VAT UPDATE
APRIL 2010

Covering material from January – March 2010

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

Note that the HMRC website now includes some information about pending appeals, described as follows:

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

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

Awaiting the ECJ:

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

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

UK appeals awaiting hearing:

- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of ECJ's ruling on how "risk of distortion of competition" is to be applied
- *Pendragon plc*: HMRC will appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive"
- *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 A real credit note?

A married couple carried on a number of similar property investment businesses. Two of these were a partnership and a company, both registered for VAT under separate numbers.

In January 2006 the company sold two properties which it had bought in October 2004, realising a profit of £550,000. The couple wanted to transfer funds from the company to the partnership, so they raised an invoice for £525,000 of "professional fees in connection with the management and disposal of [the properties]". VAT was added to the invoice, paid by the company and reclaimed as input tax.

HMRC visited the company in October 2006 and noted that the company had notified an option to tax in December 2005 stating that no exempt rents had been received before that date. However, this was not true: there had been exempt income, and HMRC ruled that the option was invalid. The input tax was therefore disallowed.

The company then suggested that the payment had been treated erroneously as a management charge when it was in reality a dividend. It was treated as such for accounting and tax purposes by the company and the recipients. The partnership issued a credit note to the company (only for the VAT element) and adjusted its output tax in its December 2006 return. A new management charge for only £40,000 plus VAT was raised. HMRC assessed the partnership in September 2007 to recover the output tax on £525,000 again, arguing that the credit note was invalid.

In the early stages of the dispute there was some confusion about whether the company would appeal against the disallowance of the input tax (arguing among other things that HMRC could have given retrospective approval for the option) or the partnership would appeal against the output tax, but it was the output tax issue that went before the Tribunal. The partnership argued that the payment did not represent consideration for any taxable supply, and the credit note was therefore effective for VAT purposes to cancel any VAT liability.

HMRC's main contention was that the invoice reflected the reality of the transaction, and the credit note was an attempt to change the situation afterwards when it was discovered that the first version did not have a favourable result.

The Tribunal accepted the appellant's counter-argument that the original invoice was not a proper reflection of the facts, even though it was not intended to deceive and was not a sham. There were genuine and understandable reasons for the partners wishing to route the distribution of profits through the partnership, rather than receiving them directly in their personal capacity as shareholders, and that did not change the nature of the payments. A management charge of £525,000 would be out of all proportion with fees charged for other work. The appeal was allowed.

First Tier Tribunal (TC00374): *Stirling Investments*

2.2 Disbursements

2.2.1 Incurred in making the supply?

A trader provided a service to motor manufacturers of delivering new company cars to their managers throughout the country. The trader collected the car from the manufacturer, drove it to the manager's location, and returned in the "old" car. He charged a rate for the journey, and also charged for putting sufficient fuel in the car to complete the delivery and leave the manager with enough for his first journey in the new vehicle. Some deliveries were made using subcontractors, and no distinction was made between these and others on his invoices. However, the charges for delivery and fuel were itemised separately.

The trader was registered to use the flat rate scheme. An assurance visit revealed that he was making the common mistake of accounting for FRS VAT on the net turnover rather than the gross, and this led to an underpayment. While checking over his figures, the trader came to the conclusion that he had also been overpaying VAT in respect of the fuel charges – they should properly be treated as a disbursement and excluded from his VATable turnover altogether.

Presumably if this was the case he should not have collected VAT on these amounts from his customers, and he might as a result have been still worse off. However, the Tribunal's decision does not record in detail how he recharged the fuel or how he accounted for output tax on it.

The Tribunal accepted HMRC's argument that there was a single supply of services by the trader to the manufacturer, and the fuel was a cost he incurred in supplying that service. The purchase of the fuel did not meet the conditions for being treated as a disbursement, as set out in Notice 700:

- *You acted as the agent of your client when you paid the third party.*
- *Your client actually received and used the goods or services provided by the third party (this condition usually prevents the agent's own travelling and subsistence expenses, telephone bills, and other costs being treated as disbursements for VAT purposes).*
- *Your client authorised you to make the payment on their behalf.*
- *Your client knew that the goods or services you paid for would be provided by a third party.*
- *Your outlay will be separately itemised when you invoice your client.*
- *You recover only the exact amount which you paid to the third party.*
- *The goods or service, which you paid for, are clearly additional to the supplies which you make to your client on your own account.*

The assessing officer believed that the second bullet point had not been met. The trader obtained a letter from one of his customers in which the customer confirmed its own opinion that all the conditions for a disbursement were met, but an independent reviewing officer concluded that the first bullet point was not satisfied. The Tribunal agreed that the trader was acting as a principal rather than an agent; or, if he was acting as an agent, he was an undisclosed agent, and s.47 VATA 1994 required him to account for VAT as if he was acting as a principal.

First Tier Tribunal (TC00331): *WE Lafferty (t/a Bell Transport)*

2.3 Exemptions

2.3.1 Due diligence?

When the second *Rank* appeal was heard by the Tribunal, the chairman found that the company's arguments about fiscal distortion were convincing – it was not permissible for the UK to draw a distinction between machines that were effectively identical and treat some as exempt and others as taxable depending on whether they were regulated under s.16 or s.21 of the Gaming Act. At the end of the decision, he commented that HMRC had raised a second line of defence, that they had "acted with due diligence" in changing the law as soon as possible after the existence of the problem became known to them. He suggested that this line of argument should be considered at a further hearing.

The conclusions of that further hearing amount to a resounding defeat for HMRC, although they intend to appeal. The Tribunal considered the evidence about when different types of machine came onto the market and when the authorities knew about them, and how quickly they responded by changing the VAT law. The summary of findings is as follows:

(1) The decision of the ECJ in TNT does not have the effect that supplies under different regulatory regimes are in principle not similar for fiscal neutrality purposes. The differences between the regimes for section 16/21 machines and Part III gaming machines and those for FOBTs [Fixed Odds Betting Terminals] *and Part III were not overriding and were merely a factor in deciding whether the supplies had similar characteristics and met the same needs from the point of view of consumers (paragraphs 22 and 23).*

(2) The Tribunal's earlier conclusion that section 16/21 machines were similar to part III gaming machines is unchanged (paragraphs 24 and 25).

(3) From the viewpoint of the generality of players FOBTs and Part III gaming machines were similar (paragraphs 33 to 38 and 50).

(4) Various machines within either section 16 or section 21 were in commercial use from the late 1970s until the late 1980s in the case of stamp machines, in 1984 in the case of Express Racing, from early 2002 in the case of Bingo Royale and Jackpot Bingo, from November 2003 in the case of Casino King and Cadillac Jack and from early 2004 in the case of Jackpot Roulette. Exempt comparators were therefore in commercial use for the entire period covered by the claim (paragraphs 40 to 47).

(5) FOBTs were in commercial use from 1998 (paragraph 48).

(6) There is in law no defence of due diligence to an infringement of fiscal neutrality (paragraph 51).

(7) The obligation to comply with the Sixth Directive was an obligation on the United Kingdom. The relevant knowledge for any defence of due diligence was not limited to Customs and Excise, nor HMRC, but included the Gaming Board (paragraphs 53 and 63).

(8) The Gaming Board knew of all the comparator models with the possible exception of Express Racing, the earliest being Green Shield stamp machines which were in use before 1980 (paragraphs 40 and 60).

(9) Customs knew of FOBTs at all relevant times (paragraph 61).

(10) Customs policy officers knew of section 16/21 machines in the first half of 2004 however assurance officers must have been aware of them earlier although their significance was not recognised (paragraphs 61-63)

(11) The fact that policy officers were unaware of exempt comparators before 2004 itself involved a failure by Customs, and thus the United Kingdom, to exercise due diligence (paragraph 64).

(12) Even when Customs became aware of the existence of exempt comparators other than FOBTs the United Kingdom did not act with due diligence to ensure compliance with the principle of fiscal neutrality (paragraphs 93-96).

(13) The appeal is allowed for the entire period covered by the claim.

First Tier Tribunal (TC00301): *Rank Group plc*

HMRC have issued a Brief commenting on the Tribunal's decision. HMRC are appealing the decision to the Upper Tribunal, but they will now consider claims that have been received in respect of the takings of Fixed Odds Betting Terminals. The following restrictions apply:

As FOBTs came into commercial use in the United Kingdom in November 1998, this date agreed by the Tribunal, we will now consider existing claims submitted within required time limits for repayment of VAT paid on gaming machine takings for the period from 1 November 1998 to 5 December 2005.

Claims that have previously been rejected (for whatever reason) and which are not under appeal will not be considered. No new claims for the repayment of VAT paid for the period between 1 November 1998 and 5 December 2005 can be made.

The aim is to process all existing claims, where satisfactory evidence to support the claim has been provided, by 31 March 2011.

No new claims are considered possible because of the cap; where a previous claim was refused and not appealed, HMRC will regard the matter as "agreed" and therefore not capable of being reopened by the taxpayer. The Brief also refers to the defence of unjust enrichment.

R&C Brief 11/2010

2.3.2 Share underwriting

The Swedish court has referred a surprising question to the ECJ about the scope of the financial and insurance exemptions in art.13B 6th Directive/art.135(1) VAT Directive:

Is Article 13B of the Sixth VAT Directive (Article 135(1) of the Council Directive on a common system of value added tax) to be interpreted as meaning that the tax exemptions provided for therein also include services (underwriting) which involve a credit institution providing, for consideration, a guarantee to a company which is about to issue shares, where under that guarantee the credit institution undertakes to acquire any shares which are not subscribed within the period for share subscription?

This is a surprising question because this is a transaction that must have been carried out thousands of times throughout the EU since 1977, so most member states must have a settled view on it. The UK introduced a specific rule (Group 5 Item 5A) to cover underwriting of new issues from 10 March 1999.

ECJ (Reference) (Case C-540/09): *Skandinaviska Enskilda Banken AB Momsgrupp v Skatteverket*

2.3.3 Postal services

The Budget included confirmation that the government will change the law to restrict the scope of the postal services exemption in line with the ECJ's decision in *TNT Post UK Ltd* (Case C-357/07). The exemption will continue to apply to delivery services which are within Royal Mail's "universal service obligation", but will no longer apply to other services where it competes directly with commercial operators.

HMRC have also published a technical note explaining how they envisage the new law operating. This sets out the principles which will be applied in deciding whether a service should be exempt or not, and lists the services currently offered by Royal Mail and the likely liability after the change.

The changes will take effect on 31 January 2011.

Budget Notice BN 48; HMRC Technical Note 25 March 2010

2.3.4 Education?

A German engineering firm operated as a partnership. One of the partners was responsible for running courses at a university, and the firm derived income from his activities. The tax authorities ruled that this was VATable, but the firm argued that he was self-employed and therefore within the exemption provided for by art.13A(1)(i) or (j) 6th Directive.

Questions were referred to the ECJ on two issues:

- whether the activities of the partner, which included administration of the courses and acting as an examiner, fell within "tuition";
- whether the partner could be regarded as giving tuition "privately".

On the first issue, the ECJ ruled that the whole activity could be regarded as tuition, provided that it was all carried out in the context of the transfer of knowledge and skills between a teacher and pupils or students. Exemption would not be denied on that ground.

However, on the second issue, the ECJ ruled that the arrangement did not qualify for exemption. As the partner was presenting courses offered by a different body (the university), he could not be regarded as giving tuition “privately”. The firm’s income was therefore subject to VAT.

ECJ (Case C-473/08): *Ingenieurburo Eulitz GbR Thomas und Marion Eulitz v Finanzamt Dresden I*

Similar issues were considered by the UK Tribunal in a case concerning two golf professionals. One provided tuition as a member of a partnership (exempt) and as a director of a company (taxable); the other as a sole trader (exempt) and as an employee of the same company. The company appealed against HMRC’s refusal to treat its supplies as exempt.

