VAT UPDATE
OCTOBER 2009

Covering material from July – September 2009

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VAT Update October 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 (UK cases only):

- *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)
- *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)

In addition, the Tribunal has referred appeals by *British Sky Broadcasting Group plc* (LON/2008/7164) and *PACE plc* (MAN/2009/7008) to the ECJ, but no details of the subject matter are given (First Tier Tribunal decision TC00150).

UK appeals awaiting hearing:

- *Insurancewide.com/Trader Media Group*: HMRC have been given leave to appeal to the Court of Appeal on the extent of the exemption for introductory services relating to insurance (see 2.3.2)
- *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" (now so long delayed that it may have been settled)
- *The Rank Group plc*: whether mechanised cash bingo and gaming machines are exempt (HMRC have announced intention to appeal the Tribunal's decisions in favour of the company to the High Court, as well as further matters to be heard by the Tribunal – see 2.3.3))
- *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)

Referred to in this update from previous lists:

- *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 – see 6.4.1)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Political organisation a taxable person?

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

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

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

2.1.2 Tips etc.

HMRC have issued an updated version of their Notice E24, *Tips, Gratuities, Service Charges and Troncs*. The policy on service charges has not changed, but it is worth remembering the precise conditions for treating such charges as outside the scope of VAT:

Tips are outside the scope of VAT when genuinely freely given. This is so regardless of whether:

- *the customer requires the amount to be included on the bill*
- *payment is made by cheque or credit/debit card*
- *or not the amount is passed to employees.*

Restaurant service charges are part of the consideration for the underlying supply of the meals if customers are required to pay them and are therefore standard rated.

If customers have a genuine option as to whether to pay the service charges, it is accepted that they are not consideration (even if the amounts appear on the invoice) and therefore fall outside the scope of VAT.

The subject is currently topical because of a recent case in which it was held to be illegal for restaurant employers to use tips and the tronc to make staff pay up to the National Minimum Wage. Employers may therefore be reviewing how they deal with tips.

Notice E24 Tips, Gratuities, Service Charges and Troncs

Disbursements

2.2.1 Article on expenses recharged

There is an article in *Taxation*, 30 July 2009, on expenses incurred for clients and customers and then recharged. Neil Warren explains the crucial difference between disbursements and additions to the fee.

Taxation 30 July 2009

2.3 Exemptions

2.3.1 HMRC accept *Homeserve* decision

HMRC have announced that they will not appeal the *Homeserve* decision, and will repay other companies which have accounted for IPT on similar arrangements subject to the usual rules on capping and unjust enrichment.

However, they will resist claims where they believe that fees have been “artificially carved out of what would ordinarily be taxable insurance premium”. They will also take action to close the loophole which has been revealed by the outcome of the case.

R&C Brief 47/09

2.3.2 Consequences of *Insurancewide*

HMRC have issued a Brief to set out their views of the consequences of the High Court judgment in *Insurancewide/Trader Media Group*. It confirms that HMRC have been given leave to appeal to the Court of Appeal. HMRC do not believe that the provision of the “click-through” service, whereby surfers are directed to websites selling insurance and the companies are paid commissions on successful sales resulting, is an insurance intermediary service because there is no involvement in the contract.

HMRC assert that the decision has no relevance to the liability of similar services in relation to other financial products, because the Group 5 exemption specifically requires the intermediary to carry out “work preliminary to the contract” as well as performing an introduction. The High Court judge held that the insurance exemption did not require anything more than an introduction, and a major part of HMRC’s reason for appealing is to clarify the scope of that part of the decision.

The usual advice is given about making claims for repayment, which will be the subject of protective assessments pending the completion of litigation.

R&C Brief 59/09

Fallout from *Rank* decision

HMRC have accepted defeat in relation to the part of the *Rank* decision that related to mechanised cash bingo participation fees, and they will process claims which are on all fours with that case.

In relation to gaming machines, HMRC say that the appeal to the High Court related only to an interim decision of the Tribunal. As the Tribunal has not yet given a full ruling on the case, other claims will not be considered until it is settled.

The Brief gives the usual advice about making claims and adjustments, and also draws attention to the direct tax implications of a VAT repayment as set out in *R&C Brief 14/09*.

R&C Brief 40/09

Meanwhile, the Treasury has issued a consultation document which may lead to changes in the way in which gaming machines are taxed. The main proposal under consideration appears to be a gross profits tax to replace the various levies which are currently charged on such machines.

HM Treasury Consultation 16 July 2009

A further Brief states that HMRC have applied for leave to appeal against the High Court's ruling that MCB "par fees" are also exempt, and will not process claims in respect of these until that dispute is resolved. In case the decision goes against HMRC, they are raising protective assessments in respect of bingo duty which will be due if the VAT exemption applies. The Brief explains the interim position which HMRC will adopt.

R&C Brief 55/09

2.3.4 Investment management or arranging?

It has been reported that HMRC are reviewing the treatment of execution fees charged by discretionary fund managers to their clients. Investment management services are generally chargeable, whereas fees for arranging specific transactions are exempt. HMRC apparently are considering whether execution fees charged to a discretionary management client are in effect to be compounded with the taxable management fee – they are incidental to it and therefore ought to take on the same liability.

2.3.5 More references on healthcare

Following the reference of *Future Healthcare Technologies* to the ECJ, three other cases on the scope of the exemption for healthcare have been referred.

In the first case, from Germany, the first few questions appear to relate to place of supply rather than exemption.

Is the first paragraph of Article 28bF 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 to be interpreted as meaning that:

(a) cartilage material ('biopsy material') which is taken from a human being and entrusted to an undertaking for the purpose of cell multiplication and subsequent return as an implant for the patient concerned constitutes 'movable tangible property' for the purposes of this provision,

(b) the removal of joint cartilage cells from the cartilage material and the subsequent cell multiplication constitute 'work' on movable tangible property for the purposes of this provision,

(c) the service has been supplied to a customer 'identified for valued added tax purposes' simply if the value added tax identification number is stated in the invoice of the supplier of the service, without any express written agreement as to its use having been made?

If any of the above questions is answered in the negative:

Is Article 13A(1)(c) 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 to be interpreted as meaning that the removal of the joint cartilage cells from the cartilage material taken from a human being and the subsequent cell multiplication constitute the 'provision of medical care' where the cells obtained from the cell multiplication are reimplanted in the donor?

ECJ (Reference) (Case C-156/09): *Finanzamt Leverkusen v Verigen Transplantation Service International AG*

The second case is a simpler question which relates to a more limited activity, and at first sight appears less likely to fall within the exemption:

Does the activity of transporting, in a self-employed capacity, human organs and samples for hospitals and laboratories constitute the supply of human organs, blood and milk, which is exempt from value added tax under Article 13(A)(1)(d) 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?

ECJ (reference) (Case C-237/09): *État Belge v Nathalie De Fruytier*

The third case has reached an opinion from Advocate-General Sharpston. The opinion is that "*a service such as the collection, transportation, analysis and storage of umbilical cord blood is to be regarded as closely related to hospital or medical care*", within Article 13A(1)(b), "*if the blood collected can be used for the purpose of such care, is collected for that purpose and cannot be used for any other purpose. It is irrelevant in that regard whether such care is specifically envisaged at the time the service is provided. A service which does not seek to avert, avoid or prevent the occurrence of a health disorder, or to detect such a disorder in a latent or incipient state, is not a preventive medical service covered by Article 13A(1)(b)*".

In order to qualify for exemption, "*a body not governed by public law must provide its services under social conditions comparable to those applicable to bodies governed by public law; be of a similar nature to a hospital or centre for medical treatment or diagnosis; and be duly recognised for that purpose. A decision of the national authorities not to grant such recognition is not precluded by the fact that services, such as*

the collection, transportation, analysis and storage of umbilical cord blood, are performed by professional health personnel or the fact that the establishment in question has obtained authorisation to handle stem cells from such blood pursuant to national legislation which implements Directive 2004/23/EC of the European Parliament".

These answers were "*not affected by whether the services are supplied with a view to autologous or allogeneic use*". This means use on the person who provided the material in the first place or on someone else.

This opinion will be encouraging to *Future Healthcare Technologies*, who appear to be covered by the same principles.

ECJ (A-G) (Case C-262/08): *CopyGene A/S v Skatteministeriet*

2.3.6 Psychologists become exempt

Practitioner psychologists have become regulated by the Health Professionals Council with effect from 1 July 2009, and their services are therefore capable of falling within Sch.9 Group 7 VATA 1994 from that date. HMRC explain in a Brief that the exemption may extend to "services such as counselling, working with children with emotional problems, dealing with criminals' behavioural problems or running stress management courses".

However, in line with the principles of the *d'Ambrumenil* case, work which is not primarily concerned with the well-being of the patient would be excluded from exemption. The Brief explains that "assessing a patient's mental condition for legal reasons at the behest of a third party" is not exempt because "the primary purpose of such services is to enable a court to take a decision on whether the patient is fit to stand trial rather than any immediate concern about the patient's mental health.".

R&C Brief 43/09

2.3.7 Help to stop smoking

A trader supplied services to clients who wanted to stop smoking using a version of a method that was devised by Allen Carr in the 1980s. HMRC ruled that the services were standard rated, and assessed for tax and misdeclaration penalties. The trader contended that the services were medical in nature and were directly supervised by a registered medical practitioner.

The appellant had been the subject of an earlier decision (*Easyway Productions Ltd* (14,938)) in which no view was expressed about whether the services were medical care, but the conclusion was drawn that they were not directly supervised by a medical practitioner. The company argued that the way in which its business was organised had changed: there was now greater input and more direct supervision from a new doctor, who had adapted the earlier method for assisting clients to give up smoking and who provided advice to therapists.

The Tribunal examined the arguments in detail. It noted that the "original" Allen Carr method probably does not qualify as medical care, but the input of the appellant's medical consultant meant that the services of the company did so qualify. Similarly, his level of involvement meant that the services were "directly supervised". The appeal was allowed.

The Tribunal also noted that the appeal against the penalty would have been allowed even if the main decision had gone against the company. HMRC appeared to believe that the company had ignored the earlier Tribunal decision and had carried on treating the supplies as exempt without good reason; the company produced ample evidence to show that it had tried without success to resolve the issue with HMRC over many years.

First Tier Tribunal (TC00136): *Allen Carr's Easyway (International) Ltd*

2.3.8 Cosmetic surgery was not healthcare

In the case of *Joan Burke* (TC00055), HMRC successfully argued that intense pulse laser treatments to remove unwanted hair were cosmetic surgery and were therefore not "medical care" and fell without the exemption in Sch.9 Group 7 VATA 1994. In a more recent case they appear to be arguing the opposite: it was accepted that the company provided cosmetic surgery (of various kinds), but HMRC ruled that it fell within the exemption because it was a regulated institution (i.e. a hospital). A large amount of input tax was therefore disallowed.

The Tribunal agreed with the earlier decision. The fact that a procedure took place within a hospital was not enough on its own to qualify for the exemption: the purpose had to be considered, in line with the *d'Ambrumenil* case and related decisions. The supplies were standard rated which, in this case, was what the taxpayer wanted.

First Tier Tribunal (TC00142): *Ultralase Medical Aesthetics Ltd*

2.3.9 Online manual updated

HMRC have moved their online manual on burial and cremation from their "V Series Guidance" to the main body of HMRC manuals.

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

Zero-rating

2.4.1 Carbon credits become zero-rated

The government has responded to the threat of emissions allowances (often called "carbon credits") being used for carousel fraud by changing the law to make their supply zero-rated with effect from 31 July 2009. This prevents the purchase of emissions allowances from elsewhere in the EU followed by their taxable sale within the UK – similar to a carousel using mobile phones or computer chips.

Similar action has been taken by the Netherlands and France. Although no derogation has yet been granted, the government believes that immediate action was required to prevent the risk of fraud. A derogation has been applied for and further action to reach an EU-wide solution is being discussed.

R&C Brief 46/09; SI 2009/2093

2.4.2 Outsourced services and transport relief

A charity conducted scientific studies of the condition of sea water and all forms of marine life in the river estuary and the sea surrounding

Plymouth. The Department of Trade and Industry made large donations to fund the research, such that, although the Appellant was not state-owned, it was substantially state-funded.

Initially the appellant organised the operation of three boats to carry out its work, but it then decided to outsource the operation to another company, Serco. The boats were charted to Serco for a nominal £1; Serco then entered into a detailed contract with the charity, setting out what the company would do for the charity in return for payment.

The charity argued that the payments to Serco should be zero-rated because it was receiving services under a charter of a qualifying ship (zero-rated within Item 1 and Note 1, Sch.8 Group 8 VATA 1994).

The Tribunal examined the contract in detail and decided that it did not constitute a charter-back of the boats from Serco by the charity. Instead, Serco had acquired the use of the boats on a charter, but used them in its own trade which involved providing a range of services to the charity. This could not be described as a charter. It would be artificial to split the supply and to regard any part of it as zero-rated, because the dominant purpose was the rendering of services to which the boats were incidental.

The Tribunal commented that the drafting of the contract was crucial: had the contract been drafted differently, the result might also have been different.

First Tier Tribunal (TC00134): *Plymouth Marine Laboratory*

2.4.3 Dutch barges

Following the High Court's decision in *HMRC v Stone; The Kei*, HMRC have decided to treat similar vessels as eligible for zero-rating. However, the majority of narrow boats designed for permanent residential use will continue to be standard-rated, due to their weight. The relief will only apply where the boat is a "qualifying ship", i.e. with a weight of at least 15 gross tons.

