VAT UPDATE
JULY 2010

Covering material from April – June 2010

Notes prepared by Mike Thexton MA FCA CTA

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

VAT Update July 2010

Contents

1. INTRODUCTION ... 1
1.1 Appeals pending ... 1
2. OUTPUTS ... 3
2.1 Scope of VAT: linking supplies to consideration ... 3
2.2 Disbursements ... 3
2.3 Exemptions ... 5
2.4 Zero-rating ... 5
2.5 Lower rate ... 12
2.6 Computational matters ... 13
2.7 Discounts, rebates and gifts ... 14
2.8 Compound and multiple ... 17
2.9 Agency ... 19
2.10 Second hand goods ... 19
2.11 Charities and clubs ... 22
2.12 Other supply problems ... 22
3. LAND AND PROPERTY ... 22
3.1 Exemption ... 27
3.2 Option to tax ... 27
3.3 Developers and builders ... 28
3.4 Input tax claims on land ... 30
3.5 Other land problems ... 33
4. INTERNATIONAL SUPPLIES ... 35
4.1 E-commerce ... 35
4.2 Where is a supply of services? ... 35
4.3 International supplies of goods ... 35
4.4 European rules ... 40
4.5 Eighth Directive reclaims ... 41
5. INPUTS ... 48
5.1 Economic activity ... 49
5.2 Who receives the supply? ... 49
5.3 Partial exemption ... 49
5.4 Cars ... 50
5.5 Business entertainment ... 52
5.6 Non-business use of supplies ... 53
5.7 Bad debt relief ... 53
5.8 Other input tax problems ... 57
6. ADMINISTRATION AND PENALTIES ... 61
6.1 Group registration ... 63
6.2 Other registration rules ... 63
6.3 Payments and returns ... 65
6.4 Repayment claims ... 71
6.5 Timing issues ... 72
6.6 Records ... 74
6.7 Assessments ... 74
6.8 Penalties and appeals ... 75
6.9 Other administration issues ... 76

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:

The HMRC website section which reported the progress of appeals stopped being updated some time ago and now appears to have been dropped altogether. It is now only possible to pick up clues to unsettled cases from Revenue & Customs Briefs which announce HMRC's intention to appeal a decision or to concede defeat.

Awaiting the ECJ:

- *AstraZeneca UK Ltd*: whether an employer is entitled to deduct input tax on the cost of buying face-value vouchers which are given to employees as part of their remuneration (Advocate-General's opinion in this update)
- *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 (Advocate-General's opinion in this update)
- *Future Health Technologies Ltd*: whether the supply of services relating to the processing and storage of stem cells qualifies for exemption as "healthcare" (Advocate-General's opinion in this update)

- *Macdonald Resorts Ltd*: nature of supplies where timeshares are sold for "points" (Court of Session has referred questions to the ECJ in taxpayer's appeal against the Tribunal decision)
- *T-Mobile Ltd*: whether additional charges for paying by cheque could be exempt (High Court has referred questions to the ECJ in taxpayer's appeal against the Tribunal decision)
- *RBS Deutschland GmbH*: whether arrangements exploiting differences between UK and German law on car leasing constituted an abuse of rights (Court of Session has referred questions to the ECJ in HMRC's appeal against the Tribunal decision)
- *Weald Leasing Ltd*: artificial leasing arrangements and abuse of rights (Court of Appeal has referred questions to the ECJ in HMRC's appeal against the High Court decision)

UK appeals awaiting hearing:

- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of ECJ's ruling on how "risk of distortion of competition" is to be applied
- *Pendragon plc*: HMRC will appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive"
- *Rank Group plc*: the exemption for FOBT gaming machines (HMRC have appealed the decision of the First Tier Tribunal to the Upper Tribunal in relation to the "due diligence defence")
- *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)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 HMRC online guidance

HMRC have added sections of their manual on "supply and consideration" to the online guidance on the website. The material covers:

- The role of policy teams
- Basic principles and underlying law
- Further guidance for identifying supply
- Consideration
- Whether supplies are goods or services
- Single and multiple supplies
- Direction of supplies
- Illegal supplies

www.hmrc.gov.uk/manuals/vatscmanual/VATSC01000.htm

2.1.2 Private or business?

An interesting question has been referred by the Polish courts. A farmer used land for a VATable agricultural activity. It then appears that the land was designated for other purposes through planning processes which were out of his control. He therefore reclassified the land as his private property, and subsequently sold it to someone who intended to develop holiday accommodation on it.

The question referred is:

Is a natural person who carried out an agricultural activity on land and subsequently, on account of a change to urban management plans which occurred for reasons beyond his control, ceased that activity and reclassified his property as private property, divided it into smaller parts (land designated for a holiday home development) and began to dispose of it, on that basis a taxable person for VAT within the meaning of Article 9(1) of Directive 2006/112/EC and Article 4(1) and (2) of Sixth Directive 77/388/EEC who is liable for payment of VAT on the basis of a trading activity?

ECJ (Reference) (Case C-180/10): *Jaroslaw Slaby v Minister Finansów*

2.1.3 Private, business or flat rate?

A slightly different but related question has arisen in relation to a flat rate farmer who has sold plots of land designated for residential and service development.

The questions referred are:

Is a flat-rate farmer within the meaning of Article 295(1)(3) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ... who sells plots of land used for his agricultural activity which are designated in a municipality's urban management plan for residential and service development and were purchased as agricultural land (VAT-free) covered by Article 16 of that directive, which regards the application of business assets for the taxable person's private use or for purposes other than those of his business as a supply of goods for consideration only where the tax on those assets was wholly or partly deductible?

Must a flat-rate farmer within the meaning of Article 295(1)(3) of Directive 2006/112/EC who sells plots of land previously used for his agricultural activity which are designated in a municipality's urban management plan for residential and service development and were purchased as agricultural land (VAT-free) be regarded as a taxable person who is required to account for VAT on that sale under the general rules?

ECJ (Reference) (Case C-181/10): *Emilian Kuc and Halina Jeziorska-Kuc v Dyrektor Izby Skarbowej w Warszawie*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Intermediary services on the internet

The Court of Appeal has upheld the decision of the High Court in the cases of *Insurancewide.com* and *Trader Media Group*.

Background

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

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

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

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

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

Insurancewide appeared to lose before the Tribunal largely because the website stated that the company was not an insurance agent (probably for regulatory reasons, and only for a specific period). The judge commented that whether or not an individual seeking exemption was entitled to it

depended upon what that individual was actually doing and not how he might describe himself or be described.

Court of Appeal

HMRC argued again that the traders simply provided a "click-through" facility which enabled customers to access insurers' websites. Without any involvement in the negotiation of contract terms, the collection of premiums or the handling of claims, and without any direct relationship with the insured, the website operators could not be insurance agents or brokers for the purposes of the exemption.

The Court disagreed. It considered in detail what was required for a person to enjoy the exemption, and concluded that:

- it was not necessary for the trader to have a direct relationship with either or both of the parties to the insurance contract, as long as it was involved in putting them in contact and carrying out some of the essential functions of an insurance agent;
- it was not necessary for the trader to carry out all the functions of an insurance agent or broker as defined in the EU Insurance Directive, as long as it was carrying out enough of them to be fairly described as providing insurance services;
- it made no difference how the services might be described by the trader or by others – the exemption depended on what the trader did.

These traders provided more than mere advertising. They were an essential step in putting people wanting insurance in contact with people who offered insurance, and that was capable of being exempt as the service of an insurance agent or broker.

Court of Appeal: *Insurancewide.com Services Ltd and another v HMRC*

2.3.2 German gambling rules acceptable

After the ECJ held in 2005 that German law was not allowed to distinguish between licensed and unlicensed gambling in applying the VAT exemption, a whole industry arose in making "*Linneweber* claims". The German courts referred a question to the ECJ on a different distinction now drawn by German law (which was amended in 2006 following the *Linneweber* decision) – between horse race betting and lotteries, which are exempt, and other forms of gambling, which are taxable. The appellant argued that supplies from gaming machines in a gambling hall should be exempt. The change in the law resulted in some 63% of all gambling transactions within Germany becoming taxable, which the company contended was contrary to the Directive.

The Advocate-General gave an opinion that the state is entitled to draw such a distinction, and the full court has supported that conclusion. Member states have a broad discretion over the extent of the gambling exemption, and the German law did not in this case infringe the principles of fiscal neutrality.

The question referred was as follows:

"*Is Article 135(1)(i) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax to be interpreted as meaning that Member States are permitted to have a rule under which*

only specified forms of (race) betting and lotteries are exempt from tax, and all 'other forms of gambling' are excluded from the tax exemption?"

The answer was:

"Article 135(1)(i) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that the exercise of the discretionary power of the Member States to fix conditions and limitations on the exemption from value added tax provided for by that provision allows those States to exempt from that tax only certain forms of gambling."

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

2.3.3 Postal services

Following the announcement in the March Budget that certain services supplied by the Post Office will be taxable from 31 January 2011, HMRC have issued a Brief to comment on claims that have been received from businesses in respect of input tax they believe they have incurred in the past. The Brief does not go into detail about the basis for the claim, but presumably this is:

- the trader has received a supply which should have been treated as taxable under EU law;
- although the trader does not hold a tax invoice (as the Post Office would not have issued one), there is alternative evidence that a supply was received and consideration paid;
- HMRC ought to accept this alternative evidence and give credit for input tax.

As the UK law provided for the Post Office company's exemption, no VAT can be assessed on that company. The claims by its customers would therefore, if successful, represent a one-sided correction of the VAT.

Surprisingly, HMRC do not say that they reject such claims on principle. The Brief sets out the general categories of PO service which are likely to become taxable, and then explains the criteria for a claim to be valid as follows:

To be valid, a claim must have included the information required, as set out in Notice 700/45 How to correct VAT errors and make adjustments or claims. Claims that do not meet these basic criteria will be rejected.

Where a valid claim has been submitted, we will consider:

- *the contractual arrangements between the claimant and Royal Mail over the period of the claim*
- *(in relation to 'Fleming' claims only) developments in the postal market and related legislation over the period of the claim*
- *whether the supplies to which the claim relates would have been taxable at the standard rate under the new rules*
- *evidence that Input Tax has been incurred.*

Unless they were made under the transitional provisions in section 121(2) of the Finance Act 2008 (Fleming claims), all claims will be subject to the four-year time limit in regulation 29(1A) of the VAT Regulations 1995.

R&C Brief 19/2010

The March Budget proposal did not make it into the last Labour Finance Act. It was announced again in the June Budget and will be included in the third Finance Bill of 2010, which is to be issued after the summer recess.

BN 41

2.3.4 Not healthcare (1)

A business provided a service which was described by the Tribunal as "involving two essential attributes".

"*The first was to arrange very swift and appropriate treatments for client companies when one of their employees sustained some musculoskeletal injury. The second aspect of the service was to understand clients' businesses, either on a site-by-site basis, or by reference to the different activities performed by employees, so as to provide collated information about injuries sustained by all employees. The purpose of this was to enable companies, sometimes actively assisted in this role by the Appellant, to locate risk areas in their businesses so that they could reduce the risks of injury, and reduce the attendant lost working time.*"

The appellant used sub-contracted registered practitioners, including physiotherapists and osteopaths, to provide treatments to employees of its clients. It was not merely acting as a booking agent, but incorporated those treatments within the service it provided.

HMRC had initially encouraged the business in the belief that its supplies were standard rated. Later this view changed, and HMRC assessed the business to recover input tax of some £60,000, arguing that its supplies were predominantly exempt healthcare.

The Tribunal examined what the business did. Its objective, as confirmed by client witnesses, was to reduce absenteeism and to improve health and safety practice in its client businesses, so protecting them from employee injury claims. The treatment of actual injuries was only a part of this. The Tribunal decided that this was a single composite service, rather than a multiple supply of consultancy and medical treatment; once that had been established, it could only be standard rated, because exempt healthcare would have to be wholly supplied by registered practitioners. The managing director was central to the delivery of services and she was not a registered person. It could also not be said that the reporting services were ancillary to treatment – if anything, it was the other way around.

The decision goes into some detail on arguments about the mixed/compound borderline and also the way in which the exemption for healthcare should be interpreted. The trader also felt very aggrieved about alleged misdirection by HMRC in the early years of her business, and the Tribunal records facts concerning this without drawing any firm conclusions.

First Tier Tribunal (TC00434): *Health Response UK*

2.3.5 Not healthcare (2)

Two cases on similar issues have come before the ECJ. In the first case, referred by Denmark, the full court has disagreed with the Advocate-General's opinion. The case concerned "*a service such as the collection, transportation, analysis and storage of umbilical cord blood*"; the question was whether this could be exempt as *"closely related to hospital or medical care*" within Article 13A(1)(b). The Advocate-General thought that it could, "*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)*".

The full court decided that the service was only potentially related to healthcare, because the treatments had not yet been performed, commenced or even envisaged. The services could therefore not be regarded as "closely related" to any healthcare. As the exemptions have to be narrowly construed, the services must be standard rated. The exemption was not subject to a limitation based on time, but the lack of any temporal link between the service and the possible healthcare meant that the service could not be exempt.

The ECJ also ruled on the question of whether a private stem cell bank could be treated as an "eligible body" (effectively a hospital, falling under one of the other terms of the exemption) because it was subject to regulations issued by the European Parliament concerning such services relating to human tissue. The judges concluded that it was open to member states to recognise such an organisation as falling within that part of the exemption, but it was not mandatory. It would be for the referring court to decide whether fiscal neutrality was infringed.

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

The second case concerned a UK company which collected, tested, processed and stored umbilical cord blood stem cells for future therapeutic use. The contract between the parents and the company prohibited research or experimentation: the cells could only be used for medical care, if it was found that such care was in the future medically feasible and desirable. A typical storage contract provided the blood to be held for at least 20 years in the company's freezer.

HMRC initially accepted that the services qualified for exemption under VATA 1994 Sch.9 Group 7 Item 8 (supplies of human tissue for therapeutic purposes). However, they later withdrew this ruling on the grounds that the company was not supplying the tissue: the customer supplied the tissue, and the company's services were the processing and storage of it. The principal service was the storage, and that was wholly taxable.

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

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

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

The Tribunal decided that questions should be referred to the ECJ to clarify the extent of these exemptions. The ruling was similar to that in *Copygene* – the service could only be exempt if the analysis of the umbilical cord blood was used at the time to make a medical diagnosis. If it was for some other purpose, it was not sufficiently closely related to healthcare.

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

A third case dealt with a simpler question which related to a more limited activity, and predictably (in the light of the above decisions) fell outside the exemption. A trader supplied the service of "*transporting, in a self-employed capacity, human organs and samples for hospitals and laboratories*". The question for the court was whether this could "*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*". Not surprisingly, the court ruled that the transporting of the goods did not involve the supply of the goods, and therefore the exemption did not apply.

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

2.3.6 Secondment of staff

The Commission took infringement proceedings against the Netherlands, asserting that the country allowed exemption for certain supplies of staff in contravention of the requirements of the VAT Directive. The Commission was concerned about "*making available of personnel in the socio-cultural sector, the health sector and the education sector to so-called Euregios and for promotion of work mobility*".

The judgment of the court is currently not available in English, but the following points appear to come out of it:

- the Court rejected the Commission's arguments (and awarded costs against the Commission);
- the exemption in the Netherlands appears to depend on the status of the person supplying the staff (as a non-taxable person), and the Court considered that these conditions made the national exemption acceptable.

The judgment refers to the earlier decision in *Horizon College* (Case C-434/05), in which the Netherlands exemption for supplies of educational staff were found to be drawn too widely. In that case, the Court ruled that a supply of teaching staff could be a supply closely linked to education, but it would only fall within the EU exemption if the body supplying the staff and the body receiving the supply were both "eligible bodies" (i.e. non-commercial or public bodies). As the current case leads to a different

conclusion, it seems that such conditions must exist within the Netherlands exemption for these supplies of staff.

The judgment also appears to require that the secondment is for an indefinite period rather than for short and fixed terms, and also that the person making the secondment does not make a profit.

ECJ (Case C-79/09): *Commission v Netherlands*

2.3.7 Sharing staff

Readers' Queries in *Taxation*, 3 June 2010, contains a question and two answers about the VAT, tax and NIC issues that might arise where two connected companies, which operate care homes, share staff. As the companies' supplies to third parties are generally exempt, they do not currently have to register for VAT; however, if they should supply staff to each other for consideration, they might exceed the registration threshold and create a sticking VAT cost. This could be avoided by registering the companies as a VAT group, but then any small third party taxable supplies which are currently below the registration threshold would become liable to output tax.

Taxation 3 June 2010

2.3.8 Cost sharing consultation

HMRC have published a list of consultations announced at the time of the June Budget. The only one falling under the VAT heading is a formal consultation on implementing the EU Directive exemption for cost sharing (by exempt and non-taxable persons). The response date is given as Autumn 2010.

www.hmrc.gov.uk

2.4 Zero-rating

2.4.1 Vending machines

A company sold snacks from vending machines. Initially it accounted for output tax on its supplies, but it subsequently submitted a repayment claim on the basis that it should have treated its supplies as zero-rated. HMRC rejected the claim and the Tribunal dismissed the company's appeal, holding that the snacks were intended "for consumption on the premises on which they were supplied".

First Tier Tribunal (TC00435): *West Country Service Ltd*

2.4.2 Caravans

HMRC have announced a change to their policy on the zero-rating of caravans. Unlike houses, caravans which are intended to be lived in can benefit from zero-rating when sold new or second-hand. The conditions are simply that the caravan should exceed "the limits of size for the time being permitted for the use on roads of a trailer drawn by a motor vehicle having an unladen weight of less than 2,030kg".

From 20 April 2010 the minimum width of a zero-rated caravan rose from 2.3m to 2.55m. The minimum length remains 7m. If either limit is exceeded, the caravan cannot be towed by a car. This follows infraction proceedings taken by the European Commission against the UK for imposing a lower limit on road caravans than applies in the rest of the EU.

As a result, some caravans which were previous sold zero-rated will become standard rated.

R&C Brief 20/2010

2.4.3 Aircraft

The change to the rules on the zero-rating of aircraft that was announced in the March Budget did not make it into Labour's last Finance Act. It was reannounced in the June Budget and is earmarked for the September Finance Bill. The change is still planned to come into effect on 1 January 2011.