The appellant’s representative (BJ Rice, who won a case in the Court of Appeal in the 1990s) argued that the principles of fiscal neutrality were infringed by the different treatment of what were essentially identical supplies.

The Tribunal concluded that the EU law was clear in its meaning, even if the reason for the distinction between employment and self-employment was not obvious. Mr Rice was trying to use a principle “to override a rule rather than to interpret a rule. This is not permissible.” The Tribunal was satisfied that the UK law had correctly transposed the Directive.

First Tier Tribunal (TC00323): *Marcus Webb Golf Professional*

2.3.5 Eligible?

HMRC have issued a Business Brief and an Information Sheet about the VAT status of subsidiaries of universities. The question has arisen in disputes and cases about whether the “eligible body” status of the university extends to subsidiary companies which it owns. Sometimes the exemption is beneficial (generally, when the customers are members of the public) and sometimes it is not (when the customers can recover VAT, for example local authorities or commercial companies). The two documents contain a change in policy which will apply to all supplies made after 11 March 2010.

The new policy applies the exemption to a university trading subsidiary providing education. HMRC have concluded, mainly based on the cases of *School of Finance and Management* (High Court 2001) and *HIBT Ltd* (VTD 19,978), that such companies are acting as “a 'college, institution, school or hall of a university” within the meaning of Note (1)(b), Group 6, Schedule 9, VATA 1994.

This policy change is limited to those companies that

- are owned/controlled by a university;
- provide university level education leading to a qualification awarded by a university or a nationally recognised body;

- have close academic links with their parent university; for example, where students on the company's courses are registered/enrolled with the parent university, subject to its rules and regulations and awarded qualifications by it.

As a transitional measure to relieve those universities which have budgeted according to the previous understanding of the law, supplies up to 1 August 2010 can be treated as taxable. This will not apply if it used for tax avoidance purposes.

Universities may submit claims for the policy to be applied retrospectively, in which case HMRC expect overclaimed input tax to be taken into account as well.

HMRC will apply what is becoming the "normal" interpretation of the Capital Goods Scheme on such a change in policy. Because the new policy represents what HMRC believe the law always to have been, there is not a change from taxable use in the first period to exempt use currently – the use in the first period was exempt, but input tax recovery was allowed because of the mistaken understanding of the law. HMRC will not attempt to recover the original input tax credit, and will not require CGS adjustments in respect of current exempt use. However, if the company wishes to apply the exemption retrospectively, HMRC will expect the CGS recovery to be taken into account as well.

The Information Sheet contains a detailed analysis of the factors which suggest that a subsidiary company takes on the eligible status of its parent, and gives a number of examples to illustrate the practical application of the new policy.

R&C Brief 09/2010; Information Sheet 03/2010

2.3.6 Supplies of healthcare staff

HMRC have issued a Revenue & Customs Brief to clarify their policy on the supply of health professionals, nursing auxiliaries, care assistants and support workers by employment businesses.

The essence of the policy is that an employment business makes a taxable supply of staff if the individual worker comes under the control of the client. If the employment business continues to control the worker, the supply may be exempt under the provision of healthcare services. It seems likely that most such supplies are taxable staff rather than exempt services, and specific examples are given including the supply of locum GPs. The supply is taxable even if the employment business is responsible for making sure that the workers are appropriately qualified and trained.

There is a concession which applies to nursing agencies in certain circumstances. The Brief gives details of the conditions in which HMRC will allow exemption to be applied to what would normally be treated as a supply of staff.

The Brief explains that subcontracted welfare services will be exempt if they are provided to the final consumer, even if they are paid for by a local authority. This is because the service is being provided under the control of the supplier and is not therefore a supply of staff.

As this is a clarification rather than a change of policy, presumably HMRC intend to apply it with retrospective effect. However, they offer the following reassurance:

If businesses can demonstrate that they have taken reasonable steps to follow our previous guidance and that has resulted in their applying the wrong VAT treatment then we will take that into account when considering whether any corrective action is necessary.

R&C Brief 12/2010

2.3.7 Manual updates

HMRC have made amendments to the online manual which deals with services provided by medical care staff. It covers services of the medical and paramedical professions, care and treatment in institutions, blood and associated products, transport of the sick and injured, and the zero-rate for dispensed drugs.

www.hmrc.gov.uk/manuals/vathealth/vathlt1000.htm

HMRC have also made amendments to the online manual which deals with welfare services. It covers the bodies which provide exempt welfare services, welfare services themselves, spiritual welfare, and goods provided in connection with welfare.

www.hmrc.gov.uk/manuals/vathealth/vatwelf1000.htm

2.3.8 Jolly hockey

HMRC have announced a change to the treatment of affiliation fees collected by national sports bodies in line with the ECJ judgment in *Canterbury Hockey Club and Canterbury Ladies' Hockey Club* (C-253/07). From 1 September 2010, it will be compulsory for bodies which meet the eligible body conditions in Notice 701/45 *Sport* to exempt fees where the true beneficiaries are persons taking part in sport, even if they have previously been treated as standard rated because of the way in which the fee was calculated. HMRC previously regarded fees which were calculated according to the size of the club, or the number of teams fielded, as "not charged to individuals" and therefore incapable of falling within the exemption.

HMRC will not require retrospective application of the exemption before that date. However, any body which wishes to claim the exemption at an earlier date can do so, subject to the rules on unjust enrichment and the cap (which, from 1 April 2010, stands at four years for the first time).

R&C Brief 15/2010

2.3.9 Professional?

The Institute of Information Security Professionals was established in 2006 "*to promote the study and practice of Information Security and to advance knowledge, education and professionalism therein for the benefit of the public*". It was a not for profit organisation, and claimed that its membership subscriptions should be exempt under Sch.9 Group 9 item 1:

1. The supply to its members of such services and, in connection with those services, of such goods as are both referable only to its aim and available without payment other than a membership subscription by any of the following non-profit-making organisations –

(b) a professional association, membership of which is wholly or mainly restricted to individuals who have or are seeking a qualification appropriate to the practice of the profession concerned;

(c) an association, the primary purpose of which is the advancement of a particular branch of knowledge, or the fostering of professional expertise, connected with the past or present professions or employments of its members;

HMRC argued that the area of expertise was too narrow for "information security" to be regarded as "a profession". A number of precedent cases was considered, together with evidence about the activities and aims of the organisation. The Tribunal was impressed that its role had been recognised by the Cabinet Office, which recognised its qualification as valuable for people working with data in government. The Tribunal also considered HMRC's losses of data as the sort of thing that the Institute was set up to help to avoid in future.

The Tribunal decided that it was not clear that the Institute fell within Item 1(b), mainly because it was not clear that a particular qualification was required for entry. However, the Tribunal was satisfied that it was a body falling within Item 1(c). The fact that it was not "a professional association" did not stop it "fostering professional expertise". The appeal was allowed.

First Tier Tribunal (TC00303): *The Institute of Information Security Professionals*

2.3.10 Investment gold coins

HMRC have issued an updated version of their Notice on the exemption for investment gold coins. It contains a revised list of coins which can be supplied within the exemption. It was previously updated only one month earlier.

Notice 701/21A February 2010

2.3.11 The missing exemption

The exemption at 6th Directive art.13A(1)(f)/VAT Directive art.132(1)(f) provides an exemption for:

"The supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition."

This allows non-taxable persons to set up an entity to meet common costs without creating a VAT cost on the "supply of services" by that entity to them when they reimburse it for their share of its costs. It has never been enacted in UK law.

The "Red Book" issued with the Budget includes the comment that the government is considering whether charities should enjoy an exemption when they share services with each other. At present the one which incurs and recharges expenditure can create a VAT liability and cost. There have been several cases on the issue over the years, in some of which the VAT has been avoided by a successful argument based on agency (e.g. *Durham Aged Mineworkers' Homes Association*, High Court 1994). The new initiative appears to be related to the missing European exemption.

Economic and Fiscal Strategy Report 5.89

2.4 Zero-rating

2.4.1 Lovely lolly

A company manufactured and sold kits for making "choco lollies" (which were made by melting "buttons" made of a substance which tasted like, but which was not, chocolate). The kits consisted of the buttons and some icing for decoration, as well as lolly moulds and sticks. HMRC decided that the kits were standard rated; the company appealed. The appeal was in the names of two separate companies because the trade was transferred as a going concern during the period under review.

There was substantial agreement between the parties. The kits did not constitute "confectionery", and the foodstuffs on their own would be zero-rated as cooking ingredients. HMRC's case was based on the contention that the foodstuffs were incidental to the things that were not food – the moulds and the sticks. HMRC believed that the moulds could be used again and again, while the manufacturer did not think that this was either possible (they were flimsy) or a realistic possibility (the ingredients were only sold as part of a kit, and it was unlikely that parents would create their own ingredients in order to re-use the moulds).

The Tribunal considered several precedent cases including *Card Protection Plan* and *Dr Beynon & Partners*. The Tribunal considered that the proportions of cost – over 80% food, less than 20% "other" – and the way in which the product was marketed suggested that there was a single

supply, and the standard rated elements were "for the better enjoyment" of the food rather than the other way around. The chairman stated that this was the result of an attempt to avoid over-analysis and to apply common sense to arrive at the "social and economic reality".

The appeal was allowed, and costs were awarded to the taxpayers (as the appeal had commenced before the change of rules on 1 April 2009).

First Tier Tribunal (TC00332): *Supercook UK LLP & Dr. Oetker UK Ltd*

2.4.2 Hot or fresh?

A company sold a range of home delivery food. It made a voluntary disclosure to reclaim output tax it alleged it should not have charged on a range of items which were delivered at above the ambient temperature, but which could be eaten hot or cold. It argued that its purpose in heating the food was to demonstrate that it had been freshly prepared and to comply with food safety regulations, and it was indifferent as to whether the customer ate the food hot or cold. The items included crispy duck with pancakes, spring rolls with dip, samosas and various types of bread.

The Tribunal examined the Court of Appeal's judgment in *John Pimblett & Sons Ltd* (about fresh pies rather than hot pies), as well as other related cases such as *Malik* (which concerned home-delivery curry). The members of the Tribunal were divided: the Chairman (who has the casting vote) thought that the purposes of demonstrating freshness and enabling the food to be consumed hot were indistinguishable; the Tribunal member's dissenting opinion was also recorded, holding that there were two purposes of which one could be predominant.

As well as an examination of the case law, there was also a detailed consideration of how the various items were prepared and sold. The Chairman held that the only way the appellant could truly show indifference to whether the food was eaten hot would be to supply it cold. The appeal was dismissed.

First Tier Tribunal (TC00289): *Deliverance Ltd*

2.4.3 Changing planes

The Budget included the announcement that the law will be changed to reflect recent ECJ decisions on the scope of the exemption for the zero-rating of supplies of aircraft. The UK definition has in the past been based only on the size of the plane, but it will in future be related to the EU definition from 1 September 2010. From that date, zero-rating will apply to supplies of aircraft "used by airlines operating for reward chiefly on international routes".

Budget Notice BN 47

2.5 Lower rate

Nothing to report.

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 An unusual application of TOMS

A trader bought tickets for concerts and other events and sold them on at cost (as he was not allowed to make a profit on reselling them) together with coach transport to the event (on which he made a profit). From 1990 onwards a number of HMRC officers told him that he should be using TOMS. He appeared to disregard this for two reasons:

- first, he could not see that he was a "travel agent" or tour operator in any ordinary sense of the expressions;
- second, he believed that there could be no VAT on the resale of the tickets because there was no profit, and coach transport was zero-rated.