The High Court held that use as a permanent residence did not mean that the boat had been designed or adapted for recreation or pleasure. Houseboats are in any case zero-rated, but unlike most houseboats Commander Stone's Dutch barge was capable of moving about under its own power.

A R&C Brief explains the conditions HMRC will expect to see satisfied in order to benefit from zero-rating, and the extent of the relief (which will extend to some related services such as repairs and maintenance).

R&C Brief 38/09

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Polish car registration charges

The Commission has referred Poland to the ECJ in a dispute about the calculation of the taxable amount on sales, acquisitions and importations of cars. Poland includes the vehicle registration charge in the amount that is subject to VAT. In the 2005 decision in Case C-98/05 *De Danske Bilimportører*, the ECJ held that similar Danish rules were contrary to the 6th Directive.

The Commission takes the view that the operation of the Polish registration charge in the case of successive transactions concerning the same vehicle prior to its registration shows that it is in essence a registration tax/charge, and not a tax on sales as the Republic of Poland maintains. The taxable person can deduct the amount of the registration charge from the amount of tax chargeable. This means that ultimately, through the system of deduction of the tax paid previously, the tax/charge is levied only once.

The Commission does not concur with the Republic of Poland's argument that the person liable for payment of the registration charge is the seller, the intra-Community acquirer or the importer of the vehicle and not the person in whose name the car is registered.

Car sellers in the UK are usually able to tell the difference between items in the "on the road price" which are subject to VAT and those which are not, although disputes sometimes arise where some of the consideration is allocated to insurance.

ECJ (application) (Case C-228/09): *Commission v Republic of Poland*

Rate change

HMRC have published on their website a detailed guide to a number of issues relating to the rate increase.

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

HMRC's regular publication "Working Together" gives some advice to accountants on how to help their clients prepare for the rate change on 1 January 2010. Helpfully, it says "*We will be operating a 'light touch' in terms of errors made in the first VAT return after the change where the error relates to a change of rate issue. What this means is that we will not target change of rate errors that are unlikely to lead to any material net revenue loss. Also if we find errors which relate to a change of rate issue we will not seek an adjustment unless we have reason to suppose that there is an overall revenue loss. In situations where we do need to adjust (and issue an assessment) we will take into account the difficulties the business has faced in adjusting to the change in considering whether penalties apply.*

HMRC also refer to the anti-forestalling legislation and suggest that accountants should explain this to their clients, although they do not expect it to apply to many people.

Working Together Issue 37

There is an article in ICAEW *TAXline*, October 2009, pointing out some practical issues arising on the change of rate on 1 January 2010. Neil Warren explains the rules and highlights some problems. One important distinction is the difference in VAT treatment between a continuous supply of services (where an invoice after the rate change can be apportioned on a fair and reasonable basis) and a single supply (where some of the work may straddle the rate change, but the invoice can only have one or other VAT rate on it). However, HMRC will allow someone to charge 15% for work done up to the end of December, even though an invoice is raised in January, as long as the split can be justified by records of completion of the services.

TAXLine October 2009

There is also an article in *Taxation*, 27 August 2009, in which Richard Asquith speculates on the likelihood of future VAT rises in the UK. Higher rates are being imposed across the EU, and it seems unlikely that the UK can narrow its deficit without raising taxes considerably. VAT seems an obvious candidate.

Taxation 27 August 2009

2.6.3 Tickets

There is an article in Tax Adviser, July 2009, in which Adam Rycroft questions HMRC's view that the sale of a ticket fixes a tax point for the supply of the performance, regardless of when the performance takes place. The writer suggests that taxpayers who sold tickets before 1 December 2008 for events happening afterwards should not accept HMRC's view that the tax rate is fixed at 17.5%.

Tax Adviser July 2009

Amusingly, the deputy director of GST in Jersey wrote in to *Tax Adviser* to question Mr Rycroft's article. Because he appeared to be unaware that HMRC had raised the point in the first place, he argues that "it is obvious that the time of supply is when the performance takes place". This only strengthens the point that Mr Rycroft was making.

Tax Adviser August 2009

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Dietary help was a single supply

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

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

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

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

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

The Court of Appeal agreed with the judge's reasoning. The Tribunal had not adequately addressed the question of the interdependency of the two parts of the supply. According to precedent, they could only be a single supply with a single liability.

Court of Appeal: *HMRC v David Baxendale Ltd*

2.9 Agency

2.9.1 Staff on secondment: agent or principal?

Sussex Police Authority seconds employees to two charities, the Sussex Police Welfare Fund and the Sussex Police Staff Welfare Fund. HMRC ruled that SPA was liable to output tax on payments received from the Funds; the Funds would not be able to recover this as input tax.

SPA offered two arguments against the liability:

- the staff were employed by SPA as agent for the Funds, rather than as principal, so there was no supply by SPA to the Funds; or
- the supply of the staff was a "domestic arrangement" which was not by way of business.

A number of different circumstances led to the conclusion that the staff were employed by SPA. First among these was their need to have access to confidential information: it was considered inappropriate for someone to have this access unless they were employed by SPA. The Tribunal found that the situation was therefore analogous to that in *Tarmac Roadstone*, in which staff of one group company were supplied to another for reimbursement of the employment costs.

The cases put forward by SPA on the "business" argument were either inapplicable (*Lord Fisher*) or very old and superseded (*Processed Vegetable Growers Association,* a 1973 case). *Durham Aged Mineworkers Homes Association* also did not apply because there was no evidence of a mutual arrangement between the two bodies as there was in that case: here, the SPA incurred all the costs and supplied them on to the Funds.

The appeal was dismissed.

First Tier Tribunal (TC00143): *Sussex Police Authority*

It is worth noting that the Staff Hire Concession still contains a provision that might help the SPA, if they set up the arrangements appropriately:

Concession for secondment of staff by businesses other than employment businesses

Where an employer (other than an employment business within the meaning of the Employment Agencies Act 1973) seconds a member of its staff (the employee) to another business which

(a) exercises exclusive control over the allocation and performance of the employee's duties during the period of secondment; and

(b) is responsible for paying the employee's remuneration directly to the employee and/or discharges the employer's obligations to pay to any third party PAYE, NICs, pension contributions and similar payments relating to the employee,

then, to the extent that any payments within (b) above form the consideration (or part) for the secondment of the employee to the other business, they are disregarded in determining the value of seconding the employee. For these purposes, an employer is not to be treated as seconding an employee to another business if the placing of the employee with that other business is done with a view to the employer (or any person associated with him) deriving any financial gain from

- the placing of the employee with the other business, or
- any other arrangements or understandings (whether or not contractually binding and whether or not for any consideration) between the employer (or any person associated with him) and the other business (or any person associated with it) with which the employee is placed.

VAT Notice 700/34/05, para.4B

By contrast, a company succeeded in persuading the Tribunal that it acted as agent and paymaster when it paid certain employees who worked for other companies in its corporate group (outside a VAT group registration). Initially the appeal was based on the argument that there was a joint agreement between the companies and the workers, but this was abandoned at the hearing and replaced with the assertion that the "employer" had acted as agent.

HMRC initially applied for an adjournment because they had not had enough time to prepare for this alternative argument. The Tribunal would not accept this because the assessment dated from 2005 and witnesses had been called for a two-day hearing: there was no prospect of rescheduling the hearing in the foreseeable future. After a break, the Tribunal was told that the parties had agreed that the alternative defence would be accepted, so the appeal was formally allowed.

First Tier Tribunal (TC00153): *Hilltop Assistance Ltd*

2.9.2 Article on TOMS

There is an article in *Taxation*, 23 July 2009, on the forthcoming changes to TOMS. Stephen James explains the new rules from 1 January 2010.

Taxation 23 July 2009

2.9.3 Taxis: whose turnover?

An individual registered as a taxi operator in 1999. From 2005 onwards he was in dispute with HMRC over the VAT liabilities of the business. He used several other drivers who were self-employed, and they shared the responsibilities of "controller". The other drivers paid a contribution to the business in order to pay the controller. The individual also drove his own taxi, but did not pay the contribution for the controller. He did not account for output tax on:

- the income of the self-employed drivers, because they were independent businesses;
- the contributions by the self-employed drivers to the business, because he did not think it was consideration for any supply;
- his own income from driving, because he believed that he was below the VAT registration threshold.

As a result, he had filed repayment returns for many years. HMRC did not argue that he should account for output tax on the first of these, apparently accepting that the drivers were independent principals; however, they assessed for VAT on the second and third headings, using the individual's own accounts as the basis for the figures.

The individual continued to argue about the liability for another four years, but the Tribunal dismissed his appeal with a detailed examination of the facts and arguments. He suggested that he had been misdirected by Customs to register in the first place when he did not have to: there was no evidence for this, even if it was something that the Tribunal could consider. The assessments were confirmed.

First Tier Tribunal (TC00121): *Mark Lancaster t/a Airport Cars*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Private use of company cars

HMRC agreed with representatives of the motor industry an average amount which should be charged to output tax where employees have private use of cars on which the company can deduct input tax (generally demonstrator vehicles which do not leave the trading stock of the business). Some traders sought to circumvent this by charging a nominal amount of actual consideration to the employees, which would be chargeable instead of the deemed consideration agreed with HMRC. A Sch.6 para.1 direction would not be possible because the trader would not be "connected" with its employees in the required sense.

FA 2004 introduced a new Sch.6 para.1A to cover this situation. The appointed day for it to take effect was 1 January 2005. This permitted HMRC to issue a market value direction in the precise circumstances exploited by the scheme.

A trader had entered into the scheme with its employees during 2004. They paid a nominal £10 to cover use of various employer vehicles over the next 10 years (i.e. £1 per year, payable at the outset of the agreement). HMRC issued directions and assessments on the trader. The appeal was centred on the argument that the tax point for the £10 payments fell before the appointed day for Sch.6 para.1A to come into effect, so the directions were invalid.

The Tribunal ruled that the time of supply was governed by SI 1995/2518 reg.81. It was the last day of the trader's "*prescribed accounting period, or of each such accounting period, in which the goods are made available or used*". The direction was open-ended, and it was therefore necessary to determine the open market value on different facts at different times. The assessments were upheld.

First Tier Tribunal (TC00165): *Lookers Motor Group Ltd*

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Use of country house

A company owned a country house, which it rented out for weekends for weddings, wedding receptions and other functions. HMRC assessed the company on the basis that the supply was of a property "similar to a hotel" or "holiday accommodation" and was therefore excluded from exemption within Items 1(d) or (e), Sch.9 Group 1 VATA 1994. A misdeclaration penalty was also assessed.

The trader argued that the letting of the whole property on a self-catering basis for short-term events was not similar to the services of a hotel, and the fact that the events were not holidays meant that the supply was not of holiday accommodation.

The Tribunal examined a number of precedent cases for principles that might be applied, noting similarities to and differences from the circumstances of the earlier disputes. It concluded that the property was similar to a hotel; if it was wrong in that, it also concluded that it was holiday accommodation. The appeals against the assessments were dismissed.

However, the appeal against the misdeclaration penalties was upheld. A director had phoned the National Advice Line in 2004 and had been given the impression that the supplies would be exempt. The Tribunal appeared to accept this as a fact, which suggests that HMRC should have applied the Sheldon concession. However, misdirection and the operation of the concession are not matters that the Tribunal can take into account for the assessment. The misleading advice was considered to be a reasonable excuse which cancelled the penalty.

First Tier Tribunal (TC00173): *Acrylux Ltd*

3.2 Option to tax

3.2.1 Changes and corrections to new option rules

A number of changes to Sch.10 VATA 1994 came into operation on 1 August 2009. They are described in a R&C Brief as:

- minor changes to the operation of the option to tax;
- changes to the connected persons rules.

The minor changes arise from ongoing discussions with businesses about the practical operation of the new Schedule. It was introduced in 2008 and some difficulties have arisen which HMRC did not foresee or intend. The changes include:

- The period for notification of the exclusion from the effects of an option to tax has been increased to 30 days or such longer period as HMRC may allow.

- Denying automatic revocation under the six year rule, or on making a Real Estate Election ('REE'), where further supplies (for example, overages) will or may arise after revocation.
- Ensuring that all members of a VAT group are considered when options are revoked.
- Changes to the rules on REEs so that if there is more than one tax point for a supply, the option is made on the date of the first supply.
- Amending the capital item condition of the 20 year automatic revocation rules so that a taxpayer who meets all the other conditions can still have automatic revocation if the sum of all the remaining Capital Goods Scheme adjustments is £10,000 or less.
- Amending the rules on granting permission to revoke an option to tax after 20 years so as to enable the time of revocation to be tied to an event. This would allow revocation to be linked to say, the sale of a property.

The changes to the connected persons rules have become necessary following the effective nationalisation of banks. As a result of the Government taking shares in them, several banks have become 'connected' for the purposes of s839 ICTA 1988. This triggers certain anti-avoidance rules which would lead to unintended tax implications on certain transactions. The amendment treats taxpayers as unconnected where their only connection (within the meaning of s.839 ICTA 1988) is because they are controlled by the Crown, a minister of the Crown, a Government Department or a Northern Ireland Department. The changes affect:

- the option to tax (para.34 to Sch.10 VATA 1994);
- supplies of land for indeterminable consideration (reg.84 SI 1995/2518);
- supplies of construction services (reg.93 SI 1995/2518);
- continuous supplies of services (reg.94 SI 1995/2518).

Further details of the changes are given in an Information Sheet, which contains an Annex which has the force of law (tertiary legislation). This will be reproduced in a new version of Notice 742A in due course.