BN 39

2.4.4 Online manual

HMRC have published online their manual setting out details of the standard rating and zero-rating of transport services and related supplies in the UK. It covers:

- *Introduction and overview*
- *Zero-rating of passenger transport*
- *Passenger transport connected with recreational activities or airport car parking*
- *Agents for passenger transport*
- *Freight transport and related services – introduction*
- *Zero-rating of international freight transport*

- *The handling and storage of ship and aircraft cargo*
- *Transport and related services connected with imports and exports*
- *Making arrangements for a supply of freight transport or related services*
- *Freight Transport and related services – the Azores and Madeira*
- *The supply of ships and aircraft*
- *Repair, maintenance, modification and conversion of ships and aircraft and their parts*
- *Parts and equipment for ships and aircraft*
- *Handling of ships and aircraft*
- *Air navigation services*
- *Pilotage, salvage, towage and surveying services*
- *Services supplied to overseas businesses in connection with non-zero-rated ships and aircraft*
- *Ships' managers, aircraft managers and port agents*
- *Intermediary services relating to ships and aircraft (brokers and other agency services)*

http://www.hmrc.gov.uk/manuals/vtransmanual/index.htm

2.5 Lower rate

2.5.1 HMRC online guidance

HMRC have added new material on the supply of fuel and power to the online guidance on the website. It covers the scope of the reduced rate for supplies of domestic fuel and power, the treatment of cross-border supplies, and new guidance on fuel for private pleasure craft.

www.hmrc.gov.uk/manuals/vfupmanual/vfup2100.htm

2.6 Computational matters

2.6.1 Another change of rate

By far the most significant VAT measure included in the June Budget was the announcement that the standard rate will rise from 17.5% to 20% with effect from 4 January 2011. The Budget forecasts show that the Government is relying on the increased rate throughout the whole of this Parliament (but has no current plans for a further increase). Balanced against the increase in the standard rate was a specific announcement that there will be (for the moment at least) no extension of the scope of the tax – all the zero-rated and exempt supplies remain the same. Supplies subject to the lower rate are also not affected.

BN 43

Because we have recently had a similar 2.5% increase, the rules on anti-forestalling have been largely copied from last year's provisions and repeated.

BN 44

Draft legislation and guidance for traders has been issued. The guidance outlines the charge as follows:

The legislation will affect you if you receive a payment or issue a VAT invoice before 4 January 2011 for goods or services that you are to provide on or after that date and one of the following conditions is met:

- *you supply the goods or services directly or indirectly to a connected person (such as another business controlled by you); or*
- *you provide or arrange funding of your customer's payment; or*
- *you issue a VAT invoice to your customer that does not have to be paid in full within six months; or*
- *the payment or VAT invoice is in excess of £100,000 (including any other supplies made as part of the same scheme or arrangements), and this is not normal commercial practice.*

The legislation may also affect you if, before 4 January 2011, you supply rights or options to receive goods and services from you on or after that date, free of charge or at a discount.

Even then, the legislation will not affect you if the recipient of your supply ("the customer") can recover the VAT on that supply in full.

The legislation only applies to transactions entered into on or after 22 June 2010, but any tax due will not become payable before 4 January 2011.

The exceptions to the charge are perhaps the most interesting part of the draft legislation:

Letting etc of assets

11 (1) This paragraph applies in relation to a supply within paragraph 2 which arises from the letting, hiring or rental of assets.

(2) There is no supplementary charge under this Schedule if —

(a) the period to which the VAT invoice or payment referred to in paragraph 2(1) relates does not exceed 12 months, and

(b) the VAT invoice is issued, or the payment is received, in accordance with normal commercial practice in relation to the letting, hiring or rental of such assets.

Condition B cases involving normal commercial practice

12 There is no supplementary charge under this Schedule on a supply of goods or services within paragraph 2 or a grant of a right to goods or services within paragraph 3 if—

(a) the only relevant condition met is condition B, and

(b) the supply is made, or the right is granted, in accordance with normal commercial practice in relation to the supply of, or the grant of a right to, such goods or services.

Condition D cases involving hire purchase, conditional sale or credit sale of goods

13 There is no supplementary charge under this Schedule on a supply of goods within paragraph 2 if—

(a) the only relevant condition met is condition D,

(b) the VAT invoice —

(i) relates to a supply of goods made under a hire-purchase, conditional sale or credit sale agreement,

(ii) forms part of that agreement, and

(iii) is issued in accordance with normal commercial practice in relation to a supply made under such an agreement, and

(c) the basic time of supply of the goods is intended and expected to be within 6 months of the date of the VAT invoice which relates to the supply.

Normal commercial practice

14 In this Part of this Schedule, "normal commercial practice", in relation to a supply or grant of a right, means —

(a) normal commercial practice of the supplier or grantor at a time when an increase in the rate of VAT in force under section 2 of VATA 1994 is not expected, or

(b) if the supplier or grantor has no such practice, the normal commercial practice of suppliers making similar supplies, or granters granting similar rights, in the United Kingdom at such a time.

Further exceptions

15 (1) The Treasury may by order provide that there is no supplementary charge under this Schedule on supplies (including grants of rights to goods or services) of a description specified in the order.

(2) An order under this paragraph—

(a) may make provision having effect in relation to supplies of goods or services that are treated as taking place on or after 22 June 2010 or a later date, and

(b) may have effect in relation to a supplementary charge which has become due before the order is made.

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

A detailed guide to the change in rate has also been issued. In effect, this is the same guidance that was issued in respect of 1 January 2010. At least the new Chancellor has observed that midnight on New Year's Eve is a bad time to change the rate. 4 January is the first working day in 2011; even that might be regarded as not the best time to impose a requirement to change accounting for receipts.

2.6.2 Comment on the Budget

There has been a predictable range of reaction to the Budget: retailers do not want an increase in VAT, nor do campaigners for the poor, who are recognised as suffering disproportionately from taxes on spending. On the other hand, business in general appeared to welcome the package of measures, believing that it is necessary to begin to address the deficit in the public finances. The VAT increase is expected to raise about £13bn in a full year, which dwarfs the other significant tax measure – the increase in the rate of CGT, which is only expected to bring in less than £1bn.

2.7 Discounts, rebates and gifts

2.7.1 Samples dispute

In the *EMI Group plc* case the issue is whether HMRC's interpretation of the word "samples" in the UK legislation at VATA 1994 Sch.4 para.5 was in accordance with the 6th Directive's slightly different treatment of the same issue (now in Art.16 of the 2006 Directive – "*the application of goods for business use as samples or as gifts of small value shall not be treated as a supply of goods for consideration*".)

EMI have traditionally given away records and CDs to disc jockeys. These do not qualify under HMRC's interpretation of "samples", because there is no intention that the disc jockeys themselves should buy further examples. However, they are clearly for business purposes. Until 2003, EMI would have been precluded from ignoring them as being "of low value", because there would have been a series of gifts to the same person within a year.

The Tribunal has heard this case several times as HMRC disputed the taxpayer's right to make an appeal and the Tribunal's jurisdiction to refer it to the ECJ. During the course of the appeal hearings it became clear that there was an additional appeal in respect of the same issues, relating to periods after the UK's rules on series of gifts changed in October 2003 (so that the £50 limit applied to a 12-month period, rather than any series of gifts to the same person being excluded from the de minimis exception). Questions on all these matters were eventually referred to the ECJ. A second part of the dispute related to the operation of the cap, but that fell away because of the House of Lords' decision in *Fleming*.

The questions referred were as follows:

a) *How is the last sentence of Article 5(6) of the Sixth Directive to be interpreted in the context of the circumstances of the present case?*

b) *In particular, what are the essential characteristics of a "sample" within the meaning of the last sentence of Article 5(6) of the Sixth Directive?*

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

   (i) *an industrial sample in a form not ordinarily available for sale to the public given to an actual or potential customer of the business (until 1993),*

   (ii) *only one, or only the first of a number of samples given by the same person to the same recipient where those samples are identical or do not differ in any material respect from each other (from 1993)?*

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

   (i) *a gift of goods forming part of a series or succession of gifts made to the same person from time to time (to October 2003),*

   (ii) *any business gifts made to the same person in any [twelve] month period where the total cost exceeds £50 (October 2003 onwards)?*

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

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

The Advocate-General has now given an opinion on the matter:

'Applications for the giving of samples' ... means:

- *any supply by a taxable person;*
- *for the purpose of promoting future sales of a product (being goods for VAT purposes);*
- *to an actual or potential customer or a person who, owing to his particular position, is able to influence the exposure to market of that product;*
- *of one or several items of goods that serve as examples of that product by retaining all the essential properties of the product as to its quality and characteristics, and thus enabling the recipient, his customers, or others receiving communications from the recipient to assess or test the nature, properties, and quality of the product.*

This appears to favour EMI's view.

Member States may fix a ceiling for the monetary value of a 'gift of small value' referred to in the second sentence of art.5(6) of 6th Directive, taking into account the general price and income level and other economic circumstances of that Member State, provided that the ceiling is not so low as to make art.5(6) meaningless or inapplicable, or so high as to deviate from what 'small value' might be understood to mean in common language, and if individual exceptions to the ceiling may be allowed in circumstances where that is justified by objective reasons. Applications for the making of gifts of small value in that provision means individual supplies by a taxable person. The Member States may not apply the ceilings referred to above cumulatively to several gifts made during a defined period of time.

Given that EMI appear to be winning on the "samples" argument, the small value point is less important to them. However, the last sentence suggests that the UK law may not be in compliance with EU law.

It is for the national court to determine who the recipient of an application within the meaning of the second sentence of art.5(6) 6th Directive is, having regard to all the circumstances of the specific case. With regard to the VAT treatment of an application under the second sentence of art.5(6) of this directive it is irrelevant whether or not the recipient of the application is entitled to deduct input tax.

Again, this does not appear directly to affect EMI's repayment claim.

ECJ (A-G) (Case C-581/08): *EMI Group Ltd v HMRC*

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 "Hotel billback" transactions

HMRC have issued a Brief commenting on the treatment of "hotel billback" transactions under TOMS. These are explained as arising where a booking agent arranges accommodation for a business customer, receives the invoice from the hotel, and charges it on to the customer, effectively building in the commission earned into the bill the customer pays.

Up to 31 December 2009, TOMS traders were allowed to account for sales to business customers for their own use outside TOMS, enabling them to recover input tax and issue a VAT invoice. From 1 January 2010 this is no longer possible, so the business customer would suffer VAT built into a charge that would not itemise any output tax.

HMRC suggest that arrangers of such transactions can still act as "disclosed agents", which will allow the business customer to recover the VAT. The procedure agreed between HMRC and travel industry representatives is:

- *Invoices from hotels will be addressed c/o the hotel booking agent for payment (this is to indicate that the invoice has been issued to the hotel booking agent in its capacity as an agent).*
- *The booking field on the hotel invoice will identify the hotel guest, their employer and will ideally carry a unique reference number (until hotels can address their invoices directly to their business customers, it may be necessary for hotel booking agents to enter an employer identification number on the invoice).*
- *The hotel booking agent will arrange for payment of the invoice(s) but will not recover the input tax thereon.*
- *The hotel booking agent will send the customer a payment request/statement of the expenditure incurred by the hotel booking agent on its behalf, separately identifying the value of its supplies, VAT, etc.*
- *The payment request/statement should say something along the lines of 'The VAT shown is your input tax which can be reclaimed subject to the normal rules'.*
- *The customer will use the payment request/statement as a basis for their input tax reclaim.*
- *The hotel booking agent will retain the original hotel invoices and these will be made available if evidence of entitlement is required by VAT staff.*

- *The hotel booking agent will send a VAT invoice for its own services, plus the VAT. This may be consolidated with the statement of hotel charges, or it can be a separate document.*
- *The hotel booking agent will charge its client the exact amount charged by the billback supplier, as a disbursement.*
- *The significant commercial impact of this is that the commission charged by the agent becomes entirely transparent.*

R&C Brief 21/2010

2.9.2 Article

There is an article analysing the effects of the 1 January 2010 TOMS changes in *Tax Adviser*, May 2010.

Tax Adviser, May 2010

2.9.3 Taxi payments

A taxi operator was assessed to a total of £197,000 in VAT and interest for periods from 1 February 2006 to 31 July 2008. The operator was a substantial business with a turnover of £5m – £6m a year and a computerised booking and accounting system which dealt with 7,000 – 8,000 jobs per week.

The dispute concerned an accounting method under which the operator's computer system produced a weekly statement of amounts due to each driver. This showed:

- a listing of fares recorded as provided by each driver at end of the week;
- an indication of whether the fares were for cash or account work;
- an amount recording items identified as "Cash Work Commission" (20% or 26% of the fare paid – or, in some cases, a flat "circuit fee" of up to £120 per week) and "Account Work Commission" – later called "Account Work Discount" (74% or 80% of an adjusted fare called the "account cost tariff");
- additional charges made in respect of account customers;
- a rental charge for the XDA receiver installed in the driver's car (£12 per week);
- a schedule identifying other miscellaneous charges;
- the total amount collected by the driver from passengers during the week (cash work);
- the total amount due from the driver to PCS (Cash Work Commission/Account Work Commission);
- XDA rental fee and any other fees;
- the amount payable to the driver by PCS (i.e. total of any fees paid for account work and other charges);

- the total sum due from each driver to PCS netted off against the total sum due from PCS to the driver to provide an overall "settlement statement".

The assessment was based on the assertion that the difference between the "Account Work Commission" and the account fares received represented VATable turnover of the operator – that is, the fares were 100% due to the driver, and the driver was charged this difference (26% or 20%) for a supply of services by the operator to the driver.

The appellant argued that the commission or discount was simply a method of calculating an amount due to the driver – it did not represent consideration paid by the driver for any service supplied by the operator to the driver. The only such service was the provision of the receiver, which was already charged at £12 a week (VATable). The circuit charge and the cash work commission were also treated as consideration for a supply of administrative services by the firm to the drivers, and were charged to output tax.

HMRC's main contention was that the service provided by the firm to the driver in respect of cash work and account work was the same. The payment of 26% in one direction and 74% in the other mirrored each other – both involved consideration from the driver for a supply of services from the firm.

The Tribunal's consideration of the precedents (particularly *Camberwell Cars* VTD 17,376 and *Argyle Car Taxis Ltd* VTD 20,277) show how varied and complex the arrangements between taxi operators and their drivers can be. This Tribunal drew distinctions between the current case and those precedents, holding that it was significant that account drivers paid for the XDA receiver, and they did not receive a percentage of the actual fare paid by the passenger but a percentage of a standardised amount. The Tribunal accepted that the "Account Work Commission" was, as in *Gemini Cars (Egham) Ltd* VTD 20,035.

The Tribunal agreed that the only supply made by the firm to the drivers in respect of account work was the supply of the XDA, fully paid for at £12 per week, and allowed the appeal with costs (under the transitional rules).

First Tier Tribunal (TC00528): *Parker Car Services*

2.10 Second hand goods

Nothing to report.

2.11 *Charities and clubs*

2.11.1 "Pay-per-click" advertisements for charities

HMRC have issued a Brief announcing that "pay-per-click" advertising for charities will now be treated as zero-rated. A charity pays a search engine such as Google a fee for every time someone clicks on a "sponsored link" from a search results page. HMRC have previously held the view that this could not be zero-rated because it was not strictly advertising but was rather a means of accessing the charity's own website. The cost of "creating or contributing to" a charity's own website is excluded from zero-rating by Note 10B, Group 15 Sch.8 VATA 1994. However, the cost of placing an advertisement on another person's website is zero-rated within item 8 of that group.

HMRC now accept that PPC-sponsored links on search engine websites are indeed advertisements for the purposes of items 8 and 8A, and that copyright and design services associated with such sponsored links also fall within zero-rating. However, they still believe that "search engine optimisation" (structuring a website so that it contains as many keywords as possible) does not qualify for relief, because it relates to the charity's own website rather than an advertisement for the charity.

Businesses that have accounted for VAT will now be able to reclaim it, subject to the four-year cap and unjust enrichment. Although this would normally involve asking the supplier to make the reclaim and pass it on to the charity, in many cases search engines are based outside the UK. The charity would therefore be able to make its own reclaim to adjust the reverse charge it should have accounted for at the time.

R&C Brief 25/2010

2.12 *Other supply problems*

2.12.1 Vouchers

The Advocate-General has given an opinion in the *Astra Zeneca* case. The company offers its employees the choice of receiving some of their remuneration in the form of retailer vouchers. Typically these are issued by the retailers to intermediaries at below their face value (e.g. £9 for a £10 voucher), sold to Astra Zeneca at a mark-up (e.g. at £9.50) and then charged on to the employee by deducting them from the employee's cash pay at the amount paid by the employer. The employee therefore "pays" £9.50 for a £10 voucher.

There are specific income tax rules in the UK that will make the direct tax consequences the same as receiving the cash. However, the VAT treatment is less clear. The questions referred to the ECJ were:

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

provision of that voucher by the employer to the employee constitutes a supply of services for consideration?

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

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

The Advocate-General considered that the supply of the vouchers should be treated as a taxable supply by the employer for consideration (i.e. the answer to Q1 is "yes"). This would mean that the VAT system would operate in accordance with its normal principles, and the employee (as final consumer) would bear the proper amount of VAT in a purchase.

The opinion goes on to say that if the full Court disagrees with this answer to Q1, the conditions for a deemed supply under art.26 are not met. The transaction in which the employee forgoes some pay in return for the voucher cannot be regarded as a supply for no consideration.

If the third question has to be answered, the Advocate-General's opinion is that there should be no input tax deduction for the employer if there is no output tax charge. This would be an irrational result, and could only be acceptable if it was the only possible interpretation of the law. The Advocate-General believes that the law should be interpreted in a way that produces the rational result – preferably output tax on the supply of the vouchers, but if not, neither input tax nor output tax.

The Commission argued that a supply of vouchers should be regarded as a supply of goods or of services, depending on what the voucher was subsequently used to obtain. The Advocate-General commented on this view, even though it was not necessary in order to deal with the questions referred. He considered that it would lead to greater complications as it would not be possible to determine which rules to apply until later than the time of supply. He also set out a clear legal basis for regarding the supply of vouchers as a supply of services, whether or not they could be used to buy goods.

ECJ (A-G) (Case C-40/09): *Astra Zeneca UK Ltd v HMRC*

2.12.2 Who makes the supply?

The High Court has allowed HMRC's appeal against the Tribunal's decision in the case of *The Atrium Club*.

Background

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

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

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

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

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

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

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

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

High Court

HMRC appealed on a point of law, and the judge had to consider the following three issues:

(i) whether the overall effect of the scheme was such as to be an abusive practice within the *Halifax* principle;

(ii) whether the failure of an essential element of the scheme meant that it could not be an abusive practice; and

(iii) whether and to what extent the scheme should be redefined, for example to make AC liable for the VAT instead of AAB.

The judge disagreed with the chairman on the question of whether a tax advantage had accrued to AC. It had received income from AAB on which it had not accounted for VAT, and the payment of that income had rendered AAB unable to pay the VAT for which it was properly liable because the scheme was ineffective. The funds retained by AC therefore constituted a tax advantage, even though it was not the advantage that the planners had in mind.