In 2000 an officer wrote to him to explain that the rules had changed in 1996 so that all margin scheme supplies were standard rated. If he was supplying a package, he could not regard the supplies separately (i.e. one with no margin, one zero-rated). He would have to account for output tax. He claimed before the Tribunal that he had never had a clear explanation from any officer, nor from two accountants he approached about the issue, of how he should apply TOMS to his business, so he never did.

The trader accepted during the hearing that TOMS applied. It seems that he only finally understood what the rules were when the case was being presented. Even so, his appeal was allowed: the assessment that had been raised was not to best judgement, because the calculation of his margin ignored the purchases of the tickets. The calculation had to include all the costs, and it was only the existence of the tickets that brought him within TOMS in the first place. Although the overall result would be the same either way, the assessment did not make sense as it was presented.

The Chairman did not award costs to the appellant. He commented that the trader was very fortunate to have escaped a liability that he ought to have known he would eventually have to face from 2000 at the latest. Presumably he will now be able to calculate his margin properly and account for output tax going forward.

First Tier Tribunal (TC00318): *Stephen John Stanley*

2.9.2 Agent or principal?

A company operated a website which marketed hotel accommodation in countries around the Mediterranean. HMRC formed the view that it was buying and selling hotel accommodation as principal or undisclosed agent, and should therefore account for VAT in the UK under TOMS. The company argued that it was not liable for the VAT, because either:

- it was selling the hotels as disclosed agent, so the supplies were made where the accommodation was located and was therefore outside the scope of UK VAT; or
- it was selling as principal but on a wholesale, business to business basis, which would take the supplies outside the scope of TOMS. 94% of its supplies were to tour operators and travel agents.

The decision examines the EU and UK legal background to TOMS, and also the contractual arrangements between the company, the hotels and the customers. HMRC's counsel put forward 8 pointers which suggested that the company was not acting as an agent:

- The hotels looked to it for payment, not to the customer. The invoices were paid by it unless it decided to withhold payment in circumstances where a customer complained. If the Appellant became insolvent, the hotel could not look to the customer for payment.
- It had the ability to determine its own undisclosed level of profit.
- The absence of any requirement upon it to account for its profit or commissions to the hotels.
- The fact that it retained any under-invoicing. This was said by Mr McLintock to be consistent with the contract, but it was not consistent with a fiduciary relationship between it and the hotel.
- The paying of the hotel in advance before a customer booked laid it open to a significant foreign exchange risk.
- The absence of any requirement for a separate account which was to be compared with the Travel Agent contract in which the travel agent was bound to provide a separate account.
- The fact that the hotels owed money to it was inconsistent with it being the hotel's agent.
- The fact that it set the terms and conditions with the customer was not what was to be expected in an agency situation where the principal is expected to tell the agent what its terms were with its customer which it was for the agent to procure. In the present case, for the most part the hotels did not produce terms and conditions.

After a small change to the terms and conditions, the company accepted that for a period it was acting as a principal. It argued that the change had

been significant and had arisen for reasons unconnected with VAT. HMRC said that the change was small and insignificant, so the fact that in the later period the company accepted principal status meant that it had been a principal throughout.

The Tribunal examined the agreements in detail and how they were operated in practice. It dismissed the appellant's arguments that certain aspects that appeared inconsistent with agency were merely breaches of its fiduciary duties: even though the agreements stated that they were agency contracts, the substance of them was inconsistent with that. The appeal was dismissed, and costs were awarded to HMRC (without an explanation of why this should be so – there is no indication that the company acted unreasonably in respect of the appeal, which would appear to be required for an award of costs to HMRC either before or after 1 April 2009).

First Tier Tribunal (TC00431): *Secret Hotels2 Ltd (formerly Med Hotels Ltd)*

2.10 Second hand goods

2.10.1 No value?

A second hand car dealer ascribed no value to vehicles he took in part exchange on the sale of another car. He argued that he simply negotiated the best deal he could based on the cash price, and all the records – invoices and stock books – reflected that. As a result, he calculated the margin on any sale only based on the cash; when he later sold a traded-in vehicle, he regarded it as having no cost, so the whole sale price was chargeable to output tax under the margin scheme.

HMRC objected to this and instructed him to amend his method of accounting. He appealed against this ruling. The Tribunal was not sure whether that was an appealable decision, but decided it could give a ruling on the calculation of a single sale which would establish whether HMRC would be entitled to issue an assessment if the trader failed to change.

The Tribunal acknowledged that the trader was straightforward and was not trying to avoid paying VAT. His method would generally only produce a timing difference. Nevertheless, it was clear from the legislation that the traded-in vehicle had to be valued and included in the VATable consideration for a sale. The appeal was therefore dismissed.

First Tier Tribunal (TC00406): *Mr Grenville Duncan*

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Goods or services?

The French court referred a case to the ECJ to determine whether a company which carried on reprographics activities was supplying goods or services. The company used its own materials to make copies of documents, files and maps at the request of customers who retained title to the original documents. It regarded itself as a supplier of services, while the French authorities believed that it was supplying goods (on which the VAT would have been higher).

The judgment of the court was "it depends":

Article 5(1) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment must be interpreted as meaning that reprographics activities have the characteristics of a supply of goods to the extent that they are limited to mere reproduction of documents on materials, where the right to dispose of them has been transferred from the reprographer to the customer who ordered the copies of the original. Such activities must be classified however as a 'supply of services', within the meaning of Article 6(1) of Sixth Directive 77/388, where it is clear that they involve additional services liable, having regard to the importance of those services for the recipient, the time necessary to perform them, the processing required by the original documents and the proportion of the total cost that those services represent, to be predominant in relation to the supply of goods, such that they constitute an aim in themselves for the recipient thereof.

It is therefore a matter for the national courts to determine whether the extent of the "services" takes the supply beyond the normal treatment of a supply of goods.

ECJ (Case C-88/09): *Graphic Procédé v Ministère du Budget, des Comptes publics et de la Fonction publique*

The German court has referred two questions on the same issue, this time applied to hot food. The nature of the dispute in German law is not the same as it would be in the UK, but it appears that a lower rate is applied to "food for human consumption" in accordance with the provisions of Annex H 6th Directive. The questions referred in the first case are:

Does the sale of dishes or meals prepared for immediate consumption constitute a supply of goods within the meaning of Article 5 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes?

Does the answer to Question 1 depend on whether additional service elements are supplied (the provision of facilities for consumption)?

In the event that Question 1 is answered in the affirmative: is the term 'foodstuffs for human consumption' in Category 1 of Annex H to Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes to be interpreted as covering only 'take away' foodstuffs as typically sold in the grocery business, or does it also cover dishes and meals which have been prepared by boiling, grilling, roasting, baking or other means for immediate consumption?

ECJ (Reference) (Case C-497/09): *Finanzamt Burgdorf v Manfred Bog*

The second case will presumably be heard along with the first, because the only difference in the questions is an expansion of the second:

Does the answer to Question 1 depend on whether additional service elements are supplied (the provision, for use, of tables, chairs and other facilities for consumption, the experience of a visit to the cinema)?

ECJ (Reference) (Case C-497/09): *Hans-Joachim Flebbe Filmtheater GmbH & Co. KG v Finanzamt Hamburg-Barmbek-Uhlenhorst*

2.12.2 Scale rates

The Budget included the usual annual adjustment of the scale rates for the fuel self-supply charge in s.57 VATA 1994. The scale rate system operates under a 2006 Council derogation which is due to run until 2015. The amount of VAT collected is supposed to be broadly the same as it would be if exact figures were used – the VAT rates are not used to promote a “green agenda”, as the direct tax rules on capital allowances and benefits in kind are.

Budget Notice BN 44; SI 2010/919

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Licence to occupy

A married couple owned and operated a golf course. They charged green fees to casual visitors and also operated a bar and restaurant, both of which sources of income they treated as chargeable to VAT.

They also granted a members' golf club a non-exclusive licence to use the course during certain periods. They did not account for output tax on the licence fees, regarding the supply as a licence to occupy land and therefore exempt within Sch.9 Group 1.

The Tribunal agreed with HMRC that the economic reality of the agreement was a supply of the right to use the facilities, rather than the right to occupy land. It was therefore taxable. This was based on an examination of the terms of the licence and the way in which the club and the owners applied its terms. The club obtained certain priority rights of access to the facilities, but this did not constitute occupation or control.

First Tier Tribunal (TC00327): *J & M Gillan (t/a Gracehill Golf Course)*

3.2 Option to tax

3.2.1 Automatic permission

Two companies were part of a corporate entity which was broken up by demerger in November 2002. Before the demerger, one of these companies (C) had administered the finances of the other (U), and they were so closely connected that for some time after the demerger U (the appellant in the case) did not have its own bank account. Transactions between the two were accounted for in an inter-company account and were therefore not straightforward to identify individually.

U purchased a property from its former holding company and leased part of it to C. The lease was dated 1 January 2003. In July 2003 U received a VAT control visit. Accounts of the visit were contradictory, but it appears that the financial controller of U formed the opinion that it would be a good idea to opt to tax the building. A notification of option to tax was completed on 1 October 2003.

The building was sold in August 2004 and no VAT was charged. HMRC not surprisingly assessed for output tax, and the company appealed, arguing that the option to tax was invalid. The argument was on two lines:

- the control officer had misdirected the financial controller at the control visit and as a result the option was a mistake – this could not be considered by the Tribunal, so the chairman commented that he did not make any finding about it, although he was satisfied that the matter was discussed at the meeting;
- the option had to be invalid because the company had made exempt supplies of the building to C under the lease since 1 January 2003, and it had not obtained HMRC's permission to opt before doing so.

HMRC argued that permission was not required because no exempt supplies had been made: this was because no rent had been paid from C to U. The chairman was satisfied that the inter-company account constituted payment of rent, so there had been supplies.

However, the chairman was also satisfied that "automatic permission" was available within the terms of Notice 742A. The company did not attempt to recover any input tax incurred before the time of the option. The financial controller produced various input tax claims which were supposed to undermine the availability of the automatic permission, but the chairman believed that they were all related to operations carried on in the building rather than the building itself (e.g. CCTV cameras to protect valuable goods stored there). Any remaining input tax was de minimis and therefore automatic permission would have been available.

The option to tax was therefore valid and output tax was due on the sale.

First Tier Tribunal (TC00324): *Ultrapolymers Ltd*

3.2.2 Who opted?

A dispute arose about whether some land, in use by a partnership for a commercial golf club business had been opted by the partnership. The Tribunal had to consider this as a preliminary issue. The decision does not appear to contain the consequences of the land being opted – presumably supplies were made with it that were treated as exempt.

Customs received an option letter dated 27 June 1990. It was on letterheaded notepaper referring to a husband and wife who became two of the partners in the firm. The appellants put forward many arguments to try to invalidate the option, but the main one was that the registered firm (a partnership of four, being the husband, wife and two sons) did not exist when the letter was sent. As it came into being later, it was not possible for it to be bound by a letter sent by someone else.

The Tribunal accepted that the witnesses attempted honestly to recall events which took place over nearly 20 years previously. There was very little documentary evidence to explain why the option had been exercised or what was intended at the time, but the documents that did exist suggested that there was a partnership between the husband and wife and it had later admitted the sons. For VAT purposes, changes in the composition of a partnership are disregarded: the firm is deemed to continue. Accordingly, the four-partner firm was bound by the option notified in the letter dated 27 June 1990, and the appeal was dismissed.

First Tier Tribunal (TC00344): *Wrag Barn Golf and Country Club*

3.2.3 Relaxations of rules

A statutory instrument has addressed two issues affecting the option to tax. The first is a relaxation of the "exempt land" test: where a bank has provided funding for a development, and subsequently occupies a minor part of that development (no more than 10%), the option will not be disapplied as a result of the grantor/financier's exempt business use.

