customs office when the bus enters Poland;
- the amount of the tax being set for each passenger at a standard amount, 7% of PLN 285;
- the transport company not being able to recover any VAT borne in Poland.

This means that VAT due in Poland is collected through payment at the border of an amount calculated on the basis of an average taxable amount per traveller. This contravenes Community rules since, according to the VAT Directive:

- VAT due from the supplier of a transport service must be declared and paid by means of a VAT return and not through a one-off payment at the border;
- the amount of tax due results from the application of the VAT rate to the part of the total consideration paid for the transport service which is proportional to the distance travelled in Poland, not a standard amount as under the Polish rule;
- the transport company must be allowed to deduct VAT borne in Poland in a periodical VAT return.

In addition, the Polish provisions lead to fiscal cross border controls, thus contravening the essential principles of the internal market.

http://ec.europa.eu/taxation_customs/common/infringements/infringement_cases/index_en.htm

4.4.5 Building land in Latvia

Under art.135(1)(k), exemption applies to "the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1)". Building land is defined in that article as "any unimproved or improved land defined as such by the Member States".

Latvian law excludes "unused immovable property" from the exemption; "unused" means before first occupation. The Commission has sent a reasoned opinion to Latvia pointing out that the article 12 definition of building land does not refer to whether land has been used or not, and the provision is therefore not in compliance with the Directive. If the law is not changed within two months, a case will be referred to the ECJ.

IP/09/781

4.4.6 Supply of staff in the Netherlands

Netherlands law provides for exemption to apply to the making available of personnel in the socio-cultural sector, the health sector and the education sector to so-called Euregios and for promotion of work mobility. The Commission has referred a case to the ECJ for a declaration that this is not in accordance with the Directive – the supply of staff in these circumstances cannot qualify for any of the exemptions.

ECJ (Application) (Case C-79/09): *Commission v Kingdom of the Netherlands*

4.4.7 Public authorities in Ireland

In the Irish Republic, public authorities are only treated as taxable persons if a specific order is made to that effect by the Finance Minister. The Commission regards this as a contravention of the principles of the Directive, which require that public authorities should be regarded as taxable in any situation in which non-taxation would lead to significant distortion of competition.

As Ireland has failed to change its policy in response to a reasoned opinion, the Commission has now referred the matter to the ECJ for a ruling.

ECJ (Application): *Commission v Ireland*

4.4.8 Small businesses and establishment

Art.24(2) 6th Directive and art.282 VAT Directive 2006/112/EC provide for special schemes for small businesses. Arts.24(3) and 28i 6th Directive permit member states to extend these special schemes to traders established within their territory but to exclude traders established elsewhere. The Austrian court has referred questions to the ECJ to find out if this provision in the Directive is contrary to the EU Treaty.

The questions referred are as follows:

1. Does the wording 'as well as supplies of goods and services effected by a taxable person who is not established in the territory of the country' in Article 24(3) and in Article 28i of the Sixth Council Directive 77/388/EEC of 17 May 1977[1] on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, in the version of No 21 of Council Directive

92/111/EEC of 14 December 1992[2] amending Directive 77/388/EEC and introducing simplification measures with regard to value added tax, and a scheme transposing this provision into national law infringe the Treaty establishing the European Community, in particular the principle of non-discrimination (Article 12 EC), the freedom of establishment (Article 43 EC et seq.), the freedom to provide services (Article 49 EC et seq.), or fundamental rights under Community law (the Community-law principle of equal treatment) because the provision has the effect that Union citizens who are not established in the territory of the relevant country are excluded from the exemption under Article 24(2) of the Sixth Directive (Special scheme for small undertakings), whilst Union citizens who are established in the territory of the relevant country are able to claim this exemption where the relevant Member State grants an exemption for small undertakings in accordance with the Directive?

2. Does the wording ‘supplies of goods or services carried out by a taxable person who is not established in the Member State in which the VAT is due’ in Article 283(1)(c) of Council Directive 2006/112/EC of 28 November 2006[3] on the common system of value added tax and that of a scheme transposing this provision into national law infringe the Treaty establishing the European Community, in particular the principle of non-discrimination (Article 12 EC), the freedom of establishment (Article 43 EC et seq.), the freedom to provide services (Article 49 EC et seq.), or fundamental rights under Community law (the Community-law principle of equal treatment), because the provision has the effect that Union citizens who are not established in the relevant Member State are excluded from the exemption under Article 282 et seq. of Directive 2006/112/EC (Special scheme for small enterprises), whilst Union citizens who are established in the territory of the relevant country are able to claim this exemption where the relevant Member State grants an exemption for small enterprises in accordance with the Directive?

3. If the answer to the first question is in the affirmative: is the wording ‘as well as supplies of goods and services effected by a taxable person who is not established in the territory of the country’ in Article 24(3) and in Article 28i of the Sixth Directive invalid within the meaning of Article 234(b) EC?

4. If the answer to the second question is in the affirmative: is the wording ‘supplies of goods or services carried out by a taxable person who is not established in the Member State in which the VAT is due’ in Article 283(1)(c) of Directive 2006/112/EC invalid within the meaning of Article 234(b) EC?

5. If the answer to the third question is in the affirmative: should ‘turnover’ within the meaning of Annex XV of the Treaty between the Kingdom of Belgium, the Kingdom of Denmark, the Federal Republic of Germany, the Hellenic Republic, the Kingdom of Spain, the French Republic, Ireland, the Italian Republic, the Grand Duchy of Luxembourg, the Kingdom of the Netherlands, the Portuguese Republic, the United Kingdom of Great Britain and Northern Ireland (Member States of the European Union) and the Kingdom of Norway, the Republic of Austria, the Republic of Finland, the Kingdom of Sweden, concerning the accession of the Kingdom of Norway, the Republic of Austria, the Republic of Finland and the Kingdom of Sweden to the European Union together with the Final Act (The Treaty of Accession), IX. Taxation,[4]

(2)(c) and of Article 24 of the Sixth Directive respectively be understood to mean the turnover generated in one year in the particular Member State for which the small undertakings scheme is utilised or the undertaking's turnover generated in one year throughout the Community?

6. If the answer to the fourth question is in the affirmative: Should 'annual turnover' within the meaning of Article 287 of Directive 2006/112/EC be understood to mean the turnover generated in one year in the particular Member State for which the small undertakings scheme is utilised or the undertaking's turnover generated in one year throughout the Community?

ECJ (Reference) (Case C-97/09): *Ingrid Schmelz v Finanzamt Waldviertel*

4.4.9 Dutch horses

Dutch law allows a reduced rate to apply to the supply and importation of horses. The Commission has referred to the ECJ for a declaration that this is contrary to the Directive where the live animals are not of a kind normally used for foodstuffs.

ECJ (Application) (Case C-41/09): *Commission v Kingdom of the Netherlands*

4.4.10 Goods or services?

A question of general importance has been referred by the French court in respect of a particular application: "What are the criteria to be employed in order to determine whether reprographics is a supply of goods or a provision of services for the purposes of the 6th Directive?"

ECJ (Case C-88/09): *Graphic Procédé v Ministère du budget, des comptes publics et de la fonction publique*

4.4.11 French undertakers

French law permits undertakers to charge a reduced rate of VAT on the transportation of a body by vehicle. The movement of a body by bearers and other operations generally provided by undertakers attract the normal rate of VAT. A French undertaker will therefore charge two rates of VAT on a charge that could be regarded as consideration for a single service.

The Commission issued a reasoned opinion to France in early 2008 threatening infringement proceedings. It stated that the member state is entitled to allow a lower rate to attach to certain services of undertakers, but if it adopts that option, it must do so consistently. The Commission believes that the distinction drawn by French law is artificial and illogical.

As France has not changed its rules, the case has now been referred to the ECJ for a ruling.

ECJ (reference) (Case C-94/09): *Commission v French Republic*

4.4.12 German gambling

After the *Linneweber* case showed that there were significant problems with the German implementation of the exemption for gambling, a further question has been referred to the ECJ: "Is Article 135(1)(i) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax to be interpreted as meaning that Member States are permitted to have a rule under which only specified forms of (race) betting and lotteries are exempt from tax, and all 'other forms of gambling' are excluded from the tax exemption?"

ECJ (Reference) (Case C-58/09): *Leo-Libera GmbH v Finanzamt Buchholz in der Nordheide*

4.4.13 Transitional blocking rules

The Netherlands court has referred questions to the ECJ about whether Netherlands law blocking deduction of certain categories of input tax is permitted under the Directive. In particular, it is not clear whether the blocking order is sufficiently precise, and it is not clear whether the transitional rules apply which protect legislation in force when the 6th Directive took effect.

The questions are as follows:

1. Are Article 11(4) of the Second Directive and Article 17(6) of the Sixth Directive to be interpreted as meaning that a Member State wishing to make use of the possibility offered by those articles of (retaining) the exclusion of deduction in respect of categories of expenditure described as:

- 'the provision of food and drink to the staff of the trader';
- 'giving business gifts or other gifts to persons in relation to whom, if they had been charged or were to be charged the relevant turnover tax, such tax would be entirely or mainly non-deductible';
- 'providing the staff of the trader with accommodation';
- 'providing the staff of the trader with opportunities for recreation'

has satisfied the condition requiring the designation of a category of adequately defined goods and services?

2. If the answer to the first question is in the affirmative for one of the categories listed, do Article 6(2) and Article 17(2) and (6) of the Sixth Directive leave room for a national statutory provision, such as that which is the subject of the dispute, which was enacted before the Sixth Directive entered into force and on the basis of which a taxable person may not deduct in full the turnover tax paid on the acquisition of certain goods or services because a fee was charged in respect thereof which incurred turnover tax, but may only deduct an amount equivalent to the amount of tax owed in respect of the transaction concerned?

3. If, in respect of 'the provision of food and drink', the condition is satisfied which requires the designation of a category of adequately defined goods and services, does Article 17(6) of the Sixth Directive preclude an amendment to an existing exclusion of the deduction, from which amendment it seems likely that in principle the scope of the exclusion will be restricted but where it cannot be ruled out that in an individual case in a particular year the scope of the restriction of the deduction might be extended, in particular through the fixed-rate nature of the amended provision?

ECJ (Reference) (Case C-33/09): *Oracle Nederland BV v Inspecteur der Belastingdienst Utrecht-Gooi/kantoor Utrecht*

4.4.14 Portuguese farmers

The flat rate scheme for farmers is supposed to allow farmers not to register for VAT, but to retain a flat rate compensation amount instead of claiming credit for input tax. Portugal has set the compensation at zero, effectively treating farmers as exempt from VAT. The Commission has requested the law to be changed because it is not in accordance with the policy underlying the flat rate scheme, and it disadvantages Portuguese farmers.