R&C Brief 44/09; Information Sheet 12/09; SI 2009/1966

Subsequently an error was spotted in the way in which the Information Sheet and Business Brief described the "20 year condition" in Box G. The two documents were withdrawn and replaced. The correct version of the condition, which relates to automatic permission for revoking an option, is:

The taxpayer or a relevant associate connected to the taxpayer held a relevant interest in the building or land which is:

- *after the time from which the option has effect; and*
- *more than 20 years before the option is revoked.*

R&C Brief 51/09; Information Sheet 14/09

There is an article by Neil Warren in *Tax Adviser*, August 2009, which partly deals with the long-awaited opportunity to revoke options to tax:

3.2.2 New Notice 742A

A new version of Notice 742A was issued on 27 July 2009 to incorporate the 2008 revision of Sch.10. The changes from the earlier versions are explained as follows:

This notice replaces Information sheet 03/08 and notice 742A Opting to tax land and buildings (March 2002 edition). The notice has been revised to incorporate updates 1, 2 and 3 into the text, and provides additional guidance on changes introduced with effect from 1 June 2008. The main changes are as follows.

- *new rules providing that an option to tax affects land and buildings on the same site, with transitional rules, and ability to exclude new buildings from the scope of an option to tax (section 2).*
- *new certificate for buildings to be converted to dwellings etc and new ability for intermediaries to disapply the option to tax (section 3)*
- *new certificate for land sold to housing associations (section 3)*
- *new rules for ceasing to be a relevant associate of an opter (section 6)*
- *extension to the 'cooling off' period for revoking an option to tax (section 8)*
- *introduction of automatic revocation of the option to tax where no interest has been held for 6 years (section 8)*
- *introduction of rules governing the revocation of an option to tax after 20 years (section 8)*
- *revised definition of occupation for the anti-avoidance test including new exclusion for automatic teller machines (section 13)*
- *introduction of a new way to opt to tax (a real estate election) (section 14).*

The latest amendment, in Information Sheet 14/09, is not yet incorporated.

Notice 742A

Developers and builders

3.3.1 Deposits for land on which houses will be built

HMRC have commented on the situation in which a customer pays a deposit for a supply of land on which houses will be built. The principle is of general application, although the Brief refers in particular to sales by developers to Registered Social Landlords.

Where construction has not reached what is called "the golden brick" (above ground level, qualifying as a "house in the course of construction" and therefore zero-rated rather than exempt), the question arises whether the payment of a deposit triggers an exempt supply by the developer which might restrict input tax.

HMRC believe that no tax point arises, and therefore no issue arises, if the deposit is held by a stakeholder and not made available to the vendor until completion. Where the vendor receives the money, there is a tax point; however, HMRC believe that the liability of the supply depends on what happens at completion. If it is clear from the contracts that the intention is for a completion of transfer when the "golden brick" stage is passed, the deposit will represent part payment for an intended zero-rated supply.

If the intention changes later, it may be necessary to revisit the computations and revise recovery on the basis that the supply would have become exempt.

R&C Brief 36/09

3.4 Input tax claims on land

3.4.1 Attempted scheme fails

A college of further education appears to have attempted to recover input tax on building costs by means of a scheme involving a taxable subsidiary, but the Tribunal did not consider the scheme effective.

The input tax was claimed by a commercial company, Grimsby College Enterprises Ltd (GCEL). This company had been established by the Corporation of Grimsby Institute of Further and Higher Education (CGI) in 1993 to carry on commercial teaching operations. This was not driven by tax considerations, but out of concern that the charitable status of the parent might be compromised by carrying on commercial activities. GCEL had no staff or resources of its own: it bought in resources from CGI in order to sell them on to its customers. CGI was an "eligible body" for the purposes of Sch.9 Group 6 VATA 1994; GCEL was not.

HMRC enquired into GCEL's returns and initially appear to have accepted that it was entitled to the credit. However, on further investigation HMRC formed the view that the supplies of building services were in reality made to its parent. They raised an assessment to recover the input tax reclaimed by GCEL. The company appealed.

On appeal, HMRC offered two alternative lines: either the supplies were made directly to CGI for use in an exempt business of education or exempt supplies of land to GCEL, or else GCEL used the supplies to make exempt supplies of land to CGI. HMRC also argued that the arrangements were abusive, but were persuaded that they were not when CGI disclosed that the building would in any case be demolished within 10 years (so there would be no absolute advantage through use that exceeded the capital goods scheme adjustment period).

The Tribunal examined the background to the contract for construction. It had originally been entered into by CGI, but after taking tax advice the governors decided that it would be better if GCEL incurred the costs. It was argued by the taxpayer that a novation of the building contract followed; the Tribunal did not agree. The builders addressed their invoices to the company, which paid for them with funds loaned by CGI, but there was insufficient evidence to show that the contract had been legally transferred to GCEL. The supply of building services was accordingly received by CGI.

On the other hand, the supply of equipment within the buildings was input tax of the company. It had entered into the contracts for the fitting out of the building after the tax advice, so the same issue of novation did not arise. Even so, it was irrecoverable. The Tribunal concluded that the supply made by the company was an exempt licence to occupy granted to CGI. It was not a grant of "facilities" that would be taxable. GCEL had no resources or staff to "occupy" the building in a meaningful sense; it was CGI which used the buildings to make supplies of education, and it did so under a licence from its subsidiary. The Tribunal distinguished the facts from those in *Newnham College*, because in that case the subsidiary carried out the administration of the library.

The chairman concluded with the remarks, "*I have some sympathy with the Company and the Institute which, if they had organised (and documented) their affairs rather better, might have been able to achieve a tax saving. As it is, however, I am bound to conclude that they have failed in that objective, and that the appeal must be dismissed.*".

First Tier Tribunal (TC00129): *Grimsby College Enterprises Ltd*

3.4.2 Change to DIY form

HMRC have introduced two new claim forms for VAT refunds under the DIY housebuilders scheme with effect from 15 August 2009. One of the new forms will deal with new houses and the other will deal with conversions. The intention is that the guidance will be much clearer and there will be a reduction in the confusion of claimants, requirements by HMRC for further information, and disputes which have arisen in the past.

Public Notice 719 has been withdrawn and will be replaced with dedicated guidance for each of the new claim forms. This is referenced as VAT431NB for new builds and VAT431C for conversions.

R&C Brief 45/09; SI 2009/1967

DIY success

An individual demolished a house and constructed a new one, apparently doing nearly all the work himself. When HMRC refused his DIY

builder's claim, he represented himself before the Tribunal and won. The question was whether the dwelling constructed was truly "new", because he had retained the façade and the eastern wall of the former building.

He argued that the eastern wall was a party wall, without which the neighbouring property would have collapsed. The Tribunal agreed with this contention. Chimney stacks could be regarded as part of the wall for this purpose.

He also argued that the retention of the façade was a requirement of his statutory planning consent. The building was historic and in a conservation area, and he had discussed the requirements with the planning authorities in some detail. HMRC said that the planning consent did not explicitly state that he was required to retain the façade, and they argued that it was not permitted – according to precedent case law – to look to other documents to explain or expand the contents of statutory planning consents.

The Tribunal allowed the appeal. The consent was explicit in requiring the work to be carried out in accordance with the plans that had been submitted. The plans showed that the façade would be retained. The Tribunal was in no doubt that the planning authority would have taken action against the individual if the façade had been destroyed. Even if the words were not used, the planning consent required the retention of the façade. The building therefore satisfied the conditions of Sch.8 Group 5 Notes 16 and 18 to be regarded as a new building and the DIY claim succeeded.

First Tier Tribunal (TC00132): *Kevin Almond*

3.4.4 DIY failure

A builder zero-rated some work to a listed building even though listed building consent was not required for the operations, which appeared to be essentially repairs and maintenance in character. Not surprisingly, HMRC assessed for output tax, and their decision was upheld when the taxpayer did not turn up to argue the case. There was no evidence that the conditions of Group 6 Sch.8 VATA 1994 were satisfied.

First Tier Tribunal (TC00126): *John Lawlor*

An individual had been in business investing in and letting property for many years. He was not registered for VAT because he only made exempt supplies. He agreed with a long-standing friend to supervise the building of a cottage for the friend's disabled son. Once the building was completed, HMRC ruled that:

- the individual who built the house could not recover the VAT incurred on costs because the project was undertaken in the course of his business (and was therefore outside the DIY scheme) and he was not registered for VAT (so his a zero-rated supply of building services could not make him eligible for recovery);
- the person for whom the house was built could not claim under the DIY scheme because the materials which were the subject of the claim had been supplied to the builder, not to the customer.

The Tribunal accepted that HMRC were correct in their application of the law, but the chairman was struck by the unfairness of the result. Apart

from examining the facts of the case in some detail to demonstrate that the conclusion was inevitable even if unwelcome, the chairman explored possible ways in which the VAT might still be recovered – mainly by the individual applying for retrospective registration (the appeal was approximately three years after the project commenced) which would entitle him to recover VAT on the invoices.

First Tier Tribunal (TC00155): *WJ Terry t/a Wealden Properties*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Special scheme for e-traders

The usual Information Sheets have been published to set out the exchange rates in use for Special Scheme registered e-traders in the quarter to June 2009.

Information Sheets also publicise increases in the Estonian VAT rate from 18% to 20% and Hungarian VAT rate from 20% to 25%, both from 1 July 2009; and the Lithuanian VAT rate from 19% to 21% on 1 September 2009.

Information Sheets 09/09, 10/09, 11/09, 13/09

4.2 Where is a supply of services?

4.2.1 Place of supply of services delivered electronically

A company was established in the UK as an issuer of electronic money. It was regulated by the Financial Services Authority. Electronic money is defined by Article 3 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 as "*monetary value, as represented by a claim on the issuer, which is:*

(a) stored on an electronic device;

(b) issued on receipt of funds; and

(c) accepted as a means of payment by persons other than the issuer".

The Appellant issued electronic money in three ways: through particular merchants who branded the product as their own; to provide a form of pre-payment for credit and debit cards; and as Ukash, which could be purchased by members of the public from participating retailers. The appeal concerned the VAT treatment of Ukash.

The company contracts with merchants who agree to honour Ukash for purchases by consumers on their websites. Consumers buy Ukash vouchers (which carry a 19-digit identification code) from retailers and usually redeem them within a matter of hours. There is no contractual relationship between the consumer and the company: Ukash is simply the means by which the consumer buys something from the merchant.

HMRC's argument was that the essential service provided by the company to the merchants was in the nature of advertising and administration, and they were not provided electronically. The merchants enjoyed commercial advantages by agreeing to accept Ukash, and the operation of the system was what they were paying for.

Counsel for HMRC tried to draw analogies between the arrangements and the old cases of *Diners Club* and *High Street Vouchers*, but the Tribunal was not convinced that these contained any general principles about the nature of the supply – they rather concerned whether there was any supply from the operator of the system to the merchants, which was accepted in the current case.

The Tribunal found for the taxpayer on two separate grounds. Firstly, it held that the essential nature of the service was simply the provision of the means of payment, and that was clearly supplied electronically. The operation of the system and any marketing advantages supplied to the merchants were ancillary to that.

Secondly, even if the Tribunal was incorrect and the operation of the system was an important part of the supply, the Tribunal believed that it was still an electronically supplied service. By analogy with some of the other items which are clearly within Sch.5 para.7C, such as music, the Tribunal considered that it is the means of delivery which is important rather than the nature of the service. The operation of the Ukash system could only be delivered electronically, so it fell within the provision.

The details of assessments were not considered in the appeal. Presumably the company must account for output tax on supplies to UK merchants, but will not have to account for output tax on supplies to merchants elsewhere.

First Tier Tribunal (TC00131): *Smart Voucher Ltd*

4.2.2 Right to deduct on international supplies

EGN, an Italian company supplied telecommunications services to Ensys Ltd, a company which is established in Ireland, where it is subject to VAT. However, under Italian law, those services were not subject to VAT since the condition of being established in Italy was not met.

EGN applied to the Italian Revenue Authority (Agenzia) for a refund of VAT paid on the costs of providing the telecommunications services to Ensys Ltd. The Agenzia refused the refund and the company appealed, eventually reaching the ECJ.

The ECJ ruled that the company had to be entitled to recover its input tax, because a similar company making similar supplies to domestic customers in Italy would be so entitled.

The UK would allow such a claim as a matter of course.

ECJ (Case C-377/08): *EGN BV – Filiale Italiana v Agenzia delle Entrate – Ufficio di Roma 2*

4.2.3 Update on VAT package implementation?

HMRC have published further updates on the time and place of supply rules and ESL system that will operate from 1 January 2010. Details can be found at:

- http://www.hmrc.gov.uk/vat/place-supply-services.pdf; and
- http://www.hmrc.gov.uk/vat/ec-sales-lists.pdf.

Unfortunately, the documents do not highlight what new information has been added in July, and the press release which announced their publication stated “not updated at the time of publication”, which is self-contradictory.

HMRC Release 23 July 2009

HMRC's regular publication "Working Together" gives some advice to accountants on how to help their clients prepare for the changes to international supplies on 1 January 2010.

Working Together Issue 37

An article in *Taxation* reviews the fourteenth and fifteenth sittings of the Public Bill Committee's deliberations on the Finance Bill, in which the VAT package measures were debated. MPs were told that 220,000 businesses would be affected and would have to adjust their accounting system to cope with the changes.