The second provides relates to the possibility of revoking an option during the "cooling off period" of six months after it is made. In general, "use" of the land during the cooling-off period precludes revocation of the option to tax. This rule has been deleted, but new tertiary legislation (i.e. a Notice with the force of law) will be introduced to impose conditions.

The order also amends the definition of a "relevant housing association" following changes to the regulation of social landlords in England, Wales and Scotland, to make sure that the disapplication of the option operates as intended where supplies are made to such landlords.

The changes are also described in a Revenue & Customs Brief and Information Sheet. The Information Sheet contains an annex which has the force of law – it will be inserted in the next edition of Notice 742A, but in the meantime has legal effect from 1 April 2010.

SI 2010/485; R&C Brief 08/2010; Information Sheet 02/2010

3.3 Developers and builders

3.3.1 Supplies to housing associations

Under item 3 Group 5 Sch.8 VATA 1994, certain supplies of building services can be zero-rated if they are made to "relevant housing associations". Amendments have been made to the system of regulation of housing associations, and corresponding changes have been made to the VAT legislation to ensure that the intended classes of providers of social housing enjoy the relief under the different legislation that now applies in England, Wales and Scotland.

SI 2010/486

3.3.2 Substantial reconstruction

A private school decided to carry out works to some of its boarding houses. One of them was a listed building, and the college believed that it would be substantially reconstructed. It therefore sold the house to a subsidiary which carried out the works, so that the building could be sold back again zero-rated within Sch.8 Group 6 para.1 VATA 1994. HMRC accepted that the building was protected and the supply was the first grant of a major interest, but did not accept that the building had been substantially reconstructed. This was the issue before the Tribunal.

The Tribunal had to consider whether this was a preliminary hearing, deciding a single point, or a final hearing which would determine the outcome. It was persuaded by HMRC's argument that they had only so far ruled on "substantial reconstruction" and had reserved their position on whether Note 4 was satisfied (60% of the works being zero-rated as

approved alterations to a protected building). The appellant's counsel unsuccessfully contended that HMRC should be taken to have conceded this point, as otherwise they would be unjustifiably stringing out the litigation by taking each point in turn.

The Tribunal considered in detail how the expression "substantially reconstructed" should be interpreted, and how the statutory words fitted together with their context and the notes in the schedule. The chairman considered that the word "substantially" in this context means "more than 50%" rather than anything more than that.

The Tribunal then examined the works in detail and decided that, looked at as a whole, the project constituted a substantial reconstruction in accordance with the normal meaning of those words. The parties will have to return to argue about the Note 4 conditions on another occasion.

First Tier Tribunal (TC00429): *Cheltenham College Enterprises Ltd*

3.4 Input tax claims on land

3.4.1 The wrong rate

A farmer contracted with some builders for the conversion of a disused barn into a dwelling house, and made a claim for repayment of VAT under the DIY builders' scheme. The builders charged 17.5% VAT on certain supplies which HMRC believed should have been charged at only 5%, and they refused to refund the difference under s.35. The Tribunal confirmed that this was the correct approach and dismissed her appeal.

Normally the advice to the individual in this situation is to go back to the builder and ask for a refund of the difference. Unfortunately, the project had started and then stopped for lack of funds, and by the time it was finished and the DIY claim submitted, the builders would have been out of time to recover their overpayments from HMRC because of the 3-year cap in s.80 VATA 1994. It appears that the farmer did not even try this route.

First Tier Tribunal (TC00287): *SF Nike*

A similar problem, and a similar decision, arose in a second case.

First Tier Tribunal (TC00413): *Ian Robertson*

3.4.2 Non-residential?

An individual obtained permission to convert a building which had been used as a garage and workshop into a dwelling. HMRC refused his claim under the DIY builders' scheme on the grounds that it did not qualify as a "residential conversion". Note 8, Group 8 Sch.8 VATA 1994 states that "*References to a non-residential building or a non-residential part of a building do not include a reference to a garage occupied together with a dwelling*". The individual argued that the building had in fact been an agricultural outbuilding rather than a garage, but HMRC contended that it had been used as a garage and therefore fell within Note 8. It was therefore not "non-residential" before the conversion work.

HMRC argued that the Tribunal had misdirected itself in law in two earlier similar appeals [*Cottam* (VTD 20,036) and *Blacklock* (VTD 20,171)].

However, the Tribunal distinguished the case from the facts of the earlier decisions, and instead accepted HMRC's main argument that the building had been in use at least partly as a garage. The appeal was dismissed.

First Tier Tribunal (TC00322): *J Podolsky*

3.4.3 Statutory construction

An individual purchased materials to build a log cabin. HMRC disallowed a DIY claim on the basis that the planning permission prohibited occupation of the resulting property during February each year, so it was not a "dwelling" (Sch.8 Group 5 Note 13).

The individual appealed, arguing that Note 13 was not relevant to a claim under s.35. The judge agreed, commenting that Note 13 affected supplies within Item 1 of Group 5 (supplies of the constructed building) but not supplies within Item 2 (supplies of construction services). If a builder supplied construction services with materials, that would fall within Item 2, so the cost of the VAT in the materials would not be borne by the consumer. The judge decided that the interpretation of s.35 should not impose that cost on the DIY claimant when it could be avoided under Sch.8 Group 5.

It is curious that the judge felt that it was contrary to the intention of the legislation to impose a VAT cost where a DIY builder purchased labour and materials separately. That is a common result if an individual breaks the chain of supply by making separate purchases of goods and services. However, the judge appears to have been persuaded that there were many other similar log cabins on the same site, subject to the same planning restrictions, on which the VAT cost had been avoided by the builder supplying goods with services.

First Tier Tribunal (TC00362): *Mrs IS Jennings*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have published the usual information about exchange rates to be used by those registered under the special scheme for e-traders for the period to December 2009.

Information Sheet 01/2010

A separate information sheet notes the decrease in the standard rate in Ireland from 21.5% to 21%, effective 1 January 2010.

Information Sheet 17/2009

Further information sheets note the increase in the standard rate in the Czech Republic from 19% to 21%, effective 1 January 2010; and a similar increase in Greece which took effect on 15 March 2010.

Information Sheet 06/2010

4.2 Where is a supply of services?

4.2.1 Property-related services?

A UK company provided services to an American company which was two steps above it in a wholly-owned American corporate group. The company between them was a UK intermediate holding company. The services were considered by HMRC to relate to land, but the location of the land could not be identified specifically; the basic place of supply in s.7(10) VATA 1994 would therefore apply, and the UK subsidiary would have to charge VAT to its American parent. An assessment for £607,749 was issued in 2003 relating to the period 1 May 2000 to 31 December 2002; subsequent to that the company accounted for output tax under protest, and submitted a repayment claim for £1,094,235 in May 2006 covering the period up to March 2006. The Tribunal considered an appeal against the assessment.

The company argued that the services were within art.9(2)(e) 6th Directive (now art.56) rather than art.9(1) (now art.43). There was no written contract between the US parent and the appellant, nor was there any correspondence or documents passing between them evidencing the services to be performed. Counsel suggested that there were multiple supplies falling under the following five headings: Finance Management, which operated daily; Project Management and Transaction management, both of which were ad hoc; Facilities Management, which was ongoing, and Blue Sky thinking. The fact that some of the facilities management activities were outsourced showed that they were separate and separable from the others.

HMRC's argument was based on the principle confirmed by the ECJ in the *Levob* case that it was necessary to consider whether elements in a supply were so closely linked that they formed, objectively, a single, indivisible economic supply, which it would be artificial to split. HMRC believed that what the company did for its parent fell within that principle.

The Tribunal identified the following four issues:

1. Are Customs correct in contending that there were overall composite continuing supplies as opposed to separate continuing supplies;

2. If there were composite continuing supplies, did such supplies fall within the activities in the third indent of Article 9.2(e), or did such supplies go beyond the third indent or beyond Article 9.2(a);

3. If there were not composite continuing supplies but separate continuing supplies were there five separate streams or were there fewer and, if so, what were those streams;

4. If there were separate streams, in respect of each stream did that stream either fall within the third indent of Article 9.2(e) or within 9.2(a)?

The Tribunal decided that it was necessary to consider what the customer (the holding company) wanted in return for the consideration paid. This was not the same as the appellant's counsel's list of five services: rather, "*It seems to us therefore that the supplies obtained by AETRSCo for the payments to the Appellant formed three broad categories : the performance of those management functions which AETRSCo had delegated to the Appellant including approval of lease transactions; the provision of advice, information and support to the local business units in relation to real estate; and the provision to AETRSCo itself of reports, information and recommendations.*"

These supplies were so closely linked together that it would be artificial to split them. The supplies did not relate to specific properties, so they did not fall within art.9(2)(a); however, the common feature of the supplies was "management", which did not fall within art.9(2)(e). The Tribunal therefore decided that they fell within art.9(1), and dismissed the appeal.

The company appealed, but the High Court agreed with the Tribunal. The question of single or multiple supplies was a question of law, but the appellate court should be slow to disagree with the Tribunal's decision, which was based on primary findings of fact. The Tribunal had applied the correct test and its decision could not be faulted. It would be artificial to split the single supply into different elements; the place of supply followed logically from the identification of the nature of that single supply.

High Court: *American Express Services Europe Ltd v HMRC*

4.2.2 Reverse charge replaces zero-rating

The Budget included the announcement that a purchaser of emissions allowances will be required to account for VAT due under the reverse charge mechanism with effect from 1 November 2010. This is an anti-fraud measure which will replace the zero-rating of such supplies that was introduced on 31 July 2009.

Budget Notice BN 49

4.2.3 Transport question

The Dutch court has referred a question about successive supplies involving the same goods in which there is a single intra-community despatch. The question referred is:

In the light of Article 28c(A)(a) of the Sixth Directive, and of Article 8(1)(a) and (b), the first subparagraph of Article 28a(1)(a), and the first subparagraph of Article 28b(A)(a) of the Sixth Directive, where, with regard to the same goods, two successive supplies are effected between taxable persons acting as such, in respect of which there is one single intra-Community dispatch or one single intra-Community transport, how should one determine to which supply the intra-Community transport should be ascribed, when the transport of the goods is effected by or at the expense of the person who acts both in the capacity of purchaser for the first supply and in the capacity of vendor in the second supply?

The ECJ's judgment may give further details which will make the situation clearer, but it appears that the question refers to a case in which the triangulation simplification is not possible. If the original supplier (A) and the final customer (C) are in different member states from each other and from the intermediate customer/supplier (B), the treatment under triangulation is reasonably clear. If, on the other hand, A and B are registered in the same country, triangulation is impossible; the supply from A to B cannot be zero-rated because B cannot give a foreign VAT number; and B's supply might not be regarded as a despatch because the goods left the country as part of A's supply. There clearly should be no VAT cost, but the question has been referred to establish exactly how the VAT rules achieve this.

ECJ (Reference) (Case C-430/09): *Euro Tyre Holding B.V. v Staatssecretaris van Financiën*

4.2.4 Transport answers

HMRC have issued a brief to announce that the "use and enjoyment rules" will apply to "B2B" supplies of freight transport or services closely associated with freight transport. This means that where the rest of the place of supply rules would place the supply in the UK, but the use and enjoyment of the service is outside the EU, then the supply will be outside the scope of UK VAT.

This is a temporary administrative easement to deal with an unintended consequence of the VAT package. B2B supplies of freight transport have moved from "where they are physically carried out" to "where the customer belongs". This means that supplies of such services which are wholly carried out outside the EU, but charged to a UK customer, could now be charged to VAT under the reverse charge; they would only be zero-rated if they related to imports into or exports from the EU, which would not always be the case.