As a result, the principle of *Halifax* was properly engaged. There was nothing special about the scheme which meant that it should not be regarded as abusive. There was also no single correct way in which a scheme could or should be redefined, once the principle was applied. Here, the intention of the plan had been to extinguish AC's liability for output tax on supplies that continued to be made on its behalf by AAB; it enjoyed the tax advantage; therefore it was proper to assess AC as if AAB had never been interposed in the arrangement. HMRC's appeal was allowed.

High Court: *HMRC v The Atrium Club Ltd*

2.12.3 Repossessions

Art.4 SI 1995/1268 regards the re-supply of goods repossessed under a finance agreement as "neither a supply of goods nor a supply of services", provided that they are sold on in the same condition that they were in when repossessed. Presumably the logic is that there is no value added at this point: full output tax will have been charged when the item was sold

for the first time on HP, and the repossession and second sale are related to an attempt to settle a bad debt.

A trader supplied domestic appliances on HP terms but with an unusual method of payment: the appliances (e.g. televisions, washing machines, tumble dryers) were coin-operated, and the customer inserted money in order to use them. This was supposed to represent the HP consideration. However, some customers fell behind with their payments, and the goods were repossessed.

The dispute which the Tribunal had to consider was whether minor repairs contravened the "same condition" requirement of SI 1995/1268. It was normal for the goods to require a new remote control, new hoses or new power leads, and in all cases cleaning and checking.

There was a preliminary issue. HMRC claimed that the appellant had conceded that most of the operations in dispute did "change the condition" and could therefore not qualify for "de-supply". The appellant did not accept this, and in the alternative argued that it should be able to change its pleadings in order to deal with all the operations. The Tribunal agreed that the history of the dispute was confusing, and that the fault for this lay mainly with the appellant and its representatives, but nevertheless it was appropriate to consider all the operations. The "concession" which HMRC alleged did not appear to mean what HMRC said it did.

The Tribunal's decision is long and detailed, but the main principles are these:

- where an operation involved some very minor action and/or part (e.g. sticking a new plastic button on a steel spindle), it should not be regarded as changing the condition of the appliance at all;
- where something was missing (e.g. television remote, power leads, hoses), the sale of the item with a replacement was not a single compound supply of something in a different condition – it should be treated as the "de-supplied" item in the same condition, together with a VATable spare part;
- the replacement of consumables such as batteries or fuses should be disregarded, so the whole appliance could be sold outside the scope of VAT;
- more significant repairs such as the replacement of circuit boards, housings or TV tubes must be regarded as changing the condition.

The Tribunal formally found for the appellant in respect of the four items that HMRC said should be the subject of the appeal, and gave indications about what ought to be the result of the dispute in relation to the other items (some in the appellant's favour, some not). Costs were not awarded, even though the old regime applied: the chairman considered that the appellant had contributed to the difficulties of the case, and it had not been wholly successful in relation to the wider appeal that it wished to make.

First Tier Tribunal (TC00486): *Buy As You View Ltd*

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Wedding receptions

A company owned a building in which Indian weddings were held. HMRC argued that its supplies were standard rated on one of two bases:

- it bought in catering and supplied a single service of "rooms plus catering", which was standard rated;
- if, as the company contended, the catering was supplied directly to the customers, the supply of the rooms was still a composite supply of a number of services that went beyond simple exempt room hire.

The company had not filed returns for three of the periods covered by the assessment, and the Tribunal could not entertain an appeal in the absence of a return. In respect of the one period for which a return had been submitted, the Tribunal held that there was a composite supply of services.

Interestingly, the Tribunal did not consider the exclusion from exemption in Sch.9 Group 1 Item 1(d) "*the provision in an hotel, inn, or boarding house or similar establishment of ... accommodation in rooms which are provided ... for the purpose of a supply of catering*" to be relevant. The argument was only concerned with whether the supply constituted a "licence to occupy land" or something that could not be so described.

The Tribunal considered that there were factors which indicated that the supply of catering was made by the appellant, and others which indicated that it was directly supplied from the caterer to the customer. Overall, it seemed most likely that it was made directly, a conclusion which favoured the taxpayer. However, when the Tribunal examined what actually was supplied, it decided that this "went far beyond merely providing the key to a door". There was a great deal of help and support for the wedding party. It was a single package which it would be artificial to split into different elements. The overall effect was not the passive exploitation of land but a service which fell to be standard rated.

First Tier Tribunal (TC00480): *Best Images Ltd*

3.2 *Option to tax*

3.2.1 Success in quashing an option

HMRC assessed a trader to some £568,750 in relation to the sale of a property which they believed was subject to an option to tax. The trader argued that no valid option had ever been made.

The company was a special purpose vehicle which was formed to buy and exploit a single property. This was purchased in February 2006 for £2.28m and sold for £3.25m in November 2006. In between those dates the company's accountants had submitted a VAT 1 and a VAT 1614 together with property questionnaires, but the registration of the company was not completed until January 2007. No-one appeared to have thought about the consequence of an option to tax until a routine visit by a HMRC officer in May 2007.

The company had three directors, one of whom was a partner in the firm of accountants. The managing director had suggested VAT registration in order to recover VAT on fees, and all the paperwork from that point onward was dealt with by the firm's staff. The various forms were all signed by the partner without detailed consideration.

The company argued that there never was an intention to opt to tax. Given the residential nature of the property, it would have made no sense. There was a breakdown in communications between the managing director and the accountancy staff; the partner, even though he was also a director, had not properly addressed his mind to the contents or consequences of the documents.

Not surprisingly, HMRC argued that the company – and in particular the partner/director – had to take the consequences of the documents they had signed and submitted. This argument prevailed in the outwardly similar case of *Windsor House Investments Ltd* (VTD 19,666).

The Tribunal rehearsed a number of points from precedent cases. The option itself was different from the notification, but if there clearly was notification, then the burden lay on the appellant to show that it was a mistake and no option had been exercised. In this case, the Tribunal held that this burden had been satisfied. There was a misunderstanding, and it was clear that there never was a positive intention by the managing director to exercise the option – and the partner/director had not addressed his mind to the question.

The major difference between this case and *Windsor House Investments* seems to be that the earlier case involved a VAT 1 which made no sense without the option. The estimate of annual taxable supplies roughly equated to the rental income expected on the property. Here, the accountant had entered "£100,000" as a round number to get the form processed – it bore no relation to any actual taxable income from the property.

Even so, the firm may count itself lucky, and will no doubt be reviewing its procedures.

First Tier Tribunal (TC00480): *Grenane Properties Ltd*

3.2.2 Relaxations of rules

HMRC have published two information sheets to give details of further changes to the option to tax, in addition to those announced in Revenue & Customs Brief 08/2010. Information Sheet 07/2010 contained an error and was superseded by Information Sheet 08/2010. The following new changes take effect from 1 April 2010:

- amendments to tertiary legislation within box G, Notice 742A Opting to tax land and buildings (conditions for revoking an option to tax after 20 years);
- amendments to tertiary legislation within box E, Notice 742A Opting to tax land and buildings (conditions for ceasing to be a relevant associate of someone who has opted after 20 years);
- amendments to option to tax forms VAT1614C, VAT161E, VAT 1614F and VAT 1614G.

The Information Sheet also includes a summary of all the recent changes.

Information Sheet 08/2010

3.2.3 New Notice

HMRC have published an updated version of Notice 742A *Opting to tax land and buildings*. Under "what's changed?" the Notice states:

This notice replaces the June 2008 edition of Notice 742A Opting to tax land and buildings and incorporates VAT Information Sheets 06/09, 14/09, 02/10 and 08/10, which are now withdrawn. The notice has been revised and provides additional guidance on recent changes to the law. The main changes are:

- *allowing 30 days in which to notify an exclusion of a new building from the effect of an option (see paragraph 2.7.4)*
- *changes to when a body corporate ceases to be a relevant associate (see paragraph 6.3.3, third bullet point)*
- *anti-avoidance provisions to prevent automatic revocation of an option to tax when taking out a real estate election (see paragraph 14.8.2) or when a lapse of six years occurs since a relevant interest has been held in the opted property (see paragraph 8.2.2)*
- *changes to the conditions for revoking an option to tax within the six month 'cooling off' period (see paragraph 8.1)*
- *changes to the conditions for revoking an option to tax where more than 20 years have elapsed (see Box G at paragraph 8.3.3)*
- *changes to the time an option is revoked where prior permission is given by the Commissioners, (see paragraph 8.3.9)*
- *an amendment to 'the connected persons' test (see paragraph 13.7)*
- *an updated definition of occupation for the purpose of the anti avoidance measures (see paragraph 13.8) and a new 10% occupation rule' (see paragraph 13.8.4)*
- *updated guidance on real estate elections (see section 14)*
- *defining when acquisition of a property takes place for the purpose of a real estate election (see paragraph 14.5).*

3.3 Developers and builders

3.3.1 Scheme ineffective

An institute of further education incorporated a wholly-owned subsidiary to undertake commercial operations. This was done in 1993 and was not related to VAT but rather the governors' concern that the charitable status of the institute would be undermined by the existence of such activities within the same entity.

When the institute needed to construct a new classroom block in 2001, the subsidiary claimed input tax on the costs, arguing that it had received the supplies of building work and used them to supply facilities to the institute. The First Tier Tribunal (TC00129) examined the contracts and decided that the original agreement had been made between the builders and the institute, and the arrangements had only been changed to bring in the subsidiary following the late consultation of tax advisors. This apparently followed the realisation that the work itself would not be zero-rated, so it would be necessary to consider how the VAT incurred could be recovered.

The appellants argued that the contracts had been novated, but the Tribunal did not think that an effective novation had been carried out. As a result, the supplies were received by the institute and the subsidiary could not claim the VAT on the building work because it was not input tax.

By contrast, the subsidiary had itself bought equipment and rented it to the institute; but the Tribunal considered this to be an exempt licence to occupy land rather than a taxable provision of facilities, so the subsidiary could not recover any input tax on the equipment either. It was clear from the wording of the agreement that it was intended to be treated as a licence to use facilities, but the judge did not believe that this reflected the reality of the bargain between the parties.

The subsidiary appealed the second part of the decision to The Upper Tribunal, arguing that the judge had erred in law in regarding the licence as a supply of land. The Upper Tribunal considered the agreement and the law and dismissed the appeal, using even stronger language than the First Tier – the new decision comments that parts of the agreement amount to a "sham" in that they attempted to recharacterise the real supply as something else. The judge's decision was a reasonable one based on the facts found, and the Upper Tribunal also concluded that it was correct.

Upper Tribunal: *Grimsby College Enterprises Ltd v HMRC*

3.3.2 Reminder of withdrawal

HMRC have issued a reminder that the old concession about allowing full zero-rating of a charitable use building (ESC 3.29) has been withdrawn with effect from 1 July 2010. Any charity wishing to make use of the concession before 1 July 2010 must have issued the necessary certificate before that date (late certificates will not be permitted) and by 1 January 2011, either:

- the building must have been constructed to a point above foundation level; or
- the charity must be in occupation of the building if it is being acquired or leased.

The concession allowed charities to claim full zero-rating if the building was used 90% for a relevant charitable purpose. Strict methods were prescribed for calculating the proportion. Now full zero-rating is allowed at 95%, but any method of calculation is permitted as long as it is fair.

R&C Brief 26/2010

HMRC have also issued an Information Sheet explaining how qualifying use can be calculated. It is the result of consultation with charity representative bodies. It gives examples of:

- time-based methods;
- headcount-based methods;
- floor-space based methods;

and outlines the possibility of other methods as well. Here are three of the examples given:

Example one

A research laboratory employs 275 full-time staff but no specific area or member of staff is used exclusively on non-business research. It is therefore not possible to use any of the methods quoted above.

Of the 275 staff employed, 75 work 90 per cent of the time on non-business work, 150 are researchers engaged 75 per cent of the time on non-business research and the remaining 50 staff provide technical and administrative support equally to the researchers.

Full-time equivalent of staff engaged on non-business research = (75 × 90 per cent) + (150 × 75 per cent) = 67.5 + 112.5 = 180

Therefore the percentage of researchers' time that is spent on non-business research is 180 ÷ 225 = 80

Since the support staff equally support the researchers, 80 per cent of their time must also be spent on non-business work.

Percentage qualifying use = 80

Qualifying use < 95 per cent therefore the building is not eligible for the zero rate using this method.

Example two

Another potentially acceptable method of calculating percentage qualifying use could be, in a similar scenario to the one above, to compare commercial funding of the use of the building to the total funding of the use of the building. However, where funding is used (funding would include all income including grants donations etc), it would only likely give a fair answer where the costs of using the building for non-business activity are similar to those for business activity.

For example, if 98 per cent of the funding comes from a non-business source, but only 20 per cent of the building is physically used for a non-business activity, this method would not be fair as it does not fairly reflect how the building is physically used. We would expect that, to be seen as fairly representative, if 98 per cent of the income is non-business, 98 per cent of the building would physically be used in non- business activities.

Example three

A research laboratory will be used for a mixture of commercial and non-commercial research. There is no difference in the ways that the two types of research are carried out. Commercial clients will pay 3 per cent of the research costs.

Percentage qualifying use = 97

Qualifying use > 95 per cent therefore the building is eligible for the zero rate.

The Information Sheet also contains the following important explanation about change of use:

Zero-rating is conditional upon the building in question continuing to be used at least 95 per cent for a qualifying purpose for the 10 years following completion. Should the use of the building (or a part) change from a qualifying purpose within that 10 year period, a standard rated charge will arise.

A chargeable change of use can come about in two ways:

a) You acquired or constructed a building and have sold or leased the building (or part) to another party who does not intend to use the building (or part) solely for a qualifying purpose.

b) You acquired or constructed a building and no longer use the building (or part) solely for a qualifying purpose.

In the former situation, the sale or lease will be liable to VAT at the standard rate.

In the latter situation, you will incur a standard-rated self supply equal to the value of the original zero-rated purchase or construction, adjusted for the number of years since completion that the building (or part) was used for a qualifying purpose.

Example

A charity acquires a building for £1 million with the intention of using the building to administer its non-business fund-raising activities. The purchase of the building is zero-rated for VAT purposes. Within six years of completion (five whole years) the building's use changes to administering the charity's business activities.

The standard-rated self supply that the charity must account for is:

£1 million × 5 ÷ 10 = £500,000

The charity must account for output tax on the above amount. Please note however that the VAT accounted for can also be treated as deductible input tax, should the business activity be a taxable one.

Information Sheet 13/2010

3.3.3 Repairs not alterations

An individual appealed against a ruling by HMRC that the replacement of the roof of his listed home were repairs and therefore standard rated. He argued that the roof had not been in a particularly bad state, and the main purpose of the work was to install insulation, which the building had previously lacked.

The Tribunal examined the available evidence in the form of tender documents and correspondence with the architect, and concluded that the roof was in a much worse state than that represented by the appellant. The nature of the works appeared to fall within repairs and maintenance much more than an alteration or improvement, and therefore HMRC were correct to regard the work as standard rated.

First Tier Tribunal (TC00488): *GGN Builders Ltd*

3.4 Input tax claims on land

3.4.1 HMRC accept defeat

Following the Tribunal's decision in *Susan Irene Jennings* (TC00362), HMRC have issued a Brief to explain their acceptance of the conclusion that the DIY housebuilders' scheme does allow recovery of VAT on building materials for holiday homes, if they are constructed by the claimant for a non-business purpose. HMRC will also accept claims which relate to conversion of non-residential property into a holiday home.

Claims for VAT previously incurred can now be submitted as long as the completion certificate is not older than four years and three months at the date of the issue of the Brief, 16 June 2010.

R&C Brief 29/2010

3.4.2 HMRC win two DIY cases

An individual reclaimed VAT incurred on the construction of a new house. HMRC refused a large part of the claim, pointing out that it included services in the course of construction that should have been zero-rated. Many of the suppliers refunded the VAT on the basis of this ruling, but the individual was in dispute with two of the suppliers and received no refund.

He argued to the Tribunal that HMRC ought to refund the VAT because the claim form was misleading. It asked for details of "goods, materials and services", which implied that services could be included in a claim. That part of the form related to conversions of non-residential property, on which it is possible to claim for services which would not be zero-rated; there are now separate forms for new build and conversions in order to alleviate this problem.

The appellant also argued that the purpose of the DIY scheme was to put a self-builder in the same position as a developer. The refusal of his claim disadvantaged him.

The Tribunal had some sympathy for his situation, but it could only reject his appeal. It was clear that the invoices concerned zero-rated supplies, and they could not be included in a DIY claim.

First Tier Tribunal (TC00535): *M O'Donnell*

Another difficult case on a DIY claim was also decided in favour of HMRC's refusal. In this case the claimants had fitted out a flat in a block which had been converted from industrial premises into dwellings. Unknown to the claimants, the developer had contravened the terms of its planning permission and had to apply for retrospective approval of what it had done to the site; the work carried out by the claimants did not breach the original planning consents. Other occupants had claimed VAT and had it refunded.

During the processing of this claim, HMRC became aware that the original planning permission for the site had been withdrawn and a new consent had been issued. This meant that the work was not lawful at the time it was carried out, which breached the rules in s.35(1)(b) VATA 1994.

The Tribunal suggested that the appellants might have a case based on unfairness that could be taken up with the Revenue Adjudicator, but they did not have a case in law that could be supported by the Tribunal. The appeal was dismissed.

First Tier Tribunal (TC00539): *Sam Bond and Sarah Baxter*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Spanish rate

HMRC have announced, for the benefit of those registered under the special scheme for e-traders, that the Spanish VAT rate rises from 16% to 18% with effect from 1 July 2010.

Information Sheet 11/2010

Similarly, the standard rate in Finland goes up from 22% to 23% on the same date.

Information Sheet 14/2010

HMRC have also issued the usual table of exchange rates to be used by e-traders for the quarter ended 31 March 2010.

Information Sheet 09/2010

4.2 Where is a supply of services?

4.2.1 Offshore structure was effective

A UK-based loan broker found that his business was suffering VAT on advertising costs, while his competitors were not. On accountancy advice, he established a new structure:

- he set up a wholly-owned Jersey company which obtained the appropriate credit licences and which carried on a loan broking business;
- he entered into a service agreement with his company in which he allowed it to use his trading name, and he agreed to carry on the processing of loan applications for it;
- the company entered into an agreement with a Jersey-based advertising agency to place adverts for the loan broking business in the UK.

The effect of this was that the advertising was treated as supplied outside the EU and was therefore outside the scope of UK VAT. HMRC argued that the loan broking business was in reality still carried on by the UK individual, and therefore the advertising services were received by him. As a result, there should be a reverse charge, which would be irrecoverable because it was being used for exempt supplies (the assessment was for more than £10m).

The Tribunal examined the arrangements in detail and allowed the trader's appeal, both on the question of who received the supplies and on the question of abuse of rights. Although the arrangement had been set up initially to achieve a VAT advantage, nevertheless it had been carried through properly so that the Jersey company had commercial substance and reality. The agreements were not at arm's length, but the Tribunal

held that the parties did make the supplies that were described in them – that is, the Jersey company made supplies to UK customers, and the appellant made supplies of processing to the Jersey company. Accordingly, the advertising services were received only by the Jersey company, and there was no reverse charge.