Taxation 6 August 2009

4.2.4 Place of supply of timeshare services

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. Until 2004, the company had accounted for UK VAT on everything within the EU, but had not accounted for VAT on exchange fees relating to properties outside the EU. In 2004 it ceased to account for output tax on any of the fees which related to non-UK properties – i.e. a member who deposited non-UK rights into the "pool" of timeshares would not be charged UK VAT on the enrolment or subscription fees.

The Advocate-General's opinion was that only the exchange fee could be "directly connected with immoveable property". The enrolment fee and the subscription fee were not, according to the opinion, directly connected with a supply of immoveable property for the purposes of the VAT Directive and would therefore be consideration for "basic rule" supplies.

Unusually, the ECJ has come to a different conclusion from the Advocate-General. The judgment is that the whole of the company's operation relates to the supply of exchange services by the member who puts property into the pool. This means that all the fees paid by someone who owns a Spanish timeshare will be VATable only in Spain, even if the exchange results in that person using a timeshare somewhere else.

The court has looked at the transactions together rather than individually, and has concluded that the enrolment and subscription payments are not independent supplies. The whole point of the operation is to facilitate the exchange of the property rights.

ECJ (Case C-37/08): *EGN BV – RCI Europe v HMRC*

4.2.5 Relocation of internet and telecom businesses

HMRC have commented on what they must see as a trend for internet and telecom businesses to relocate to other member states which have a more favourable VAT rate. Supplies to consumers could presumably be made just as easily from an establishment in another member state, but they would currently be subject to the local VAT rate rather than the UK's rate.

HMRC confirm that they understand that businesses have an absolute right under the EU Treaty to establish themselves wherever they want to and to move that establishment. However, HMRC say that they will monitor any such movements and will consider whether a "fixed establishment" remains in the UK afterwards, which would make it possible for HMRC to assess for VAT on supplies which are "most closely connected" with that UK establishment. That would depend on "sufficient human and technical resources to make the supplies" being present in the UK on a permanent basis. HMRC will also consider whether the presence in the other state is not sufficient to make the supplies.

HMRC only refer to the old *Berkholz* test of a fixed establishment – there has been no up-to-date consideration of how the concept might have changed in an internet-driven world.

R&C Brief 58/09

4.2.6 Reference on place of supply

The Polish court has referred a question to the ECJ on the classification of supplies of engineers who are undertaking investigation and measurement of CO_2 emissions. This could be a physical supply which is made in the state where the work is carried out, or it could be an intellectual supply which is made where the customer belongs (if the customer is in business).

ECJ (Reference) (Case C-222/09): *Kronospan Mielec sp. z o. o. v Dyrektor Izby Skarbowej w Rzeszowie*

4.2.7 Article on place of supply

There is an article in *Taxation*, 2 July 2009, on international supplies of goods and services. Neil Warren uses the transfer of Christiano Ronaldo from Manchester United to Real Madrid to illustrate some of the problems of international trade.

Taxation 2 July 2009

4.3 International supplies of goods

4.3.1 Relief for imports of small value

A company organised the import of small value items (CDs) by post into the EU. The goods were packaged at a Swiss warehouse in individual packets with a value of less than €22, then despatched together to a distribution centre in the Netherlands. The Netherlands authorities formed the opinion that the de minimis threshold for imports did not apply, and assessed for VAT and customs duty. On appeal, the Netherlands courts cancelled the VAT assessment but referred the customs duty question to the ECJ.

The court ruled that:

Article 27 of Council Regulation (EEC) No 918/83 of 28 March 1983 setting up a Community system of reliefs from customs duty, as amended by Regulation (EEC) No 3357/91 of 7 November 1991, does not preclude grouped consignments of goods, with a combined intrinsic value which exceeds the value threshold laid down in Article 27, but which are individually of negligible value, from being admitted free of import duties, provided that each parcel of the grouped consignment is addressed individually to a consignee within the European Community. In that respect, the fact that the contractual partner of those consignees is itself established in the European Community is not relevant where the goods are dispatched directly from a third country to those consignees.

The question is then whether the way in which these parcels were imported constituted "direct dispatch" from Switzerland to the customer. If it did, the relief appears to be available. The possible problem is that the transportation of the combined consignment appears to have been under control of the appellant company, which may therefore be treated as too involved in the movement of the goods.

ECJ (Case C-7/08): *Har Vaessen Douane Service B.V. v Staatssecretaris van Financiën*

4.3.2 No proof of despatch

A company zero-rated the supply of a Caterpillar earth moving machine which it stated it had despatched to a customer in Poland. There was ample evidence that the sale had taken place, but the customer had organised the collection of the machine and the appellant had retained no evidence that the goods had left the UK. The customer was retrospectively deregistered by the Polish authorities and listed as a missing trader.

Although there was no suggestion that the UK company was involved in a fraud, and the managing director's checks would have shown that the Polish registration number was valid on the date of the sale, the conditions for zero-rating a despatch were not met. HMRC were entitled to assess for output tax on the supply.

First Tier Tribunal (TC00099): *Littler Machinery Ltd*

Proof of import

An individual purchased some CDs and DVDs from Amazon.com. HMRC decided that they were imported from the USA and imposed customs duties on them, to be collected by the Post Office on delivery. The individual appealed against the imposition of these charges, arguing:

- there were Deutsche Post stamps on the packages, providing evidence that they were imported into the UK from Germany;
- HMRC produced no evidence for their assertion that the goods arrived from the USA;
- HMRC had failed to carry out a review of their initial decision, as required by the law, and should not benefit from their failure to carry out the review.

The Tribunal considered that these arguments were misconceived. The burden of proof was on the appellant. There was a stamp on the packages saying that they had been despatched from the USA; HMRC had provided a reasonable explanation for the Deutsche Post stamps (a central collection point in Germany which was within the external transit system and so did not bring the goods into free circulation), and it was therefore up to the appellant to provide more evidence to support his claim. He failed to establish on the balance of probabilities that the items were Community goods.

The second argument was also misconceived. The law provided that a decision which was not reviewed was deemed to be upheld on review. The Tribunal had the power to hear an appeal against that deemed decision to uphold; it did not mean that the appeal would be automatically allowed.

First Tier Tribunal (TC00169): *Peter Terence O'Neill*

4.3.4 Import irregularities

A company imported cycles and parts and operated a Type C private customs warehouse, in which it was permitted to store its own goods but no-one else's. The warehouse was damaged by fire, and a decision was taken to store an incoming consignment at another company's customs warehouse. HMRC were not informed; the other company went into liquidation; it is not clear what happened to the goods.

During an assurance visit, HMRC discovered that the consignment had never been entered into the warehouse records of the first company. After trying to track down the consignment in the records of the other company, which were provided by the liquidator, the officer decided that the goods had been removed from the warehouse procedure without permission, and raised an assessment for duty and VAT.

The Tribunal had some sympathy with the appellant, but agreed that the law was clear in its application. The proper procedure had not been followed and the duties were payable. It was possible that the freight handling agent, who completed the paperwork for the company, might have been negligent, but that was not a matter for the Tribunal to decide.

First Tier Tribunal (TC00158): *Cycle Citi Ltd*

Manual online

HMRC have updated their online Single Market manual. It sets out the rules as they apply to intra-EC supplies and acquisitions of goods within the Single Market together with HMRC interpretation of those rules, presented from the perspective of UK suppliers and acquirers.

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

4.4 European rules

4.4.1 Further proposals to fight fraud

The Commission has published new proposals to fight intra-EU VAT fraud, including the creation of "Eurofisc", a structure to enable the authorities to respond quickly to the threat of fraud. The press release describes Eurofisc as "*an operational structure where Member States will in practice, fight fraud together. It should allow a very fast exchange of targeted information between all Member States as well as the setting up of common risk and strategic analysis. This will enable Member States to react timely to stop fraud and catch fraudsters, making it more difficult for new fraud schemes to emerge and spread around the Community*".

Regulations are proposed also which will:

- make authorities in each member state jointly responsible for protecting revenues in all member states;
- give the authorities in each member state direct access to the databases of other member states' authorities;
- set out standards for the quality, comparability and usability of the information contained in the databases.

IP/09/1239

4.4.2 Public bodies as taxable persons

The Advocate-General has given an interesting opinion on the subject of distortion of competition and public authorities. The Commission is seeking a declaration by the ECJ that Finland has failed to meet its obligations under the Directive by allowing public legal aid offices (part of the government's legal system) to supply legal advice to the public without charging VAT (where the member of the public is required to make a financial contribution). The Commission believes that this is an area in which the public authority competes directly with commercial lawyers, and failing to charge VAT therefore will lead to a significant distortion of competition.

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

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

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

By contrast, the ECJ has ruled that Ireland is in contravention of its responsibilities to implement the Directive in relation to the treatment of public authorities.

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 dispute with the Commission arose from the failure to charge tax on off-street parking supplied by public authorities (illustrating the support of the Commission for the UK authorities' approach in the *Isle of Wight Council* case), but the Commission's action against Ireland was in respect of the general wording of the law rather than in relation to the specific issue of parking.

The Directive requires that public authorities should be regarded as taxable in three situations:

- where they are not acting in the capacity of public authorities;
- where non-taxation would lead to significant distortion of competition;
- where they are making supplies listed in Annex I of the 2006 Directive to more than a negligible extent.

The ECJ agreed with the Commission that, by making the taxable status of Irish public authorities depend only on an order of the Finance Minister and nothing else, Ireland had failed to implement the Directive properly. The above principles had to be transposed into the domestic legal framework. It was not enough to suppose that the principles might be followed by the Finance Minister where appropriate.

ECJ (Case C-554/07): *Commission v Ireland*

4.4.3 Greek implementation delays

The Commission has applied to the ECJ for a declaration that Greece is in breach of its obligations because it has failed to transpose the 2006 VAT Directive into domestic law within the required timescale (by 1 January 2008).

ECJ (Application) (Case C-183/09): *Commission v Hellenic Republic*

4.4.4 penalties

The Swedish tax authorities decided that a company had reclaimed input tax in respect of false invoices. They imposed surcharges on the company, and applied to the court for the company's assets to be sequestered. The Supreme Administrative Court found in favour of the tax authority, finding that "there was a considerable risk that the applicant company would try to shirk responsibility for the debt".

The company applied to the ECHR for a ruling that the imposition of the surcharges, and the sequestration of its assets, contravened Article 6 of the European Convention on Human Rights. The ECHR rejected this contention and dismissed the application.

ECHR (Case 12637/05): *Plat Ror Och vets Service i Norden AB & Others v Sweden*

4.4.5 Polish penalties

The Polish court has referred questions to the ECJ about the legality of penalties which the country imposes on traders who fail to meet their obligations to record turnover by operating cash registers. The penalty operates by denying a deduction for 30% of the input tax on goods and services for the period.

ECJ (Reference) (Case C-183/09): *Dyrektor Izby Skarbowej w Bialymstoku v 'Profaktor' Kulesza, Frankowski, Trzaska spólka jawna w Bialymstoku*

4.4.6 Commission offer e-learning package

The Commission has developed a free e-learning package which is available online to help people acquire a good basic knowledge of the VAT Directive. It contains the following elements:

- Introduction
- Context
- Legal framework
- Scope
- Territory
- Taxable persons
- Transactions
- Place of taxable transactions
- Chargeable event and taxable amount
- Rates
- Exemptions
- Right to deduct
- Obligations
- Final assessment

http://ec.europa.eu/taxation_customs/common/elearning/vat/article_4537_en.htm

4.4.7 Res judicata

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

An Italian company transferred the administration of a sports complex to a non-profit-making body in December 1985. The tax authority subsequently formed the opinion that this was designed to avoid VAT and was an "abusive practice". Assessments were raised on the company for

1988 to 1991. The company appealed, contending that the effect of a previous court decision relating to 1987 was that the transfer was effective for VAT purposes.

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

The ECJ has agreed with the opinion of the Advocate-General (Mazák). Community law precludes the application, in circumstances such as those of this case, of a provision of national law, in a VAT dispute relating to a tax year for which no final judicial decision had yet been delivered, to the extent that it would prevent the domestic court responsible for a decision on that dispute from taking into consideration the rules of Community law concerning abusive practice.

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

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

4.5 Eighth Directive reclaims

4.5.1 Claim made too late

An Irish company claimed over £120,000 under the 8th Directive in respect of supplies made in 2006. HMRC received the claim on 20 July 2007 and rejected it because it had missed the deadline.

There were two possible issues before the Tribunal:

- a factual dispute about when the claim was despatched by the claimant;
- a legal dispute about when a claim is "made" for the purposes of the regulations – whether it would be enough for the claim to have been posted on the deadline date, 30 June 2007, knowing that it would not arrive until later.

In the event, the Tribunal decided that the claimant had failed to show, on the balance of probabilities, that the claim form had been posted on 30 June, so the legal issue did not arise. There were a number of factors which suggested that the form had probably been posted at a later date, not least the fact that 30 June 2007 was a Saturday – not a normal working day. The claim was rejected.

First Tier Tribunal (TC00138): *Digi Systems (Ireland) Ltd*

Claim unsupported by evidence

An American company guaranteed the lease of premises in London which were rented by a company in which it had a 30% shareholding. It was required to honour the guarantee and paid the lease premium, which

included £262,500 in VAT. It claimed repayment of this amount under the 13th Directive.

The Tribunal examined the background to the company's activities in as much detail as it could, but found that very little hard evidence was offered. The claimant was a not-for-profit entity established in 1946 to carry out various research activities for American academic institutions and the government. No details of its ownership or control were given, nor was the precise relationship between it and the tenant company (Atomic Tangerine) fully explained.