IP/09/1015

4.5 Eighth Directive reclaims

4.5.1 Electronic refund system

The Budget included details of a new electronic refund procedure for VAT incurred in other member states. From 1 January 2010 claimants will submit claims electronically to HM Revenue & Customs in the UK, rather than directly to the authorities in the other member state. It appears that this will apply to claims made after 1 January 2010 for the calendar year 2009, even if interim claims for 2009 have already been made during the year.

Businesses will be able to submit claims up to 9 months from the end of the calendar year in which the VAT was incurred, rather than 6 months as at present. Tax authorities will have 4 months, rather than 6 months, to make repayments, unless further information is requested in which case the deadline is extended to 8 months. The refunding member state will pay interest where the business has met all its obligations but the authorities fail to meet their deadlines.

BN77

Further guidance on the new system was published by HMRC on 1 May 2009. The document is split into three parts:

- The first part sets out some of the background and the main differences between the new system and the current, paper-based system.
- The second part summarises the changes for UK businesses making claims to the tax administrations in other Member States. It also describes the process from the user's point of view and in Q&A format.
- The third part contains the draft UK secondary legislation. The draft primary legislation is primarily an enabling provision and will be included in the Finance Bill.

Detailed guidance on the new system is currently being prepared and this will be published towards the end of the summer.

Interesting points at this stage include the requirement only to scan and send invoices above a set limit. It will no longer be necessary to send in every invoice with the claim, even in electronic form.

Another practical point is that the portal will only recognise claims from the representative member of a VAT group. This could be important as it will also only accept five claims a year from each registered trader in respect of any individual country (intended to be four quarterly claims plus a "sweep-up" at the end of the year, although claims do not have to be made like that). This means that VAT groups will need to consolidate their claims before submitting them.

www.hmrc.gov.uk/vat/refund-procedure.pdf

The new rules are reviewed by Neil Warren in *Taxation*, 7 May 2009 p.443.

5. INPUTS

5.1 Economic activity

5.1.1 Artificial leasing transaction

The Tribunal and High Court have both allowed the artificial leasing scheme operated by Weald Leasing to have its intended VAT effect, that is to permit a subsidiary company to recover all the VAT on the purchase of assets which were then leased at below a market rental to an unconnected company which leased them on to the holding company. The intervening unconnected company (owned by the holding company's VAT consultant) was interposed to avoid the possible operation of Sch.6 para.1 by HMRC.

The Court of Appeal has decided to refer questions to the ECJ, which has given the case the number C-103/09. The questions are:

1. In circumstances such as those that exist in the present case, where a largely exempt trader adopts an asset leasing structure involving an intermediate third party, instead of purchasing assets outright, does the asset leasing structure or any part of it give rise to a tax advantage which is contrary to the purpose of the Sixth Directive within the meaning of paragraph 74 of the judgment in Case C-255/02 *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v CCE* ("*Halifax*")?

2. Having regard to the fact that the 6th VAT Directive contemplates the leasing of assets by exempt or partly exempt traders, and having regard to the Court's reference to "normal commercial operations" in paragraphs 69 and 80 of the judgment in *Halifax* and 27 of Case C-162/07 *Ampliscientifica* and also to the absence of any such reference in the judgment in Case C-425/06 *Part Service*, is it an abusive practice for an exempt, or partly exempt, trader to do so even though in the context of its normal commercial operations it does not engage in leasing transactions?

3. If the answer to question 2 is yes:

   - what is the relevance of "normal commercial operations" in the context of paragraphs 74 and 75 of the judgment in *Halifax*: is it relevant to paragraph 74 or to paragraph 75 or to both;

   - is the reference to "normal commercial operations" a reference to:

     - operations in which the taxpayer in question typically engages;

     - operations in which two or more parties engage at arm's length;

     - operations which are commercially viable;

     - operations which create the commercial burdens and risks typically associated with related commercial benefits;

     - operations that are not artificial in that they have commercial substance;

- any other type or category of operations?

4. If the asset leasing structure or any part of it is found to constitute an abusive practice, what is the appropriate redefinition? In particular, should the national court or the tax collecting authority:

   - ignore the existence of the intermediate third party and direct that VAT be paid on an open market value of the rentals;
   - redefine the leasing structure as an outright purchase; or
   - redefine the transactions in any other way which either the court or the tax collecting authority considers to be an appropriate means by which to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice?

ECJ (Reference) (Case C-103/09): *HMRC v Weald Leasing Ltd*

5.1.2 Bought for sale

A company bought a numberplate, "1 00", from another company which had acquired it from DVLA in an auction. The company paid £300,000 plus VAT and reclaimed the VAT. HMRC ruled that it was not a business expense.

The company subsequently went into liquidation, and the numberplate did not appear on its statement of assets and liabilities. In spite of this, the Tribunal accepted the company's contentions that the numberplate had been bought with the intention of selling it at a profit. Although that was not the company's main trade, it was reasonable for a company to diversify. Because of the intention to sell, it was irrelevant that the numberplate did not promote the business of the company.

First Tier Tribunal (TC0074): *David Jacobs UK Ltd (in liquidation)*

5.2 *Who receives the supply?*

5.2.1 Loyalty points

Questions have now been referred to the ECJ by the House of Lords in the two cases on loyalty points schemes, *Baxi Group plc* and *Loyalty Management UK Ltd*. In each case, the Court of Appeal found that the promoter of the scheme was entitled to deduct input tax paid to people redeeming points under the schemes because the promoter was paying for "redemption services" rather than providing third party consideration for goods or services which were being supplied by the redeemer to the scheme participant.

In *Loyalty Management*, the questions are as follows:

1. In circumstances where a taxable person (the "Promoter") is engaged in the business of running a multi-participant customer loyalty rewards programme (the "Scheme"), pursuant to which the Promoter enters into various agreements as follows:

(i) Agreements with various companies referred to as "Sponsors" under which the Sponsors issue "Points" to customers of the Sponsors ("Collectors") who purchase goods or services from the Sponsors and the Sponsors make payments to the Promoter;

(ii) Agreements with the Collectors which include provisions such that, when they purchase goods and/or services from the Sponsors, they will receive Points which they can redeem for goods and/or services; and

(iii) Agreements with various companies (known as "Redeemers") under which the Redeemers agree, among other things, to provide goods and/or services to Collectors at a price which is less than would otherwise be payable or for no cash payment when the Collector redeems the Points and in return the Promoter pays a "Service Charge" which is calculated according to the number of Points redeemed with that Redeemer during the relevant period.

How are Articles 14, 24 and 73 of Council Directive 2006/112/EC of 28 November 2006 (formerly Articles 5, 6 and 11(A)(1)(a) of Council Directive 77/388/EEC of 17 May 1977) to be interpreted where payments are made by the Promoter to the Redeemers?

2. In particular, are those provisions to be interpreted such that the payments of the kind made by the Promoter to Redeemers are to be characterised as:

(a) consideration solely for the supply of services by the Redeemers to the Promoter; or

(b) consideration solely for the supply of goods and/or services by the- Redeemers to the Collectors; or

(c) consideration in part for the supply of services by the Redeemers to the Promoter and in part for the supply of goods and/or services by the Redeemers to the Collectors?

3. If the answer to question 2 is (c), so that the Service Charge is consideration for two supplies by the Redeemers, one to the Promoter and the other to the Collectors, what are the criteria laid down by Community law to determine how a charge such as the Service Charge is to be apportioned between those two supplies?

ECJ (Reference) (53/09): *HMRC v Loyalty Management UK Ltd*

In *Baxi*, the questions are:

1. In circumstances where:

A. a taxable person runs a business promotion scheme operated by an advertising and marketing company under which "points" are issued to the taxable person's customers in connection with the purchase of goods by the customers from the taxable person;

B. customers redeem the points by obtaining reward goods from the advertising and marketing company without payment;

C. the taxable person has agreed with that other company to pay it the recommended retail price of the reward goods

How are Articles 14, 24 and 73 and 168 of the VAT Directive (formerly Articles 5, 6 and 11(A)(1)(a) and 17(2) of the Sixth Directive) to be interpreted as regards the payments by the taxable person to the other company?

2. In particular, are those provisions to be interpreted such that the payments by the taxable person to the other company are to be characterised:

- solely as consideration for a supply of services by the other company to the taxable person;
- solely as third party consideration for the supply of goods by the other company to the customers;
- as consideration in part for the supply of services by the other company to the taxable person and in part for the supply of goods by the other company to the customers; or
- as consideration for supplies both of advertising and marketing services and of reward goods by the other company to the taxable person?

3. If the answer to question 2 is that such payments are to be characterised in part as consideration for a supply of services by the other company to the taxable person and in part as third party consideration from the taxable person to the other company in respect of the other company's supply of goods to the customers, what are the criteria laid down by Community law to determine how the payment is to be apportioned between those two supplies?

ECJ (Reference) (55/09): *HMRC v Baxi Group plc*

5.3 Partial exemption

5.3.1 Override notice

In December 1994 Loughborough University (LU) agreed a special method with Customs & Excise. Over the next few years amendments were made to the method which were not formally agreed but were accepted in practice, which meant that by 2004 the method in force was a "de facto" method. In August of that year LU sent a letter to Customs stating "this is a special method override notice", proposing to override the existing method in some respects but not in others.

Customs replied, stating that LU should continue to apply its special method but should also calculate the recoverable input tax on the basis of the use or intended use of inputs, and should adjust the input tax claimed under the method on the basis of use. This would continue until a new special method could be agreed.

In December 2008, while a new method was still being debated, LU applied to the Tribunal for a preliminary ruling on the status of a special method override notice. In particular, they wanted to know whether the issue of a notice required or permitted HMRC to revisit the whole of the special method, or whether its effect could or would be limited to the matters mentioned in the notice itself.

The taxpayer's counsel argued that the principles of effectiveness, legal certainty, legitimate expectation and proportionality should limit the effect of the override notice to the matters which were mentioned in it. The Tribunal examined the wording of the regulations and decided that they plainly meant something different: it was necessary to calculate the whole of the recoverable input tax on the basis of use and compare that with the result of the agreed method. It was not possible for the taxpayer to limit the effect of the notice it had issued only to those matters which it chose.

First Tier Tribunal (TC0059): *Loughborough University*

5.3.2 Not exclusively for ticket sales

An "eligible body" put on operatic performances, for which the tickets were exempt within Group 13 Sch.9 VATA 1994. It claimed that the input tax on its production costs were residual, rather than exclusively incurred in making the exempt ticket supplies. It should therefore be able to recover a proportion of the input tax because of its taxable sales of sponsorship, programmes, CDs, selling a production to the Barbican and prop and equipment hire. Tickets comprised about 65% of the income.