R&C Brief 13/2010

4.2.5 New Notices

HMRC have issued three updated notices to reflect the changes to the rules from 1 January 2010:

- Notice 725 *The Single Market*
- Notice 744A *Passenger Transport*
- Notice 744B *Freight Transport and Associated Services*

The "what's changed?" paragraphs comment that the main changes to Notice 725 relate to the completion of EC Sales Lists, and the changes to Notice 744A are marginal.

4.2.6 Manual update

The HMRC Place of Supply of Services manual has been updated to reflect the VAT package implementation on 1 January 2010.

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

4.2.7 Outsourcing

Even though the VAT package has been planned for a long time, some of the effects may take a while for businesses to understand and cope with. For example, financial institutions that have outsourced a number of functions to lower-cost providers in India may find that the fees are now liable to a reverse charge (new "basic rule") when they previously were not (outside Schedule 5): this will increase the cost of outsourcing by 17.5% less any fractional recovery to which the institution is entitled.

4.2.8 Articles

Neil Owen reviews the VAT package in two articles in *Tax Adviser* magazine.

Tax Adviser February and March 2010

In ICAEW *Taxline*, Neil Warren confirms that the new B2B rules can be applied on the basis of "alternative evidence of business status" – it is not essential to record a customer's VAT number. If the customer is not registered in the other member state, no entry should be made on the EC Sales List (which seems an unsatisfactory outcome if the purpose of the list is to detect possible losses of VAT).

In the same issue Neil Warren also discusses when it may be necessary for a trader to register in another country, most commonly in respect of supplies related to land and cultural, entertainment and educational services.

Taxline March 2010

4.3 International supplies of goods

4.3.1 No export

An individual, who was not registered for VAT, purchased two JCB vehicles from a UK supplier and exported them to his brother-in-law's business in Abu Dhabi. He incurred VAT on the purchase of the JCBs, and later asked the supplier to issue a credit note on the basis that the supply should have been zero-rated as an export. The supplier sought to clarify the treatment with HMRC, who ruled that the supply had been made to the UK individual and could therefore not be zero-rated. As he was not registered for VAT, he could not recover the VAT, even if he had made an export of the goods.

He appealed against this decision, but the Tribunal agreed with HMRC. It appeared that the UK supply had been made to the individual, not to the Abu Dhabi final customer, and the UK supplier did not fulfil the conditions for zero-rating an export.

First Tier Tribunal (TC00311): *Ghulam Hassan*

4.3.2 New Intrastat guide

HMRC have issued an updated edition of Notice 60 *Intrastat General Guide*. It has been restructured and rewritten in parts to improve readability. It also includes a summary on page 5 of the recent changes to relevant guidance and procedure.

Notice 60

4.3.3 Place of supply of gas, heat and cooling

The Budget included the announcement that the place of supply rules which apply to natural gas and electricity will change with effect from 1 January 2011. The notice states that "*the application of the reverse charge to certain supplies of gas and electricity will be extended to supplies in all categories of natural gas pipeline, where the pipeline is situated in the EU or is linked to such a pipeline. The reverse charge will also apply to heat and cooling supplied through networks. In addition, the import VAT relief (in the form of zero-rating) will apply to all natural gas, heating and cooling imported via a network (including liquefied natural gas by tanker).*"

Budget Notice BN 47

The UK legislative change is made in response to Directive 2009/162/EU, which was passed by the Council on 22 December 2009 and took effect on 15 January 2010. It appears that the Directive only clarifies the application of Directive 2003/92/EC as amended by Directive 2006/112/EC, which if taken literally would only have applied the "reverse charge" system to international supplies of gas through pipelines which were part of the distribution system. That was not the intention of the 2003 Directive, so it has been amended going forward to include supplies relating to the supply of access to any type of natural gas and electricity systems or networks and to heating and cooling networks.

The use of "reverse charge" appears inexact in the Budget Notice as supplies of gas and electricity are categorised by Sch.4 para.3 VATA 1994

as supplies of goods rather than supplies of services. However, the EU press release states that the supply of related services is also subject to the same special treatment.

www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:010:0014:0018:EN:PDF

4.3.4 Supply of freight containers

HMRC have issued a revised version of their Notice about the supply of freight containers for export or removal from the UK, which explains the VAT arrangements under which such supplies can be zero-rated. It has been revised to improve readability, but does not introduce any new rules or procedures. Certain parts of the Notice have the force of law.

Notice 703/1

4.3.5 Sundry exemptions on import

The EU Council has adopted a Directive to codify the rules on sundry exemptions under Art.143(b) and (c) of the 2006 VAT Directive. This covers such varied categories as personal property belonging to individuals coming from third countries or third territories; importation of school outfits, educational materials and related household effects; imports of negligible value; capital goods and other equipment imported on the transfer of activities; importation of certain agricultural products and products intended for agricultural use; importation of therapeutic substances, medicines, laboratory animals and biological or chemical substances; importation in the context of certain aspects of international relations; and goods imported for examination, analysis or test purposes.

The full Directive can now be viewed on the EU law website.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:291:0001:0007:EN:PDF

4.3.6 Travellers' allowances

HMRC have publicised the new duty-free allowances that came into effect on 1 January 2010. Details can be found on the HMRC website.

HMRC Press Release 4 January 2010

4.4 European rules

4.4.1 Emissions trading

The Council has adopted a directive allowing member states to impose a "reverse charge" system of accounting for traders in emissions allowances. This will run until 30 June 2015. The UK implemented this provision in the Budget with effect from 1 November 2010 (see section 4.2.2).

The original proposal also covered other "carousel-prone" items such as mobile phones and electronic circuits, but the Council is still working on those areas. The UK has a specific derogation which allows its reverse charge mechanism in these areas.

Council Press Release 6945/10

4.4.2 Invoicing

The Council has announced agreement on a general approach towards a new directive simplifying VAT invoicing requirements, increasing the use of electronic invoicing, and countering VAT fraud. The directive will be adopted after the Parliament has considered it.

4.4.3 Debt recovery

The Council has also adopted a draft directive which is aimed to improve the mutual assistance between member states in relation to recovery of tax debts. National rules on recovery of tax are generally limited to taxes of that member state. This has been exploited by fraudsters engineering insolvencies in member states where tax is owed, while channelling assets into other member states.

The draft directive aims to improve exchange of information between authorities.

Council Press Release 7403/10

4.4.4 Belgian gambling

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". Now the Belgian courts have referred a question to the ECJ on a different distinction drawn by Belgian law – between betting and lotteries, which are exempt, and other forms of gambling, which are taxable. The Advocate-General has given an opinion that the state is entitled to draw such a distinction.

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?*"

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

4.4.5 Repayment claims

A company made a claim for overpaid VAT in Latvia. The claim covered six years, contrary to a three-year limitation period in that country. The company appealed through the Latvian courts, arguing that there was no limitation period in art.18(4) 6th Directive, and Latvia ought to have transposed it exactly into its domestic legislation.

The ECJ repeated the judgment from the *Marks & Spencer* case – there is nothing in EU law to preclude a member state introducing a limitation period. The company does not appear to have been adversely affected by the introduction of the rule without notice, so it will not succeed in overturning the provision.

ECJ (Case C-472/08): *Alstom Power Hydro v Valsts ienemumu dienests*

4.4.6 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. He suggested the following answers to the questions set:

(1) Article 11(4) of Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax, and Article 17(6) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, are to be interpreted as meaning that a Member State which has made use of the possibility offered by those articles of excluding deduction in respect of categories of expenditure described as:

- *"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",*

has satisfied the condition requiring the designation of a category of adequately defined goods and/or services, by reference, even implicitly, to the nature of those goods and/or services.

On the other hand, the exclusion, by the Member State, of the right to deduct input VAT in respect of categories of expenditure described as:

- *"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",*

does not satisfy that condition.

(2) Article 17(6) of the Sixth Directive is to be interpreted as meaning that it allows a Member State to retain a partial exclusion from the right to deduct input VAT in respect of expenditure relating to certain goods or services, introduced by national legislation enacted before the entry into force of the Sixth Directive.

(3) Article 17(6) of the Sixth Directive is to be interpreted as meaning that it allows Member States to introduce, after the entry into force of the directive, an amendment to the exclusion from the right to deduct VAT on a category of expenditure, such as that relating, in the main proceedings in Case C-33/09, to the provision of food and drink by the taxable person to members of his staff, which is intended, in principle, to restrict the scope of the exclusion but where it cannot be ruled out that, in an individual case in a particular year which is not relevant to the main proceedings, it might extend the scope of the exclusion through the flat-rate nature of the amended provision.'

ECJ (A-G) (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*

Graham Elliott comments on this case in *Accountancy's* VAT update section (April 2010). He considers that the UK blocking of "business entertainment" may fall foul of the same rule as that in the Netherlands – there is no clear definition in UK law that would enable a trader to know what is blocked and what is allowed.

4.4.7 Damages and equivalence

A Spanish company followed domestic law in making VAT returns and later discovered that the law was contrary to EU rules following *Commission v Spain* (Case C-204/03). By that time it was time-barred from making an adjustment to its self-assessment. It claimed damages against the Spanish State, and this claim reached the ECJ for consideration.

The Spanish Supreme Court had observed that a claim for damages arising from a breach of the Spanish constitution was not subject to the same

restrictions in Spanish law as a claim arising from a breach of EU legislation. The ECJ had therefore to consider whether the extra requirements infringed the principle of "equivalence", in that an EU-based claim was harder to establish than a domestic one.

The ECJ could see no substantive difference between the two types of claim, and ruled that the extra conditions were ruled out by the principle of equivalence. Whether this means that the company will now succeed is not certain, but it means that its claim can proceed further in the Spanish courts.

ECJ (Case C-118/08): *Transportes Urbanos y Servicios Generales SAL v Administracion del Estado*

4.4.8 French lawyers

The Commission has applied for a declaration that France is in breach of its obligations under the Directive in applying a reduced VAT rate to certain supplies of lawyers within the legal aid system. The Advocate-General's opinion agrees with the Commission's argument (in spite of the court deciding recently that the Finnish legal aid system did not involve lawyers making supplies for a consideration).

ECJ (A-G) (Case C-492/08): *Commission v French Republic*

4.4.9 Infringement proceedings

The Commission has applied to the ECJ for a declaration that Austria's application of a reduced rate to supplies of horses is contrary to the VAT Directive. Annex III permits the application of a reduced rate to "live animals", but only if they are normally used as human or animal foodstuffs. Austria allows supplies of horses for riding to be charged at the lower rate.

ECJ (Application) (Case C-441/09): *Commission v Republic of Austria*

The Commission has applied to the ECJ for a similar declaration in relation to Germany's rules. It appears that Germany has attempted to defend its rules on the basis that horses may be used in agricultural production and may therefore be "used to make food for human consumption"; the Commission does not agree that this indirect use is an acceptable interpretation of the Directive, and also believes that the German law allows lower-rating of breeds of horses that are only used for sporting or recreational purposes.

ECJ (Application) (Case C-453/09): *Commission v Federal Republic of Germany*

The Commission has also applied to the ECJ for a declaration that Austria's calculation of VAT on the sales of new cars. A "standard fuel consumption tax" is included in the VATable amount. The Commission believes that this is similar to the registration levy considered by the ECJ in *De Danske Bilimportorer* (Case C-98/05), and it should therefore be excluded.

ECJ (Application) (Case C-433/09): *Commission v Republic of Austria*

A case against Denmark is slightly less far advanced – the Commission has formally requested a change in legislation, but has not yet started proceedings in the ECJ. Denmark has a general exemption for all business

activities of charities, and for goods sold in second hand shops provided they were donated free and the proceeds go to charity. The Commission believe that the exemptions in art.132 VAT Directive do not extend this far.

IP/10/90

The Commission is taking cases to the ECJ concerning:

- Portugal in respect of its flat rate scheme for farmers, which allows exemption without any compensation for lost input tax;
- Hungary in respect of the refund of tax credits, which requires deferral of a reclaim if the input has not yet been paid for by the taxable person.