The Tribunal concluded that the 13th Directive claim had not been substantiated on the balance of probabilities on the basis of evidence. It was not sufficiently clear that SRI International carried on what would be regarded in the UK as a business activity.

First Tier Tribunal (TC00138): *SRI International*

4.5.3 Online manual updated

HMRC have updated their online guidance manual on VAT refunds to overseas business persons. It explains the roles of the Overseas Repayment Unit and the National Registration Service. It should be read in conjunction with *Notice 723 Refunds of VAT in the European Community for EC and non-EC businesses* which explains the scheme in detail, providing information needed to reclaim repayment from each member state as well as information on reclaiming refunds of UK VAT to claimants from countries outside the EU.

www.hmrc.gov.uk/manuals/vatmanual/vrobpmanual/index.htm

5. INPUTS

5.1 Economic activity

5.1.1 Spotlight on artificial leasing – pleasure craft

In a document entitled "Anti-avoidance: spotlights", HMRC have detailed six avoidance schemes that they consider ineffective in order to discourage potential users. Five relate to direct taxes; the VAT scheme is *described as follows.*

Spotlight 2: 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.

This appears to be aimed specifically at the leasing of pleasure craft, although the *RBS Deutschland* case could also be characterised as concerning a leasing scheme (possibly artificial) which is intended to exploit differences of interpretation between member states on whether a transaction is a supply of goods or of services.

HMRC Release 24 August 2009

HMRC have also issued a Brief commenting on attempts to recover input tax on pleasure craft by registering for VAT as a "yacht chartering business". The Brief sets out the tests for such an activity to be considered a business, and also highlights a number of factors which might indicate that such an arrangement was abusive even if it did entitle the owner to register. It is clear that HMRC will look closely at claims for input tax on yachts.

R&C Brief 56/09

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Attribution of advertising expenditure

A building society's VAT group makes supplies of residential estate agency services (taxable) and mortgages and other financial services (exempt). A dispute arose in relation to the treatment of newspaper advertising expenditure: the building society argued that the adverts were for the estate agency services and so were attributable to wholly taxable supplies, while HMRC contended that the advertisements were residual and some of the input tax incurred would be irrecoverable.

The disputed advertisements were the normal kind published by estate agency businesses: generally full-page spreads in newspapers, filled with descriptions of individual residential properties. Some contained a "strapline" mentioning (without details) other services offered by the business; some contained more details; some contained only properties.

HMRC contended that the promotion of the estate agency business led to the earning of exempt income from mortgage advice, as with the phones and insurance in *Dial-a-Phone*. There was a sufficient direct and immediate link between the advertising expenditure and the exempt income.

The society argued that the link was not direct and immediate, and did not satisfy the criteria laid down in *BLP Group plc* for an input to be residual. There was no doubt that there was a direct and immediate link to taxable supplies; there was no reason to look further. HMRC's argument was a version of the "but for" test rejected by the Court of Appeal in the *Mayflower Theatre Trust* case – "but for" the advertisements, there would not be as much exempt income; but that was not a sufficient link for input tax purposes.

The Tribunal ruled that any advert which mentioned, however briefly, mortgage services or related exempt activities would be residual; however, adverts which did not mention them at all would be directly attributable to making taxable supplies. The chairman agreed with the society's counsel that the incidental promotion of the exempt activities was a consequence of the advert but was not its purpose, and the case of *Royal Agricultural College* was more relevant than *Dial-a-Phone*.

First Tier Tribunal (TC00146): *Skipton Building Society*

5.3.2 Proposed special method upheld in Tribunal

A company engaged in the casino, restaurant, bar and entertainment business proposed a floor-area based special method for partial exemption. HMRC rejected it and the company appealed to the Tribunal.

The Tribunal examined the way in which the business was organised at the several different locations operated by the company. It noted that a significant amount of food (taxable) was in fact given away to gamblers. In addition, significant areas of the properties were not used to make any supplies, but were communal areas, passageways, reception etc. Some 71% of residual input tax was argued to be property-related, which the company contended made the use of floor areas a reasonable proxy for "use" of inputs.

The proposed special method took the floor areas that were used to make supplies and ignored the rest. It was proposed that residual input tax should be recovered using a calculation as follows:

- the "T" part would include the whole of the area given over to taxable gaming and entertainments, but only a proportion of the areas of bars and restaurants – that would be reduced to reflect the proportion of food and drink that was given away free;
- the "E" part would include the remainder of the bar and catering areas and the exempt gaming areas as well.

HMRC used their normal arguments against floor-based methods, citing the Tribunal's decision in *Vision Express* in support. They also argued that treating all the residual input tax as property-related was not likely to produce a fair result.

The Tribunal disagreed. The situation was quite different from that in the opticians' cases. Allowance had been made for the cross-subsidisation of food and gaming by removing the "free food and drink" from the "T" part of the calculation. The case was different from that of *Aspinalls*, in which most of the food and drink was given away; here, the catering was a genuine business activity which made a significant contribution to overheads. Overall, the Tribunal was satisfied that the proposed method would produce a fair result.

It was then necessary to consider whether it gave a fairer result than the existing special method (which dated from 1993). That was turnover-based, and the company's counsel had several criticisms of it. The two significant ones were that:

- it was wrong to use turnover as a proxy for use in this case because there were more costs incurred in earning £1 of catering income than there were in earning £1 of gaming income;
- a turnover-based method would produce unpredictably fluctuating results depending on how lucky the customers were, and this was clearly unfair and unreasonable when the costs did not vary at all.

The Tribunal accepted these arguments and allowed the appeal. The proposed method was fair and reasonable, and more so than the existing method.

First Tier Tribunal (TC00154): *London Clubs Management Ltd*

5.3.3 Payback policy

HMRC have commented on the payback rules in reg.109 SI 1995/2518 in the light of the High Court's decision in the *Community Housing Association* case. A housing association was found to have used various inputs in making a supply of "unfinished development projects" to a subsidiary which had been set up to enable it to recover input tax on construction of houses. HMRC had persuaded the Tribunal that no supply had been made, but the judge overturned that decision.

HMRC say that they will not appeal, but the wording of the Brief suggests that they do not agree with the decision. The payback rule is explained as follows:

VAT Regulation 109 in SI 1995/2518, 'payback' allows a business to recoup input tax on costs that are incurred to make exempt supplies, but are instead used wholly or partly to make taxable supplies. Payback also applies to costs incurred for both taxable and exempt purposes, but actually used to make wholly taxable supplies. A payback claim cannot be made unless:

- *the costs in question were not used as originally intended*
- *the change of use arises after the end of the partial exemption longer period (if there is one)*
- *the change of use results in taxable supplies or both taxable and exempt supplies if the original intention had been to make a wholly exempt supply*

HMRC then explain their views on what will constitute a "supply" for the purposes of triggering the payback rule:

Supply covers a wide range of circumstances but there are some basic requirements that must apply before a supply can exist. The recipient of the supply must receive some benefit, he must provide some consideration and the consideration must be paid in return for the benefit.

Any business making a supply will incur costs in doing so. These are the cost components of the supply. Conclusions on what the cost components of any supply are will flow from an analysis of the nature of that supply. The mere raising of invoices and passing of funds between companies does not automatically create supplies. Careful analysis may be called for, especially if the companies are close associates.

The implication seems to be that "we still do not think that CHA made a supply to its subsidiary".

R&C Brief 57/09

5.3.4 Article about standard method changes

There is an article by Neil Warren in *Tax Adviser*, August 2009, which partly deals with the changes standard method of partial exemption that were introduced in April 2009.

5.4 Cars

5.4.1 Claim was wrong, but no penalty

A married couple ran a pig farm. The husband bought a Land Rover Discovery and made a peculiar input tax claim: 50% of the input tax on purchase, and a further amount representing “depreciation”. HMRC assessed to recover this, and added a misdeclaration penalty.

The Tribunal found the facts were as normal: the car was available for private use, and the assessment was confirmed. However, the penalty was forgiven for the following surprising reason: “*we were satisfied that the Appellant was entirely credible and had made an honest mistake. In the circumstances Mr Haley conceded that the misdeclaration penalty would be withdrawn*”.

First Tier Tribunal (TC00140): *Robert & Lillian Waddell t/a LCD Plant Hire*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Salary sacrifice schemes

It has been suggested that HMRC are examining a number of flexible benefit packages for possible VAT implications in the light of the reference of the *AstraZeneca* case to the ECJ. That concerns the deductibility of input tax and possible accounting for output tax on vouchers which are given to staff, but other flexible benefit packages may have implications for input tax or output tax where goods or services are purchased for employees and “given” to them.

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 HMRC win carousel cases

The High Court has upheld a Tribunal decision which denied zero-rating on despatches of goods. The appellant company was assessed to output tax on the basis that the despatch documents were probably falsified so the supplies did not qualify for zero-rating. The company's problem was that the supply was most unusual, and it was difficult to regard it as a straightforward business deal: accordingly, detailed investigations should have been carried out to make sure that it was not tainted with fraud, and the Tribunal was not satisfied that such investigations were carried out.

The company's documentation showed that a large consignment of mobile phones had been despatched to an address in the Netherlands. At the last minute, it had decided not to proceed with a sale to a Belgian customer because doubt had been cast over whether it was validly VAT-registered; but another customer offered to buy the same phones for the same price for delivery to the same address. As this company was in Madeira, this seemed exceptionally convenient. The Netherlands address turned out to be a private house.

The Tribunal did not believe that the company could rely on the ECJ's decision in *Teleos* to preserve the benefit of zero-rating. Rather than carrying out all reasonable steps to be satisfied that its transactions were not tainted with fraud, it seemed that the company did what it thought would satisfy HMRC. There were many aspects of its business that did not seem reasonable for normal commercial transactions:

"*What is in our view most significant is that N2J took almost everything on trust: it relied on third parties (that is, K & L Logistics, who had been engaged by its own suppliers) for assurance that the goods existed, and were what they were claimed to be, undertaking no inspections of its own; it agreed to their being transported to a warehouse of which it knew nothing and with whose proprietor it had had no direct contact; it arranged no insurance of the goods; it accepted payment by instalments with no agreement on the time over which payment would be made; and it had no fall-back arrangement if Pro-Choice should default. When one adds those factors to N2J's lack of any curiosity when it found that Pro-Choice was willing to buy exactly the same goods as N2J had already agreed to sell to Imex, at exactly the same price, and that it wanted the goods delivered to the same warehouse, in a country remote from its own base, one would have thought that alarm bells would immediately start ringing. Miss Abreu was not merely vague in her recollection. It was clear to us as she gave her evidence that she felt very uncomfortable, and we came to the conclusion that she did indeed have misgivings at the time about what she was being required to do by her employers.*"

The company appealed to the High Court, arguing that the Tribunal had concentrated on whether the company knew about a fraud rather than on whether it was reasonable to believe that the goods had left the country. The company also argued that the CMR documents should be treated as conclusive evidence that zero-rating was avaialble, in line with the *Teleos* decision.

The High Court dismissed these arguments as misconceived. The Tribunal had addressed the correct question: whether the company could provide sufficient evidence that the goods had left the country. There was ample ground for its conclusion that the test was not satisfied. The idea that CMRs were conclusive on their own was wrong in EU law: the circumstances of the deal meant that the company needed to ask more questions than it had done. The appeal was dismissed again.

High Court: *N2J Ltd v HMRC*

The Tribunal examined a number of deal chains entered into by a trader in CPUs and accepted HMRC's view that there was a VAT loss attributable to fraud and the trader ought to have known about it. The directors were experienced in the industry and must have understood the likely connection to fraudulent activity of what they were doing; the assertion of one director at the hearing that "he understood MTIC fraud but asserted that he did not understand how it worked and operated" was not credible. The company's claims for input tax deduction were dismissed.

First Tier Tribunal (TC00137): *Euro Stock Shop Ltd*

A similar decision was reached in a similarly lengthy case concerning mobile telephones. The director was considered an "unconvincing witness". His company had entered into a new area of business, dealing in very substantial amounts of money, with minimal experience or research. If the transactions were pre-arranged, that made sense; if they were genuine arm's length deals, it did not. The conclusion was that the trader knew or ought to have known that the transactions were connected to fraud.

First Tier Tribunal (TC00128): *Late Editions Ltd*

HMRC refused to accept an input tax claim based on five invoices which purported to represent purchases of camcorders, but which did not give sufficiently detailed descriptions of the goods to identify them. The Tribunal agreed that HMRC had reasonably refused to exercise their discretion to accept lesser evidence than proper VAT invoices, and dismissed the trader's claim. Once again the Tribunal examined the evidence in detail and accepted that, on the balance of probabilities, the various discrepancies that HMRC had discovered in relation to the five invoices suggested that the supplies had never taken place.

First Tier Tribunal (TC00179): *Plazadome Ltd*

5.8.2 Reverse charge to be extended to EU

The Commission has adopted a proposal for a Directive which will allow member states to impose an optional and temporary reverse charge mechanism, similar to that operated in the UK, to the following types of supply: computer chips, mobile phones, precious metals, perfumes and greenhouse gas emission allowances.

The proposal is not intended to change the fundamental principles of the VAT system and therefore remains limited in scope, both as regards the number of goods/services and the duration of the application period. The type of supplies to whom the scheme could apply is based on recent experience with missing trader fraud.

IP/09/1376; http://ec.europa.eu/taxation_customs/index_en.htm

5.8.3 Pre-incorporation input tax

An individual started to build two houses. While the project was under way, he consulted accountants and HMRC to see if the VAT being incurred could be recovered. It was suggested that he could form a company to make zero-rated supplies of building services to himself; he could then sell the properties after the company had recovered the input tax. He formed a company the day after this advice was given and registered it for VAT soon after. When the buildings were completed, he decided to let them rather than selling them.