The Tribunal examined the agreements between the company and its sponsors, and found that there was an "inseverable link" between the sponsorship agreement and an obligation to put on three high-quality operas. The cost of the productions was therefore linked to the sale of sponsorship and was residual.

HMRC argued that the link was too indirect: there was no link between any individual input and the sponsorship supplies. The taxpayer's case is described as the "but for" argument, rejected by the Court of Appeal in *Mayflower Theatre Trust*: "but for the expenditure, the taxable turnover would not have arisen". The Tribunal chairman (Sir Stephen Oliver QC) distinguished the earlier case on the grounds that the link between a

sponsorship agreement and the three operas to be put on in the current season was much more specific than the more nebulous deal enjoyed by the sponsors of Mayflower.

The chairman also concluded that the production costs were used to make all the taxable supplies put forward by the company. The company sought to exploit its productions in any manner that it could, and there was a sufficient link to show that the costs were incurred in making all the supplies.

First Tier Tribunal (TC0045): *Garsington Opera Ltd*

5.3.3 Not exclusively for refreshments

A members' golf club supplied exempt sporting services and taxable refreshments. It carried out a refurbishment of its bar and lounge facilities and claimed that the input tax was exclusively used to make taxable supplies of catering, so the whole of the input tax was recoverable.

The Tribunal examined the arguments about attribution in detail and disagreed with the club. Some of the comments are interesting because they cast further light on how attribution should be considered:

"The Tribunal is therefore looking at not only the physical use of the lounge/dining area but also its economic use. In this context it is not possible to say that the area was used 'exclusively' for taxable supplies. Certainly its primary physical use related to taxable supplies, being the area where the members congregated and consumed the drinks supplied by the bar and the food supplied by the kitchen. Even then this use was not exclusive as there were additional events held in the lounge which were in themselves exempt charitable events which the Commissioners argued would alone mean that the area was not used for exclusively taxable supplies. The more pertinent point however is the use of the clubhouse by the members is an intrinsic part of the their membership and inseparable from the exempt supplies of sporting services. The economic driver behind the refurbishment was not merely to make the taxable supply from the bar and the kitchen but, as recognised by the Club in the minutes of the 2007 AGM, to provide an attractive facility for the attraction of new members. The costs incurred in the refurbishment thus had a direct and immediate link to the exempt supply or in other words were a cost component of that supply. As Mr. Darby very fairly said, the Club could not survive without lounge and dining facilities and these had to be at their most attractive to build up the membership. This was the economic driver behind the refurbishment. As pointed out previously, the direct and immediate link does not have to be the closest link but a sufficient link."

First Tier Tribunal (TC0094): *Bridgnorth Golf Club*

5.3.4 Amendment regulations

The new standard method of partial exemption was described in the last update. The changes to the regulations were enacted by statutory instrument.

SI 2009/820

5.3.5 Reference on "incidental"

The Danish court has referred the following questions on the interpretation of the partial exemption rules to the ECJ:

1. Is the term 'incidental real estate transactions' in the second sentence of Art.19(2) 6th Directive to be interpreted as covering the activities of a building business which is subject to VAT in connection with the subsequent sale of real estate built by the building business on its own account as an activity fully subject to VAT with a view to resale?

2. For the purposes of the answer to question 1, is the extent to which the sales activities, viewed separately, entail the use of goods and services on which VAT is payable of relevance?

3. Is it consistent with the VAT-law principle of neutrality for a building business which, under the legislation of the Member State in question – based on Art.5(7) and Art.6(3) 6th Directive – is required to pay VAT on its internal supplies in connection with the construction of buildings on its own account with a view to subsequent sale, to have only a partial right to deduct VAT for general costs for the purposes of the building business, given that the subsequent sale of the real estate is, under the Member State's VAT legislation, exempt from VAT on the basis of Art.28(3)(b) 6th Directive, read in conjunction with point 16 of Annex F?

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

5.4 Cars

5.4.1 Scrappage

HMRC have published a Brief to explain the tax and VAT effects of the government's "scrappage" incentive scheme. The effect of the scheme is that:

- participating manufacturers will subsidise sales of new cars to consumers by £1,000, with another £1,000 contributed by the Department for Business, Enterprise and Regulatory Reform (BERR);
- BERR will pay its contribution to the manufacturer, which must pass it on to the dealer, who in turn must ensure that the customer receives the benefit of it, possibly by giving a refund but more normally by deducting the subsidy on the sales invoice.

The Brief explains that:

- the BERR contribution is outside the scope of VAT and tax, and has no effect on VAT liabilities of any party;
- the manufacturer's contribution entitles the manufacturer to a reduction in output tax of the VAT fraction of £1,000 (at 15%, this is £130.43);
- if the final customer is entitled to input tax credit on the car, a corresponding reduction in input tax must be made for the amount that is recoverable by the manufacturer;

- the retailer's VAT liabilities are not affected at all – the £2,000 is effectively third party consideration for the sale of the car, so the retailer's output tax is calculated on the unsubsidised amount;
- the cost of the new car for capital allowances purposes is reduced by both subsidies (net of the adjustment to input tax, if input tax is recoverable);
- the scrapped car is valued at nil for capital allowances purposes (the subsidy is not regarded as sale proceeds).

R&C Brief 31/09

5.4.2 Non-business as usual

A farmer bought a Nissan Patrol jeep with the intention of using it only for business purposes. The rear seats were converted to fold down; the rear windows were fitted with opaque panels; and he asserted that the smell alone meant that it was not suitable for private journeys. It was used on the farm for general farm work, and he owned three other cars in which he could enjoy private travel.

The Tribunal examined the evidence and accepted that he only intended to use the vehicle for business purposes. However, the alterations were not enough to prevent it falling within the definition of "car", and it was available for private use. Although the taxpayer's representative quoted a number of cases on similar facts where the taxpayer had won, they all predated the *Upton* decision in the Court of Appeal. This Tribunal was bound to follow the higher court and find that the input tax was not deductible.

First Tier Tribunal (TC0081): *JAT Faith*

Similar arguments were followed in a case involving another farmer and a Land Rover Discovery. The fact that a Scottish partnership is a separate legal entity from the partners did not help; the precedents meant that the input tax could not be claimed.

First Tier Tribunal (TC0047): *Alex Paton & Sons*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Payment in vouchers

A company gave its employees face-value vouchers as part of their remuneration. It reclaimed input tax on the costs of purchasing and providing the vouchers. HMRC rejected the claim and the company appealed. The Tribunal has referred the case to the ECJ for a ruling on whether the company was entitled "*to recover the VAT it has incurred in purchasing and providing the voucher to the employee in accordance with the contract of employment in circumstances where the voucher is to be used by the employee for his or her private purposes*".

VAT Tribunal: *AstraZeneca UK Ltd*

The questions for reference have now been published:

1) In the circumstances of this case, where an employee is entitled under the terms of his or her contract of employment to opt to take part of his or her remuneration as a face value voucher, is Art.2(1) 6th Directive [now Art.2(1)(c) of the Principal VAT Directive] to be interpreted such that the provision of that voucher by the employer to the employee constitutes a supply of services for consideration?

2) If the answer to question 1 is no, is Art.6(2)(b) [now Art.26(1)(b)] to be interpreted as requiring the provision of the voucher by the employer to the employee in accordance with the contract of employment to be treated as a supply of services, in circumstances where the voucher is to be used by the employee for his or her private purposes?

3) If the provision of the voucher is neither a supply of services for consideration within the meaning of Art.2(1) nor is to be treated as a supply of services under Art.6(2)(b), is Art.17(2) [now Art.168] to be interpreted so as to permit the employer to recover the value added tax it has incurred in purchasing and providing the voucher to the employee in accordance with the contract of employment in circumstances where the voucher is to be used by the employee for his or her private purposes?

ECJ (Reference) (Case C-40/09): *AstraZeneca UK Ltd v HMRC*

5.6.2 Swimming pool

The ECJ has confirmed again that a VAT-registered trader is entitled to full and immediate input tax deduction on an asset purchased for part business, part private use, charging output tax later to reflect the private use. The case is particularly striking as the Austrian trader had a house constructed with a swimming pool. The authorities were willing to apply the *Lennartz* principle to the cost of the house, but not to the cost of the swimming pool. The referring court was worried that a registered trader might be regarded as obtaining an advantage over other individuals that would constitute an unauthorised State Aid.

The ECJ's response was:

1. Article 17(2)(a) and Article 6(2)(a) 6th Directive do not infringe the general principle of equal treatment under Community law by conferring on taxable persons, by means of a full and immediate right to deduct input value added tax on the construction of a mixed-use building and the subsequent staggered imposition of that tax on the private use of the building, a financial advantage compared to non-taxable persons and to taxable persons who use their property only as a private residence.

2. Article 87(1) EC must be interpreted as not precluding a national measure which transposes Article 17(2)(a) 6th Directive and which provides that the right to deduct input value added tax payable is confined to taxable persons carrying out taxable transactions, to the exclusion of those carrying out only exempt transactions, in so far as that national measure may confer a financial advantage only on taxable persons carrying out taxable transactions.

3. Article 17(6) 6th Directive must be interpreted as meaning that the derogation it contains does not apply to a provision of national law which amends legislation existing when that directive entered into force, which is based on an approach which differs from that of the previous legislation and which laid down new procedures. In that regard, it is irrelevant whether the national legislature amended the previous national legislation on the basis of a correct or incorrect interpretation of Community law. The question whether such an amendment of a provision of national law also affects, with regard to the applicability of the second subparagraph of Article 17(6) 6th Directive , another provision of national law depends on whether those provisions of national law are interdependent or autonomous, which is a matter for the national court to determine.

ECJ (Case C-460/07): *Sandra Puffer v Unabhängiger Finanzsenat, Außenstelle Linz*

5.7 Bad debt relief

Nothing to report.

5.8 *Other input tax problems*

5.8.1 Derogation

HMRC have explained that the UK's derogation which allows the reverse charge procedure to be applied to domestic transactions in "carousel-prone" goods expires on 30 April 2009. Agreement for an extension has been reached in principle, but it is possible that the formalities will not be completed in time. If there is a gap in the legal authority of the law, HMRC still reckon that traders should continue to operate the reverse charge procedure and make reports as if the law was valid.