Considering abuse of rights, the Tribunal did not accept that the situation was the same as in *Halifax*, where the ECJ had held that it was contrary to the purpose of the 6th Directive for an exempt business to recover input tax. This arrangement did not result in the recovery of input tax: it resulted in certain transactions being taken outside the scope of VAT. Although the effect (certainly from HMRC's point of view) might be similar, the Tribunal did not believe that this was contrary to the purpose of the Directive.

The Tribunal did consider the other aspects of the abuse issue in case it was wrong on that first question. If the arrangement was contrary to the Directive, then HMRC were justified in arguing that it had been established to achieve a tax advantage, and it would be correct to recharacterise it by regarding the advertising services as supplied directly to the UK-based appellant. However, as the first essential feature of abuse was not proved, the appeal was allowed.

First Tier Tribunal (TC00487): *Paul Newey t/a Ocean Finance*

4.2.2 Carbon offsetting

HMRC have issued a Brief explaining the VAT treatment of supplies of carbon credits and services provided by those offering advice and/or the facility to offset an individual's "carbon footprint".

The Brief points out that there are two types of carbon credit:

- compliance market credits, which derive from the Kyoto Protocol and the EU Emissions Trading System ('EUETS');
- non-compliance credits, of which the most common example is the Verified Emission Reduction (VER).

EUETS are subject to a formal regulatory system and a marketplace. VER are effectively a promise that emissions will be reduced somewhere to compensate for the payer's actions. HMRC regard the supply of EUETS as VATable (and subject to special rules on place of supply), while VER are outside the scope of VAT as no identifiable service is performed.

Carbon offsetting by airlines is explained as follows:

A common arrangement is where an airline offers its passengers the facility to offset the carbon emissions generated by their flights, perhaps via a third party carbon offset provider. Generally the passenger pays across an amount, calculated to be the cost of offsetting the resulting emissions, but receives no identifiable, direct benefit in return. There are a number of possible variants, including:

- *the passenger has no choice, being obliged to pay the offsetting charge – the airline is making a single zero-rated supply of transport services;*
- *the offsetting facility is optional, but a separate administration charge is made to the customer for providing the service - the admin charge is standard-rated, but the amount paid to offset provision is outside the scope of VAT;*
- *the offsetting service is optional, there is no administrative charge, and the entire payment goes to offset provision - the payment is outside the scope of VAT.*

R&C Brief 28/2010

4.2.3 Routing services through offshore company

Readers' Queries in *Taxation*, 10 June 2010, contains a question and two answers about the tax and VAT consequences of an individual who runs a UK business setting up a company in Cyprus to invoice the UK business for his services. The answers suggest that this would almost certainly be a bad idea.

Taxation 10 June 2010

4.2.4 Online Sales Lists

Agent Update issue 18 refers to information on HMRC's website about how to set up your client list for EC Sales List (ECSL) and Reverse Charge Sales List (RCSL) using the *VAT for Agent* online service.

www.hmrc.gov.uk/agents/started-vat.htm#11

4.2.5 Article

Neil Owen completes a series of three articles analysing the VAT package changes in *Tax Adviser*, April 2010.

Tax Adviser, April 2010

4.3 International supplies of goods

4.3.1 Place of acquisition and right of recovery

Where a trader uses a VAT registration number to secure the zero-rating of a despatch of goods from another member state, the trader is required to account for acquisition tax in the member state which issued the VRN (Art.28b(A)(2) 6th Directive). The ECJ has ruled that the trader does not have the right to recover that VAT in that country if the goods do not enter the country concerned.

There were two appellants in the case, both registered for VAT in the Netherlands. One had not accounted for any acquisition tax on goods which were purchased from suppliers in several states and supplied to customers in Spain; the other had accounted for acquisition tax in the Netherlands and immediately deducted it in respect of purchases of goods from Germany and Italy which were sold on to customers in Cyprus (before it was a member of the EU).

It seems that the conditions for triangulation were not met, and the effect of either not accounting for acquisition tax or allowing a deduction would be to reproduce the effect of a zero-rated despatch without satisfying the conditions.

ECJ (Case C-539/08): *Staatssecretaris van Financiën v X and fiscale eenheid Facet BV/Facet Trading BV*

A similar conclusion was drawn in a UK case. The appellant was a UK company which had purchased toilet rolls from an Italian supplier, using its UK registration number to obtain zero-rating, where the goods were delivered to an address in Spain. Acquisition tax was due, and there was no evidence that the goods were used for taxable transactions. The trader provided explanations and objected that HMRC would end up taxing the goods twice while giving no relief; the Tribunal observed that this might be so, but the trader was required to provide objective evidence of entitlement to credit. If that could be provided even at this late stage, HMRC might look at the matter again.

First Tier Tribunal (TC00468): *Mexcom Ltd*

4.3.2 Movement of boats

The Advocate-General has given an opinion concerning the exemption of a despatch of a boat from one member state to another (art.138 VAT Directive) and liability for acquisition tax in the destination state (art.20). This should not depend on a rigid time-limit but on a number of factors which evidence the buyer's intention regarding consumption, including where the boat is registered, where the owner has a permanent mooring for it, and the time taken for the journey relative to the distance between the member state of origin and the member state of destination.

The question of whether a means of transport is "new" should be considered at the time of supply and not on arrival at the final destination.

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

4.3.3 New publications

HMRC have issued an updated version of Notice 1 "Travelling to the UK", which contains details of the various duty free allowances. The new version includes the increases in limits which came into force on 1 January 2010, as well as prohibited goods and procedures for clearing customs.

Notice 1

There is also a new version of Notice 143 "A guide for international post users" (the previous version was only updated in February 2010). This explains, for the benefit of both businesses and members of the public, the customs requirements in respect of postal packages imported into or exported from the UK. The postal arrangements in the notice can only apply when a full declaration on a SAD (form C88) is not required.

Notice 143

HMRC have also issued an updated version of Notice 702 "Imports". It has been revised to update addresses, legislative references, and to reflect the enlargement of the EU. Apart from that, the main technical content is unchanged from the October 2006 edition.

Notice 702

Notice 702/7 "Import VAT relief for goods supplied onward to another country in the EC" has been revised to "attempt to clarify the difference between a 'Freight Agent' and an 'Import Agent'". A freight agent is responsible for movement of goods, while an import agent is appointed to act as importer on behalf of a non UK consignor or consignee. An appointed import agent has responsibility for completing VAT invoices and EC Sales List entries as though they are the UK Importer. The agent acting as Importer also bears any VAT liability in the event of onward supply relief criteria not being met.

Notice 702/7

There is also a new version of notice SIVA 1 on Simplified Import VAT Accounting. The main change is an addition to paragraph 3.9 which clarifies that only UK-based fixed tangible assets can be included for the purposes of HMRC Liquidity Risk Assessment.

Notice SIVA 1

HMRC have issued a new Notice 703/2 *Sailaway boas supplied for export outside the EC*. It replaces the May 2002 Notices 703/2 and 703/3, and contains the information that was previously included in 703/3. The old Notices divided the rules for the supplier (703/2) and the "scheme" (703/3) which was effectively information for the purchaser.

Notice 703/2

4.3.4 Goods destroyed

The ECJ has given a judgment about the situation in which goods are confiscated and destroyed by a member state's customs authorities. If this happens at the point of entry, the goods have never been imported and no customs debt for duty or VAT arises. If the goods have entered the territory of the EU and are subsequently discovered and confiscated, duty and VAT will be due to the member state where they crossed the border, and excise duties may be recovered by the member state which seized the goods.

ECJ (Case C-230/08): *Dansk Transport og Logistik v Skatteministeriet*

4.3.5 Place of supply of gas, heat and cooling

The changes to the place of supply of gas, heat and cooling through all categories of natural gas pipeline network, announced in the March Budget but omitted from the last Labour Finance Act, were reannounced in the June Budget and will be included in the September Finance Bill. The intention is that such supplies will be included in the reverse charge mechanism from 1 January 2011.

BN 40

4.3.6 Small non-commercial consignments

The exemption for small non-commercial consignments coming from outside the EU has been raised from £36 to £40 with effect from 28 April 2010. This is because EU law requires the limit to equate to €45, measured using the exchange rate on the preceding 1 October.

SI 2010/1185

4.4 European rules

4.4.1 Council and fraud

The Council has issued yet another statement about clamping down on VAT fraud. This is in the form of a political agreement on a draft regulation creating Eurofisc, a network of national officials to detect and combat new cases of cross-border VAT fraud.

EU Council 10730/10 Presse 166

4.4.2 Rates of tax

Eurostat has published a comparison of rates of tax across the EU, including the overall ratios of tax to GDP and corporate tax rates. It also includes a table of standard VAT rates, as follows:

In the EU27, the average standard VAT rate (as an arithmetical average) rose to 20.2% in 2010 from 19.8% in 2009. It was 19.2% in 2000. In 2010, the standard VAT rate varied from 15.0% in Cyprus and Luxembourg to 25.0% in Denmark, Hungary and Sweden.

Between 2000 and 2010, the VAT rate remained unchanged in 13 Member States, rose in 12 and fell only in Slovakia (from 23.0% in 2000 to 19.0% in 2010) and the Czech Republic (from 22.0% to 20.0%). The highest increases were registered in Greece (from 18.0% to 23.0%) and Cyprus (from 10.0% to 15.0%).

Standard value added tax rate %:

	2000	2009	2010	Difference 2000-2010
EU27*	19.2	19.8	20.2	1.0
Belgium	21.0	21.0	21.0	0.0
Bulgaria	20.0	20.0	20.0	0.0
Czech Republic	22.0	19.0	20.0	-2.0
Denmark	25.0	25.0	25.0	0.0
Germany	16.0	19.0	19.0	3.0
Estonia	18.0	20.0	20.0	2.0
Ireland	21.0	21.5	21.0	0.0
Greece	18.0	19.0	23.0	5.0
Spain	16.0	16.0	18.0	2.0
France	19.6	19.6	19.6	0.0
Italy	20.0	20.0	20.0	0.0
Cyprus	10.0	15.0	15.0	5.0
Latvia	18.0	21.0	21.0	3.0
Lithuania	18.0	19.0	21.0	3.0
Luxembourg	15.0	15.0	15.0	0.0
Hungary	25.0	25.0	25.0	0.0
Malta	15.0	18.0	18.0	3.0
Netherlands	17.5	19.0	19.0	1.5
Austria	20.0	20.0	20.0	0.0
Poland	22.0	22.0	22.0	0.0
Portugal	17.0	20.0	20.0	3.0

Romania	19.0	19.0	19.0	0.0
Slovenia	19.0	20.0	20.0	1.0
Slovakia	23.0	19.0	19.0	-4.0
Finland	22.0	22.0	23.0	1.0
Sweden	25.0	25.0	25.0	0.0
UK	17.5	15.0	17.5	0.0

http://epp.eurostat.ec.europa.eu/portal/page/portal/product_details/publication?p_product_code=KS-81-09-553

Meanwhile, the Commission has proposed to maintain the level of the minimum standard rate at 15%. The 2006 Directive provided this from 1 January 2006 until 31 December 2010; the new Directive proposes that it will remain at this level until 31 December 2015.

COM(2010) 331

4.4.3 Right to deduct

Two companies appealed against the denial of input tax on certain expenditure relating to staff entertainment and benefits. The Netherlands authorities relied on the permission in the Directive to retain exclusions from deduction that were in force when the Directive entered into force, as long as those exclusions were adequately described and were not extended subsequently.

The Dutch law provides that a number of categories of staff-related expenditure are not deductible, including:

- *"providing the staff of the employer with the opportunity for private transport";*
- *"the provision of food and drink to the staff of the employer";*
- *"the provision of accommodation for the staff of the employer";*
- *"providing the staff of the employer with opportunities for recreation";*
- *"[giving] business gifts or other gifts ... to persons in relation to whom, if they had been charged or were to be charged the relevant turnover tax, such tax would be entirely or mainly non-deductible".*

The Advocate-General did not consider all of these to be sufficiently closely described. However, the full court did not see the same problems. The following answers to the questions clearly support the legality of the Netherlands' blocking order:

1. Article 11(4) of Second Council Directive 67/228/EEC ..., and Article 17(6) of Sixth Council Directive 77/388/EEC ... must be interpreted as not precluding the tax legislation of a Member State from excluding from deduction value added tax which relates to categories of expenditure concerning, on the one hand, the provision of 'private transport', 'food', 'drink', 'accommodation' and 'opportunities for recreation' to the members of staff of a taxable person and, on the other hand, the provision of 'business gifts' or 'other gifts'.

2. Article 17(6) of Sixth Directive 77/388 must be interpreted as not precluding national legislation, enacted before the Sixth Directive entered into force, under which a taxable person may deduct value added tax paid

on the acquisition of certain goods and services used partly for private purposes and partly for professional purposes not in full but only in proportion to their use for professional purposes.

3. Article 17(6) of Sixth Directive 77/388 must be interpreted as not precluding an amendment by a Member State, after the entry into force of that directive, to an existing exclusion from the right of deduction, designed in principle to restrict the scope of that exclusion but in respect of which it cannot be ruled out that, in an individual case in a particular tax year, the scope of that exclusion might be extended by reason of the flat-rate nature of the amended scheme.

ECJ (Cases C-538/08 and C-33/09): *X Holding BV v Staatssecretaris van Financiën, and Oracle Nederland BV v Inspecteur van de Belastingdienst Utrecht-Gooi*

4.4.4 Reverse charge extension

Details are available of the Directive (2010/23/EU) which the Council has passed to allow member states to impose a reverse charge mechanism on emissions trading in order to prevent fraud.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:072:0001:0002:EN:PDF

4.4.5 Polish transport and children's clothes

The ECJ has ruled that the Polish rules which impose a flat rate VAT charge on businesses registered outside the country bringing passengers into Poland by bus is contrary to the VAT Directive. It did not give the business any opportunity to deduct input tax on costs incurred, and it imposed an obligation to pay VAT related to the crossing of an EU frontier. It was contrary to articles 73, 168 and 273 of the 2006 Directive.

ECJ (Case C-311/09): *Commission v Poland*

The Advocate-General has given an opinion on the application of the transitional rules which allowed member states to retain certain beneficial treatments such as reduced or zero rates of VAT if they were in force in 1991. Poland sought to rely on this provision in relation to a reduced rate (7% instead of 22%) on children's clothing and footwear, but the Commission argued that it could not be applied because Poland only joined the EU in 2004.

The Advocate-General believes that the fact that the provision refers to a date earlier than the country's accession does not prevent the transitional provision from applying to that country. Poland could still rely on article 115 of the VAT Directive.

ECJ (Opinion) (Case C-49/09): *Commission v Poland*

4.4.6 French lawyers, undertakers, actors and smokers

The Commission has referred the French rules on fiscal representatives to the ECJ, after France has refused to amend its legislation in line with the Commission's earlier requests. A French customer of a non-established business may be liable to account for a reverse charge on the purchase, but France allows the vendor to account for the tax instead. In order to do

this, a non-established vendor has to register for VAT in France, and must appoint a French fiscal representative to account for and pay the tax. Allowing the vendor to account for the tax appears to be a permitted derogation allowed to France, but member states are no longer allowed to require non-established persons to appoint a domestic fiscal representative in order to obtain any beneficial treatment under VAT law.

IP/10/513

In an unrelated argument also about lawyers, the ECJ has agreed with the Commission that France's application of a lower rate to the services of lawyers, when they are paid for in part or in full by the State, is a breach of community law. This appears to differ from the Finnish case about legal aid because there the payment by the client's member of the public depended on the client's resources, and so was not linked to the service provided. In France, the legal aid subsidy was provided by the State paying the lawyer's fees – but with only 5.5% VAT instead of the full rate.

The court considered that the lawyers were not permanently engaged in work devoted to social wellbeing, so they could not benefit from any of the provisions which might allow a reduced rate or exemption.

ECJ (Case C-492/08): *Commission v France*

The ECJ has refused to uphold the Commission's objection to the treatment of undertakers' services in France. The French law applies a lower rate of VAT to the transport of a body in a hearse, apparently on the basis that it is the same as "passenger transport". The Commission argued that the service of an undertaker should be regarded as a single supply which should have a single rate of VAT applied to it.

The Court ruled that it was not necessary to treat the service as a single supply if a different treatment was applied to a "concrete and specific aspect of the supply". The Court was satisfied that the transport in a hearse was such an aspect, and that fiscal neutrality was not undermined by the lower rate. In particular, the fact that the full rate was applied to the charge for bearers carrying a coffin was not illogical: that was not similar to passenger transport.

ECJ (Case C-94/09): *Commission v France*

Undeterred, the Commission has referred France to the ECJ in respect of two other alleged breaches:

- a super-reduced rate of VAT (2.1%) for the first 140 performances of theatre productions;
- limiting the amount of tobacco that can be brought into France from other member states by individuals.

The super-reduced rate was allowed under transitional provisions because it existed in 1990 when rates below 5% were banned. However, at that time it could only be applied to performances where no refreshments were served. That restriction was abolished in 2007; the Commission argues that this is an extension of the scope of the super-reduced rate and is therefore a breach of the transitional rules.

IP/09/1495

4.4.7 Hire of leisure craft

Services relating to vessels which are used "on the high seas" are generally exempt with credit under EU Directives. A question has been referred to the ECJ by the Luxembourg court asking whether this extends to hire and transport services relating to leisure craft.

May services provided by the owner of a vessel who, for reward, with a crew, makes it available for natural persons for the purpose of leisure travel on the high seas by those clients, be exempted under Article 15(5) of Sixth Council Directive 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, where those services are considered to be both vessel hire services and transport services?

ECJ (Reference) (Case C-116/10): *Etat du Grand-Duché de Luxembourg v Feltgen (Administrator in bankruptcy of Bacino Charter Company S.A.), Bacino Charter Company S.A.*

4.4.8 Taxable amount

The Portuguese court has referred the following question to the ECJ:

Is point (a) of the first paragraph of Article 78, read in conjunction with point (c) of the first paragraph of Article 79, of Directive 2006/112/EC of 28 November 2006 to be interpreted as prohibiting, in the case of intra-Community purchases, the inclusion in the taxable amount for VAT of the vehicle tax introduced by Law No 22-A/2007 of 29 June 2007?

Previous case law of the court has suggested that vehicle taxes should not be regarded as part of the consideration for the purchase of a new car for VAT purposes (*De Danske Bilimportører v Skatteministeriet* Case C-98/05). There may be something different about the Portuguese tax which makes the question worth asking again.