The company claimed for pre-registration and pre-incorporation input tax on its first return. HMRC disallowed a great deal of it, arguing that the conditions of reg.111 SI 1995/2518 had not been met.

The Tribunal examined those conditions in detail, and decided that HMRC had misinterpreted them. In respect of expenditure incurred after the company had been incorporated, the claim should be allowed.

However, the conditions for pre-incorporation expenditure were not met. The first requirement is that the expense has to be incurred "for the company". It is not enough that an individual should incur expenditure and later form a company: the intention must be there at the time that the expenditure is incurred. That was not the case here, and to this extent the appeal was dismissed.

The decision contains a useful analysis of reg.111, and a useful explanation of how it might be misconstrued by HMRC.

First Tier Tribunal (TC00145): *Oaks Pavilion Ltd*

5.8.4 A tangled web

An individual worked as an expert engineer. Over many years he had set up and operated a number of companies, and had at various times had disputes with Customs which ended up in the Tribunal. Now a large number of disputes were heard at once in relation to several of the companies. The chairman noted that the engineer had been successful in some of his earlier appeals, so this was not a case of a vexatious litigant making hopeless arguments.

The decision spends some time analysing the tortuous relationships between the various businesses and companies controlled by the engineer. It appeared that the engineer tried to give HMRC the impression that there were more people involved in running these companies than himself, but in the end it was all down to him. There may have been valid reasons for the complex structure in the past, but it appeared that now there was little substance to the various trades – the transactions were mainly with other companies within the "group".

The related appeals were against decisions of HMRC to refuse input tax, bad debt relief and credit note adjustments. The Tribunal chairman found it difficult to establish the facts, but noted that the engineer appeared honestly to believe what he said in evidence. The problem was that he appeared to have an "idiosyncratic" approach to the operation of his companies – that is, he ran them according to how he believed a business should be run, regardless of the provisions of the Companies Acts or the preferences of HMRC.

After examining the circumstances of each appeal in detail, the chairman dismissed them all. However, a number of further appeals were put forward during the course of the hearing, and the chairman admitted them for consideration on another day.

First Tier Tribunal (TC00117): *APS-Centriline Ltd and others*

5.8.5 Voluntary aided schools

Where a school is run by a local authority, VAT can be reclaimed on all its expenditure under s.33 VATA 1994. Voluntary aided schools (usually with a church connection) have a complicated financial structure: usually the governors are responsible for capital expenditure, with subsidies from central government, and the local authority is responsible for running expenditure. VAT cannot be reclaimed on expenditure that the governors incur, because they are not a s.33 body. The grants from central government are made on a VAT-inclusive basis accordingly. The governors are typically responsible for:

- the existing buildings (internal and external);
- those buildings previously known as ‘excepted’ (kitchens, dining areas, medical/dental rooms, swimming pools, caretakers' dwelling houses);
- perimeter walls and fences, even if around the playing fields;
- playgrounds;
- furniture, fixtures and fittings – including ICT infrastructure and equipment;
- other capital items (which can include capital work to boilers or other services).

Where a capital project cannot be funded wholly from the governors’ funds and the grants, it is common for the school’s revenue budget to be used to make up the shortfall. Until now, HMRC have accepted that expenditure met in this way was eligible for VAT relief because it was incurred by the local authority.

This policy has now been reviewed. If the project is the responsibility of the governors, it does not matter who pays for it: the VAT cannot be recovered. The new policy will apply to projects undertaken from 1 September 2009 onwards.

R&C Brief 53/09

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Compulsory registration?

A strange Tribunal report deals with a taxi operator who apparently exceeded the registration threshold in 1996 and was the subject of assessments and belated notification penalties issued in 1998 and 1999. No explanation is given for the ten-year delay in the dispute about these matters arriving before the Tribunal; the appellant did not appear, so the facts did not have to be examined in great detail, so no further light is cast.

To complete the peculiarity of the decision, the final ruling is that the appellant was compulsorily registrable from 1 December 2006, which appears to be a misprint – presumably that would have invalidated the assessments and penalties relating to the late 1990s.

First Tier Tribunal (TC00159): *Javed Ahmed t/a Star Private Hire*

6.3 Payments and returns

6.3.1 Changes coming to filing and payment

HMRC have begun to publicise the forthcoming change to compulsory online filing and electronic payment for most traders which will apply from 1 April 2010. The latest issue of Working Together (aimed at agents) sets out the following:

We are planning to raise customer awareness of these changes in a variety of ways – including messages on the VAT Returns and envelopes, articles in VAT Notes, and a mailing in late 2009 to all VAT registered customers. There will be a series of nationwide events providing businesses with practical advice on the VAT online service and how to enrol. We will also be taking advantage of other departmental mailings to get the message over to customers.

From February 2010, the focus will shift from raising awareness to encouraging customers to take action. HMRC will then write to all customers affected by the changes, explaining that in future they must file online and pay electronically. The letter will explain the help and support available to them to file online for the first time, should they need it.

The HMRC publicity campaign, which will extend well into 2010, will highlight the changes, and encourage customers to register for online services and file their returns online.

We hope that all customers affected by the changes will read about them in this publicity and take appropriate action. However it would be very helpful if you could please advise your clients about the changes due in April 2010 along with their obligation to file VAT returns online and pay any VAT due electronically at an early stage. Some businesses may need to revise their security processes for checking and authorising the return before filing online, and may need your input and support in tackling this at an early date.

Working Together Issue 36

The following issue gives further details of improvements to the online service, as follows:

- *At present there is a service on the Government Gateway for your client to assign you as an agent to act on their behalf in order to file returns for them. From late November 2009 we are extending to the Online Agent Authorisation service (OAA) that already exists for Corporation Tax, PAYE and Self Assessment to include VAT. Under the new service your client will no longer have to enroll directly with the Government Gateway themselves to allocate you as an agent. If you use the OAA service to set up authorisations for your clients, we will send your client a letter containing a unique authorisation code. Your client should give you the code, and in doing so, is confirming that they wish you to act for them. You simply input the code online and you will be fully authorised to file online and for information disclosure by phone and paper. There is no need for a paper 64-8 since the OAA provides authorisation for online, phone and paper channels.*
- *We plan to remove the need for agents to be VAT registered themselves, before they can file clients' VAT returns online. Our aim is to do this in time for April 2010, but we may succeed in achieving this earlier, in late November. We will keep you posted.*

Working Together Issue 37

6.3.2 New Notice on interest, and interest rates

HMRC have issued an updated notice on default interest. Meanwhile, the rates of interest have changed with effect from 29 September 2009 to:

- default interest: 3%;
- repayment interest under s.78: 0.5%.

Notice 700/43

Repayment claims

6.4.1 Cap confirmed by Court of Session

An insurance company submitted a repayment claim in September 2002, relating to output tax which it had paid between January 1995 and January 1998 in respect of services that it realised should have been treated as exempt following the CA decision in Century Life plc.

The Commissioners rejected the claim on the basis that it had been made outside the three-year time limit of s.80 VATA 1994. The company

appealed, contending that s.80(4) should be treated as wholly invalid because it failed to provide for a transitional period, as required by the ECJ decision in *Grundig Italiana SpA v Ministero delle Finanze*. The Tribunal accepted this contention and allowed the appeal,.

It was reported that questions would be referred to the ECJ, but the Court of Session has now itself reversed the Tribunal's decision, holding that the failure to provide for a transitional period did not render the three-year time limit invalid.

Court of Session: *HMRC v Scottish Equitable plc*

HMRC have issued a Brief to comment on this decision. Apart from predictably celebrating the court's confirmation that the cap was not fundamentally flawed, they say that a significant number of appeals to the First Tier Tribunal (Tax Chamber) are on hold pending the outcome of this litigation. They suggest that appellants will need to consider whether they wish to withdraw their appeal or proceed to a full hearing. HMRC are now taking steps to have these appeals restored to the Tribunal list so that, where necessary, a hearing date can be fixed.

Presumably a hearing will only be necessary if a taxpayer has failed to appreciate the significance of the court's decision, or believes that it is worth pursuing an appeal all the way to the ECJ.

R&C Brief 41/09

6.4.2 Guidance on capped repayment claims

HMRC have issued updated guidance to their staff on how to handle claims which might be subject to the three-year (becoming four-year) cap. It was amended on 6 August to replace a version from July 2009. It covers every aspect of the procedure in great detail with legal back-up, and it will be useful for anyone proposing to make a "historical" VAT claim to read it in detail. It also considers the question of interest on repayments, including the arguments about compound interest.

HMRC Release 12 August 2009

6.4.3 Impact of *Fleming* claims

A Freedom of Information Act request has revealed the following estimate of the cost of *Fleming* claims to the Exchequer:

The Budget 2009 forecast for VAT receipts included an allowance for repayments in this connection of £4.8 billion: £2.7 billion for 2009-10 and £2.1 billion for 2010-11.

The estimate was based on:

- *the existing analysis of claims received well before the deadline;*
- *for those received in the run up to the deadline for new claims, a sampling exercise to determine the number of duplicate claims received, the average value of claims, the time period covered (which would affect the exposure to statutory interest);*
- *survey of the Large Business Service's Sector Lead Officers to identify any individual claims above £20m notified to them. Each of these was individually examined to determine the likely amount to be repaid after verification; and*
- *HMRC's provisional assessment of the likelihood of success of the new claims, based on both evidence from previously verified claims*
- *and an examination of the sample of new claims.*

These provisions will be updated in the 2009 Pre-Budget Report to reflect latest information on these factors.

Treasury Freedom of Information Disclosure 29 July 2009

6.4.4 Interest claim strike-out: one-all

In 2007 Grattan plc applied for an award of interest on a compound basis to be added to repayments of VAT that had been made in 2005 with "simple" statutory interest. HMRC refused, regarding the application as an appeal out of time against the decision to award simple interest in 2005. HMRC's attempt to have the appeal struck out has been through the Tribunal and High Court once owing to a procedural mix-up, but has now returned to the Tribunal for a full hearing.

The company argued that the decision to refuse compound interest was made in a letter in February 2008, and this was appealed in March 2008, just one day after the 30 day time limit. The Tribunal did not agree. In reality, Grattan had not considered the possibility of claiming compound interest in 2005; the letter of February 2008 was not a new decision but confirmation of an old one, that had not been appealed when it was made. The application to strike out the appeals in respect of the 2005 repayments was granted.

However, there was also a separate repayment, also made with simple interest, which was released by HMRC following the *Fleming* decision. There had been no decision on interest in that regard in 2005 – the only decision was that given in February 2008. The application to strike out this appeal was therefore dismissed. The claim for compound interest on this appeal will be substantial – the VAT was £71m and simple interest under s.78 was £95m.

First Tier Tribunal (TC00139): *Grattan plc*

Arguments about interest on repayments

A charity claimed substantial repayments from HMRC. In 2006, HMRC questioned the basis on which input tax had been attributed to business and non-business activities, and raised an assessment on a best judgment basis. A claim for input tax on the July 2006 return was also adjusted

downward by over £100,000. The charity did not appeal, but entered into protracted correspondence with HMRC. Eventually, in 2008, a substantial extra repayment was made. The charity claimed that interest should be added; HMRC refused; the charity appealed against that refusal.

The Tribunal ruled that it was restricted to what the legislation provided. The charity thought that an award of interest would be "fair", but the law only provided for interest if the late repayment had arisen from an "error" by HMRC. The assessment and refusal to repay in 2006 had been reasonable decisions on the information provided at that time, and the charity had been slow to answer the questions which eventually led to the repayment. As a result, no interest was due.

The charity had not claimed repayment supplement, so no appealable decision to refuse repayment supplement had been made; and the charity had not appealed against the original decisions, so no award of interest could be made by the Tribunal under s.84(8) VATA 1994. The appeal had to be dismissed.

First Tier Tribunal (TC00141): *Walk the Walk in Action Ltd*

A group of motor dealers appealed to the Upper Tribunal about HMRC's refusal to pay compound interest on "Elida Gibbs" and "Italian Republic" claims that had been paid out to them in 2003 – 2005 with simple interest calculated in accordance with s.78 VATA 1994. They argued that the statements of the ECJ in *Test Claimants in the FII Group Litigation v HMRC* (2007), of the House of Lords in *Sempra Metals Ltd v HMRCs* (2007) and by Henderson J in *FJ Chalke Ltd and another v HMRC* (2009) all supported the assertion that compound interest should have been paid on their claims.

HMRC responded by acknowledging that compound interest "should be paid in certain circumstances", but they argued that the UK legislation would not permit the award of compound interest in the circumstances of any of the claimants.

The Tribunal accepted HMRC's argument that the appeals were out of time. If they had wished to object to the award of simple interest, the claimants should have done so within the normal period after the original decisions to repay in 2003 – 2005. The application for compound interest did not lead to a new decision to refuse to pay compound interest: the earlier decision to pay simple interest was the point at which 30 days started to run. There was no justification for extending the time limit for appealing; the later judicial decisions did not give the appellants more time to argue about their interest awards.

Further, it was clear from the legislation that s.78 only provided for simple interest. Suggestions that it should be interpreted to require a payment of compound interest were contrary to the "grain of the legislation". The Tribunal considered the relationship between community law and domestic law which had led to the award of compound interest in *Sempra Metals*, but did not find that the same principles were engaged in the current cases.