R & C Brief 28/09

The extension of the derogation was confirmed following the ECOFIN meeting on 5 May.

www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/107540.pdf; R&C Brief 34/09

5.8.2 New service

The Commission has launched a new online facility which will enable traders to print a certificate which will show that they checked the validity of a customer's VAT number at a particular point in time. This is supposed to help traders who might otherwise unwittingly become involved in carousel fraud. By obtaining the certificate "compliant taxpayers involuntarily caught in a fraudulent chain of transactions will get one additional element to prove their good faith and subsequently to avoid being liable for the payment of the tax".

http://ec.europa.eu/taxation_customs/vies/vieshome.do?selectedLanguage=EN

5.8.3 Carousels

Two associated companies claimed some £18m of VAT between them in the first three months of 2006. The companies' counsel and director argued before the Tribunal that they had never dealt with a defaulting company, and could not be expected to know anything about transactions further removed in the supply chain than their own immediate suppliers and customers; they carried out due diligence procedures, and the fact that they had never dealt directly with a fraudster showed how effective those procedures were.

In 2007, The Tribunal dealt with these arguments in a robust way. The chairman commented that the transactions in which the company was involved were inexplicable if they were not intended from the outset to defraud the public revenue. The director explained that the trade was based on a "grey market" in surplus telephones, but it did not appear credible that any legitimate market could exist or operate in the way in which this one appeared to (many successive transactions in unaltered consignments of goods on the same day between several UK companies before one of them would despatch the goods). The director's evidence was considered incredible and evasive. The turnover of an operation with 10 employees – in total £678 million in the year to 31 March 2006 – was unbelievable if it really reflected a genuine trade.

At the start of the hearing, HMRC were relying on the argument that the director "had the means of knowing" that there was a fraud. In spite of that, the Tribunal found:

- *Mr Gohir knew that the Appellants were engaged in transactions whose purpose was the commission of a fraud on the Commissioners;*
- *The Appellants' creation and assembly of the documentation relating to each deal into which they entered and their due diligence were designed only to persuade the Commissioners that they were legitimate traders;*
- *The transactions between the two Appellants had no true purpose other than to shift their respective VAT liabilities and repayment claims;*
- *Every one of the transactions, including those described as contra-trading, had as its objective the defrauding of the Commissioners;*
- *The decision to withhold the Appellants' repayment claims was correct.*

There were some small amounts that were held to be valid claims, but they were insignificant in the context of the rest of the dispute. The Tribunal made two findings which were disputed by the trader:

- the conclusion that the UK high volume, wholesale secondary mobile phone market had been wholly or largely corrupt, and without any obvious justification apart from defrauding the Crown of VAT (the market finding); and
- the conclusion that the owner of the two taxpayer companies had been himself guilty of fraud (as a ringleader) as opposed to merely having knowledge of the fraud of others (the fraud finding).

In 2008, the High Court agreed with HMRC that it was appropriate to require the company to deposit security for legal costs before an appeal could proceed. That appeal has now been heard, and has been dismissed. The judge held that the Tribunal was entitled to find that the companies and their controlling director "were well aware that the appellants were dealing in goods which were being used as the instrument of fraud, and the transactions in which they were themselves engaged were arranged for no other purpose". There was no "error in the decision of the tribunal which would justify intervention by this court".

A further argument for the traders, that the claim should be allowed to the extent that it did not exceed HMRC's overall tax loss from the supply chain, was rejected. Once it had been established that the trader was effectively an accomplice in MTIC fraud, the right to deduct input tax was lost in its entirety. This was not a disproportionate response to the problem of fraud.

High Court: *Calltell Telecom Ltd and another v HMRC*

By contrast, a contra-trader had an appeal upheld by the High Court. The Tribunal had decided that the trader ought to have known that the company's transactions would be connected with fraud, but the judge considered that the Tribunal had made the test for the trader too difficult to satisfy. At the time of the trader's purchases in the "clean chain", the fraud had not happened. The onus should be on HMRC to show that the

trader ought to have known about the connection with fraud; the Tribunal appeared to believe that the trader had to prove that it had no means of knowing.

The judge considered that a contra-trader had to be "connected with fraud" in that the chains of supply would always provide that connection. However, that was not enough on its own. There had to be actual knowledge or the means of knowing. HMRC had shown that the traders ought to have known that the transactions "might" be associated with a tax loss, but that was well short of the legal test.

High Court: *Blue Sphere Global Ltd and another v HMRC*

Yet another case involving a detailed examination of deal chains ended in most of the disputed input tax being disallowed. The Tribunal was satisfied that the trader had not carried out the appropriate due diligence procedures, and would have been aware of the connection with fraud if the appropriate procedures had been carried out. The case is useful for a detailed consideration of the tests the Tribunal chairman thought were appropriate in determining whether the *Kittel* principles applied.

First Tier Tribunal (TC0076): *S&I Electronics plc*

An even stronger conclusion was drawn by the Tribunal in another case. The chairman believed that the director had lied in giving evidence before the Tribunal; this cast doubt on his version of events, and suggested that he was a knowing participant in the fraud, even if he had perhaps not been one of the instigators. It is interesting to note that the chairman commented that the director was too intelligent not to have understood what was going on.

First Tier Tribunal (TC0095): *PD Concepts Ltd*

5.8.4 Subsidies

In a Hungarian case, a company received State aid towards the purchase of plant and equipment. It claimed full input tax deduction on the costs, but was subsequently assessed by the tax authority which ruled that only the unsubsidised proportion qualified for deduction. A law was passed in Hungary to that effect.

The ECJ ruled that the right to deduct input tax was a fundamental provision of the VAT Directive, and could not be restricted by a domestic law which contradicted it. The law would have required a derogation, and none had been applied for. The trader was therefore entitled to full deduction, and any other trader similarly affected will now be entitled to make a retrospective claim.

ECJ (Case C-74/08): *PARAT Automotive Cabrio Textiltetoket Gyarto Kft v Ado - es Penzugyi Ellenorzesi Hivatal Hatosagi Foosztaly Eszak-magyarorszagi Kihelyezett Hatosagi Osztaly*

5.8.5 Charter trustees

The historic property of a number of councils has been handed over to "charter trustees" for conservation. A statutory instrument has specified these charter trustees as bodies entitled to reclaim VAT incurred on non-business expenditure to put them on the same footing as the councils from which they received the property. The order specifies a list of charter trustees, and comes into force on 1 June 2009 (except in respect of the Wimbledon and Putney Commons Conservators, to which it applies from 1 April 2010).

SI 2009/1177

5.8.6 No evidence

A control officer noticed that a number of purchase invoices in one company were recorded as coming from another company whose records he had inspected. The invoices did not look like the sales invoices he had seen before. On further investigation, the proprietor of the "supplier" signed a witness statement to confirm that the invoices were not his, and that he had no trading relationship with the other company. Nevertheless, the company appealed an assessment to the Tribunal, arguing that it would produce supporting evidence to show that the invoices had been paid.

In the event, the trader did not appear and was not represented. The Tribunal found that there was no evidence to support the claim to input tax and confirmed the assessment. Costs were awarded to HMRC.

First Tier Tribunal (TC0080): *Banbridge Fuel Services Ltd*

A trader claimed to have purchased a "bank charges recovery system" from another company for £116,000 including VAT. HMRC refused to give credit for the VAT, to start with on the basis that the evidence was inadequate, and later contending that the transactions never happened at all. The Tribunal chairman agreed that there was insufficient evidence to conclude that anything had been purchased; the records were inconsistent and incomplete, and the trader's explanations of what he was trying to achieve with the business did not make commercial sense. The supplier had never accounted for output tax and had been deregistered. HMRC were justified in refusing the input tax claim.

First Tier Tribunal (TC0073): *Justrading Ltd*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 European rules

The Commission has issued a communication setting out its position on the VAT grouping rules. At present 16 of the member states allow grouping, but their rules vary widely. The Commission would like to see greater consistency in the rules which apply, in particular:

- Only taxable persons may join a VAT group. Additionally, a taxable person should only be able to join one VAT group at a time.
- The group is itself a taxable person subject to the same rights and obligations as any other taxable person and all the provisions of the VAT Directive as well as the rulings by the European Court of Justice apply to it.
- The group, as a single taxable person, should be identified for VAT purposes by a single number.
- Only companies or fixed establishments physically present in the Member State that has introduced the VAT grouping scheme may be members of a VAT group. A VAT grouping scheme should be open to all sectors of economic activity in the Member State which introduces such a scheme.
- The financial, economic and organisational links must exist simultaneously.
- The VAT group's right to deduct input VAT shall be determined on the basis of the transactions of the group as such with third parties.
- One of the most important consequences of forming a VAT group is the "disappearance" from a VAT perspective of transactions between the members of the group, i.e. transactions for consideration between the individual members of the group. These transactions are considered non-existent for VAT purposes.
- It is of utmost importance that Member States take all necessary measures to prevent tax evasion or avoidance, as well as abusive practices, through the use of their national VAT grouping schemes. No unjustified advantage or unjustified harm should arise from the implementation of the VAT grouping option.

The UK's rules appear to comply with most of these; however, the first condition may be breached by permitting companies which only make exempt supplies and "pure" holding companies to join groups.

IP/09/1078; http://ec.europa.eu/taxation_customs/index_en.htm

6.2 *Other registration rules*

6.2.1 No exception

A builder exceeded the registration threshold in the 12 months to July 2006, with the result that he was liable to register from 1 September 2006. He did not realise at the time, but contacted HMRC in January 2007 to enquire about the correct action to take. He was told that he might not have to register if his future turnover would fall below the deregistration threshold. He applied for exception from registration on the basis of this advice, and several months later it was refused: HMRC concluded that he could not have provided any evidence in September 2006 to show that his turnover would be below the relevant limits.

The Tribunal commented that the position in law was clear: the decision to refuse exception could not be faulted. The trader's main reason for appealing appeared to be dissatisfaction with the fact that he had been unable to charge his customers VAT while applying for exception, but he had been assessed to VAT on those customers' receipts when exception was refused. If he had not been advised to consider exception, or if HMRC had come to a decision more quickly, he would not have suffered this disadvantage. The Tribunal had some sympathy with him, but commented that this was not within the Tribunal's jurisdiction. If he wanted to complain about the conduct of HMRC, he would have to pursue that by other means.

First Tier Tribunal (TC0029): *Nicholas Paul Drury*

6.2.2 No retrospective adjustment

In March 2007 company applied to be registered for VAT with an EDR of 1 April 2007, the day on which it intended to make its first taxable supply. It subsequently claimed pre-registration input tax, but this was disallowed because the goods were not still on hand at 1 April. The company then asked for the EDR to be amended to 1 February 2007 in order to permit the claim for input tax, and appealed to the Tribunal against HMRC's refusal to allow this.

The disputed input tax related to three vehicles which had been despatched to Malta, so there was no output tax to be declared even if the EDR was backdated. The company's grounds of appeal were "the Appeals Unit are being unreasonable. They are suggesting that it is ok if they make a mistake then the date of registration can be changed. However if we make a mistake it can't be changed". The Tribunal chairman did not agree: the VAT 1 had been correctly completed by the company's accountant and signed by the managing director, and HMRC had given the EDR that was applied for. The fact that the accountant and director might have made inadvertent errors in doing this, which they only noticed when HMRC investigated the first return and disallowed input tax, was of no help to them.