ECJ (Reference) (Case C-106/10): *Lidl & Companhia v Fazenda Pública*

A difference was observed in a similar case brought by the Commission against Poland. Once again, the issue was the inclusion of car tax in the VATable amount. The court concluded that the payment of the car tax and the delivery of the car were directly linked, so the inclusion of the tax in the taxable amount for VAT was in compliance with the Directive.

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

4.4.9 Scope of TOMS

The German court has referred the following question to the ECJ:

Does the 'special scheme for travel agents' in Article 26 of Directive 77/388/EEC apply also to the sale by a travel agent of opera tickets in isolation, without the provision of additional services?

ECJ (Reference) (Case C-31/10): *Minerva Kulturreisen GmbH v Finanzamt Freital*

4.4.10 Restriction of beneficial rule

Belgium permits a lower rate of VAT (6%) on construction services, but only if the supplier is registered as a contractor in Belgium. The ECJ has referred questions to the ECJ to establish whether this is permissible under EU law.

The Commission has issued a press release explaining its stance. The Belgian law allows the reduced rate to be applied to the first €50,000 of a supply, with the standard rate of 21% applying to the rest. This might be acceptable under the derogation which applies to certain labour-intensive supplies, but there is no reference in the Belgian law to "social policy". The Commission also objects to the artificial splitting of a supply into two different segments, liable to two different rates, using an arbitrary monetary threshold.

ECJ (Reference) (Case C-114/10): *Belpolis Benelux SA v Belgische Staat; IP/10/661*

4.4.11 Extension of time for repayment

Bulgarian law provides that the 45-day time limit for the state to repay VAT claimed by a taxpayer is extended if a tax inspection is commenced within this period. No interest is payable to the taxpayer, even if the inspection subsequently shows that the amount claimed was correct. The only way in which the taxpayer can secure an earlier repayment is by making a deposit of security.

Questions have been referred to the ECJ to establish whether this is permissible under EU law. This may be of interest to those traders who are subject to extended verification in relation to suspicions of carousel fraud.

ECJ (Reference) (Case C-107/10): *Enel Maritsa Iztok 3 v Director of the Office 'Appeals and the Administration of Enforcement' at the Central Administration of the National Revenue Agency*

4.4.12 Unusual route to VAT recovery

An organisation set up an "incubator" for small and medium-sized businesses by agreement with the Austrian Ministry of Foreign Affairs. It incurred expenses and reclaimed input tax. The tax authorities in its own state carried out an audit which involved a cross-check of supplier records. They discovered that one of the suppliers had failed to record or account for VAT charged to the organisation, and so disallowed the input tax claim, ruling that no VAT had been "charged" on the expense. The organisation was unsuccessful in a tax appeal, so it made an application to the European Court of Human Rights, arguing that it had a legitimate expectation of a deduction based on its own correct and proper accounting.

The ECHR upheld the application, commenting that there were several precedent cases which supported the argument, and nothing had been put forward by the authorities to justify a different conclusion. There had been a breach of article 1 of the First Protocol to the Convention.

ECHR (Application 6689/03): *Business Support Centre v Bulgaria*

4.4.13 Small businesses

Austria does not require businesses with a turnover below a set threshold to register for VAT. However, this is restricted to persons established in Austria. A German resident, who generated income from letting an apartment in Austria, was refused the exemption. Questions were referred to the ECJ about whether this complied with EU law.

The Advocate-General has given an opinion that the restriction is contrary to EU law because it is based on place of establishment and favours those based in the member state over outsiders. The Austrian government's argument that the distinction was necessary for good fiscal supervision was rejected.

However, as the treatment of small businesses was a "partially harmonised special scheme which derogates from the general system of VAT", it should be applied only to the extent necessary to achieve its objective (which is to strengthen the competitiveness of and reduce the administrative burden on small businesses). This meant that it was permissible for the Austrians to require that a person was only eligible for exemption if they only generated taxable income within Austria. It would therefore not be possible for someone to exploit the registration thresholds in several different countries at the same time.

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

4.5 Eighth Directive reclaims

4.5.1 Second application fails

In 2009 the Tribunal (TC00171) refused an appeal against HMRC's denial of a 13th Directive claim by an American organisation. The claim related to the payment of a guarantee on premises leased in London to a subsidiary of the organisation; the Tribunal was no more satisfied than HMRC had been with the evidence presented to show that the claimant carried on any business within the EU law meaning of that expression, and was therefore entitled to a repayment of VAT. In spite of the large amounts involved and the representation by a large firm of international lawyers, it was impossible for the Tribunal to establish the precise background to the organisation or its subsidiary, or the relationship between them.

The organisation appealed, and the Tribunal re-examined the matter in even more detail than before, as well as considering at length whether it had the jurisdiction to do so. It concluded that the appellant had the burden of providing evidence to support a claim, and had failed to do so: the appeal was dismissed again.

First Tier Tribunal (TC00495): *SRI International*

4.5.2 Incomplete claims

Meridian is a company which processes and submits VAT claims for clients under the 8th and 13th Directives. Four of its clients (representatives of a large number of others) appealed against the refusal of claims in similar circumstances: in each case, the claim had been submitted close to the deadline; HMRC had returned the claim, pointing out some inadequacy in the documentation; by this time, the deadline for making the claim had passed, so it was automatically too late to rectify the situation.

The companies (supported by Meridian, who presumably had a financial interest in the outcome) argued that the conditions attaching to 8th and 13th Directive claims were more onerous than those attaching to domestic claims, in that the claimant had to submit a certificate of taxable status and supporting invoices. The Tribunal was satisfied that the rules were different because the circumstances were different: this was not unfair discrimination. Each of the claims had been incomplete in a material aspect at the deadline date; HMRC were entitled to refuse them.

First Tier Tribunal (TC00443): *Areva T&D Protection et Controle; Canal; Gilhead Sciences Inc; Lockton Insurance Agency Inc*

5. INPUTS

5.1 Economic activity

5.1.1 Suing former directors

A company claimed input tax in relation to a lawsuit against its former management. HMRC initially allowed some of this claim, but subsequently assessed to recover it, arguing that the officer who allowed it had not been given the full facts. The company had never declared any output tax, but contended that the legal fees were essential overheads of the business – it was the intention of the current directors to commence trading, but they could not do so until they had recovered funds from the former directors.

The Tribunal examined the history of the company and its disputes with the former directors and with HMRC. It concluded that there was no direct and immediate link between the legal expenses and any taxable supplies; they were an attempt to protect and recover assets rather than an attempt to secure funds so that the company could carry on a business. The appeal was dismissed.

First Tier Tribunal (TC00497): *Denbrae Ltd*

5.1.2 Investment transactions

Readers' Queries in *Taxation*, 24 June 2010, contains a question and two answers about the VAT treatment of professional fees relating to two transactions undertaken by a VAT-registered limited liability partnership. One concerned the sale of an investment in shares, and the other concerned the receipt of money on a reduction of share capital by an investee company.

Taxation 24 June 2010

5.2 Who receives the supply?

5.2.1 Not the LLP's cars

A limited liability partnership claimed input tax on the purchase of a Range Rover and an Aston Martin. HMRC disallowed it, and the Tribunal confirmed this. There was no evidence that the cars actually belonged to the LLP rather than to the individual partners, so the VAT was not the LLP's input tax; even if it was, it did not appear that the cars were let on arm's length terms, and they were admitted to being available for private use by one of the partners, so the blocking order would apply.

First Tier Tribunal (TC00448): *Moto Self Drive (UK) LLP*

5.3 *Partial exemption*

5.3.1 Dinner for the fellows

St John's College Oxford agreed a partial exemption special method (PESM) with HMRC in 1998. This was described as a "rough and ready method" by the Tribunal: the college could recover an amount equal to 14.9% of its taxable supplies together with any input tax on supplies made by it which were used exclusively in making taxable supplies.

The college was not satisfied with this method, and proposed a series of different ones which would, in its view, give a fairer result (and more input tax recovery). It also served a special method override notice in September 2004, which would have the effect of making the input tax recovery residual from that point on.

Agreement could not be reached on the recovery issues, and eventually an appeal was made to the Tribunal. This covered the general issue of whether the proposed special methods had been rightly refused by HMRC, and also the specific treatment of expenditure on the Senior Combination Room, which was used for dining and accommodation of fellows and also for governing body meetings.

The college argued that the provision of free meals to the fellows was a taxable supply within art.6(2) of the VAT Directive. The SCR was therefore used for taxable purposes, and the college's proposed special methods reflected this.

The Tribunal did not agree. The provision of free meals was a service, and it could not be said to be for "private" purposes following the *VNLTO* and *Danfoss* cases. It supported the whole activities of the college, and was therefore "non-economic" but not "private". As a result, it could not justify the recovery of input tax.

The decision is interesting in that the chairman provides a step-by-step approach to applying *Lennartz/VNLTO* and partial exemption, and this may be useful in similar disputes:

Stage 1: determine whether any input is to be used in whole or part for a non-economic use (bearing in mind that a private use within Article 5 or 6 will not be treated as non-economic use). If so determine according to section 24(5) VAT Act the portion not attributable to such use (the economic and private proportion).

Stage 2 the taxpayer may then integrate into his business either the whole of the economic and private part of the assets or just the economic part. If he chooses the second course of action section 24 (5) applies again and the deductible amount is settled. If he chooses to integrate the whole then stage 3 needs to be considered.

Stage 3: Article 6 (or 5) applies. To the extent of the private and nonbusiness use (in the wide economic and non-economic sense),a taxable supply arises. VAT may be chargeable.

Stage 4: the input tax attributable to the economic and private use must be recovered in accordance with Article 17. Where the input is used for exempt and taxable economic business purposes a method needs to be sought determining the deductible proportion on the basis of the use of the assets of each of those purposes.

The end result was that the appeal against the refusal of the special methods was dismissed; the Tribunal declined to rule on exactly how much input tax should be recovered, commenting that further evidence might be required to apply the principles that the chairman had outlined in the decision. However, it seemed unlikely that the college would recover more than a small fraction of the input tax it had hoped for.

First Tier Tribunal (TC00424): *St John's College, Oxford*

5.3.2 Capital goods scheme

A Jewish theological college entered into a lease and leaseback transaction which, in 1996, secured repayment of input tax on an extension to its buildings. The arrangement would have been ineffective following the introduction of the current version of the disapplication of the option to tax in 1997, but it was accepted at the time that it worked. The counterparty was a company which was claimed to be unconnected; the Tribunal chairman suspected that this would not have turned out to be the case had the facts been examined in detail, but the presence or absence of a connection was not relevant to the present dispute.

It appeared that the two parties to the lease paid and received rent, and accounted for output tax and input tax on it, for about the first two years of the arrangement. Then they stopped doing so. The company was dissolved and struck off the company register on 20 July 1999; it was reinstated with retrospective effect a few days before the hearing in 2010, but for ten years it had not existed.

HMRC discovered in 2002 that rent had ceased to be paid under the lease and leaseback, and they raised an assessment for capital goods scheme adjustments for the years to 30 November 1999, 2000 and 2001. There were a number of procedural problems with the appeal against this assessment, and the further assessments that followed, but eventually the Tribunal had to consider the question of whether the CGS was engaged by the failure to collect the taxable rent under the opted lease.

The college argued that the lease continued to exist, even if no rent was collected, and therefore taxable supplies continued to be made. Certainly no exempt supplies were made. The Tribunal chairman rejected this reasoning. As the counterparty had ceased to exist, there could not have been any supplies at all. The CGS regulations require an adjustment where there is a reduction in the extent of taxable use; where the reduction is to zero, the full adjustment must be made. The appeal was dismissed.

First Tier Tribunal (TC00541): *Gateshead Talmudical College*

5.3.3 Special method frameworks

HMRC have published guidance on partial exemption special methods for the housing association sector. It analyses the activities of housing associations, the partial exemption issues that arise from those activities and how they should be addressed. The document has been prepared after consultation with representative bodies and is expected to be regularly updated.

This is clearly required reading for anyone dealing with a housing association, but the general issues for special methods have a wider application. Sadly one of the sections that is not yet completed is Annex F: *example PESMs* – there is no material included.

www.hmrc.gov.uk

At the same time HMRC have updated their guidance on special methods for further and higher education institutions. Once again, this contains information which is specific to the sector, but which is also capable of more general application.

www.hmrc.gov.uk

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Supplies for no consideration

The British Dental Association is a mutual association targeted at, and providing various services to, dentists, retired dentists and dental students. It is not compulsory for anyone, even dentists, to join. Its services for VAT purposes include standard-rated services (including the provision of conferences and seminars) as well as services provided in exchange for membership subscriptions that are exempt.

The association provided free membership to students at university. HMRC regarded this as a non-business activity and therefore wanted a disallowance of 13% of the association's VAT under s.24 before carrying out a partial exemption calculation. The appellant argued that admitting university students to free membership was good "business": it was easier to locate them while they were at university and easier to attract them to membership if it was free, and they would then remain as paying members for the rest of their careers.

HMRC argued that:

- s.94 VATA 1994 deemed an association providing services for a consideration to be doing business, and this implicitly deemed the provision of services by an association for no consideration to be services rendered outside "the course of that business";
- the provision of free membership was not a taxable supply and it was not a supply made in the course of business because it was made for no consideration;
- the right to deduct input tax was available to taxpayers only insofar as that input tax was incurred on expenses which had a direct and immediate link to taxable supplies, or, in other words, were cost components of those supplies; so that
- it was necessary to apportion the input tax, and to disallow 13% of it, as being referable to the provision of supplies for no consideration.

The Tribunal considered the facts to be simple, although it examined them in some detail anyway. It adopted the reasoning of the earlier case of *The Imperial War Museum* (VTD 9,097), and concluded that:

- the Appellant conducted only one business;
- it did not, in the normal usage of the phrase, conduct any distinct activity that might be a non-business activity; and
- the provision of free membership was a commercially sensible introductory offer made entirely for business purposes, and made to foster the Appellant's one and only business, and thus made in the course of that business.

The chairman commented that the business case for the BDA was much stronger than that of providing free admission to the museum.

The decision explains that s.94 is to be taken as bringing within the scope of VAT mutual associations that might otherwise be regarded as non-taxable persons because they are not similar to ordinary commercial businesses. The chairman did not agree that it requires the activities of

such an association to be picked apart in the manner that HMRC suggested.

The Tribunal also concluded that there was no statutory or case law authority for the proposition that the provision of services for no consideration was automatically a non-business activity. It was outside the scope of VAT, but HMRC's conclusion from this that it was non-business was "an unwarranted jump". The chairman comments that "*No provision or authority was quoted for this proposition and we conclude that there is none*." It was clearly something that HMRC believed to be self-evidently true and therefore did not require justification.

The wording of what is now reg.101(2) SI 1995/2518 has changed slightly since the *Imperial War Museum* case: input tax is now to be attributed to taxable and exempt supplies if it is "exclusively" used in making them, rather than "wholly". The irrecoverable input tax is that which is exclusively used to make exempt supplies or "any activity other than the making of taxable supplies". The decision considers the significance of the word to the BDA's situation. There was no separate non-business activity to which any of the input tax could be "exclusively" attributed. Reg.101 did not assist HMRC's case at all: it operated to restrict input tax in relation to exempt supplies, but there were no non-business activities which could bring reg.101(2)((c) into effect. As the supplies were for no consideration, they also did not trigger any disallowance under the "T over T plus E" formula for apportionment under reg.101(2)(d).

The chairman comments that "there was considerable argument" in the case, so the conclusion is given and then justified with further discussion. He likens the BDA's "free" supplies to students to the "buy one, get one free" promotions in a supermarket, and suggested that common sense required that there was no restriction of input tax in that circumstance. He also commented that the various precedent cases that the two counsel relied on were not as relevant as *The Imperial War Museum*, which they appear not to have mentioned:

- *Ian Flockton Developments* and *Kretztechnik* for the appellant;
- *Optigen*, *Securenta* and *VNLTO* for HMRC.

First Tier Tribunal (TC00481): *British Dental Association*

5.6.2 Transfer of housing stock

Leicester City Council was considering the demolition and reconstruction of a housing estate. It accepted representations from the tenants that instead it should refurbish the properties, but it did not have the funds. It therefore transferred the houses to a housing association for £1; the association undertook to carry out the refurbishment, with the intention that in due course the properties would be transferred again to a Community Social Landlord. In the event this had not happened, and the association still owned the properties and let them to tenants.

The association claimed input tax in relation to the works carried out on the properties. HMRC argued that the input tax was not incurred in making any taxable supply; although it was not explicitly stated in the case, HMRC's attribution of the expenditure would be to the exempt rent received from tenants.

The association argued that it had made a taxable supply of "refurbishment services" to the council. The consideration for this supply was the undervalue in the transfer of the land. Presumably the council would have been able to recover VAT under s.33 in relation to carrying out its statutory obligations to maintain its housing stock.

The Tribunal examined the transaction and concluded that there was no supply from the association to the council. The refurbishment was carried out after the transfer and was effectively for the association's own purposes. It was obliged to carry out the work under the terms of the transfer agreement, but that did not mean that carrying out the work was part of the consideration for that agreement.

In an earlier case, *South Liverpool Housing* (VTD 18,750), there had been a similar transfer of housing stock together with a substantial payment from the council to enable the relevant association to carry out repairs. That association had argued unsuccessfully that it had made a supply of "relieving the council from its statutory obligations". This association had no more success in identifying a taxable supply made to the council. It was clear from the correspondence that the council did not think it was receiving such a supply, and the Tribunal did not believe that it was either.

Even if there was a supply of some sort to the council, there was no "direct and immediate link" between the inputs and that supply that would justify recovery of the input tax.

First Tier Tribunal (TC00482): *LHA-ASRA Group Ltd*

5.6.3 Farmhouse

A company owned and operated a substantial farming estate in Kent. Its managing director occupied a house on the estate with his family. Substantial works were carried out to the house, and VAT was claimed by the company on the whole of the expenditure.

HMRC argued that s.24(3) VATA 1994 meant that there should be no recovery at all, because the house was domestic accommodation for a director. The company argued that there should be full recovery because, from the company's point of view, the expenditure was entirely for the purposes of the business: it was essential that the estate manager lived on the farm, and it was a condition of his employment that he did so. An unincorporated farming business did not have an equivalent disallowance to s.24(3), and it was unreasonable that the legal status of the trader should block genuine business input tax. The appellant's counsel cited *Lennartz* and *Danfoss* as supporting a claim.

The Tribunal agreed with HMRC that *Lennartz* was of no assistance to the taxpayer, because the *Lennartz* approach had never been adopted. The company had always asserted that there was 100% business use. However, the Tribunal did consider that there was some business use of the property, and so some input tax should be allowed. The extent of domestic use was a matter of impression rather than something that could be measured precisely, and the Tribunal concluded that only 30% of the input tax could be deducted.