The Commission has also written to France to request a change to its exemption for supplies related to ships, which is more extensive than allowed by the Directive (covering all passenger and commercial vessels, rather than being limited to those ships which are to be used for navigation on the high seas).

IP/10/296

The Commission is taking Greece to the ECJ for failing properly to implement three ECJ judgments against the state. In cases C-62/93(*BP Supergaz*), C-78/02 to 80/02 (*Karageorgou, Petrova and Vlachos*) and C-13/06 (*Commission v Greece*), Greece was found to have failed to comply with its obligations in respect of refunding taxes which had been unduly paid. The Commission sent reasoned opinions to Greece in February 2008 and October 2009, complaining that appropriate remedial action has not been taken. As this did not lead to a satisfactory result, infringement proceedings will now begin.

IP/10/297

4.4.10 The right to deduct

The Polish Court has referred a question about whether a member state is entitled to deny input tax deduction where an unregistered person has issued a VAT invoice. This seems obvious, but perhaps is less so if the person who issued the invoice is liable to account for the tax to the authorities, and may have actually done so. The questions referred are:

Do the rules of the common system of VAT, in particular Article 17(6) of the Sixth VAT Directive (Directive 77/388/EEC), preclude legislation of a Member State under which a taxable person does not acquire the right to deduct input tax arising from a VAT invoice issued by a person who is not entered on the register of taxable persons for the purpose of tax on goods and services?

Is it relevant to the answer to the first question that:

(a) there is no doubt that the transactions indicated on the VAT invoice are subject to VAT and that they have actually been carried out;

(b) the invoice contained all the details required under Community legislation;

(c) a restriction on the taxable person's right to deduct input tax arising from an invoice issued by an unregistered person operated in national law prior to the date on which the Republic of Poland acceded to the Community?

Does the answer to the first question depend on additional criteria being satisfied (for example, proof that the taxable person acted in good faith)?

ECJ (Reference) (Case C-438/09): *Boguslaw Juliusz Dankowski v Dyrektor Izby Skarbowej w Lodzi*

4.4.11 Private cinemas

Belgian cinemas are permitted to charge a reduced rate of 6%, covered by art.12(3)(a) and Annex H 6th Directive. A company allowed customers to watch erotic films of their choice, alone, in private booths. The tax authorities ruled that this was not a "cinema" and therefore did not qualify for the reduced rate. The ECJ agreed with the authorities.

ECJ (Case C-3/09): *Erotic Center BVBA v Belgische Staat*

4.5 Eighth Directive reclaims

4.5.1 OECD report on VAT recovery

The Organisation for Economic Co-operation and Development has published a report which highlights the complexities of international VAT relief mechanisms. Most OECD countries have instituted claims procedures for foreign traders incurring their VAT, but:

- 72% of respondents to a survey said that they found the procedures "difficult";
- more than 20% of respondents said that they were unable to recover any of the foreign VAT they incur;
- many businesses said that they recover less than 25% of the foreign VAT they incur;
- a third of respondents said that these factors influenced decisions on investment.

www.oecd.org/dataoecd/18/52/44560750.pdf

4.5.2 Warning on new refund system

Taxation magazine (11 February 2010) contains a warning from Darren Aldrich about the practical difficulties in operating the new electronic refunds system for 8th Directive claims. It is supposed to make life simpler for businesses, but the following are either teething troubles that will go away, or more worryingly complications that are built into the system:

- incompatible software implemented by the 27 member states;
- restricted access to portals – some states only allow persons resident in that country to access their portal;
- treatment of VAT groups by some states which do not recognise grouping – those countries may insist that all purchase invoices are in the name of the taxable person making the claim, i.e. the representative member, which is unlikely to be possible;
- badly designed portals, e.g. not having a "save" facility;
- coding problems – the basic analysis of expenditure is under 10 headings, but some states have introduced sub-categories so that the total is up to 150 possible classifications;
- requirement to scan and submit invoices, combined with a 5MB limit on attachments;
- requirements imposed by some countries to include a description of Code 10 "other expenses" in the country's own language (Italy, for example, insists on this).

Taxation, 11 February 2010

4.5.3 Claimed too late

From June to October 2007, a UK company issued a series of invoices to a Norwegian company in respect of supplies of remote operated vehicles for underwater work. The Norwegian company submitted a 13th Directive claim on 29 January 2008. In respect of the first invoice, on which the VAT was over £200,000, HMRC refused the claim because it should have been submitted by 31 December 2007.

The Tribunal had some sympathy with the claimant, but held that it had no discretion. The chairman thought that the invoice should probably have been zero-rated as an export in any case, and suggested that this should be taken up with the suppliers (even though HMRC had not raised this as an issue in settling the 13th Directive claim in respect of the other 6 invoices). The claim was subject to a strict time limit, and it had not been met.

First Tier Tribunal (TC00299): *Oceanteam Power & Umbilical ASA*

5. INPUTS

5.1 Economic activity

5.1.1 Holding company expenditure

In Spring 2006 a Spanish company formed a new subsidiary (ADIL) to make a takeover bid in respect of BAA plc. After this bid was successful (July 2006), the new holding company joined BAA's VAT group registration (September 2006). BAA then claimed an input tax deduction for some £6.7m incurred in respect of the costs of making the bid and in refinancing the group operations afterwards. HMRC refused the claim, arguing that there was no direct and immediate link between these inputs and any taxable supplies made or to be made by the group.

The company appealed, contending that the activities of a holding company are "economic activity" in European law, and the preliminary activities of the bidder were regarded as such in line with cases going back to *Rompelman*. The new holding company actively managed the acquired business, and obtained finance to fund the group's capital expenditure programme.

The Tribunal accepted this argument and allowed the appeal. Even though the new holding company never made any supplies in its own right, it was regarded as a single taxable entity with BAA, and the arrangement of group finance facilities was an economic activity linked to the whole trade. The decision includes a detailed consideration of the meaning of "economic activity" in the context of holding companies. Fiscal neutrality also required that the input tax was deductible.

First Tier Tribunal (TC00357): *BAA Ltd*

Graham Elliott comments on this case in *Accountancy's* VAT update section (April 2010). He considers it very likely that HMRC will appeal.

5.1.2 No business

A company was incorporated as a wholesaler of confectionery, soft drinks and toys. Its first repayment return was subject to verification; the next two were paid by HMRC without further checking, but the fourth successive repayment return was investigated. The main element of the claim appeared to relate to an invoice for a "childcare agency licence" which the company director said he had purchased from another company. Some company records had been lost in the theft of a car, and it was difficult to establish what exactly had happened. However, the trader failed to convince HMRC that the supply had taken place or was for the purposes of a taxable business activity.

The director was unwell on the day of the Tribunal hearing but did not object to the hearing proceeding without him. However, without him to give evidence, it was inevitable that the balance of probabilities would not be satisfied. The Tribunal could not find that the input tax deduction was justified and dismissed the appeal.

First Tier Tribunal (TC00402): *1-4-ALL Ltd*

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Changes to the de minimis rules

In the second phase of the improvements to the partial exemption rules that began on 1 April 2009 with four changes to the operation of the standard method, the "de minimis" rules have been simplified by making a number of amendments to the VAT regulations. The changes are also described in a Revenue & Customs Brief and an Information Sheet.

The changes comprise:

- two new simplified tests which can be applied in determining whether a trader is "fully taxable" and can therefore recover input tax attributable to exempt supplies in any period (return period or longer period);
- a new facility to regard the business as de minimis throughout its VAT year if it was de minimis for the previous year, enabling it to carry out only one de minimis calculation each year.
- The changes apply to periods commencing on or after 1 April 2010.

Simplified tests

The "full calculation" in reg.106 requires the following procedure:

- attribute inputs to outputs for which they are exclusively used, as far as possible;
- apportion the remaining residual input tax in the proportion "T over T plus E" (where T and E are the amounts of taxable and exempt turnover for the period;
- consider whether the total of the exempt input tax is not more than £625 per month on average, and also not more than half the total input tax for the period – if it passes both of these tests, it can be recovered.

The first simplified test will regard the business as de minimis if:

- total input tax incurred is no more than £625pm on average; and
- exempt supplies made are no more than taxable supplies made.

If the total input tax is no more than £625pm, and "T over T plus E" is at least 50%, it is very likely that the "full calculation" would be satisfied.

The second simplified test will regard the business as de minimis if:

- total input tax incurred less input tax directly attributable to taxable supplies is no more than £625pm on average;
- exempt supplies made are no more than taxable supplies made.

In this case, the exclusion of the "directly taxable input tax" leaves the total of "directly exempt and residual input tax". If that is no more than

£625pm, and "T over T plus E" is at least 50%, it is once again very likely that the "full calculation" would be satisfied.

The first simplified test is not reproduced in the legislation because any business that satisfies Test One will definitely satisfy Test Two (which is in the revised regulation). Carrying out Test One in accordance with the Information Sheet will therefore indicate whether the law is satisfied.

Use of the new tests is optional. A business which fails both may still be de minimis if it carries out the full calculation, which is still available.

It will still be necessary to carry out an annual calculation to check that the business is de minimis for the longer period, and the simpler tests can be used for that as well. If the simpler tests are failed for the longer period, it is again possible to use the full calculation instead and remain de minimis.

The Information Sheet contains the following two examples:

Example one: a business has a VAT period running from 1 April to 30 June 2010. During that period it incurs total input tax of £1,800 which it uses making taxable supplies of £30,000 and exempt supplies of £20,000. For the quarter ending June 2010, the business incurs total input tax of no more than £1,875 (£625 x 3 months) and the value of its exempt supplies is no more than 50 per cent of its total supplies (20,000/50,000 x 100 = 40%). Therefore, the business is de minimis for this period as it passes Test one and can provisionally recover £1,800 input tax on its VAT return without the need to carry out a full partial exemption calculation. This will be subject to review at year-end in accordance with paragraph.2.5.

Example two: a business has a partial exemption year running from 1 May 2010 to 30 April 2011. During that period it incurs total input tax of £30,000, of which £25,000 is on goods for resale which are directly attributable to taxable supplies. It makes taxable supplies of £75,000 and exempt supplies of £60,000. Its total input tax less input tax directly attributable to taxable supplies is £5,000 (30,000 – 25,000) which is less than £7,500 (£625 x 12), and the value of its exempt supplies is no more than 50 per cent of its total supplies (60,000/135,000 x 100 = 44%). Therefore, the business has finalised its de minimis status for the year and is entitled to recover £30,000. There is no need for any further partial exemption calculation for that year.

Annual test

The new annual test allows a business which was de minimis in its last longer period, and which does not expect to incur more than £1m of input tax in the current year, to treat itself as de minimis for all returns in the current longer period. It must operate this approach consistently throughout the period. It must still carry out an annual check at the end of the current period, and if it is no longer de minimis, its annual adjustment will require a repayment of input tax to HMRC (either on the return following the end of the longer period, or on the return for the end of the longer period, at the choice of the trader – following the changes to the standard method in April 2009).

Information Sheet 04/2010; R&C Brief 10/2010; SI 2010/559

5.3.2 Standard method override

A company which used the standard method of partial exemption purchased two commercial buildings and some land for £1.85m plus

£318,500 in VAT (14 October 2003). Its original intention was to make fully taxable sales of the buildings and then build luxury flats for zero-rated sale, and it recovered all the input tax accordingly. It then:

- sold one of the buildings as a taxable supply (£900,000 – October 2004) and the other as an exempt supply (£600,000 – January 2004);
- constructed nine flats on the remaining land.

The land and buildings had been opted (January 2004), but one sale was exempt because the purchaser intended to use the land for residential purposes. The option was therefore disapplied.