First Tier Tribunal (TC0083): *Drosden Plantruck Ltd*

A company was established to act as a project manager for a substantial property development. The contact partner of its accountants completed a VAT 1 for the company on the understanding that it was about to make a substantial taxable supply, but filled in the form as if it was a voluntary registration rather than a compulsory registration on the forward look. There were a number of anomalies in the registration form, but HMRC gave the company a current EDR. It later transpired that it had incurred pre-registration VAT on services more than six months earlier and wished to recover it as input tax. HMRC refused to allow an amendment to the EDR.

The Tribunal did not believe that the anomalies in the form were so great that HMRC ought to have investigated the request further. The form was a valid application for registration and there was no reason to allow an amendment.

First Tier Tribunal (TC0090): *Lead Asset Strategies (Liverpool) Ltd*

6.2.3 Late registration and deregistration

A married couple who operated a hotel failed to register for VAT. HMRC formed the opinion, from examination of income tax returns, that they had been required to register from 1997 and issued an assessment covering the period May 1997 to November 2005. The couple appealed, contending that their turnover had fallen below the registration threshold from April 2005 onwards and that the period from April to November 2005 should therefore be excluded from the assessment. The business was deregistered by HMRC from November 2005.

The Tribunal rejected this contention and dismissed the appeal, holding that “HMRC were justifiably not satisfied that the period between April and November 2005 was not a time when the appellants would be subject to a requirement to be registered”. HMRC would have had to have been satisfied in advance that turnover would fall; in order to deregister on the basis of future drops in turnover a trader has to provide some evidence in advance, and it is difficult for a trader who has failed to register in the first place to do this retrospectively. In this case the trader was in discussions with HMRC by April 2005, but the Tribunal did not think that they or their representatives had provided enough reliable information for HMRC to be satisfied on a “forward look”. The chairman considered that the deregistration date of November 2005 was generous.

The appellant also argued that the assessment had been raised more than 12 months after knowledge of sufficient facts had been in HMRC’s possession. The chairman commented “It comes ill from the mouth of the Appellants to suggest otherwise when they themselves procrastinated and provided incomplete and unvouched information.”

First Tier Tribunal (TC0050): *Mr & Mrs D Robbie (t/a Dunlaw House Hotel)*

6.2.4 Deregistration

An individual registered for VAT (apparently twice) and sent in some unconventional VAT returns. Although he only made a single supply (a sale of tee-shirts) for which he was never paid, so he reclaimed the output tax that he had initially accounted for, he nevertheless claimed the input tax on his expenditure on a cumulative basis. This meant that he claimed £6,902 on each of his first four VAT returns. The Tribunal report explains some other peculiarities of his view of the way the VAT system works.

The Tribunal reviewed the case and decided that the individual did not meet the "Lord Fisher tests" for carrying on a business. HMRC were therefore entitled to deregister him. He was also not entitled to recover the input tax (even once) on the purchases because he did not have enough evidence to support the input tax figure. A small amount of VAT was allowed as supported by evidence and falling between the dates when HMRC accepted his registration application and the date they deregistered him, but the majority was disallowed.

VAT Tribunal (20,982): *Nicholas Nehemiah Gayle*

6.2.5 A different business split

A company owned and operated a golf driving range. In 2004 it entered into agreements, purporting to be leases, under which the range was to be operated by various individuals (including a professional golfer and two relatives of the company's controlling shareholder). The identity of the lessee changed every three months.

HMRC issued assessments on the basis that, notwithstanding the purported leases, the company was continuing to operate the driving range and was required to account for VAT on the takings. The Tribunal held on the evidence that the purported leases were "shams". The agreements were not leases but were "means by which the appellant delegated the day to day running of its own business". There were a number of defects in the documents that meant that they could not be leases (e.g. no clear definition of the premises), and the only possible reason for rotating the lessees was to avoid VAT registration. This meant that the company was making supplies to customers of the driving range, and was required to account for VAT accordingly.

Although the chairman used the word "sham" and recognised that it was a pejorative term, he said that he simply meant something that was presented in one way when it was in fact something else. He did not believe that the directors had been duplicitous or dishonest in the way that they had presented their evidence to the Tribunal. Their scheme simply did not work.

First Tier Tribunal (TC0036): *Rotherham Golf Academy Ltd*

6.2.6 Thresholds

The registration threshold increases from £67,000 to £68,000 with effect from 1 May 2009, and the deregistration threshold increases from £65,000 to £66,000 on the same date.

BN70; SI 2009/1031

6.3 Payments and returns

6.3.1 Online filing

HMRC have published online guidance about filling in VAT forms online and the various payment methods that HMRC accept.

www.hmrc.gov.uk/vat/managing/returns-accounts/completing-returns.htm

HMRC have issued a draft statutory instrument setting out the requirements for compulsory online filing which are likely to be brought in on 1 April 2010. There will be penalties for failing to file online which will go up to £400 for traders with turnover above £22.8m, and will be £100 for traders with turnover below £5.6m.

HMRC 9 April 2009

HMRC have also published a report investigating the administrative burden on businesses of requiring online filing of corporation tax and VAT returns, and the readiness of businesses to cope with these new requirements.

www.hmrc.gov.uk/research/comp-research-report.pdf

6.3.2 Paper filing

HMRC have commented that "In order to minimise scanning errors when completed VAT Returns (VAT 100) are inputted, only the original centrally issued VAT Return must be completed and submitted. If a VAT Return form is lost or mislaid, please request a replacement from HMRC's National Advice Service, tel: 0845 010 9000. Please do not submit photocopied VAT Returns or any other form of adapted VAT Return."

www.hmrc.gov.uk/vat/managing/returns-accounts/index.htm

6.3.3 Flat rate notice

HMRC have issued Update 1 (April 2009) to Notice 733. It explains the changes to the eligibility criteria, clarifies what is included in the flat rate turnover, and includes the new postal address for application forms.

Notice 733

6.3.4 Flat rate disputes

A company was registered under the flat rate scheme from 1 January 2004. At that time the rate applicable to couriers was 5.5%. With effect from 1 April 2004, it was increased to 9%. In spite of HMRC notifying traders through a letter, VAT Notes and a Business Brief, the company failed to notice the change, and three years later was assessed to a shortfall of £8,758 plus interest.

The trader had no substantive grounds for appeal against the assessment apart from a sense of grievance that HMRC should have noticed the problem earlier from the returns that were submitted. The chairman had some sympathy with the sense of grievance but commented that VAT was a self-assessed tax and the trader had the ultimate responsibility for the accuracy of returns. The assessment was confirmed.

First Tier Tribunal (TC0084): *Cannon Express & Logistics Ltd*

A trader was registered under the flat rate scheme in respect of a riding school. She claimed a large amount of input tax on the construction of a riding arena, but found that it was not regarded as qualifying for the special deduction of input tax for capital goods costing at least £2,000 under the FRS because most of the supplies constituted services.

The Tribunal considered that one of the elements of the disputed input tax was a service incidental to the delivery of goods, and was therefore claimable even under the FRS. However, it went on to consider whether the trader should be allowed to withdraw from the FRS retrospectively, so permitting accounting under the normal rules of VAT and thus allowing recovery on the capital expenditure. HMRC had refused to allow this, commenting that a precedent case in which this had been permitted had involved a 40% loss of gross profit – this trader only suffered a 23% loss, and therefore "did not suffer hardship".

The Tribunal agreed with the appellant's main contentions, which were that:

- HMRC's guidance (Notice 733) did not make clear what a "capital asset" was for the purposes of the FRS until March 2007, after the expenditure had been incurred;
- the visiting officer who examined the returns and ruled that the input tax was not recoverable had suggested retrospective withdrawal, which is within HMRC's discretionary powers;
- the loss did cause the trader undue hardship.

In this area, the Tribunal's jurisdiction is limited to considering whether HMRC's decision was made "reasonably". The Tribunal was satisfied that it was not: in overruling the offer of the visiting officer, HMRC's policy department had not considered the underlying reasons for refusing the decision and had set an arbitrary figure of 40% of gross profit to measure hardship. The appeal was allowed to that extent.

First Tier Tribunal (TC0062): *Sally March*

There is an article about the practical problems of the Flat Rate Scheme by Neil Warren in *Tax Adviser*, May 2009.

6.3.5 Interest not a penalty

A company was notified by its auditors of errors in its VAT returns totalling over £20,000. The company attempted to correct the mistake by altering the next VAT return, and also enclosed a letter with the return explaining what had happened. HMRC treated the letter as a notice of voluntary disclosure and issued an assessment for interest of £2,700. The company appealed, arguing that:

(1) The imposition of interest is a penalty for being honest

(2) The calculation of interest is high and absurd

(3) Paying the interest as a result of a genuine error is now an issue as Vividas is no longer trading.

The Tribunal did not regard any of these as a valid objection and confirmed the liability to interest in accordance with the law.

First Tier Tribunal (TC0068): *Vividas Ltd*

6.3.6 Debt management manual updated

HMRC have updated their debt management manual on the internet. Although most of the amendments relate to direct taxes, there is a general updating to cross-refer to the new Tribunals system and procedures following the changeover on 1 April 2009.

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

6.4 Repayment claims

6.4.1 *Fleming* claims guidance

HMRC published a document on the website on 27 May titled "Three-year cap – *Fleming & Condé Nast* – Section 121 of the Finance Act 2008". It appears to be internal guidance on how HMRC officers should deal with *Fleming* claims. Although it only appeared on the website on 27 May, the document is marked "this version released on 23 April 2009".

The document explains the legal background and goes into detail on many practical matters, including who can make a claim, the assignment and transfer of rights, unjust enrichment and interest.

www.hmrc.gov.uk/menus/fleming-guidance.pdf

6.4.2 No cap on capping disputes

A company received services in April 1997, before the input tax cap was introduced on 1 May 1997. The services related to a proposed merger; the deductibility of this as input tax was discussed with Customs, who ruled that it was not allowable. The company nevertheless deducted some of it in its return for the quarter to 30 June 1997; the rest was accepted as not allowable in accordance with the case authorities at the time. Subsequently Customs raised an assessment to disallow the claim, and this was paid by the company in October 1997.

After the 2005 decision of the ECJ in *Kretztechnik*, the company decided that it would have been entitled to the whole of the VAT on the expenses. This is now accepted by HMRC. However, HMRC argued that the claim was capped. The company contended that it had rights at 1 May 1997 because the invoices were dated in April, and it was therefore entitled to make a claim under the *Fleming* rules.