Counsel for the taxpayer does not appear to have argued one aspect of the *Danfoss* case – that member states are not allowed to extend their blocking of business input tax after the implementation of the 6th

Directive. S.24(3) VATA 1994 was added to the original blocking of input tax well after 1978. However, HMRC would probably argue that it only clarifies what should be regarded as business expenditure; it does not appear to have determined the appeal in this case, because the Tribunal considered the extent of domestic use rather than disallowing the entire claim.

First Tier Tribunal (TC00437): *Quex Park Estates Ltd*

5.6.4 *Lennartz*

The change to the *Lennartz* accounting rules for expenditure that is used partly for business and partly for non-business purposes, announced in the March Budget, did not make it into Labour's last Finance Act. It was reannounced in the June Budget and is earmarked for the September Finance Bill. The change is still planned to come into effect on 1 January 2011.

The brief summary reiterates that the changes will:

- distinguish between business input tax and non-business VAT;
- ensure that VAT is not recoverable on the private or non-business use of specified assets (which appears to contradict the *Lennartz* judgment, if there is some business use of the asset);
- provide a power to treat non-business VAT as input tax (which appears to go against the VNLTO judgment); and
- ensure that VAT on the private use of directors' accommodation is not recoverable (this is already enacted in s.24 VATA 1994, but has recently been examined by the First Tier Tribunal in the case of *Robert Gunkel & Associates Ltd* TC00252).

The capital goods scheme will be amended to take into account changes in the business/private use of an asset. Again, the suggested measure appears to be contrary to past ECJ judgments – it is not generally possible to use the CGS to adjust for a change in the split between business and non-business use, only for a change in the split between taxable and exempt use.

As a revenue protection measure, output tax will continue to be due in respect of supplies for which credit was allowed under the *Lennartz* mechanism. This enables HMRC to insist that those traders who do not wish to "unwind" the *Lennartz* accounting cannot have a double benefit – retain the input tax that they claimed some years ago on the basis that HMRC are out of time to assess it, then rely on the *VNLTO* case as authority for stopping the output tax payments. It will be interesting to see whether anyone tries to argue that this is unenforceable under EU law.

BN 39

5.7 Bad debt relief

5.7.1 Excessive conditions for bad debt relief

Before 1990, bad debt relief could only be claimed if the debtor was insolvent. The relaxation of the rules to allow a claim only on the basis of non-payment was a significant simplification, but it was not made retrospective. Until 1997, a claim could only be made if property in the goods supplied had passed to the customer, which was a problem for hire purchase companies (which would reserve title to the goods until they were paid for in full). Once again, when the rules were relaxed, this was not made retrospective.

GMAC claimed back a large amount of bad debt relief which it had been denied under the "old rules". The Tribunal had to consider in principle whether the UK's rules had been incompatible with EU law, and if they had, what the significance of the introduction of the cap was for this claim.

GMAC won a significant victory in an earlier case which allowed them to treat the recovery of cars surrendered by hire purchase customers both as an event allowing an adjustment of consideration under reg.38 SI 1995/2518 and also as a "repossession" which meant that the subsequent resale was outside the scope of VAT. The law was changed after that case so that a trader could not enjoy both these benefits on the same transaction, but the current claim would give rise to a double benefit in the same way. HMRC objected to the claim on the grounds that it would give rise to a windfall that was contrary to EU law.

The Tribunal considered the arguments and concluded that the UK's rules on bad debt relief had indeed imposed conditions that went beyond what was permitted in the Directive. Further, it did not appear that any "windfall" effect as alleged by HMRC was contrary to the Directive, if indeed the taxpayer would make a profit in a situation where there was a bad debt.

Lastly, the Tribunal ruled that the time-bar brought in for bad debt claims by s.39(5) FA 1997 was contrary to EU law because there was no transitional period; as a result, GMAC's current claim was not restricted by a time limit as argued by HMRC.

The decision was to allow GMAC's appeal in principle. During the course of the dispute GMAC had also put a figure on the claim, which was some £2.3m (presumably interest will be added, substantially increasing this figure).

First Tier Tribunal (TC00504): *GMAC UK plc*

5.8 Other input tax problems

5.8.1 Carousel cases

HMRC continue to wage war on carousel frauds through the First Tier Tribunal and the higher courts. Here is a summary of the outcome of cases in the last quarter.

The *Mobilx* case has been running for several years. The Court of Appeal has now joined the High Court and the Tribunal in dismissing the company's appeal against HMRC's refusal to repay input tax in respect of 85 deals, all of which led back to a fraudulent trader.

The Appeal Court's decision is an important examination of the meaning and application of the "ought to have known" test in *Kittel*. Moses LJJ explained that it was not enough for HMRC to show that a trader ought to have known that there was a possibility of a link to fraud, for example by the general connection of the trade in mobile phones and CPUs to fraudulent activities. However, if the only reasonable explanation for the transaction in which the trader was involved was that it was connected with fraud, and if it then turned out that the transaction was indeed connected with fraudulent evasion of VAT, then he should have known of that fact. Further, if it was established that a trader should have known that by his purchase there was no reasonable explanation for the circumstances in which the transaction was undertaken other than that it was connected with fraud then such a trader was directly and knowingly involved in fraudulent evasion of VAT. Such a trader forfeited the right to deduct input tax.

The High Court's decisions to refuse input tax credit to *Calltel Telecom Ltd* and *Opto Telelinks (Europe) Ltd* were also confirmed. By contrast, the Appeal Court also dismissed HMRC's appeal in the case of *Calltell Telecom Ltd*: the High Court judge had not erred in concluding that the Tribunal had not found sufficient grounds to show that the trader ought to have known that its transactions were connected with fraud.

The judgment includes a note to the Tribunal not to concentrate on the due diligence procedures undertaken by taxpayers, but rather on the underlying question – should the trader have drawn the inescapable conclusion from that due diligence that the transactions were connected with fraud? Many Tribunals have noted that the checking carried out by traders often appears aimed at providing a paper trail for HMRC rather than serving any real commercial purpose.

Court of Appeal: *Mobilx Ltd (in Administration) and others v HMRC*

A company appealed against the refusal to allow zero-rating on 128 supplies of Red Bull to Spanish and Polish customers who were missing traders. The Tribunal concluded that there was no persuasive evidence that the goods had arrived at their destinations, and the test in *Teleos* (that the supplier had taken all reasonable steps to be satisfied about the bona fides of the transaction) was not satisfied. The examination of a sample of transactions does not necessarily show what would have satisfied the Tribunal, but it is a good illustration of what is definitely not enough.

First Tier Tribunal (TC00472): *Integral Resources (UK) Ltd*

A company appealed against the refusal of input tax of £167,000 for the quarter ending October 2006. The appeal was dismissed on the basis that there was a fraud and the appellant ought to have known that the transactions were connected with it. The circumstances of the transaction were wholly uncommercial and the director was a man of sufficient knowledge and experience to understand the implications.

First Tier Tribunal (TC00540): *Roma II Ltd*

A company appealed against the refusal of input tax of £2.26m for the three one-monthly return periods March, April and May 2006. The appeal was dismissed: HMRC did not prove actual knowledge of the fraud, but they satisfied the "ought to have known" test in respect of each of the 19 deals that were the subject of their decision to refuse repayment.

The company had claimed and been repaid nearly £2.9m of VAT, mainly in relation to mobile phone business, in the previous 12 months.

The Tribunal noted that the director was very well informed about the development of case law on MTIC fraud, quoting in one letter remarks made by a judge only the week before in the High Court. It appeared that the company had carried out checks in an attempt to satisfy the requirements of Notice 726, but had not really been interested in preserving the integrity of the VAT system.

First Tier Tribunal (TC00440): *Blada Ltd*

A trader that had done no previous business claimed a repayment of £1.1m in respect of sales of CPUs worth £6.7m in the quarter to July 2005. The suspicious transaction led an officer to check the quoted serial numbers with Intel, the manufacturer, and so to discover that it appeared that the transaction involved boxes intended to look like genuine Intel CPUs but probably not containing the goods described on the invoice.

The Tribunal considered that it was not relevant that the trader was unaware that the goods were not genuine. HMRC had evidence which cast considerable doubt on the validity of the invoice, and in those circumstances the decision to refuse input tax credit was a reasonable one.

During the initial enquiry into the goods, the freight forwarder's report of a "closed box" inspection had been given to the officer. When it became apparent that the claim would be refused, the freight forwarder claimed also to have carried out an "open box" inspection and found that the goods were genuine. The Tribunal did not accept this on the basis that Intel's evidence was overwhelming proof that the boxes cannot have been what was described on the invoice.

First Tier Tribunal (TC00444): *Premier Joint Ventures Ltd*

A similar decision was confirmed in another case involving five transactions in memory cards. HMRC successfully cast doubt on the invoice documentation, and the trader was not entitled to credit. Once again, there is a detailed examination of the various transactions and the procedures adopted by the company, which were found wanting.

First Tier Tribunal (TC00464): *F I Promotions Ltd*

HMRC formed the view that a mobile phone trader was connected with fraudulent trading and issued a number of decisions and assessments concerning input tax and output tax. The trader appealed against all these

decisions and assessments, and one of the appeals was allowed when HMRC failed to comply with an "unless" order. The effect was that HMRC owed the appellant £12.95m of input tax.

HMRC did not pay this amount. Instead, it offset various other amounts which were under appeal, and eventually paid the taxpayer just £2.4m. The taxpayer appealed to the High Court, arguing that HMRC had no right to do this, and they should have paid the amount held to be due by the Tribunal's ruling.

The High Court dismissed the appeal. The Tribunal's decision was not an order for payment but a determination of a particular dispute. The effect of the resolution of that dispute could be carried through into the other appeals as HMRC had done. As appeals could not be entertained unless the VAT in dispute had been deposited (or hardship had been accepted by HMRC or the Tribunal), the offset of a credit against the amounts in dispute in other appeals was a reasonable action.

High Court: *Infinity Distribution Ltd v HMRC*

An unusual case involved a claim by the liquidator of a company against the directors for fraudulent trading under s.213 Insolvency Act 1986. In effect, the liquidator was acting on behalf of HMRC, who were the largest creditor in the liquidation.

The company had entered into transactions between August and September 2001 that could not have been profitable unless a VAT fraud was intended – the only way the company would have made any margin was by retaining the VAT element from sales. There were three people involved in the company: the first and second claimed that the third was the "mastermind". However, the Court ruled that the first respondent should be liable for the whole of the company's debt, and the second respondent should be liable on a joint and several basis for 50% of it. It appears that no judgment was made against the third respondent.

High Court: *Goldfarb v Higgins and others*

Another case brought by a liquidator claimed that the directors were responsible for carrying out fraudulent transactions and diverting the proceeds of sale from the company to third parties, in breach of the duty of trust which is part of their office. The company's accounting records showed sales of some £93m, but far less had ever passed through its bank accounts.

The liquidator claimed this amount from the former directors in the High Court, and judgment was awarded. However, as the defendants seem to have disappeared, it is unlikely that the money is recoverable.

High Court: *UK Communications Ltd v Nahim and another*

5.8.2 A different phone problem

An unusual case about mobile phones involved a trader who was denied input tax because he did not personally purchase the phones in question. He claimed that members of his family and others had purchased phones which he supplied on. The total of the assessments was over £500,000.

The trader did not appear at the hearing, so the Tribunal had to try to understand his business from his witness statement. It appeared that he had been approached by another company which suggested that there was money to be made in the difference between what stores charge for mobile phones. He undertook to buy phones as an individual customer and sell them in lots of 100 to the company, making a margin of a few pounds on each.

The Tribunal calculated that, to earn the turnover that his own accounts showed, he would have had to have himself and 14 helpers buying 26 telephones a day each, 5 days a week. The chairman did not believe it. It was not clear what had really happened, but the decision to assess was a reasonable one based on the law and the evidence available. The appeal was dismissed.

First Tier Tribunal (TC00471): *M F Mahmood t/a Mahmood Mobile Service*

5.8.3 Pre-registration VAT

A company was established as a vehicle to convert a barn for sale as a dwelling. On its first VAT return it claimed a number of items which were refused by HMRC as representing services purchased more than six months before the EDR. The company argued that the supplies were in reality part of the creation of a single item of goods that was owned at the EDR and had not been supplied before it. The director used the example of a person fitting the wheels to a car – the fitting of the wheels is part of the manufacture of the car, not a separate service.

The Tribunal did not accept this analogy. Clearly the list of expenses related to services and they were outside the rules in reg.111 SI 1995/2518. The appeal was dismissed.

First Tier Tribunal (TC00536): *Glamorgan Prestige Developments Ltd*

5.8.4 Fuel advisory rates

The twice-yearly change of the HMRC approved "fuel-only mileage rates" has now moved to 1 December and 1 June. For one month from the date of change, employers can use either the old or the new rates as they choose.

The rates can be used for two purposes for VAT:

- if the employee buys fuel, the employer can pay the mileage rate for business miles and HMRC will still accept an input tax claim based on 7/47 of the amount paid (as it is all for fuel);
- if the employer buys fuel, and the employee reimburses this mileage rate for private miles and HMRC will accept that the output tax scale rates do not apply. However, the employer will have to account for output tax on the amount received, as it is an actual supply of fuel to the employee for consideration.

The rates have been adjusted slightly (upwards, where there is a change) from 1 June 2010 as follows:

Engine size	Petrol	Diesel	LPG
1400cc or less	12p	11p	8p
1401cc – 2000cc	15p	11p	10p
Over 2000cc	21p	16p	14p

These figures are also an acceptable basis for estimating the fuel element of a mileage allowance paid to someone for use of their own car. HMRC will still allow an input tax claim based on mileage allowances, so if the employer pays 40p a mile to someone with a 2100cc car, it appears that 7/47 x 21p ought to be an acceptable basis for the input tax claim. Since 1 January 2006, however, it is a requirement that the employer holds input tax invoices which show at least the amount of the VAT that is being claimed on a mileage basis.

It is still open to all drivers, whether of their own cars or company cars, to make a claim based on actual costs. However, these mileage rates are likely to be a worthwhile simplification of that.

The Press Release contains a summary of the fuel consumption figures used to generate the above mileage rates, which may provide some indication of whether a particular car is likely to give a lower or higher "actual" figure.

Revenue & Customs Press Release 26 May 2010

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Grouping and the capital goods scheme

A subsidiary company made a zero-rated supply of new student accommodation to a university. It subsequently joined the university's VAT group. As a result, HMRC argued that the input tax recovered in relation to the zero-rated supply had to be clawed back under the capital goods scheme (amounting to £248,000). To rectify the situation, the university asked HMRC to remove the subsidiary from the VAT group with retrospective effect, which HMRC refused to do.

The Tribunal had to consider in detail the effect of the subsidiary joining the VAT group. It was accepted that the subsidiary had genuinely made a zero-rated supply originally, granting a 25-year lease to the university; HMRC said that the subsidiary's business ceased on joining the VAT group because it was disregarded, so the property fell within the capital goods scheme and was now used to make exempt supplies of education.

The Tribunal disagreed. The subsidiary's business did not cease, even though it was disregarded. The representative member of the VAT group was not deemed to have made past supplies by the subsidiary which took place before it joined the group. The university continued to use the leased building for the purposes of education, while the subsidiary continued to lease that building to the university (even though the rent was now disregarded). The university did not use the subsidiary's interest, which had originally been the subject of the zero-rated grant, to make supplies of education. Accordingly, there had been no reduction in the use of that interest to make taxable supplies, and no adjustment was required under the CGS.

In respect of the application to make the degrouping of the subsidiary retrospective, the history of correspondence between HMRC and the university was examined. There had been correspondence between 2002 and 2004 about the development and the recovery of input tax, and it appeared originally that HMRC did not regard CGS adjustments as necessary. A letter changing this opinion crossed in the post with the university's application to admit the subsidiary to the VAT group. Once the university had appreciated the consequences that HMRC believed would flow from this, they applied to cancel the group registration; HMRC accepted this application but would not cancel it from the outset, so leaving the CGS adjustment to be made for the brief period during which the subsidiary was a member of the group.

The Tribunal considered that its jurisdiction in this matter was restricted to considering whether HMRC's decision had been reached in a reasonable manner, rather than deciding whether it was correct or not. The decision involved the exercise of a discretion which the law allowed to HMRC. Although there had been errors of law in the initial decision, they had been rectified on reconsideration and the Tribunal was satisfied that there were no grounds for overturning the decision that the subsidiary could not leave the group retrospectively.

Because of the Tribunal's decision on the operation of the CGS, it now appears that there was no pressing reason for the subsidiary to leave the group at all.

First Tier Tribunal (TC00467): *University of Essex*

6.1.2 Commission gets tough on grouping

As threatened over the last year, the Commission has decided to take seven member states to the ECJ on the grounds that their grouping rules are contrary to the VAT Directive. Article 11 provides as follows:

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

The Commission's objections to the states' rules are:

- in respect of the Netherlands, Ireland, Finland, UK, Czech Republic and Denmark, that they allow non-taxable persons to be members of a VAT group;
- in respect of Sweden and Finland, that they limit VAT grouping to financial and insurance services, which is a limitation by sector not provided for in the Directive.

Presumably the Commission knows what it is doing, but art.11 does not appear to require that the "independent persons" are individually taxable persons. It is also relatively easy for a mainly non-taxable person to acquire some small taxable activity if it is necessary in order to benefit from VAT grouping.

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

6.2 Other registration rules

6.2.1 More pre-registration VAT

A company was incorporated in November 2006. It operated a social networking site which intended in due course to make money through advertising. It applied to register for VAT in January 2007, but this was turned down on the basis that HMRC could see no evidence of an intention to make taxable supplies (having examined the website and seen no advertising).

The company applied again in May 2008, still on an "intending trader" basis. The new application specified 1 March 2008 as the EDR, and this was given effect by HMRC. On its first VAT return, the company reclaimed VAT of about £8,500. HMRC concluded that nearly £8,000 of this related to services purchased more than 6 months before the EDR, and refused to repay it.

The company appealed, arguing a number of different points:

- the main item in dispute, the purchase of a "fully functioning website", should be regarded as a supply of goods rather than a supply of services;
- HMRC should have accepted the first application for registration, in which case all the VAT would have been allowable;
- the 1 March 2008 EDR had been applied for as a genuine mistake by the company's accountant, who could have validly put an earlier date;
- HMRC's letter refusing the first application had been misleading and unclear about the appeals procedure;
- reg.111 SI 1995/2518 is invalid in the light of the *Fleming* decision.

On the first issue, the Tribunal did not agree that the website was "standardised software" that could be regarded as a supply of goods. It was rather a bespoke service which customised the website for the company. CDs were included, but these were merely a back-up copy of the software and were incidental to the service.

The Tribunal was also satisfied that the company failed the business tests when it first applied in 2007. It had stated on its application form at that time that it expected to make taxable supplies of £100,000 in the next year, but it did not make any supplies until March 2008. It had an opportunity to backdate the registration when it applied again, but failed to do so. The guidance issued to applicants for voluntary registration is clear: unless the circumstances are exceptional, once an EDR has been applied for and granted, it cannot be changed. There was nothing exceptional about these circumstances.