Upper Tribunal: *John Wilkins (Motor Engineers) Ltd and others v HMRC*

This will not be the end of the matter. Some claimants are pursuing a claim for restitution under civil law through a Group Litigation Order (the

FJ Chalke case). The High Court's decision in that case in May (that the claim was out of time) made it inevitable that the Upper Tribunal would hold against the current appellants on the same ground, but both decisions are likely to be appealed further and higher courts – or, ultimately, the ECJ – may hold that compound interest is due.

6.4.6 Argument about repayment supplement

A company made a reclaim in April 2006 which was paid to it in July 2006. The company claimed that it had only "received" the repayment on 31 July 2006, when a payable order was sent to it by HMRC, and this was more than 30 days after the submission of the claim (disregarding days spent on reasonable enquiries). HMRC argued that they had "paid" on 27 June 2006, when a form of instruction was signed by one of its officers and sent to another officer. This was before the "trigger date" of 4 July, so no supplement was payable.

The Tribunal identified the following questions which needed to be addressed:

(i) what was the meaning of "issued" in this context: in particular could a document sent by one HMRC officer to another be the "issue" of such an instruction;

(ii) on whom did the burden of proof in relation to the facts fall?

(iii) on the evidence, and in the light of the answers to the preceding questions, what was the relevant date?

The Tribunal considered the regulations which define the period for s.79 (SI 1995/2518 regs.198 – 199), and the enquiries that were made following the submission of the return. It was agreed between the parties that the return had been submitted on 25 April; by 26 June, when an HMRC officer sent an approved payment recommendation to the Credibility team in Liverpool, the total time was 63 days of which 40 had been taken up with "reasonable enquiries".

At the hearing, it was not clear what happened between 26 June and 31 July. There were forms authorising payment which were faxed between HMRC officers, but no payment was made. It is surprising that more documentation was not produced to show what had happened to an attempted payment of £117,000, but HMRC suggested that they had "probably" attempted to pay that amount to a bank account of the trader which had been closed. After that payment was rejected, they issued the payable order by mail.

The chairman concluded that an internal instruction from one HMRC officer to another was not a payment instruction "issued" for the purposes of s.79. There must be an instruction to someone outside the department in order to effect payment. The burden of proof lay on HMRC to show when an instruction had been issued, because only they would have access to the information. He reached this conclusion after the hearing, and asked HMRC for further evidence to show what happened to the attempted payment. The appellant was given the opportunity to comment on this evidence.

The further evidence did show that HMRC attempted to pay the closed bank account on or before 29 June 2006. That satisfied the statutory test and ruled out repayment supplement.

The chairman went on to examine the counting of days in more detail. HMRC and the taxpayer had produced schedules of days but had been inconsistent about "counting inclusively". The statute requires inclusive counting: in particular the date on which the officer becomes satisfied that a repayment should be made is part of the "reasonable enquiries" period. The revised count of days suggested that the total delay was 66 days, of which 36 were taken up with enquiries. HMRC just managed to issue the instruction within the required period, and the appeal was dismissed.

On the other hand, they had not produced enough evidence at the hearing to support that conclusion. The chairman therefore awarded costs of £100 to the appellant.

First Tier Tribunal (TC00180): *Beast in the Heart Films (UK) Ltd*

6.4.7 Online manual updated

HMRC have updated their online manual that deals with the handling of claims for repayments which arise from errors made by traders – i.e. voluntary disclosures of overpayments. They have also added a new section on the capping of late returns.

www.hmrc.gov.uk/manuals/vatmanual/vrmanual/index.htm

6.4.8 Direct tax on repayments

There is an article in *Taxation*, 9 July 2009, about R&C Brief 14/09 in which HMRC explained their view that VAT repayments and interest on them are generally chargeable to direct tax. John Hiddleston refers to some direct tax case law to explain that it is not as clear-cut as HMRC seem to think.

Taxation 9 July 2009

6.5 Timing issues

6.5.1 Connections and government control

The tax point for certain transactions can be affected if the parties are "connected" within the meaning of s.839 ICTA 1988. Because the government has effectively nationalised several banks, they are "under common control" within the meaning of that provision. As it is not intended that the timing rules should apply to transactions between banks in this circumstance, amendments have been made to ensure that the rules will not be triggered if the only connection between the companies is through common control by the Crown, a Minister of the Crown, a government department or a Northern Ireland department.

SI 2009/1967

6.6 Records

6.6.1 New Notice on corrections

HMRC have issued an updated Notice on correcting errors made by traders – i.e. voluntary disclosures and corrections through the VAT account. It covers the new error limits, related topics such as penalties and appeals, and unjust enrichment.

Notice 700/45

6.7 Assessments

6.7.1 Time limits for assessment

In Tribunal case TC 00052, the Tribunal held that HMRC had had sufficient information to raise an assessment for more than a year before they did so, and accordingly the assessment was out of time. HMRC applied for the decision to be set aside and the case reheard because the Tribunal service did not appear to have transmitted written submissions of HMRC to the judge, although they had been received by the service. The case was heard again, but the Tribunal did not believe that the written submissions added anything. The original decision was confirmed.

First Tier Tribunal (TC00144): *Sophie Holdings Ltd*

Application to reinstate

A company appealed against the refusal of an input tax claim of about £7.9m on the grounds that it was connected with a MTIC fraud. In November 2008 Sir Stephen Oliver dismissed the appeal in the absence of the company or any representative on the grounds that the company had been "guilty of inordinate and contumelious delay".

A further hearing took place in January 2009 on an application to set aside this decision. Once again the company was not represented, and the

decision was confirmed. A further application was made by the company to set aside the decision following the change to the new Tribunals Rules in April. The company's counsel argued that the transitional rules allowed it a further hearing, and that its earlier professional representation had been so incompetent that an extension was necessary to avoid a miscarriage of justice.

Sir Stephen Oliver disagreed. He did not accept that the transitional rules gave the new Tribunal any jurisdiction to set aside a decision that had been properly taken and determined by the old Tribunal. The company and its representatives had failed to turn up in person at the January hearing, which was a requirement for a decision taken in the absence of the taxpayer to be set aside. Even if the company's representation had been poor, the company had chosen its advisers and should perhaps have kept a closer eye on the progress of its appeal in relation to such large sums.

First Tier Tribunal (TC00133): *ATEC Associates Ltd*

6.7.3 Alternative assessments

In 2007 the Tribunal and High Court heard a dispute about the legality of HMRC raising mutually exclusive alternative assessments on a trader who was affected by a MTIC fraud (unusually, concerning confectionery and razor blades): one (preferred by HMRC) was raised on the basis that the goods which were the subject of the input tax claim never existed; the other accepted that they existed but assessed for output tax on the basis that they had not, as claimed, been despatched to Spain. The High Court ruled that HMRC were permitted to put forward alternative assessments: the fact that one contradicted the other did not necessarily mean that they were both "not to best judgement". The trader argued that it had taken all reasonable precautions and should be allowed its input tax.

At the new hearing, the Tribunal examined the facts in detail. The fraudulent transactions had taken place in early 2003, when MTIC fraud – particularly in goods that were not mobile phones or CPUs – was relatively unknown. The *Bond House Systems Ltd* Tribunal case took place in January and March of that year. The company had discussed its business and its documentation several times with HMRC officers during the period in question, trying to confirm that it was operating proper controls.

In spite of these possible mitigating circumstances, the Tribunal now held that the trader ought to have known that there was something wrong with the transactions. The fraud was carried out by a new customer who expanded his volume of trade very rapidly. When he ordered a particular quantity of goods, they could always be readily and exactly sourced by a supplier who had become known to the company at the same time as the customer. It was all too convenient. The Tribunal quotes Mr Bishopp in the *Calltell Telecom* case:

"*Much will depend on the facts, but an obvious example might be the offer of an easy purchase and sale generating conspicuously generous profit for no evident reason. A trader receiving an offer would be well advised to ask why it had been made; if he did not he would be likely to fail the test set out in paragraph 51 in the judgment of Kittel.*"

It is probably easier for the Tribunal to see this with hindsight than it was for the trader at the time.

The Tribunal decided that there was sufficient evidence to conclude that most of the goods existed, but they had not been despatched to Spain. The preferred assessment was therefore not the one that was upheld, but the appeal was dismissed.

First Tier Tribunal (TC00168): *Westone Wholesale Ltd*

Penalties and appeals

6.8.1 Guidance on penalties

HMRC have issued a Brief to give further information on the VAT and Excise wrongdoing penalties contained in the FA 2008. These apply where any person:

- makes an unauthorised issue of an invoice showing or including VAT
- misuses a product so that a higher rate of excise duty is payable, or supplies a product knowing that it will be used in such a way
- handles goods subject to unpaid excise duty.

The VAT penalty replaces the existing s.67(1)(c) penalty for unauthorised issue of VAT invoices.

The amount of the penalty is in line with the new regime for careless, deliberate, and deliberate concealed errors. The following table sets out the effect of disclosure and the seriousness of the offence:

Reason for wrongdoing	Disclosure	Min penalty	Max penalty
Reasonable excuse		No penalty	No penalty
Careless	Unprompted	10%	30%
	Prompted	20%	30%
Deliberate	Unprompted	20%	70%
	Prompted	35%	70%
Deliberate/concealed	Unprompted	30%	100%
	Prompted	50%	100%

R&C Brief 52/09

HMRC have also updated the online Compliance Handbook manual in relation to:

- changes to assessing time limits introduced in Sch.39 FA 2008;
- penalties for failure to notify or meet relevant obligations introduced in Sch.41 FA 2008;
- penalties for VAT and Excise wrongdoings introduced in Sch.41 FA 2008.

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

6.8.2 Factsheets on penalties

HMRC have issued further Factsheets in the series which explain the new compliance checks. The latest explain:

- CC/FS7 Compliance checks – Information about penalties
- CC/FS10 Compliance checks – Suspending penalties for careless errors

The suspension of penalties is wholly new. A penalty may be suspended for up to two years, during which a recurrence of the problem will lead to the penalty becoming payable (and, presumably, a further penalty for the later error). Only a careless error penalty can be suspended, and only then if clear conditions can be set so that it can be seen that the trader has complied.

CC/FS7; CC/FS10

6.8.3 Default surcharges

A company had been subject to surcharges over two years, but had gone three quarters without default and needed only one more to exit the surcharge regime. The director received a letter from his bank, Bank of Scotland, explaining that a new "prompt payment" system was being introduced under which BACS payments would arrive within at most one day of the instruction. Accordingly, he instructed the bank to pay the VAT liability for the April 2008 quarter on 5 June, so it would arrive by Friday 6 June. When he discovered that it had not done so, he asked why; he was told that the new system was not yet in place. When it was later introduced, he was disappointed to find that he could not give instructions by internet to pay Government departments – he would have to make a phone call to effect a BACS transfer to pay VAT.

The Tribunal accepted that the bank's letter was something that a reasonable trader would rely on as this trader had done, and it was therefore a reasonable excuse.

First Tier Tribunal (TC00098): *Nigel Lowe Consulting Ltd, Nigel Lowe Holdings Ltd*

A company which was within the payments on account regime had a default history as follows:

09/2006 Late return – SLN issued

12/2006 Late return and payment – 2% penalty charged

03/2007 Late return and payment – 2% penalty charged (incorrectly); subsequently revised to 5%, then dropped altogether

06/2007 Late return and payment – 10% penalty charged (incorrectly); subsequently dropped when it was found that the company had been in credit for the period

09/2007 Late return – SLNE issued

12/2007 Late return and payment – 15% penalty charged, then reduced to 10% and again to 5%

The confusion caused by the first mistake (charging 2% instead of 5% on the second chargeable default) seems to have completely confounded

HMRC. The company argued that the attempt to levy a 15% surcharge in respect of 12/2007 made the assessment invalid, and it could not be rectified by reducing the percentage. This was the reasoning of the Tribunal in *Dow Chemical Company Ltd* (13,954). HMRC's counsel appeared not to have been briefed about this line of defence, but HMRC had received notice of it 7 months in advance of the hearing and the Tribunal refused to allow an adjournment for it to be considered. This was not an "ambush" by the appellant.

The Tribunal agreed with the reasoning in the *Dow Chemical* case, which it considered and analysed. It accepted that an assessment which was wrong from the outset because it used the wrong percentage could not be amended by HMRC; it could only be withdrawn and replaced with a valid one, if time limits still permitted. In this case the errors with the percentages were not related to factors unknown to HMRC at the time the surcharges were issued (e.g. a subsequent reasonable excuse appeal "knocking out" one of the earlier defaults) – in that case the percentages can be amended. The surcharge for 12/2007 was wholly wrong and could not be corrected. The appeal was allowed.

First Tier Tribunal (TC00104): *Ideal Shopping Direct plc*

A trader gave instructions to his bank on Friday 2 May to make a BACS transfer to HMRC. Although the payment was shown leaving his bank account on that date, he was too late for the BACS process to start. As Monday 5 May was a bank holiday, the money did not reach HMRC until 8 May.

Although the trader did not appear at the hearing, the Tribunal examined the bank statements and correspondence he had sent and concluded that he had a reasonable excuse. It appeared that he had given the bank the instruction on the Friday and had been led to believe that the payment would arrive on time. Had the bank told him the true position, he could and probably would have made a CHAPS transfer. The appeal was allowed.

First Tier Tribunal (TC00014): *Geoffrey Dean Layton*

A trader had received a VAT return for its normal return period to 31 July 2008, but asked for a change of return period through its representative on 24 July. On 4 August HMRC replied that the representative did not have authority to act in VAT matters. The company denied receiving either the VAT return or the letter of 4 August, and did not think it needed to file a return for the July quarter. The result was a surcharge of £20,735.