HMRC argued that the April 1997 invoices could only have been claimed in the return to 30 June 1997, and there were therefore no rights at 1 May 1997. The whole of that amount was subject to the cap. HMRC also argued that the fact that the input tax had been deducted, then assessed and paid, and then claimed back again, turned the claim from a reg.29 input tax claim (capped from 1 May 1997) to a s.80 claim (capped from 4 December 1996).

The Tribunal considered the reg.29/s.80 point in detail, even though it was considered only a minor part of the appeal. It concluded that the claim was still a reg.29 claim in spite of the later assessment.

The major point was whether the rights accrued up to 30 April 1997, where this fell in the middle of a return period, were "pre-existing rights" within the *Fleming* principle. The Tribunal considered the precedents (which did not contain any directly relevant decisions) and the construction of the UK and EU law, and concluded that they were not. The trader had the right to deduct on a VAT return, and that VAT return could not be filed until after 30 June 1997. The possibility of a trader going on holiday and filing the return before the end of the return period was rejected as unrealistic. The introduction of the claims cap was quite different from the change of rate of VAT on 1 December 2008, which would have to apply to all traders on the same date, even if that was the middle of a return period. The claims cap applied to all the VAT creditable for the return to 30 June 1997 on the same date, whether it was incurred before or after 1 May.

First Tier Tribunal (TC0004): *Cable & Wireless plc*

An individual was registered as a management consultant. She failed to submit four returns in 2004 and received central assessments for £540 each time, which she paid. She died in 2008 and her husband, as personal representative, filed nil returns to cancel the assessments. HMRC refused to repay the £2,160 because of the three-year cap.

The Tribunal held that it had no discretion to override the cap in these circumstances and dismissed an appeal against the refusal to repay.

First Tier Tribunal (TC0057): *Jeffrey Koundakjian*

It was reported recently that the Court of Session had agreed to refer questions to the ECJ in the *Scottish Equitable* case. The argument appeared to be that the faulty introduction of the three-year cap means that it is still invalid now, even for periods after 1996: the transitional period up to 31 March 2009 was still not an acceptable repair of something so fundamentally flawed. However, it has since come out that the dispute has been settled between the company and HMRC, so the questions will not now be considered by the ECJ. The terms of the agreement are not public, but it may be that HMRC were willing to pay up just to end the matter quietly – whether to avoid creating a further legal precedent, or else because they were simply fed up with the issue.

6.4.3 Compound interest struck out

A very curious situation arose in a case in which a company claimed an award of compound interest. HMRC refused, and applied to have an appeal struck out on the grounds that it was made out of time. It appears that the Tribunal notified the company that the strike-out application would be heard in July 2008, but did not tell HMRC. The hearing proceeded without HMRC and the company's application was allowed.

The High Court has overturned this, ruling that there was a serious breach of the Tribunals rules. The decision was set aside, but it is not clear whether this means that the Tribunal will now hear the strike-out application again.

High Court: *HMRC v Grattan plc*

A number of car dealers recovered VAT on “Elida Gibbs” and “Italian Republic” principles dating back to the introduction of VAT, and were paid simple interest under s.78 VATA 1994. They claimed that they should be entitled to compound interest under the principles of EU law and the House of Lords decision in *Sempra Metals*.

HMRC argued that the statutory scheme for interest in the case of official error was comprehensive and could not be overridden. There was nothing in EU law to suggest that compound interest should be awarded instead. The taxpayers’ claims were statute-barred under the Limitation Act 1980.

The Tribunal agreed with HMRC on the domestic law point. The restitutionary claim in *Sempra Metals* succeeded because there was no statutory scheme; where there was a statutory scheme, it was the only domestic remedy available.

However, EU law would override domestic law in respect of restitution for overpaid VAT where the overpayment resulted from a failure to implement Community law, as in the present case. The normal calculation for a restitutionary claim would be compound interest at rates set by reference to Government borrowing, as in *Sempra Metals*.

Nevertheless, the claims failed because they were time-barred. The extended time limit for bringing the claims had already expired before the claims were begun, and the claims had not been revived by any subsequent acknowledgment or part payment (i.e. the payment of the s.78 interest).

High Court: *F J Chalke Ltd and another v HMRC*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Invoices

Following the Commission’s consultation on invoicing, it has been reported that further changes to the requirements for VAT invoices are likely to be implemented in 2013. These may include a requirement to show the customer’s VAT number on domestic as well as international invoices, and a requirement to issue full VAT invoices for exempt and zero-rated supplies as well as those which show an amount of output tax.

6.7 Assessments

6.7.1 Time limits

A property development company appealed against three assessments which had been raised as follows:

(a) 6 November 2006 in relation to the VAT period 11/03 in the amount of £15,725 and £3,096.80 interest;

(b) 29 January 2007 in relation to 02/04 tax period, in the amount of £23,751.00 and £4,697.65 interest; and

(c) 16 April 2007 in relation to 05/04 tax period in the amount of £35,360 and £563.25.

All related to the disallowance of input tax on a redevelopment project that HMRC regarded as likely to give rise to an exempt rather than a zero-rated supply. It was supposed to satisfy the conditions for a substantial reconstruction of a protected building, but HMRC were not satisfied that the whole of the works constituted reconstruction (one of the conditions of Group 6 Sch.8). As a result the company had made an exempt supply and was not entitled to input tax.

The trader appealed, contending that HMRC had had sufficient evidence to form the conclusion on which these assessments were based in December 2003, when an initial visit was carried out to consider the first VAT return. HMRC had therefore had sufficient evidence for over a year; as the assessments all related to periods over 2 years before they were raised, they were out of time.

HMRC argued that they had not had sufficient evidence until later. When the company applied to deregister it reported that it had no assets and no stock, and this led to further enquiries which revealed that the project had not met the conditions for zero-rating.

The Tribunal agreed with the company. HMRC appeared to be confusing the different assessments that would arise on a change of intention or on the original intention not qualifying for zero-rating. In this case, the original intention had been carried through: if HMRC had considered properly the information available at the time the company was registered and when the first VAT return was examined, it would have been clear that the project did not meet the conditions. The later investigations following deregistration did not add to the information that HMRC required to raise the assessments. The appeal against the assessments was upheld.

First Tier Tribunal (TC0056): *Sophie Holdings Ltd*

6.7.2 Underdeclared

A partnership running a fish and chip shop received an unannounced VAT visit at which the officers discovered that the turnover appeared to be running at double what the VAT returns showed. The partners immediately confessed that they had suppressed takings since they had acquired the business. There was then an argument about whether the extrapolation carried out by HMRC produced a reasonable result.

The Tribunal chairman commented that the traders were in a very difficult position: having admitted that the records were fake, it was impossible to

produce a figure for "true" turnover that might be more convincing than that produced by HMRC. He was satisfied that the assessments were raised to best judgement; although they might be a little high, on the balance of probabilities and on the basis of the evidence put before the Tribunal, there was no reason to reduce them.

VAT Tribunal (20,983): *Mr Singh & Mrs Kaur t/a "Superdish"*

At the end of a long-running investigation and dispute, the Tribunal confirmed assessments and dishonesty penalties on two related businesses. The assessments had been raised in 1999, and the chairman commented that "The delay in this case led not only to the fading of the witnesses' recollections, but also to the fading of some of the documentary evidence to the extent that in parts it had become illegible."

First Tier Tribunal (TC0058): *Pizza 1 and Chichini's*

A double glazing partnership was investigated and the officer concluded that sales had been omitted. When the case came to the Tribunal the trader applied for adjournments more than once, and in the end the chairman decided to proceed in the absence of the taxpayer. No evidence was offered to suggest that the assessments were not to best judgement, and costs were awarded to HMRC.

First Tier Tribunal (TC0096): *David McCowan & Frank Williams t/a Crystal Windows*

A couple ran a pub in partnership. The accounts showed considerable amounts of cash introduced into the business. HMRC asked their accountant what this was, and she said it was a balancing figure. HMRC concluded that it was undeclared takings and assessed accordingly. The Tribunal agreed that the assessment was made to the best of the officer's judgement and no convincing evidence had been offered by the trader to displace it.

As the trader had continued the appeal after an initial hearing but had failed to produce any of the additional information requested by the Tribunal, or to attend the later hearings, costs of £1,000 were awarded to HMRC.

First Tier Tribunal (TC0088): *Steve Craine & Kerry Anne Craine t/a The Pickwick Tavern*

6.7.3 Best judgement

In 2001, Customs & Excise investigated a company that was suspected of involvement in MTIC fraud. Its records were uplifted, and its director was arrested, prosecuted and found guilty. His conviction was later quashed in the Court of Appeal and a retrial ordered; HMRC decided to offer no evidence against him, and he was formally acquitted of all charges in 2007.

Meanwhile, Customs had directed the company to file a return, and had sent back the records to enable it to do so. It then became apparent that some of the records had been inadvertently retained. Customs issued an assessment in the absence of the return; the company then submitted a return showing a lower amount. The difference was left in abeyance while the criminal proceedings continued. If the conviction had stood, HMRC would have instituted confiscation proceedings against the director and the company, and the assessment would have been largely irrelevant.

The Tribunal had to consider whether the assessment was still valid after the company had submitted the return for the period to which it related. The company's solicitor argued that an assessment issued in the absence of a return automatically lapses when the return is submitted; if HMRC are not satisfied that the return is correct, they have to issue a new assessment. They would be out of time to do so in this case.

The Tribunal chairman disagreed with the solicitor. He held that the assessment was not automatically displaced by the submission of the return; it remained in force unless discharged by HMRC. Given that it was based on the company's own records, and did not appear to be "unreasonable" in the *Wednesbury* sense, it was "to best judgement" and was therefore valid. The appeal was dismissed.

First Tier Tribunal (TC0020): *Bestline Data Ltd*

A convenience store submitted several repayment returns. HMRC believed that this was unlikely to be correct and carried out a mark-up exercise. The officers discovered that the traders were not using any recognised retail scheme.

The Tribunal had a preliminary issue of jurisdiction in that one of the partners in the store had been declared bankrupt. It decided that he had no part in the proceedings as his trustee in bankruptcy had not entered into them. Nevertheless the appeal could be heard in relation only to the business and the other partner.

The Tribunal examined the evidence and found that there was no reason to doubt the best judgement used in reaching the assessments. The appeal was dismissed.

First Tier Tribunal (TC0026): *Javid Aslam (A Bankrupt) & Ashia Aslam t/a Ramzan Foodstore*

A retailer was assessed on the basis of best judgement for 12 successive periods. He appealed against the mark-ups used in the calculation and the allowance for wastage. The Tribunal examined the evidence in detail and upheld the assessments, apart from that in respect of the first quarter, which had been raised out of time.