The company's activities were such that its residual recovery percentage was around 99%. The remainder of its input tax was de minimis. HMRC formed the opinion that the standard method override in reg.107B should apply, and the company appealed.

The Tribunal specifically disapproved of the earlier Tribunal decision in *Camden Motors (Holdings) Ltd* (20,674), in which it was held that a trader could not be subject to the override if the de minimis rules would otherwise make it "fully taxable". The chairman considered this a misunderstanding of the procedure for operating the override, and contrary to a purposive interpretation of the rules. HMRC claimed that they had not appealed the earlier decision because of the particular facts of that case. The override should be considered before the de minimis limit.

The override applied in the longer period to March 2004 because the company knew before the end of that time that the land would be used for both taxable and exempt supplies (i.e. there was no "initial recovery" that was sufficiently final to require adjustment under reg.108).

The company then argued that the respective sale prices would be the most appropriate method for determining any required adjustment under the override. If this was applied, the percentages would be 85.28% taxable and 14.72% exempt, producing an adjustment of only £47,656 – too small to be "substantial" for the override.

HMRC disagreed. The two commercial buildings had been sold on in the same state, while the flats had been developed. 63.21% of the sales proceeds therefore included substantial further costs as well as the inputs which were in dispute. The chairman considered that an apportionment of the site area gave a fairer picture of the use of the input for taxable (80.94%) and exempt (19.05%) supplies, giving rise to a "substantial" adjustment of £61,674, and he dismissed the appeal.

First Tier Tribunal (TC00347): *HJ Banks & Co Ltd*

5.3.3 Manual updates

HMRC have updated their online partial exemption manual to reflect the changes to the standard method that came into force on 1 April 2009, and also R&C Briefs 45/07 and 65/09 on theatre production costs.

www.hmrc.gov.uk/manuals/pemanual/updates/peupdateindex.htm

5.4 Cars

5.4.1 Converting a car

Readers' Queries in *Taxation*, 7 January 2010, includes the issue of whether converting a Land Rover into a van changes the VAT treatment. Neil Warren's answer confirms that the input tax deduction only becomes available if the car was bought with the intention of carrying out the conversion and the vehicle has never been used "as a car". If it has been driven home from the showroom, that would probably be enough to deny recovery.

On the other hand, the answer clarifies the rules on the fuel scale rate, which are clearer in HMRC's internal manuals than they are in the public notice. The scale rate only applies to cars, so it should not be applied to the Land Rover. Strictly, this means that any private use would have to be accounted for by other means – either by disallowing a proportion of input tax, or by accounting for output tax on the "actual private use" (however measured) under Sch.4 para.5 VATA 1994.

Taxation, 7 January 2010

5.4.2 Demonstrators

Before the rules were changed in 1997, demonstrator vehicles in car dealerships were regarded as available for private use. The input tax was therefore blocked, and sales were dealt with under a version of the margin scheme. When the *Italian Republic* case established that any asset on which input tax was blocked should be exempt on sale, many car dealers reclaimed large amounts of output tax they had accounted for.

In a recent case, the dealer claimed instead that the input tax should not have been blocked. According to the argument, the cars were courtesy cars (outside the scope of the blocking order) rather than demonstrators. The Tribunal found the trader to be a straightforward witness, but did not accept that the cars were purely courtesy vehicles. They had mixed use as courtesy cars and demonstrators, and they were therefore within the scope of the blocking order. The appeal was dismissed.

First Tier Tribunal (TC00427): *Wolverhampton Jeep Ltd*

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 *Lennartz* accounting

HMRC have finally responded to the decision of the ECJ in *Vereniging Noordelijke Land-en Tuinbouw Organisatie v Staatssecretaris van Financien (VNLTO)* (Case C-515/07). This updates the guidance in Information Sheet 14/07, which explained the rules brought in for "*Lennartz* accounting" with effect from 1 November 2007. This refers to the choice that a trader has when something is bought for part private, part business use:

- to claim a proportion of the input tax at the outset reflecting the extent of business use;
- to claim the whole of the input tax at the outset and subsequently to account for output tax to reflect the private use.

The *VNLTO* case changed the understanding of *Lennartz*: previously it had been thought that a person had a right to claim all the input tax upfront if there was a mixture of "business" and "non-business" use. The ECJ ruled that this was not so: only "private" use, in the sense of something completely separate from the purposes of the registered entity, qualified for the *Lennartz* treatment. It would therefore be available to an individual who could use something for business and for wholly private purposes; but a charity would not be able to apply the treatment to something that was bought partly for "VATable purposes" and partly for activities which were within the objects of the charity, but were outside the scope of VAT.

HMRC's response is as follows:

From 22 January 2010, Lennartz accounting will only be available where:

(a) the goods are used in part for making supplies in the course of an economic activity that give a right to input VAT deduction (broadly, taxable supplies, supplies that would be taxable if made in the UK, or certain financial and insurance supplies to non-EC customers); and

(b) they are also used in part for the private purposes of the trader or his staff, or, exceptionally, for other uses which are wholly outside the purposes of the taxpayer's enterprise or undertaking.

From that date, where Lennartz accounting is not available, and goods are used (or to be used) for both economic activities and non-economic business activities, subject to the transitional provisions outlined below, the VAT incurred must be apportioned between these different activities on the basis of use (or intended use). The VAT attributed to the economic activities is input tax and is recoverable to the extent that the economic activities give rise to supplies with a right to input VAT deduction. The VAT attributed to the non-economic business activities is not input tax and cannot be recovered.

Taxpayers with assets subject to existing Lennartz accounting arrangements

Taxpayers for whom Lennartz accounting has, strictly speaking, never been available would normally be expected to unravel the mechanism and adjust both any input tax claimed and any output tax accounted for accordingly.

However, HMRC is committed to easing the administrative and financial burden on taxpayers who have already embarked on, and continue to operate, Lennartz accounting under HMRC's old policy.

Consequently, where a taxpayer has applied Lennartz accounting on the basis of HMRC's pre-VNLTO understanding of the law, the taxpayer may opt to continue using Lennartz accounting in respect of the assets concerned.

Taxpayers exercising this option must honour the full, ongoing commitment to account for output tax imposed under Lennartz accounting and HMRC will take action if a taxpayer fails to do so.

Those taxpayers who do not exercise this option must unravel the Lennartz accounting mechanism by adjusting both their output tax and corresponding input tax. They should write to their Client Relationship Manager within HMRC or the HMRC Written Enquiries Section at Alexander House, Victoria Avenue, Southend. SS99 1BD to discuss and agree a fair way of doing so. HMRC will not accept one-sided claims for repayment of the output tax only.

Taxpayers who have committed to projects anticipating the availability of Lennartz accounting

Taxpayers who are not permitted to use Lennartz accounting must apportion VAT incurred for both economic and non-economic activities on the basis of use and intended use from the date of this announcement.

However, HMRC will consider claims from taxpayers who have already entered into binding commitments for projects on the understanding that Lennartz accounting will be available. Taxpayers should contact HMRC at the addresses above.

Fleming claims

Some taxpayers (following the House of Lords' judgments in the cases of Fleming and Condé Nast) have submitted "Fleming" claims for Lennartz treatment for assets where VAT was incurred in accounting periods ending before 1 May 1997. No decisions on these claims were taken pending the issuing of this announcement. These claims will now be reviewed and, where appropriate, rejected if the taxpayer had not taken up the option to use Lennartz accounting at the time the input tax was incurred (where this was available) and/or where the VNLTO decision means that the claimants were not entitled to use Lennartz accounting as there was no EU law right to do so.

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HMRC must have noticed the flaw in their approach: it would be possible for a trader who had claimed the input tax back under *Lennartz* over four years ago to stop accounting for output tax, relying on *VNLTO* to confirm their right to do so and the cap to prevent HMRC clawing back the input tax. It might even be possible to claim back the output tax accounted for in the last four years, although "unjust enrichment" might well be held to apply if no input tax adjustment was made.

The Budget included the announcement that the Capital Goods Scheme will be amended with effect from 1 January 2011 (but with retrospective effect) to require adjustments for changes in the business/non-business use of an asset. This is described as a "revenue protection measure", and is

presumably intended to prevent the argument described above. However, it is not clear that the CGS can be used in this way under EU law – ECJ decisions have confirmed that the CGS is a mechanism for adjusting input tax, which must by definition be incurred for business rather than non-business purposes.

Budget Notice BN 50

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Carousel appeal fails at High Court

In a carousel case the Tribunal believed that the trader was too intelligent not to have known what was going on: all the deals were fraudulent, and it did not seem possible that the trader could have been ignorant of the true nature of his company's business. There were factors which suggested that he was creating a paper-trail to satisfy HMRC, for example paying a third party to carry out a "100% open-box inspection" of the phones in one transaction but then ignoring the fact that it was highly unlikely that this could have been carried out on 26,000 phones in the time available.

The High Court dismissed an appeal against this decision, holding that there were ample grounds for the Tribunal to conclude that the due diligence procedures were a sham. The judge commented that "*the primary findings amount to a whole series of alarm bells which would have caused any honest and reasonable trader in (the director's) position to ask the most searching questions about the propriety of the transactions in which it was engaged and, in the light of what is now known about those transactions, (the director) could not possibly have obtained satisfactory answers to its inquiries*".

High Court: *Megtian Ltd v HMRC*

5.8.2 Carousels in the Tribunal

A trader was held to have "had the means of knowing" that transactions were connected with fraud. The Tribunal concluded that the directors "*went into what [they] knew was an artificial market intending to profit from it. They may well not have been participants in the fraud, but as the courts have pointed out, in Kittel and elsewhere, a trader in PJL's position aids the fraudsters by making the transactions possible*."

The Tribunal noted the appellant's argument that HMRC's approach was discriminatory: they generally allow the offset of input tax against output tax in "buffer" companies in a missing trader chain, and only "go for" the "broker" company who makes the zero-rated sale and reclaims money from HMRC. The argument to disallow input tax would be the same in a broker or a buffer. The Tribunal did not accept that this was a disproportionate or inappropriate action by HMRC in the circumstances.

First Tier Tribunal (TC00298): *Powa (Jersey) Ltd*

Another trader was held to have been actually involved in the fraudulent evasion of VAT. The transactions were so transparently artificial that there was no other possible explanation.

First Tier Tribunal (TC00310): *MBC Trading Ltd and another*

A trader succeeded in a first appeal to the Tribunal: it was held that the directors neither knew nor had the means of knowing that their transactions were connected with fraud. HRMC appealed to the High Court, which referred the case back to the Tribunal, ruling that the first panel had "set the bar too low" and "applied a lower standard than that which would have been appropriate to support a finding of constructive knowledge".

In the second hearing, the Tribunal *considered the* evidence again (mainly as set out in the earlier decision) in the light of the new understanding of the burden of proof. The Tribunal ruled against the company on eight transactions, but in favour of the company on seven, where "*We do not consider that the circumstances ... would lead to a conclusion that the Appellant ought to have known that the fraud of the importer in the chain was more likely than not*".

Both parties were invited to consider whether to make a further appeal once the Court of Appeal has ruled in the *Blue Sphere Global* case, which will be covered in the next update.

First Tier Tribunal (TC00358): *Olympia Technology Ltd*

One company's director presented his own case, and was commended by the Tribunal chairman for doing so cogently and in detail. It was clear that he had prepared his case very thoroughly, and he had plainly studied the case law on MTIC with great care. However, in spite of approving of the way in which he put his case, the Tribunal still decided that he had actually known that the company was involved in a fraud, and dismissed his appeal. The due diligence procedures he claimed to have put in place were a sham which was supposed to satisfy HMRC that proper checks were made, rather than actually intending to identify improper transactions.