The Tribunal did not think that a request to change the date, made late in the quarter and not followed up at all, constituted a reasonable excuse for the late filing and payment, particularly for a trader who was liable at 10% on the next default.

The following return arrived with an unsigned cheque on 1 December 2008, a day after the due date. The trader produced a post book entry stating that the return had been sent on 27 November, but that was contradicted by the date on the return which was 28 November. The Tribunal concluded that the trader had no defence to the 15% surcharge resulting.

First Tier Tribunal (TC00114): *Seatechs Ltd*

6.8.4 Misdeclaration

A solicitor purchased a property for £47,000 and claimed £7,000 as input tax. There was no evidence to support the supposition that the seller had charged or accounted for VAT. HMRC assessed the solicitor for tax and interest, and also a misdeclaration penalty that was mitigated by 55%. He appealed against the penalty.

The Tribunal had no sympathy. As a solicitor, he should have known that property is generally not subject to VAT, and he should not have claimed input tax without a shred of evidence to support the claim. No further mitigation was due.

First Tier Tribunal (TC00161): *AS Lambert*

6.8.5 Dishonesty

A partnership running a pizza delivery business were assessed on undeclared output tax of about £71,000 and a s.60 penalty of approximately 85% of that. The essence of their defence appeared to be "the till did not work properly"; as a result, information taken from the memory of the till, which formed the basis of HMRC's assessment, was unreliable. The Tribunal preferred HMRC's version and confirmed both the assessment and the penalty.

First Tier Tribunal (TC00166): *Pizza Place and others*

A company was charged a penalty under s.60 and it was assessed in its entirety on one of the directors under s.61. He disputed this, arguing that other directors also knew what was going on. The Tribunal held that his involvement was enough to justify the conclusion that he should be fully responsible for the VAT; in any case, s.61 did not require an equitable apportionment between those responsible. If his dishonesty had contributed to the evasion, he could be assessed for all the penalty.

The Tribunal noted that the penalty had been substantially reduced because of the co-operation of the other directors in determining the proper liability of the company. The appellant had therefore benefited from their conduct, which the Tribunal thought did not appear to warrant apportioning any of the liability to them. The appellant was not a convincing witness and had properly been assessed to the whole of the penalty.

First Tier Tribunal (TC00077): *Gary Giles*

6.9 Other administration issues

6.9.1 Clearances and rulings

HMRC have issued updated guidance on applying for clearances (businesses) and obtaining VAT rulings (individuals). The substance of the existing guidance has not changed significantly, but the wording has been updated to take account of changes to the Disclosure of Avoidance Scheme rules and the new Tribunals structure.

HMRC Release 21 August 2009; Notice 700/6

An article by Stephen Taylor in *Tax Adviser*, October 2009, comments on the difficulty of getting HMRC to commit themselves to a ruling, and the problems for businesses if they have then to make their own decision on the basis that HMRC will not issue a clearance. It is clear that HMRC will not regard their own refusal to give clearance as restricting their ability to review the trader's subsequent decision once the trader is committed to the transactions and may have a significant liability at stake. This seems unfair.

Tax Adviser October 2009

6.9.2 Definition of avoidance schemes

HMRC are engaged in an attempt to simplify the anti-avoidance legislation, which presumably has grown more complicated because of more complex avoidance schemes. It is therefore hard to see how it can easily be simplified.

However, HMRC have issued a discussion document asking for views on what might be a workable definition of "unallowable purpose" for use in anti-avoidance legislation.

HMRC Discussion Document 3 August 2009

6.9.3 Disclosure of avoidance schemes

HMRC have issued new and updated guidance on the disclosure of avoidance schemes rules as they apply to direct taxes, NIC and SDLT. The VAT version is still covered separately by Notice 700/8.

HMRC Release 10 August 2009

6.9.4 Senior accounting officer

In July, HMRC published draft guidance for the new role of "senior accounting officer" who, as set out in the Budget, will have to certify that a large company's or group's accounting systems are adequate for the production of accurate tax information. The SAO will have to file a certificate no later than the filing date for the related tax return which states "I as Senior Accounting Officer of the qualifying company/companies listed below, hereby certify that to the best of my knowledge and belief throughout the company's financial year ended [....] the company established and maintained appropriate accounting arrangements or to the extent they did not an explanation is provided below, and I took reasonable steps to ensure that the company/ companies established and maintained appropriate tax accounting arrangements."

The rules commence on 1 January 2010, and early periods will only be affected to the extent that the tax accounting arrangements for 2010 are relevant to the computation of the liabilities of earlier periods.

VAT is within the scope of the SAO's responsibilities. The following example is given of the type of matter which the SAO must consider:

A company has sales which are both standard and zero rated. Staff in the sales ledger department have had training in the coding of goods and there is support through a company manual, regularly updated for changes to classifications. Reasonableness checks are conducted monthly on the ratio of standard to zero rated goods entered onto the system and sample checks of invoices to ensure accuracy of coding are conducted quarterly. As there are appropriate checks and controls in place, the miscoding of a small number of invoices through human error would be considered insignificant. If, however, there were no checks and controls in place or accountability for ensuring the correct determination of codes to new types of goods, then incorrect allocation of a tax code (for example, zero rated) to a particular income ledger code may be evidence of failure to put in place appropriate tax accounting arrangements.

The revised version was issued in August. It is a long and detailed document and should be read in full by anyone who has the misfortune to be appointed SAO.

R&C Brief 37/09; HMRC Release 17 August 2009

6.9.5 ESCs under review

HMRC have issued a new version of Notice 48 which lists all the VAT ESCs which are current in July 2009. As the post-*Wilkinson* review of ESCs continues, this document will presumably become shorter and shorter – all the concessions will either be enacted or deleted.

Notice 48

HMRC have also issued a new technical consultation on the implementation of the *Wilkinson* decision for particular concessions. The VAT ESCs on the current list relate to zero-rating of nurses' prescriptions by pharmacists and GP dispensing.

HMRC Consultation 15 July 2009

6.9.6 Responses to charter consultation

HMRC have published a document outlining their response to participants' input into the second consultation around the proposed Charter, which is supposed to be in place by the end of this year. The document includes stakeholders' views and a draft Charter.

HMRC Release 20 July 2009

HMRC powers

HMRC have published two consultation papers on its new framework of powers. The first contains proposals for bulk information powers and specialist unnamed taxpayer powers for all the main taxes (useful for obtaining information about large groups of people, e.g. customers of

banks). The second concerns a new excise checking framework. The deadline for submitting comments is 1 October 2009.

HMRC Consultation 9 July 2009

As part of the ongoing review of HMRC’'s powers, deterrents and safeguards, HMRC have agreed the Terms of Reference of the Implementation Oversight Forum. These terms have been published along with the papers and minutes of the Forum’s second meeting held on 30 June 2009.

The remit of the Forum is to provide assurance to the Financial Secretary to the Treasury and the HMRC Chairman and Commissioners that the policy outcomes of the review of powers, deterrents and safeguards are being delivered in line with the undertakings given to Parliament. The Forum will oversee the period of initial implementation including the post-implementation review and benefits realisation work. The first meeting of the Forum was held on 30 March 2009 and it is expected that the forum will continue to meet up to four times a year for the next four to five years. Forum members are mainly external stakeholders plus relevant HMRC Directors. The Chair is Dave Hartnett, HMRC Permanent Secretary for Tax. The Forum will be supported by a secretariat from HMRC who will be responsible for marshalling information required for the Forum as well as ensuring that recommendations are taken forward and reports provided to the Financial Secretary.

http://www.hmrc.gov.uk/about/implementation-oversight/agenda-300609.pdf

6.9.8 Information notices and professional privilege

Where HMRC require documents to be produced by a taxpayer under the powers in Sch.36 FA 2008, it is possible for the taxpayer to argue that the documents are subject to legal professional privilege and therefore need not be disclosed. A new statutory instrument sets out the procedure to be followed where the taxpayer claims this privilege, and the resolution of disputes about the extent of the protection which will be a matter for the Tribunal to determine.

SI 2009/1916

6.9.9 Time to pay continues

The Time to Pay initiative had helped 185,000 businesses by mid-August. The total tax payments which have been spread total £3.3bn. Around 60% of arrangements are for periods of three months and below. HMRC monitoring shows that over 90% of expected payments have been received. By 2 August, £2.12bn had been repaid (both in part and in full), leaving £1.18bn still being paid.

Treasury Release 17 August 2009

A newspaper reported that government lawyers have reviewed the Time to Pay initiative because of concerns that HMRC might be encouraging companies to carry on trading while insolvent. However, the legal advice was that the scheme could continue.

Daily Telegraph 4 August 2009

6.9.10 HMRC annual accounts

The National Audit Office has published its report on HMRC's accounts for the year 2008-2009, a year in which the economic downturn is considered to have been responsible for a £21.7 billion reduction in taxes and duties collected by HMRC. In relation to VAT, the report notes that VAT receipts fell by £6.4bn, "reflecting the effect of the worsening economic conditions in the second half of the year and the reduction in the VAT rate to 15% in December 2008."

One of the comments does not relate to VAT, but refers to it: "*Four million more businesses will be able to take advantage of our alignment of the 'Three Line Accounts' turnover limit with the VAT registration threshold saving them £54 million a year from April 2010.*" This means that businesses below the VAT registration threshold will not have to provide a detailed analysis of their expenditure on the tax return. Even the government's bold announcement appears to recognise that the saving is just £13.50 per trader per year.

HMRC Release 21 July 2009;
www.nao.org.uk/publications/0809/hmrc_accounts.aspx

6.9.11 Adjudicator's report

An article in Taxation, 3 September 2009, reviews the annual report of the HMRC Adjudicator's Office. The number of complaints against HMRC appears to be falling, although there still are some horror stories of bad administration leading to severe hardship for taxpayers. None of the examples quoted relate specifically to VAT.

Taxation 3 September 2009

6.9.12 Prosecutions and arrests

The Guardian newspaper reported the conviction and sentencing to 12 years in prison of a carousel fraudster, Craig Johnson. The trial lasted 9 months; the VAT loss was estimated at £167m. Johnson, 35, was ordered to pay back £26m of his profits from crime or face a further 10 years in prison. As a result, his grade II-listed, 17th Century mansion was put on the market in the summer at £2.75m and all his possessions were auctioned off secretly in June.

The Guardian, 30 September 2009

The Revenue and Customs Prosecutions Office's annual report, published on 22 July 2009, claims it achieved a conviction in 92% of the 1,121 cases it prosecuted in 2008/09, and it obtained 499 confiscation orders against criminals amounting to over £69 million.

During the year, it collected almost £22 million in confiscated criminal assets. Other highlights of its year included:

- the £26 million confiscation order obtained against multi-million pound VAT fraudster Craig Johnson;
- the 12 defendants sentenced to a total of 125 years in prison for drug smuggling and money laundering, following a three-year Serious Organised Crime Agency investigation;
- the successful extradition from Switzerland of Ray Woolley, who stole over £38 million from the Exchequer in an elaborate VAT fraud and had absconded from prison;
- the conviction of three men to a total of 10 years' imprisonment for trafficking military equipment to Iran in direct violation of the UK embargo; and
- the first use, in England and Wales, of serious crime prevention orders against three money launderers who laundered £25 million for organised crime networks.

http://www.rcpo.gov.uk/en-gb/Publications/AnnualReport/Documents/RCPO%20Annual%20Report%20and%20Resource%20Accounts%20200809.pdf

HMRC announced that they carried out a series of dawn raids to close down a large-scale fraud in the construction industry. This is described as "a variant of missing trader fraud", but it appears to involve the theft of income tax and national insurance deductions from amounts paid to workers in the construction industry rather than anything to do with movements of goods and VAT. 40 search warrants were executed and 21 people were arrested.

HMRC Release 9 September 2009

6.9.13 Opportunity knocks

In 2007, HMRC offered a "disclosure facility" to people who had undeclared income or gains in offshore accounts. This was prompted by HMRC obtaining lists of people who had offshore accounts with the high street banks, and finding that there were far more of them than declared foreign income on their tax returns. If people came forward then to pay the outstanding tax and interest on it, they were offered only a 10% penalty instead of the potential maximum 100%.

Now there will be another opportunity, running from 1 September 2009 to 12 March 2010. The same 10% penalty is offered, but it will be doubled to 20% for anyone who knew about the previous opportunity and failed to come forward. It will be essential to notify HMRC by 30 November 2009 that a disclosure is coming, with the details to follow later. Anyone who fails to take advantage now can expect a higher penalty if they are discovered later by HMRC.

www.hmrc.gov.uk/offshoreaccounts/offshore-ndo.htm.

There are articles discussing the New Disclosure Opportunity and the related Liechtenstein Disclosure Facility in *Taxation*, 20 August 2009; ICAEW *TAXline*, September 2009; and *Tax Adviser*, September 2009.

6.9.14 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.

The inevitability of the result may be getting out to the appellants: in three out of four of the hearings in this quarter on security, no-one from the appellant bothered to turn up. In the one case where someone did represent the company – the father and husband of the two people who had been involved in the three preceding failed businesses – he agreed that it was reasonable for HMRC to want security given the background, and his grounds for appeal were limited to the difficulty he and his wife (aged 73 and 65) would have in funding the security for their son. The appeal was dismissed.

First Tier Tribunal (TC00100): *Drivers Direct (2008) Ltd*; (TC00040): *Cardinal Entertainments Ltd*; (TC00113): *Ashby Contracting Ltd*; (TC00127): *Penta Office Furniture Ltd*