The trader did not appear and was not represented, which meant that the Tribunal had to take the decision to proceed without him, and offer the possibility of a further hearing if the appellant did not agree with the findings of this one. HMRC's counsel did not apply for costs, but said that the Department would seek costs if the appellant exercised the right for a further hearing.

First Tier Tribunal (TC0015): *T Singh Ltd*

A company operating two wine bars and several delicatessens was assessed following a dispute on the split between zero and standard rated sales. The Tribunal examined the evidence in detail and concluded that HMRC had agreed that 3 of the delis could use a fixed 30/70 split between standard and zero-rated supplies, and this overrode any factual findings by HMRC. The appeal was allowed to that extent. However, in respect of the other outlets, there was no such agreement and HMRC's assessments had been made to best judgement.

First Tier Tribunal (TC0051): *Mithras Wine Bars Ltd*

A trader running a takeaway curry house disputed the extrapolation of the results of two nights' invigilation by HMRC officers to cover two years. Although an assessment for one period was withdrawn during the hearing, the Tribunal confirmed that the extrapolation was in accordance with best judgement and did not accept the various arguments put forward by the taxpayer to try to undermine it. The appeal was dismissed in relation to the assessments which HMRC did not withdraw.

First Tier Tribunal (TC0054): *Brenda M Kassabieh*

6.7.4 DERV

A Northern Irish farmer was stopped by HMRC officers and found to have rebated fuel ("red diesel") in the tank of his car. He maintained that this was a foolish and admittedly one-off occurrence: he had run out of DERV while driving the vehicle on the farm, and had taken a few litres of red diesel from his storage tanks in order to get home. HMRC did not believe him and raised an assessment based on an extended period. This was based on mileage records for his various vehicles and the amounts of DERV (taxed diesel) for which he could show purchase invoices.

The farmer gave evidence before the Tribunal, asserting that he had bought the majority of his DERV in the Irish Republic, paying cash and keeping no receipts. The chairman believed that this was a reasonable explanation that covered some of the missing mileage. Following discussions, the assessment was reduced by about half, and the appeal was allowed to that extent. The farmer said that he was now meticulous about keeping receipts for DERV purchased on the other side of the border.

First Tier Tribunal (TC0019): *Patrick McKenna*

6.8 Penalties and appeals

6.8.1 Appeals manual and advice

HMRC have published online their manual on the new Tribunal system following the implementation of the Tribunals, Courts and Enforcement Act 2007.

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

HMRC have also published guidance on the use of the new statutory review system which applies to both direct and indirect taxes.

www.hmrc.gov.uk/dealingwith/appeals.htm

HMRC have made available on their website the "guided learning unit" for review officers under the new Tribunals system. It goes through the background to the changes, the role of the decision maker and the role of the reviewing officer, and the Tribunal system itself.

www.hmrc.gov.uk/about/review-officer-glu.pdf

Meanwhile, professional journals continue to contain numerous articles about the new appeals system (e.g *Tax Adviser*, April 2009, Watson and Halsey) and the new reviews (e.g. *Taxation*, 2 April 2009 p.318 and 14 May 2009 p.446). The specific issue of the transitional rules on reviews is dealt with in *Taxation*, 25 June 2009 p.634.

6.8.2 Full mitigation

A trader transferred an opted property to a company he controlled. His accountants failed to make the necessary notifications to ensure that this was treated as a TOGC. This was discovered by HMRC on an assurance visit to the accountants. They assessed the trader for the VAT (which was then recoverable by the company, so there was no loss of VAT), and added a misdeclaration penalty, for which they allowed mitigation of 70%. Full mitigation was not allowed because there had been no voluntary disclosure.

The Tribunal commented that it was not possible to regard reliance on the accountant as a reasonable excuse, nor to take into account for mitigation either the shortage of funds of the appellant or the fact that no VAT loss had occurred. However, it was possible to consider the reasonableness of the trader's behaviour. In the circumstances it had been reasonable for him to rely wholly on the accountants to submit the paperwork on his behalf, and 100% mitigation should be allowed.

First Tier Tribunal (TC0003): *John Connell*

6.8.3 Successful default surcharge appeals

A trader had suffered 18 default surcharges since 2001 without complaining. Finally he appealed against one because he believed that this, unlike the others, was not his fault. He had separated from his wife and lived in temporary accommodation; he had made arrangements for post to be forwarded and had not informed HMRC, because he knew the addresses would change again soon. As a result, he did not receive his return form for the period to May 2008. On 23 June he rang to ask for a copy, but it had still not arrived by 30 June, when he rang again. He was advised to file online (although he did not have access to a computer, and

would not have been able to receive authorisation codes in time). He then drove to a VAT office to pick up a copy form and posted it, but it was only received on 9 July.

The Tribunal decided that he was not given the appropriate advice on the telephone. The person he spoke to was a Debt Management officer, not a helpline assistant, and the Tribunal believed that better advice could have been given that would have enabled the trader to avoid the surcharge. The Chairman's comment is interesting:

"We accept that HMRC maintain the proposition that callers to the VAT Helplines must ask the right questions to obtain the correct answers. We also accept that people staffing the Helplines are generally furnished with text answers to common questions, and that it is too much to expect the people staffing the Helplines to give constructive and intelligent and helpful advice. We consider, however, that the Appellant was let down in this case in the phone enquiries that he made with his contact in the Debt Management section, and we consider that it was HMRC that fell short in maintaining their standard of trying to assist those having trouble with their filings."

First Tier Tribunal (TC0071): *James Jeffery t/a Jeffery-Ryde*

A trader returned from a business trip on Friday 2 May. Monday 5 May was a bank holiday, and his VAT liability had to be paid by Wednesday 7 May. He could not find the internet security device that was required to operate his bank account on the Friday, so he was only able to instigate a payment on Saturday 3 May. It left his bank account on Tuesday 6 May and arrived on Thursday 8 May.

The comments of the Tribunal, allowing his appeal on the grounds that he had despatched the payment in time to have a reasonable expectation that it would arrive by the due date, are interesting:

"*Mr. Haygarth said in evidence (and the Tribunal accepted) that the delay in transmitting bank payments was being reduced every month and that now 90%of payments are received by the payee on the same day as the payment is made out of the payer's account.*

Mr. Holl submitted that a taxable person must have a 'cast iron guarantee' from a service provider to the effect that the payment will be received by HMRC by the due date if he is to be able to show that he had acted reasonably for these purposes. The Tribunal rejects this test as being too restrictive.

It is clear that it was reasonable for Mr. Haygarth to expect that payment would be effected within the two working days (between Tuesday 6 May and Wednesday 7 May 2008) which remained after the payment had been initiated and before the payment would be received late. As it was, the payment took three working days to reach HMRC with the result that it was one day late."

First Tier Tribunal (TC0039): *Fantastic Illuminations Ltd*

A trader was late in submitting two payments: the first attracted no penalty, the second was at 2% of £524,299. The Tribunal decided that there was a reasonable excuse for the first default: the trader had an insufficiency of funds following the breakdown of negotiations with the bank which had initially appeared likely to provide funding. A reasonable trader would have relied on the funds being available from this source and the sudden unavailability was a reasonable excuse.

The second default arose from attempting to make a CHAPS payment on a bank holiday. There was no reasonable excuse; however, because the first default had been struck out, there was also no penalty, and as there had been no default in the 12 months since, the trader had fallen out of the surcharge liability regime.

First Tier Tribunal (TC0031): *Dudman Group Ltd*

A golf professional went to a five-day tournament on 29 July 2008, intending to post the VAT return on the way. He left it at home. When he remembered it, he phoned directory enquiries and asked for "Customs and Excise". He was put through to someone who told him "not to worry as they can't process all the returns immediately". Accordingly, he posted the return when he came home, and subsequently received a default surcharge.

Apparently directory enquiries tend to give the number of Customs and Excise in the Isle of Man if asked for that name rather than HMRC. If the Isle of Man authorities receive an enquiry from a trader they suspect belongs in the UK, they give the National Advice Line number out; but it appears that this did not happen in this case. The Tribunal decided that this was a reasonable excuse for the late payment in the circumstances.

First Tier Tribunal (TC0023): *Lee Patterson Ltd*

A trader tried to make a BACS payment on the appropriate date, but the internet banking screen crashed just after he had pressed the confirmation button. He tried to find out over the next two days whether the payment had gone through but the bank could not tell him; when he finally confirmed that the payment had not been made, he made a CHAPS transfer but missed the same-day deadline.

The Tribunal decided that he had a reasonable excuse. There was no evidence from the bank to support this version of events and the member of staff concerned could not appear in person because he had emigrated to Australia, but the Tribunal saw no reason to doubt the account that had been given.

First Tier Tribunal (TC0013): *Lemon Consulting Ltd*

6.8.4 Unsuccessful default surcharge appeals

The Tribunal has considered a principle for default surcharges which was laid down in the case of *Dow Chemical Company Ltd* (13,954). This was that:

- HMRC cannot amend a default surcharge assessment which is raised at the wrong specified percentage: the assessment fails altogether;
- they can, however, amend the percentage if the original surcharge assessment was based on the facts as they were known at the time, but different facts are discovered later.

For example, if a trader has three defaults with late payment in a surcharge liability period, the correct rate for the next default is 15%. If HMRC raise an assessment at 10%, it would be wrong and could not be amended. However, if they raise an assessment at 15% and one of the defaults is subsequently shown not to count towards the surcharge because of a reasonable excuse or because it was despatched in time, then HMRC would be entitled to reduce the percentage to 10% to reflect the newly discovered facts.

In the case, a trader discovered when trying to make a BACS transfer that there was a limit of £10,000 on daily transfers. He therefore split the VAT liability into two – £10,000 and the balance – and the larger amount arrived late. The Tribunal did not think he had a reasonable excuse (he could have made alternative arrangements for a faster transfer on discovering the problem).

There was then a question of whether all the earlier defaults should "count" towards the 15% surcharge rate because one had not been notified to the trader. The Tribunal did not believe that the argument helped: one of the other returns in the surcharge period was late and was subject to surcharge when the 15% penalty was issued, and was subsequently found not to be subject to surcharge because, when the return was finally submitted, the amount paid on account was found to exceed the liability. This meant that, at the time the 15% penalty was issued, HMRC were entitled to believe that there were 3 defaults in the surcharge period. When it was subsequently discovered that one of those defaults should be struck out, HMRC were entitled to reduce the liability percentage to 10%.

First Tier Tribunal (TC0066): *Juppon Trading Ltd*

A restaurateur went to the bank at 3pm to make a CHAPS payment on the due date for VAT. Unfortunately there was a queue and more paperwork than normal because he had recently changed banks, and as a result the deadline for same day payment was missed. Although the situation was unusual, the Tribunal considered that it did not constitute a reasonable excuse: as he had four defaults in the previous two years, he should have been taking particular care to ensure that the payment was made on time, and by his own admission he could have made alternative arrangements on the day had he realised that the bank would take that long to process the payment.