Lastly, *Fleming* had been about transitional rules. This case was not concerned with VAT incurred before the introduction of reg.111, so *Fleming* was not relevant.

The appeal was dismissed.

First Tier Tribunal (TC00455): *Pet Street Ltd*

6.2.2 Compulsory registration

In a hearing in October 2009, the Tribunal considered an appeal by the owner of a hairdressing business against a notice of compulsory registration that was issued in 2000 and related to periods from 1995 onwards. It appears that a business splitting arrangement had fallen apart: there were three shops – one owned by the husband, one by the wife and the other by the two in partnership. In 1995 the partnership was dissolved and the husband became the owner of two shops. This put him above the registration threshold and he was liable to VAT from that point.

The Tribunal agreed with HMRC's analysis of the facts and confirmed the decision. In view of the length of time involved and the complexity of the law, HMRC agreed only to charge a nominal penalty of £50 for belated notification.

The Tribunal report is hard to follow because it appears to contain a number of typographical errors. It is therefore difficult to understand exactly why the decision was taken, but it seems unlikely that the appellant will dispute it further on these grounds.

First Tier Tribunal (TC00458): *Peter Zacharias t/a Petros Hair and Beauty*

6.2.3 Deregistration date

A trader's accountant completed a VAT 7 deregistration application and sent it to HMRC, asking for a deregistration date of 30 June 2008. No copy was kept and there was no evidence of posting; HMRC said that they had never received it. It was also later discovered that one of the digits in the VAT number was wrong.

The accountant realised that something had gone wrong when he received a VAT return for the client to complete for the period to 31 July 2008. His attempts to amend this to 30 June and to ignore a centrally issued assessment were rejected by HMRC, who eventually acknowledged receipt of a deregistration application on 27 October 2008.

The Tribunal found that, on the balance of probabilities, it was not possible to conclude that HMRC had received the earlier application. It was therefore reasonable for them to insist that the trader should remain registered until a proper application had arrived. HMRC subsequently allowed backdating of deregistration to 30 September 2008, but they could not be forced to backdate it any further than that.

First Tier Tribunal (TC00510): *Peter Vass*

6.2.4 Seasonal trade

Readers' Queries in *Taxation*, 17 June 2010, contains a question and two answers about the VAT obligations of a seasonal trader – someone who might just exceed the VAT registration threshold in half a year's trading, but then will have no sales during the winter months. The answers also consider the direct tax implications.

Taxation 17 June 2010

6.2.5 Supplement to Notices

HMRC issue an annual supplement to Notices 700/1 and 700/11 ""Should I be registered for VAT?" and "Cancelling your registration". The supplement sets out a table of the registration and deregistration thresholds, including the latest increase to £70,000 and £68,000.

Notice 700/1 has also been revised to reflect changes in the time limits for claiming input tax and backdating registration. Under "what's changed" it says:

- Paragraph 1.5 provides a fuller explanation of the meaning of a taxable supply.
- Paragraph 2.7 clarifies what happens if a request for exception from registration is refused.
- Paragraph 2.8 gives details how registration is affected by a 'Transfer of a Going Concern'.
- Paragraph 2.13 clarifies what happens if a request for exemption from registration is refused.
- Paragraph 4.1 confirms that you will be liable to account for VAT from the date of registration, which may be before you receive your VAT number.
- Notes on completion of form VAT1, VAT1A, VAT1B, VAT1C and VAT1TR have been removed from this notice and can now be found separately.

Supplement to Notices 700/1 and 700/11

6.3 Payments and returns

6.3.1 VAT by direct debit

Agent Update 17 explains that a trader can set up a direct debit so that HMRC can collect VAT due on returns which have been filed electronically. This must be done at least 5 days before submission of the next return to give them time to process the DD application.

www.hmrc.gov.uk/payinghmrc/vat.htm#2#

6.3.2 Time to pay arrangements

Where a business applies for time to pay and the amount exceeds £1m, an Independent Business Review (IBR) is now required to give HMRC assurance that the deferment will not lead to an increased loss of tax. HMRC have published a list of firms of accountants who are authorised to provide an IBR.

http://www.hmrc.gov.uk/consultations/ibr-panel.htm

6.3.3 Online filing

The first VAT return for a period commencing from 1 April 2010 onwards will, for most traders, have to be filed online. There is a demonstration of how to register for this process on the HMRC website.

http://www.hmrc.gov.uk/demo/agent/register-and-enrol-VAT

HMRC have issued a reminder to affected businesses, referring them to online help and reminding them that the first return for most traders will not be due until 7 August 2010 (quarter to 30 June 2010, due 31 July with a 7-day extension for being filed online).

www.hmrc.gov.uk/vat/vat-online/index.htm

6.3.4 Extension of time

ICAEW *TAXline*, May 2010 points out an important change which follows from the introduction of compulsory online filing. Up to March 2010, HMRC operated a concession which allowed an extra 7 days for both filing and payment if the return was filed online and the payment was made electronically. The concession depended on both, so – illogically – it was not available for a nil return or a repayment return. If one of these was filed electronically after the due date, it would trigger a default. Although it could not lead to a surcharge, nor to an increase in the rate, it could extend a surcharge liability period.

HMRC have now confirmed that the 7 day extension applies to all returns filed electronically, even if there is no payment to be made. The only exceptions now are annual returns (which have to be made 2 months after the year end, with no extension for either return or payment) and returns from traders who make payments on account (unless they make monthly returns, in which case the extension applies to the returns).

TAXline, May 2010

6.3.5 Default interest

HMRC have issued an updated version of their Notice on default interest. The following is an important reminder of a recent change in policy:

As notified within our Business Brief 38/08, our previous policy to not charge interest on the notification of errors on VAT returns with a value under £2,000 has now been withdrawn. As a consequence all error notifications (formerly known as 'voluntary disclosures') requiring an assessment may be subject to a default interest charge. This is regardless of the amount involved. However, net VAT errors below the limit described in Public Notice 700/45 may continue to be corrected on a VAT return without incurring a charge to interest. In addition, interest will not be charged on:

- *VAT declared on returns but unpaid*
- *assessments raised because you failed to render a VAT return (excluding additional assessments)*
- *penalties*
- *interest, and*
- *amendments made to VAT returns before they are fully processed.*

Interest is also not charged where it does not represent "commercial restitution", that is an underdeclaration by the trader can be shown to be matched by an overdeclaration by another trader.

The new version also refers to the change in policy on the date of receipt of funds paid by cheque, and confirms that no interest will be charged as long as a cheque clears within 30 days of an assessment being issued.

Notice 700/43

6.3.6 Flat rate percentages

The flat rate scheme percentages will change on 4 January 2011 alongside the change in the standard rate. The following table shows a comparison of the rates before 1 December 2008, during 2009, during 2010, and after the increase. The increases are not necessarily even or proportional: HMRC take the opportunity also to refine the calculations so that the system is more accurate.

Category of business	2011	2010	2009	2008
Retailing food, confectionary, tobacco, newspapers or children's clothing	4	3.5	2	2
Post offices	5	4.5	2	2
Farming or agriculture that is not listed elsewhere	6.5	6	5.5	6
Pubs	6.5	6	5.5	5.5
Retailing vehicles or fuel	6.5	6	5.5	7
Wholesaling food	7.5	6.5	5	5.5
Retailing that is not listed elsewhere	7.5	6.5	5.5	6
Membership organisation	8	7	5.5	5.5
Wholesaling agricultural products	8	7	5.5	6

Retailing pharmaceuticals, medical goods, cosmetics or toiletries	8	7	6	7
Sport or recreation	8.5	7.5	6	7
Wholesaling that is not listed elsewhere	8.5	7.5	6	7
Printing	8.5	7.5	6.5	7.5
Repairing vehicles	8.5	7.5	6.5	7.5
Manufacturing food	9	8	7	7.5
Manufacturing yarn, textiles or clothing	9	8	7.5	8.5
Packaging	9	8	7.5	8.5
General building or construction services*	9.5	8.5	7.5	8.5
Hiring or renting goods	9.5	8.5	7.5	8.5
Library, archive, museum or other cultural activity	9.5	8.5	7.5	7.5
Manufacturing that is not listed elsewhere	9.5	8.5	7.5	8.5
Repairing personal or household goods	10	9	7.5	8.5
Mining or quarrying	10	9	8	9
Transport or storage, including couriers, freight, removals and taxis	10	9	8	9
Forestry or fishing	10.5	9.5	8	9
Travel agency	10.5	9.5	8	9
Dealing in waste or scrap	10.5	9.5	8.5	9.5
Hotel or accommodation	10.5	9.5	8.5	9.5
Manufacturing fabricated metal products	10.5	9.5	8.5	10
Computer repair services	10.5	9.5	10	11
Agricultural services	11	10	7	7.5
Social work	11	10	8	8.5
Veterinary medicine	11	10	8	9.5
Advertising	11	10	8.5	9.5
Photography	11	10	8.5	9.5
Publishing	11	10	8.5	9.5
Any other activity not listed elsewhere	12	10.5	9	10
Investigation or security	12	10.5	9	10
Boarding or care of animals	12	10.5	9.5	10.5
Business services that are not listed elsewhere	12	10.5	9.5	11
Estate agency or property management services	12	10.5	9.5	11
Laundry or dry-cleaning services	12	10.5	9.5	11
Entertainment or journalism	12.5	11	9.5	11
Catering services including restaurants and takeaways	12.5	11	10.5	12
Film, radio, television or video production	13	11.5	9.5	10.5
Secretarial services	13	11.5	9.5	11
Hairdressing or other beauty treatment services	13	11.5	10.5	12
Financial services	13.5	12	10.5	11.5
Management consultancy	14	12.5	11	12.5
Real estate activity not listed elsewhere	14	12.5	11	12
Architect, civil and structural engineer or surveyor	14.5	13	11	12.5

Accountancy or book-keeping	14.5	13	11.5	13
Computer and IT consultancy or data processing	14.5	13	11.5	13
Labour-only building or construction services*	14.5	13	11.5	13.5
Lawyer or legal services	14.5	13	12	13

Because the increase in the standard rate will tend to increase gross receipts or turnover, the level at which a trader must leave the scheme is also raised from £225,000 to £230,000 with effect from 4 January 2011. The business may remain in the scheme if it expects its turnover in the following year not to exceed £191,500 (rather than £187,500 at present).

BN 45

6.3.7 Another flat refusal

A Tribunal decision on the flat rate scheme is unusual in that it is published but is based only on written representations rather than a hearing. The appellant wanted to be admitted retrospectively into the flat rate scheme with effect from its registration date, 1 July 2005. HMRC refused, in line with their current policy which has recently been supported by the High Court in the case of *Burke*.

The trader argued that the circumstances were "exceptional" because the company had ceased to trade and was in liquidation. The reduction in VAT arising from retrospective entry into the FRS would extinguish the VAT debt to HMRC, and the balance could be used to reduce a PAYE liability.

The Tribunal saw nothing exceptional in this. Following Burke, it appeared that the Tribunal's decision in *Anderson* (VTD 20,255) – in which retrospection was allowed – is unlikely to be followed often in future. The appeal was dismissed.

First Tier Tribunal (TC00529): *S D Solutions Ltd*

6.3.8 Articles

Neil Warren highlights some anomalies in the Flat Rate Scheme in *Taxation*, 29 April 2010 – not least the reference to "fat rate" in the web address of some of the guidance, and "flate rate" in the guidance itself.

The online guidance (and the HMRC VAT Advice Line) tells FRS traders to include the VAT on reverse charge services in Box 1 and Box 4, even though FRS VAT is not due on such transactions. This produces the correct result, because the Box 1 and 4 entries should cancel out, but seems unnecessary and confusing. It is not clear why HMRC believe that entries are required.

Taxation, 29 April 2010

Neil Warren also analyses the decision in *RDF Management Services Ltd* (TC00387) in *Taxation*, 3 June 2010. This article highlights possible problems with operating the FRS, particularly if there are associated businesses in existence.

Taxation, 3 June 2010

6.4 Repayment claims

6.4.1 Compound interest again

The High Court has considered another claim for compound interest on a repayment claim, this time in relation to overpayments arising from the mistaken operation of retail schemes. The judge considered that s.78 VATA 1994 prescribed simple interest to be paid for claims that were within s.80 VATA 1994, but it was possible that restitutionary claims for interest were also possible where there was a breach of EU law. This should be referred to the ECJ for a preliminary ruling.

If a restitutionary claim was made out, the measure of the loss would be compound interest, in line with the decision of the House of Lords in *Sempra Metals*. It would also be based on the unjust enrichment of the recipient rather than the loss to the claimant. The judge considered that the claim would be restricted to overpaid tax in the 6 years before the commencement of court proceedings, not to overpayments discovered during that period. That would restrict the entitlement to such claims in respect of *Fleming* repayments.

High Court: *Littlewoods Retail Ltd v HMRC*

6.4.2 Voluntary disclosure refused

A publican made a voluntary disclosure in July 2006 on Form 652, claiming input tax in relation to the period to April 2002. HMRC had accepted at an earlier hearing that a letter written on behalf of the trader on 15 March 2005 would be accepted as a voluntary disclosure that brought the claim within the 3-year time limit.

The input tax related to works which had undoubtedly been carried out to the premises, but there was no evidence to prove the amounts claimed – not even a proper breakdown of the figures to show what they were made up of. Underlying records had been destroyed in a fire at the premises of the firm's accountants, and the builders who had carried out the works had ceased to trade.

The Tribunal expressed surprise that there should be so little secondary evidence of the amounts involved. In the absence of such evidence, the trader could not discharge the burden of proof required to show entitlement to the input tax. The appeal was dismissed.

First Tier Tribunal (TC00493): *Lyle Taggart & Anne Taggart t/a The Fullerton Arms*

6.4.3 Inconsistent claims

In 2000 a golf professional reclaimed output tax for the years 1996 to 1999 on the basis that he had discovered that his golf lessons should be exempt. Following *Fleming*, he submitted another claim, covering the years up to 1996. HMRC accepted liability and did not plead unjust enrichment, but disputed the amount. The 2000 claim had been based on evidence that a little over 7% of the taxpayer's turnover was exempt. The new claim showed 16% to 18% as exempt. HMRC made a repayment based on the earlier percentage, and the trader appealed.

The Tribunal could find no explanation of the discrepancy, and was not convinced that there was a valid one. The second claim was an arithmetical exercise which was not based on evidence. The burden was on the appellant to show on the balance of probabilities that the claim was justified, and this burden had not been discharged.

First Tier Tribunal (TC00508): *P Johnson*

6.4.4 Repayment supplement rejected

A company (which was involved in the trade in mobile phones and CPUs) submitted its return for April 2004 on 25 May. HMRC repaid the VAT claimed on 29 June, and the company claimed repayment supplement. HMRC refused, and the Tribunal agreed with them that they were making "reasonable enquiries" during the period from 7 June to 22 June. The repayment was therefore made within the 30 days allowed to HMRC. Similar decisions were reached in respect of later periods, with the result that claims for over £800,000 of repayment supplement were rejected.

First Tier Tribunal (TC00436): *Megantic Services Ltd*

6.4.5 Out of time

A trader paid centrally issued assessments in respect of periods in 2001, only filing returns in 2008. It claimed that it was unfair not to allow it credit for input tax shown on the returns. The Tribunal ruled that there was no discretion in the matter: the claims were made over three years after the periods in question, and the appeal had to be dismissed.

First Tier Tribunal (TC00450): *McGee Associates*

6.4.6 More *Fleming* guidance

HMRC have issued updated guidance on *Fleming* claims. This covers:

- the legal background;
- claims handling;
- definition of a claim and quantification;
- identity of claimant, including group aspects and partnerships, as well as the consequences of death, insolvency and striking-off of companies;
- particular issues such as claims by motor traders;
- payment of claims, abusive claims, unjust enrichment and interest.

HMRC have also updated their "internal theme narratives" guidance on *Fleming* claims. The new version includes a new Annex B on *Kretztechnik* pre-April 1987 claims; a new Annex D on motor dealer *Elida Gibbs* cases; a new Annex E on *Lennartz* cases; a new section on *Rialto Homes* construction cases; a new section on credit and debit card charge-backs; updates to sections on *Elida Gibbs*, postal services, *GMAC* pre-1978 cases, *Lennartz* cases, and construction (white goods/building materials) cases.

As before, the guidance explains to officers how they may recognise a claim that falls within a certain “themed category”; the history of the dispute in that area and what the current policy is; and what the appropriate response should be. The appendices include outlines of letters which can be used to draft replies to taxpayers making claims.

As before, the guidance is not only relevant to true *Fleming* claims for pre-1997 VAT – it can also be helpful in considering whether more recent VAT overpayments are recoverable.

www.hmrc.gov.uk

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Article

Mike Thexton analyses the rules on error correction in *Taxation*, 17 June 2010, with particular reference to the decisions in *Starglaze Windows and Conservatories Ltd* (TC00430) and *Stirling Investments* (TC00374).

Taxation, 17 June 2010

6.7 Assessments

6.7.1 Best judgement

A trader was assessed in respect of underdeclared takings at his pizza takeaway business. The Tribunal considered the basis on which HMRC had calculated the assessment and commented that it appeared generous to the trader, whose explanations were unconvincing and inconsistent. The appeal against the assessments were dismissed.

An unfounded allegation that the officers concerned were "crooks" who had acted improperly "did not enhance the Appellant's case".

First Tier Tribunal (TC00496): *Bashar Sandouk t/a Didi's Pizza*

6.7.2 Jurisdiction

In TC00051, the First Tier Tribunal had to consider the case of a company operating two wine bars and several delicatessens. It was assessed following a dispute on the split between zero and standard rated sales. The Tribunal examined the evidence in detail and concluded that HMRC had agreed that 3 of the delis could use a fixed 30/70 split between standard and zero-rated supplies, and this overrode any factual findings by HMRC. The appeal was allowed to that extent. However, in respect of the other outlets, there was no such agreement and HMRC's assessments had been made to best judgement.

The trader appealed to the Upper Tribunal, arguing that the FTT had applied the wrong test. It had restricted itself to considering only whether the assessments had been made to best judgement, when it should also have considered whether the amounts themselves were appropriate. It had effectively restricted its jurisdiction to a supervisory one instead of the full appellate role it held in respect of an assessment.

The Upper Tribunal decided that the FTT did appear to have restricted its decision incorrectly. It was possible that its conclusions were in fact based on the correct test, but if so they had not been adequately described. The case should be referred back to the same panel of the FTT in order to consider further submissions to the extent it felt necessary to reach a conclusion about the quantum of the assessments, rather than just asking itself whether the amounts of the assessments were reasonable.