First Tier Tribunal (TC0030): *The Depot Ltd*

A property management company appealed against default surcharges for 9 periods over 3 years, pleading a variety of reasonable excuses involving "insufficiency of funds, were changes in key members of staff, changes in

accounting systems, change to auditors, changes in accounting software, changes in property management software and loss of key customers". The Tribunal listened to what was described as a "general overview of the trading pattern of the appellant" and did not find that any of the circumstances amounted to a reasonable excuse.

First Tier Tribunal (TC0024): *Lever Street Properties Ltd*

A company pleaded reasonable excuse on the basis of poor performance by the financial controller and difficulties arising from poor payment by customers, as well as the bank tightening up overdraft and factoring facilities. The Tribunal did not consider any of these to constitute a reasonable excuse: in particular, the late payers were not sufficiently significant to make a material difference to the VAT liability, and the financial controller was within the definition of "any other person" for the exclusion of reliance as a reasonable excuse.

The Tribunal did allow the reallocation of two payments by the company from one VAT return period to another, which had the effect of substantially reducing the surcharge amount. It is not clear what effect this may have had on the other return period from which the payments were reallocated.

First Tier Tribunal (TC0002): *Touch Logistics Ltd*

A trader used a part-time book-keeper to prepare VAT returns. She had drawn up the return and the cheque for the period to September 2007 and locked them in her office awaiting the right time to send them out, but she was unexpectedly taken ill. The return and payment were therefore not posted until she returned, and they arrived too late. The Tribunal ruled that this constituted "reliance on another" and her dilatoriness or failure could not constitute a reasonable excuse.

First Tier Tribunal (TC0004): *Andrew Francis Acquier*

6.8.5 Late registration

A trader registered late (at least 19 months) for VAT and was issued with a s.67 penalty at 15%, mitigated by 50% for the fact that he voluntarily disclosed his liability to register when he became aware of it. He pleaded reasonable excuse on three grounds:

- he had acted in good faith;
- he had relied on his accountant and a succession of managers who ran the business for him;
- he had been unable to attend to the business personally because he was heavily involved in caring for his sick wife.

The Tribunal pointed out that the first two grounds could not be a reasonable excuse within the law; the third was not a reasonable excuse because the sickness was long-term rather than sudden and unexpected, and the trader should have paid sufficient attention to his VAT liabilities in spite of it. The Tribunal saw no reason to interfere with the 50% mitigation offered by HMRC.

First Tier Tribunal (TC0052): *Sinnathaby Sivarajah t/a Everest Curry King*

The owner of a hairdressing salon was the subject of an income tax enquiry, at the end of which his turnover was agreed to be over £67,000 rather than about £51,000. As a result HMRC investigated his VAT position and determined that he should have been registered for VAT many years before. He received a substantial assessment and a s.67 penalty at 15% with no mitigation.

The only substantive point in his defence (which was not put by him at the hearing because he did not attend) was that the turnover consisted in whole or in part of exempt "chair rent". The Tribunal accepted HMRC's argument that this was very unlikely to succeed because of the judgment of the High Court in *Vigdor Ltd* – it was very likely that the stylists used all the facilities of the salon and the rents would be liable at the standard rate. As the trader had not attended the hearing, the Tribunal allowed him the opportunity to ask for a further hearing if he wanted to bring forward evidence that might change the decision.

First Tier Tribunal (TC0041): *Michael Howe*

A partnership incorporated and realised at about the same time that they had become liable for VAT registration. They asked their accountants to apply, but the accountants did not do so. About a year later they changed accountants and the registration was proceeded with. A late registration penalty was levied, mitigated by just 10% for voluntary disclosure.

The Tribunal did not consider that reliance on the former accountants constituted a reasonable excuse. The trader was responsible for making sure that the registration took place, and had failed to do so. They were "not so concerned as they ought to have been".

First Tier Tribunal (TC0027): *Art & Soul (Glasgow) Ltd*

HMRC formed the opinion that a married couple, who were not registered for VAT, were carrying on two hairdressing businesses in partnership, and had exceeded the registration threshold. They imposed a s.67 penalty of £8,892 for failure to notify liability. The couple tried the unusual defence that the partnership had been a sham set up on the advice of their accountant to use the husband's income tax allowances – he did not have any involvement in the business and did not draw any of the profits.

The Tribunal upheld the penalty in principle, holding that the partnership was real enough and that there was no reasonable excuse for the failure to register, but directed that the penalty should be mitigated to just £25 to take account of co-operation.

First Tier Tribunal (TC0042): *JA & LA Hooper*

Meanwhile, HMRC have issued a new version of the notice on the late registration penalty. It has been restructured to improve readability, but the technical content has not changed. New rules come in for this penalty on 1 April 2010.

Notice 700/41

6.8.6 Dishonesty

A company was assessed to a s.60 penalty and HMRC sought to recover it from one of the directors under s.61. The director appealed, admitting his dishonesty but arguing that the other directors had also known about the evasion and should contribute. The Tribunal did not accept this as a fact, but held that he was in any case liable for the penalty because of his own dishonesty.

HMRC had mitigated the penalty by 80% because of co-operation and voluntary disclosure. This had been carried out by the other directors after the appellant had left the company. The Tribunal chairman considered that the appellant could not reasonably impugn the honesty of the other directors, who had achieved a substantial reduction in the penalty by making a full disclosure, and thereby make them contribute some of the penalty that was due because of his own dishonesty.

The background to the fraud, and the conflicting accounts given by the HMRC officer and the appellant, were considered in detail. The Tribunal considered that a number of inconsistencies undermined the appellant's credibility. The chairman was reluctant to find that the other directors had been dishonest because they had not attended the hearing and had no chance to give their side of the story directly. In any case, the 20% penalty after mitigation was a fair reflection of the appellant's culpability in the fraud even if the other directors had been dishonest as well, and his appeal was dismissed.

First Tier Tribunal (TC0077): *Gary Giles*

6.9 Other administration issues

6.9.1 Articles about administration

The recent plethora of changes on administration – implemented, in transition and proposed – are reviewed in numerous articles in the professional press:

- HMRC's efforts to provide "customer service": Neil Warren in *Tax Adviser*, April 2009;
- the proposal to "name and shame" defaulters: *Taxation* 30 April 2009 p.406;
- HMRC's new powers: *Taxation* 21 May 2009 p.496;
- HMRC's consultation on "Working with tax agents": *Taxation* 11 June 2009 p.576 (Robert Maas is very unhappy about the proposals);
- the proposed HMRC charter: *Taxation* 18 June 2009 p.603 (Mike Truman is unhappy about the proposals).

6.9.2 Crackdown

The Budget included several announcements of proposals to make life more unpleasant for people who deliberately default on their tax obligations. Anyone penalised on a deliberate understatement of £25,000 or more will be "named and shamed" on the HMRC website. In addition, there is a proposal that people penalised for deliberate understatements of £5,000 or more may be subject to more detailed filing requirements for up to 5 years in order to confirm that they have put their records in order and will now file accurate returns.

BN63

The Budget also included the proposal that HMRC should be given the power to require large companies and large groups to nominate a "senior accounting officer" who will have to certify to HMRC that systems are in place to ensure that tax reporting is accurate or, if there are deficiencies, certify that they have been reported to the company's auditors.

BN62

6.9.3 New compliance checks

HMRC have published a series of factsheets covering their new procedures for carrying out compliance checks on businesses. All can be viewed on the HMRC website:

- CC/FS1 General information
- CC/FS2 Requests for information and documents
- CC/FS3 Visits – Pre-arranged
- CC/FS4 Visits – Unannounced
- CC/FS5 Visits – Unannounced – Tribunal approved
- CC/FS6 What happens when we find something wrong
- CC/FS8(T) Help and advice

www.hmrc.gov.uk/leaflets/cop9-2009.htm

6.9.4 New COP9 and Notice 160

HMRC have published an updated version of COP 9, the code of practice for investigation of serious civil fraud. It has been updated to reflect the new appeals process. The procedure remains much as before, centring on the meeting with the taxpayer and the asking of the following four questions (for VAT – there are five for direct taxes):

Question 1

Have any transactions been omitted from, or incorrectly recorded, in the books and records of (name of legal entity) for which you are (responsible status)?

Question 2

Are the books and records you are required to keep by HMRC for (name of legal entity) for which you are (responsible status), correct and complete to the best of your knowledge and belief?

Question 3

Are all the VAT returns of the (name of legal entity) for which you are (responsible status) correct and complete to the best of your knowledge and belief?

Question 4

Were you aware that any of the VAT returns were incorrect or incomplete at the time they were submitted?

www.hmrc.gov.uk/leaflets/cop9-2009.htm

Meanwhile, HMRC have issued a new version of Notice 160 *Enquiries into indirect tax matters*, even though it was last updated in April 2009. The new version has separate consideration of the penalty regimes that will apply if the misstatement relates to a period with a filing date before 1 April 2009 (the "old penalty rules") or after 31 March 2009.

Notice 160

6.9.5 Avoidance "spotlight"

HMRC have commented recently on a number of artificial avoidance schemes that they are investigating. The only one involving VAT is described as follows:

VAT artificial leasing

We are aware of schemes using an artificial leasing structure to exploit possible differences of interpretation by EU Member States of a lease with an option to purchase. The scheme user acquires a new pleasure craft which purportedly has 'VAT paid status' while, in reality, paying little or no VAT. The user provides the funds, directly or indirectly, that are used to purchase the asset. We will challenge examples of this scheme falling within our jurisdiction and recoup the tax that has been avoided.

HMRC release 27 April 2009

6.9.6 Security

As usual, all those traders who have appealed against a notice requiring security have lost their appeals. The only benefit from making such an

appeal is the fact that HMRC suspend the requirement to lodge the security while the appeal is being heard: this means that the trader is not automatically guilty of criminal offences on losing the appeal. However, the decision to require security is invariably found to be a reasonable one, and presumably the traders then have to comply within 30 days or go out of business. As many of them appeal on the grounds that complying with the notice will force them to close, it must be interesting to HMRC to see whether this actually happens.

In one case, the trader had perhaps realised that the appeal was only a delaying tactic, because no-one turned up to represent the taxpayer before the Tribunal. Costs of £500 were awarded to HMRC in addition to the confirmation of the notice.

First Tier Tribunal (TC0072): *St Enoch's Garage Ltd*; (TC0072): *Lougula Ltd and others*; (TC0097): *Arkzone Ltd*; (TC0092): *Winshill Scaffolding Services (UK) Ltd*