Upper Tribunal: *Mithras Wine Bars Ltd v HMRC*

6.8 Penalties and appeals

6.8.1 Surcharge appeals

A married couple ran a small company. In spite of receiving default surcharge liability notices, they went on holiday without making adequate arrangements to make sure that VAT was paid on a timely basis in their absence. The insolvency of a customer was too insignificant in amount to constitute a reasonable excuse. The appeal against a surcharge was dismissed.

First Tier Tribunal (TC00500): *Shaun Batchelor Electrical Contractors Ltd*

A company appealed against default surcharges for 6 periods, but turned up at the hearing asking to explain away defaults for other periods on account of an alcoholic administrator and a break-in at the company's offices. HMRC objected that the grounds of appeal had been changed at the last minute, and HMRC's counsel was not able to take instructions in respect of the new excuses offered.

The Tribunal agreed with HMRC that this was not reasonable conduct. Nevertheless the chairman heard and recorded the new material introduced by the taxpayer at the last minute, and commented that none of it appeared to constitute a reasonable excuse – whether for the surcharges that were properly the subject of the hearing, or for any other surcharges. The appeal was dismissed.

First Tier Tribunal (TC00460): *PIC Build Construction Ltd*

A married couple ran a public house. They were under considerable financial pressure, and submitted several VAT payments late. On the returns which would have been penalised at 2% and 5% the end result would have been less than £400, which HMRC do not collect at the lower percentages. The first surcharge to be levied was therefore at the 10% rate in respect of the August 2008 return, amounting to £665.

The Tribunal agreed with HMRC that the financial difficulties in August 2008 did not and could not amount to a reasonable excuse. However, the Tribunal held that entering into (and complying with) a "time to pay" arrangement in February 2008 constituted a reasonable excuse for one of the earlier returns. Applying the Tribunal's decision in *Aardvark Excavations Ltd* (VTD 20,468), striking out an earlier default should be followed through to its consequences for later defaults. The rate in August 2008 should therefore be 5%, so the appeal was allowed to the extent of cutting the surcharge in half. The Tribunal did not instruct HMRC to follow their own policy and not collect the result because it was less than £400.

HMRC's counsel objected to the application of *Aardvark*, arguing that it had been wrongly decided (even though HMRC did not appeal it). The chairman disagreed: he considered that the analysis of the law in that case had been careful and detailed, and the result was right and was applicable to the present circumstances.

First Tier Tribunal (TC00521): *RP Griffin and DM Griffin*

6.8.2 Surcharge and penalties

A company had submitted its VAT returns for many years without experiencing any difficulty. When the chief accountant retired and was replaced, the new employee received training on the systems and worked alongside the retiring officer for some time, but still found it difficult to fulfil his responsibilities. Returns were not submitted. The management only discovered this when HMRC served a winding-up notice on one of the businesses in the group. When the full picture emerged, the company was subject to misdeclaration penalties for failing to correct inadequate central assessments, and default surcharges for late payment of VAT.

The only defence was reasonable excuse. The company director explained that the management had believed in the new accountant's references, experience and qualifications, and had given adequate training, support and a ten-week handover period. In the circumstances there was nothing more that they could have done to ensure that the VAT accounting would be properly carried through.

The Tribunal did not agree. The excessive reliance on the employee, without adequate control or supervision, had led to the problem; this was "reliance on another" and could not be a reasonable excuse. The directors were aware that the new accountant was late in preparing management accounts, and should have followed this through to the possibility that other parts of his duties were also in arrears.

First Tier Tribunal (TC00512): *Pinnacle Office Equipment Ltd*

6.8.3 Costs

In 2009 the Tribunal heard a case about the place of supply of management services. HMRC changed their statement of case very late, with the result that the taxpayer had prepared for an argument that was not in the end used. The taxpayer objected at the beginning of the hearing on a Monday morning that the skeleton argument, delivered only on the previous Friday, was materially different from the statement of case that had been made earlier. The Tribunal decided to allow HMRC to change their argument but contemplated an award of costs to the taxpayer.

The taxpayer then lost the substantive appeal, and claimed for costs of £312,500. Unusually for such a situation, the Tribunal did allow some costs to the unsuccessful appellant – however, the amount was only £20,000. The case was different from *M G Rover Group Ltd* (VTD 20,871) in which the taxpayer should have known that its position was hopeless at a much earlier stage and appeared to be hoping that HMRC would not notice. An award of costs was therefore appropriate, but it would be restricted to about 10% of the costs that were estimated to have related to preparation for the hearing itself. These were stated to be £187,500; the remainder related to earlier arguments which had been settled without a hearing.

The Tribunal therefore decided to award £20,000.

First Tier Tribunal (TC00505): *Sumitomo Mitsui Banking Corporation Europe Ltd*

6.8.4 Statement of case

HMRC applied for leave to amend their statement of case in an appeal. The appellant applied for a direction that their appeal should be allowed because this amendment of the case should not be permitted.

Reed Employment won a case in 1995 which established that the company supplied nurses as agents rather than as principal, and HMRC made a repayment accordingly. The company then made a separate claim in respect of non-nursing staff. This was ruled out by the introduction of the three-year cap. It was later resubmitted after the *Marks & Spencer* judgment; HMRC continued to object using the cap and unjust enrichment. After the *Fleming* decision, the company thought that it must have won, but HMRC applied to amend its argument so that the company would have to produce evidence that it had supplied the staff concerned as agent rather than as principal (going back to the early 1990s and beyond).

The company objected that HMRC had had the opportunity to raise the agency point ever since the resubmission of the claim and had not done so. They should not be allowed to do so now; everything that they had originally put in the way of the claim had been resolved in the company's favour.

The Tribunal chairman recognised that a decision for either party would prejudice the other. However, he decided that, on balance, the prejudice to HMRC was more serious. It was not surprising that the agency point was not argued earlier when HMRC thought that the preliminary issues were strong enough to win the case for them. Agency had been mentioned in correspondence, and although both parties had "lost sight of it", the company must have been aware that it was an important issue.

The chairman expressed the hope that the Tribunal that heard the substantive appeal would take into account the difficulties of the company in providing evidence, and would perhaps accept that the provable situation in later years, where the evidence still existed, should be assumed to apply also in the earlier years.

First Tier Tribunal (TC00523): *Reed Employment plc*

6.8.5 Categorisation

The Tribunals Rules require cases to be allocated into one of four categories: default paper, basic, standard and complex. A major difference between complex and other cases is that different costs rules apply (see reg.23 The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009).

An appellant applied to have the case categorised as complex. It concerned the recovery of input tax on the purchase of a helicopter for leasing out. The "business" had input tax of £550,000 and annual turnover of £120,000 a year. The Tribunal did not agree that there was anything particularly complex about the law or the evidence, and the possibility of a three-day hearing did not raise it from the standard run of First Tier Tribunal cases. The application was refused.

First Tier Tribunal (TC00465): *Capital Air Services Ltd*

6.8.6 A tangled web

A British truck manufacturing company was bought by a Canadian company in 1996 and sold on to a German company in 2000. Following the German acquisition, accounting discrepancies were discovered. On further investigation, it appeared that there was a £100m "hole in the balance sheet". Part of this related to overclaims and underdeclarations of VAT. The chief financial officer appeared to have carried out an extensive fraud, not for personal gain but to keep the company going. He had concealed what he had done from all his colleagues.

An investigation by accountants took several years to establish the extent of the problem, including the amount of fictitious VAT entries. As the investigation progressed from March 2001 onwards, HMRC raised several assessments, culminating in a s.60 penalty levied on the company and a final assessment for £5m in early 2004. The company appealed against these assessments, but only did so within the statutory time limit in respect of the last one.

The Tribunal had to consider first whether to allow appeals out of time in respect of the earlier assessments, and concluded that there was no good reason to. It also went through the complicated history of the fraud and its unravelling and decided that the assessments should not be displaced, nor should the penalty be reduced by more than the 80% mitigation that HMRC had already allowed. The only adjustment to the company's liability was to remove some transposition errors from the base figure for the s.60 assessment – as these were innocent errors in the midst of the dishonesty, they should not be subject to a civil evasion penalty.

Costs, which must have been substantial, were awarded to HMRC. This was done under the transitional rules – before April 2009, HMRC would apply for costs if the case was complex, and also in s.60 cases.

First Tier Tribunal (TC00537): *ERF Ltd*

6.8.7 Way out of time

On 10 December 2009 a trader filed a notice of appeal in respect of an assessment raised on 1 July 1980 in respect of a period in 1978. The trader claimed that his appeal was so late because he had believed that a "*Grepe v Loam*" order against him prohibited him from bringing an appeal in the VAT Tribunal. Such an order constrains its subject from bringing actions in the courts. It appears that he was found at some past point to be a vexatious litigant and was forbidden to carry on going to law.

In 2009 he discovered that the order did not apply to proceedings in the First Tier Tribunal, so he promptly commenced an appeal. The Tribunal refused leave to appeal out of time. Firstly, several of his grounds of appeal would require findings of fact, and it would be very hard to establish the facts after such a long time. Secondly, the order was only made in 1994, and there was no explanation of why he had not appealed before that.

The application for leave to appeal out of time was struck out on the basis that the substantive appeal had no realistic prospect of success.

First Tier Tribunal (TC00442): *D A Gardner t/a Gardner's Transport Co*

6.8.8 Restoration of appeal

A company was refused payments of £7.9m of input tax because HMRC suspected it of involvement in a carousel fraud. The company appealed in 2008, but it appears that its accountant failed to keep the directors informed about the progress of the appeal. As a result, the company failed to comply with directions of the Tribunal and had the appeal struck out. It applied to have the appeal reinstated; this was refused by the VAT Tribunal in January 2009 in the absence of the taxpayer, again apparently because the accountant had not told anyone about the hearing. At this time the directors engaged new advisors and applied again to have the appeal reinstated.

The change of Tribunals intervened, and the First Tier Tribunal decided that it did not have jurisdiction to reinstate an appeal in these circumstances. The company appealed again to the Upper Tribunal, which allowed the application and referred the case back to the First Tier Tribunal to hear the substantive appeal. The fault appeared to be with the previous accountants; there was a real risk of injustice to the directors, partly because of the sum of money involved and partly because they would have no chance to clear their names of serious allegations of tax fraud. HMRC's only risk was wasted costs.

Upper Tribunal: *ATEC Associates Ltd v HMRC*

6.8.9 Legitimate expectations

A company is engaged in a dispute with HMRC which has been set down for a five-day hearing. It applied to be allowed to add a new ground of appeal to its existing grounds of appeal – that it had a "legitimate expectation" that tax would not be assessed based on Notice 700/34 para.3.2. This states:

In cases of joint employment, there is no supply of staff for VAT purposes between the joint employers. Staff are regarded as jointly employed if their contracts of employment or letters of appointment make it clear that they have more than one employer. The contract must specify who the employers are, for example "Company A, Company B and Company C", or "Company A and its subsidiaries".

Staff are not jointly employed if their contract is with a single company or person, even if it requires them to work for other companies. Paragraphs 2.1 to 2.3 therefore apply. It is not accepted that there is joint employment where there is a contract with one company—

- *which lays down that the employee's duties include assisting other companies; or*
- *that the employee will work full-time for another; or*
- *where the job title shows that the employee works for a group of associated companies (such as group accountant).*

This is not an exhaustive list.

This appears to be the only indication in the current Tribunal decision as to the subject matter of the main dispute.

HMRC argued that no additional grounds of appeal should be allowed. The Tribunal examined the precedent cases on legitimate expectation in

detail and allowed the appellant's application. This did not imply any conclusion about whether a legitimate expectation existed or whether it helped the appellant's case; however, it would be more efficient to consider the evidence at the same time as examining the rest of the arguments so that the Tribunal could make findings of fact which could be used if this aspect of the dispute went on to a higher court, rather than requiring a reference back later if a higher court decided that the legitimate expectations argument could be valid.

First Tier Tribunal (TC00525): *CGI Group (Europe) plc*

6.8.10 Penalties in force

HMRC have set out in a Brief the rules concerning the new "failure to notify" penalty under Sch.41 FA 2008. This applies to most taxes, including VAT, from 1 April 2010, and replaces the belated notification penalty under s.67 VATA 1994.

The penalty can be avoided altogether if there is a reasonable excuse for the failure. If there is not, the amount of penalty is tax-geared and will depend on similar principles to the error penalties which have applied since 1 April 2009. If the conduct leading to the failure was accidental, deliberate, or deliberate and concealed, and if the rectification was prompted or unprompted, together with the level of co-operation in putting matters right, produce the following table:

	Max %	Prompted, min %	Unprompted, min %
Non-deliberate	30	20	10
Deliberate	70	35	20
Concealed	100	50	30

One important difference between this penalty and error penalties is that full unprompted disclosure will not mitigate the penalty to zero. As with the old s.67 penalty, it is likely that there will be a charge simply for having failed to observe the rules at the right time.

R&C Brief 30/2010

Meanwhile, HMRC have updated their online Compliance Handbook to reflect the changes to penalties for inaccuracies, failure to notify and VAT and excise wrongdoing; and also penalties for failures to make payments on time, the publishing of details of deliberate tax defaulters and assessing time limit information.

http://www.hmrc.gov.uk/manuals/ch1manual/Index.htm

6.8.11 Penalties to come

The June Budget repeated the announcement from the March Budget that default surcharge is to be replaced (by a lesser penalty for late payment, but including a new penalty purely for late filing). As stated earlier, the new system will not be introduced until HMRC's systems are ready for it, which may take several years. The new penalty regime already applies to other taxes under FA 2009 Sch.55, but will be applied to VAT, IPT, aggregates levy, climate change levy, landfill tax and excise duties in stages by Treasury Order.

BN 37

6.9 Other administration issues

6.9.1 Compliance checks

HMRC have updated their series of leaflets about compliance checks. All the new versions are available on the HMRC website. They cover the following subjects:

- CC/FS1 General information
- CC/FS2 Requests for information and documents
- CC/FS3 Visits – Pre-arranged
- CC/FS4 Visits – Unannounced
- CC/FS5 Visits – Unannounced – Tribunal approved
- CC/FS6 What happens when we find something wrong
- CC/FS7 Penalties for errors in returns or documents
- CC/FS8(T) Help and advice
- CC/FS9 Human Rights Act
- CC/FS10 Suspending penalties for careless errors in returns or documents
- CC/FS11 Penalties for failure to notify
- CC/FS12 Penalties for VAT and Excise wrongdoing
- CC/FS13 Publishing details of deliberate defaulters

www.hmrc.gov.uk

HMRC have made their internal learning modules on compliance checks and penalties available to agents and to the public. The details are given as follows:

Overview – provides an overview of the system and takes half an hour to complete. This has been revised to include the FA 2009 changes.

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

Information powers – explains how HMRC can obtain information and documents and takes about three hours to complete. This has been revised to include the FA 2009 changes.

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

Inspection powers – explains how the inspection powers are used and takes about one hour to complete. This has been revised to include the FA 2009 changes.

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

Penalties under Schedule 36 FA 2008 – explains the penalties HMRC can charge if requested information is not given to us and takes about one hour to complete. This has been revised to include the FA 2009 changes.

www.hmrc.gov.uk/e-learning/Compliance_Checks_External/penalties_externa_l/HTML/Penalties_ext_menu.html

How the inaccuracy penalty affects the main taxes from 1 April 2009 – provides an overview of the system and takes half an hour to complete.

www.hmrc.gov.uk/about/new-penalties/NPA/HTML/NPA_menu.html

How the inaccuracy penalty will affect the other taxes from 1 April 2010 – provides an overview of the system and takes half an hour to complete.

www.hmrc.gov.uk/e-learning/NPA_ext/NPA_FA2008_ext/HTML/NPA_FA2008_ext_menu.html

The inaccuracy penalty legislation and how HMRC will apply it – explains the inaccuracy penalty in depth and will take several hours to complete. This has been updated to include the FA 2008 changes.

A short overview of the failure to notify and VAT and Excise wrongdoing penalties – this should take less than an hour to complete.

www.hmrc.gov.uk/e-learning/FTN/FTN_external/HTML/FTN_external_menu.html

The failure to notify penalty legislation and how HMRC will apply it – explains the penalty in depth and will take several hours to complete.

www.hmrc.gov.uk/e-learning/penalty-legislation.htm

The VAT and Excise wrongdoing penalty legislation and how HMRC will apply it – explains the penalty in depth and will take several hours to complete.

www.hmrc.gov.uk/e-learning/vat-excise-wrongdoing.htm

6.9.2 Review of powers

In connection with the June Budget, HMRC have published a summary of the legislation arising from their review of powers, deterrents and safeguards (penalties, compliance checks, time limits and interest) and the date these measures come into effect.

http://www.hmrc.gov.uk/about/road-map.pdf

6.9.3 Clearances

HMRC have put guidance on the non-statutory business clearance procedures on the website. Non-statutory clearances for businesses are separate from statutory clearances which operate under a number of specific legal provisions, and clearances for individuals which are covered by Code of Practice 10 and Notice 700/6.

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

6.9.4 Prosecutions

HMRC have announced the successful prosecution of a missing trader gang, resulting in 21 people being sentenced for a total of 74 years in prison. The fraud amounted to £37.5m. One of the companies was called Shivani Ltd – an anagram of "I vanish".

HMRC Press Release 25 May 2010

Meanwhile, four people have been arrested in connection with a suspected £38m attempt to exploit the VAT treatment of emissions allowances. Firearms and large amounts of cash were discovered at the addresses which were the subject of the raids.

HMRC Press Release 21 May 2010

A London accountant has been jailed for eight years for manipulating his clients' tax and VAT returns and falsifying his own. His clients trusted him absolutely to submit the correct figures; instead, he submitted other information which generated repayments, kept a "commission" for himself and paid the balance to the clients. He also omitted significant amounts of client fee income from his own returns.

HMRC Press Release 30 June 2010

6.9.5 Articles

Neil Warren reviews the significance of the new ways in which HMRC make contact with taxpayers (greater use of the telephone and website) in *Tax Adviser*, June 2010.

Tax Adviser, June 2010

Neil Warren also sets out a number of useful points to consider in an annual VAT review in *Taxation*, 29 April 2010. The article examines compliance issues, planning opportunities and a review of future developments as three major areas to consider.

Taxation, 29 April 2010

6.9.6 Manual updates

HMRC have updated their online guidance on special civil investigations. Amendments have been made in respect of disclosure reports, penalties and information notices.

http://www.hmrc.gov.uk/manuals/scigmanual/Index.htm

HMRC have also added some material to the civil evasion penalty manual, explaining that a penalty can be apportioned unequally between directors in exceptional circumstances.

www.hmrc.gov.uk/manuals/vatcep/updates/vatcepindex.htm

6.9.7 Security

The standard result was reached in the solitary appeal this quarter in relation to a notice requiring the deposit of security – HMRC's decision was found to be reasonable, as it nearly always is.

First Tier Tribunal (TC00502): *Bellflower Racing Ltd*