First Tier Tribunal (TC00360): *Quality Import Export Ltd*

Another appeal failed on the "ought to have known" ground, without a finding that the directors were actually involved. The Tribunal drew a distinction between the two tests – "knew" equated roughly to dishonesty or fraud, while "ought to have known" equated to negligence. The traders in this case had been negligent; HMRC had not satisfied the burden of proof that would be required to show dishonesty. However, the result was the same – the input tax would be disallowed.

First Tier Tribunal (TC00359): *Next Generation International Ltd*

The Tribunal found a director "not credible" in his assertions that he only considered there to be "a possibility" that the company's transactions were tainted by fraud. He had shown a "reckless disregard" for the consequences of those transactions. The Tribunal decision considers the precedent cases in great detail, examining the tests that should be applied in measuring actual and imputed knowledge.

First Tier Tribunal (TC00359): *VIP (Scotland) Ltd*

A relatively unusual MTIC hearing considered a business that had existed for twenty years before it was caught up in the problematic transactions, and which still exists today. The amount involved was relatively small by MTIC standards (£150,000) and it appears that the director was caught up in a one-off misadventure which he realised should be avoided in future.

He argued that he neither knew nor had the means of knowing that the deals were tainted by fraud, but the Tribunal held his experience and qualifications (as a chartered accountant) against him. There were warning signs that should have raised his suspicions; the Tribunal specifically found, however, that he did not know what was going on.

First Tier Tribunal (TC00377): *PCCI Ltd*

A trader submitted repayment claims for three one-month return periods in 2006. HMRC subjected them to extended verification, and the company in time withdrew some of the claims. However, it stood by some of the claims and appealed against an assessment to recover some of the tax. HMRC argued that the director "knew or ought to have known" that the transactions were part of a contra-trading exercise involved in a MTIC fraud.

In August 2008, the Tribunal (20,781) examined the background to the transactions in great detail, and concluded that the directors did not have the means of knowing that the transactions were fraudulent. The appeal was therefore allowed in principle. However, some of the invoices that were the subject of one of the claims had not been paid, so the input tax would be repayable six months later; the claim was reduced by the Tribunal by £30,000 and as a result only 90% of the trader's costs were awarded.

The Tribunal rejected the appellant's counsel's assertion that contra-trading was "a flawed concept". A knowing contra-trader would have input tax refused. However, the Tribunal was more impressed with the argument that the trader was involved in a "clean chain" and the fraud was too far removed from the company for the directors to have the means of knowing about it – it took place after the company's involvement, and was carried out by people with whom the directors had no contact.

HMRC appealed to the High Court in 2009, and the judge remitted the case to the Tribunal for further consideration. The judge wanted more

detailed conclusions on the reasons for accepting the various deals as entitling the company to input tax. Accordingly, the Tribunal has now reconsidered the evidence, and the decision comes to a very striking conclusion: the chairman says that he only allowed the appeal on the first hearing to preserve unanimity, and he would dismiss the appeal again if it were up to him. However, he was outvoted by the two members of the Tribunal sitting with him, who appear to have had more sympathy for the people running the business. The chairman's dissenting conclusion is set out in full, followed by the views of the members which eventually determine the matter in the company's favour.

Presumably HMRC will consider the chairman's dissent to be a possible ground for appeal; however, it has already been before the High Court once, and the members must have been mindful of the judge's decision when formulating their own.

First Tier Tribunal (TC00410): *Brayfal Ltd*

5.8.3 Article

There is a useful article in *Tax Adviser*, March 2010, reviewing HMRC's current approach to carousel fraud and the circumstances in which they will prosecute suspected fraudsters.

Tax Adviser March 2010

5.8.4 Budget measures

The Budget included a long list of measures to combat evasion and avoidance under the heading "Protecting Tax Revenues". The only one concerned with VAT is the implementation of the reverse charge mechanism for trading in emissions allowances (see section 4.2.2).

Budget March 2010 Press Notice PN03

5.8.5 Hijacked numbers

A scrap metal dealer claimed input tax of over £50,000, supported by some 24 invoices from a company called SHS Ltd with an address in Poole, Dorset. HMRC followed this up and found that the address belonged to a man who owned a company called SHS Ltd, but it had never commenced its trade (which was intended to be in solar heating kits) and had deregistered for VAT.

The company did not appear at the hearing and its appeal was dismissed with costs.

First Tier Tribunal (TC00404): *Barnsley Metal Company Ltd*

A trader purchased some land and decided to build a standalone industrial unit on it for renting out. The director received a number of cold calls from builders offering to carry out the work. She tried out one builder, who she then engaged to do the job. He was paid regularly in cash (against signed receipts) over more than a year and a half, but only provided an invoice at the very end. There was nothing else in writing at all. The invoice showed £122,850 plus VAT of £21,498. The company reclaimed this in its VAT return for 01/07.

HMRC decided to check the return and discovered that the invoice showed a false address and a VAT number that did not relate to the supposed building firm. The claim was refused.

The company appealed, arguing that HMRC ought to exercise their discretion to allow alternative evidence. The Tribunal reviewed the procedures that HMRC had followed and ruled that the decision to refuse the claim had not been unreasonable. The chairman had some sympathy with the director, but pointed out that it was unwise to deal for so long and in such amounts with nothing in writing.

First Tier Tribunal (TC00352): *Hurstbourne Properties Ltd*

5.8.6 Old-fashioned fraud

A trader claimed a repayment of some £70,000 of VAT, supported with invoices from five suppliers. HMRC officers noticed that the invoices were similar in appearance and none were folded, and suspected that they had been produced by the claimant. Enquiries of the suppliers showed that they had not raised the invoices.

The trader did not turn up to the hearing, pleading back pain (but without evidence to show that this actually prevented him from attending). As HMRC had turned up with several witnesses, the likelihood was very great that the decision would go against the trader. The trader's written explanations were considered:

"*In a fax dated 1 November 2007 to Mr Golightly, the Appellant suggested that he received the invalid invoices from bogus employees of the five named suppliers, who pocketed the Appellant's cash. There was no evidence to back up the Appellant's allegations. Further the chances of the same event happening involving bogus employees in five different companies were extremely remote. In the Tribunal's view, the Appellant's explanation verged on the incredible.*"

First Tier Tribunal (TC00286): *Inayat Gulam Hussein*

A second case concerned an invoice which was accepted by the director of the company as "*a clumsy forgery*". The question was who had created it. In this case the director appeared for the company and was commended by the chairman for the way in which he presented the case, "outnumbered and alone" and in the face of allegations of dishonest conduct by those ranged against him in the courtroom. The chairman commented that "The tribunal had seen worse advocates". Nevertheless, the Tribunal concluded that he had perpetrated the forgery and dismissed the appeal, both against the input tax and a s.60 assessment with 15% mitigation.

HMRC also applied for costs on the basis that the appeal commenced under the "old rules" (when a s.60 appeal, if unsuccessful, would generally be accompanied by an award of costs to HMRC). The chairman decided after some reflection not to award costs.

First Tier Tribunal (TC00286): *Activ8 Alarms Ltd*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 No TOGC

A fine dining restaurant in Arbroath ran into difficulties, and two of the waitresses approached the landlord with a view to taking over the premises and operating a cafe there instead. This happened in June 2008. In October 2008 they were visited by an officer of HMRC who alleged that there had been a TOGC and they were therefore liable to be registered from the outset. He helped them to complete a VAT 1 form at the meeting. Subsequently they approached an accountant who helped one of them (now operating as a sole trader) to appeal against the backdating of the registration.

The Tribunal report is striking for the heavy criticism of the HMRC officer, who appears to have had problems with:

- his evidence (he claimed to have spoken to both of the proprietors at the meeting, but the Tribunal was satisfied that this could not have happened);
- his understanding of the law (he quoted the case of "*Kenmuir v Frizzell*", which he both misspelled and mispronounced – it should be *Kenmir* – and the Tribunal chairman said he clearly had no idea what the case was about);
- his understanding of the business (he produced an extrapolation of the turnover of the cafe to show that it did not have the right to deregister, but this was a straightforward multiplication by 4 of the first 3 months' trading – the whole of the summer season, which would represent a high proportion of the annual sales of such a business).

The Tribunal was satisfied that the two businesses were different from each other, and that nothing significant had been transferred between the two owners so that a TOGC could result. The previous business had been going bust because it was not possible to run a fine dining restaurant in that location and make money at the prices that were being charged. The cafe did not require the large commercial freezers that had been used to store meat, and it did not have an alcohol licence so considerable amounts of stock and equipment relating to liquor sales were removed. The landlord granted a new licence on different terms rather than transferring the existing agreement to the new business.

The Tribunal upheld the appeal against the retrospective registration, but I am not sure that this would cancel the VAT 1 altogether. It seems likely that the trader would not have been required to register for VAT at all. The Tribunal report is probably good grounds for a compensation claim to the HMRC Adjudicator.

First Tier Tribunal (TC00316): *A Cargill and K McWilliams t/a The Pende Café*

6.2.2 TOGC

A trader owned a company called Prima Blinds Ltd. It had deregistered in 2007 owing £48,000 of VAT. In April 2008 she registered a new company Express Window Furnishings Ltd with anticipated turnover of £180,000. Later this company changed its name to Prima Blinds.

HMRC investigated the circumstances and found evidence that she had continued to make blinds on her own account at her home in the interim period. She did not attend the hearing, but gave consent for the hearing to proceed on the basis of her written submissions. The Tribunal decided on the evidence produced by HMRC that there had been two TOGCs and the business was liable to be registered for VAT throughout.

First Tier Tribunal (TC00297): *Jane Wallace Brown*

6.2.3 Misunderstanding of partnership

A partnership was formed between:

- a company, which owned some residential property;
- some individual investors, who introduced money;
- a builder, who was intended to carry out refurbishment works.

The builder was only entitled to a 1% profit share in the partnership, which was expected to yield about £2,000. Separately, the builder contracted with a member of the owning company's group to carry out the refurbishments for a total price of about £195,000. VAT was not charged because the company directors had assured the builder that contributions by a partner to a partnership were not VATable.

The Tribunal examined the background to the arrangements and concluded that the building contract was separate from the partnership agreement. The builder was not acting as a partner when carrying out the works, and the works were therefore VATable in the normal way. The customer had given an assurance that if VAT was found to be due, the customer would pay it; the chairman expressed the hope that this promise would be honoured.

Presumably the end result would have been an exempt supply of residential property, so the VAT charged on the building work would be a cost. It may be that the partnership structure was a misconceived way of avoiding that VAT cost.

First Tier Tribunal (TC00378): *Space 2 Build Ltd*

6.2.4 Deregistration and TOMS

A trader registered for VAT as a tour operator in 1988. In 2008 he realised that he was entitled to consider the registration requirement in

relation only to the margin on his TOMS supplies, rather than in relation to his gross turnover. He applied for deregistration, which HMRC accepted, and asked for this to be backdated to 1995, when he had received an assurance visit. He argued that the officer should have pointed out that he did not need to be registered.

The Tribunal agreed with HMRC that "misdirection by omission" is not within its jurisdiction; it is also the trader's responsibility to understand his liabilities and entitlements, and it is not HMRC's role to advise a trader on the most advantageous of two valid options.

First Tier Tribunal (TC00350): *Wessex Continental Travel Company Ltd*

6.2.5 Left holding the baby

An individual was involved in a missing trader fraud. He had been prosecuted but found not guilty of being knowingly concerned in the fraudulent evasion of tax. HMRC then issued a notice of compulsory registration on him and an assessment of £1.594m dating back to 1998 as the surviving partner in a partnership which had carried on a "telecommunications business".

He argued that he had not been a partner in a firm. The other principal, who had died before the prosecution took place, had acted as a sole trader. However, he felt unwell and was unable to give evidence to the Tribunal. On the basis of the evidence that the Tribunal had heard, his appeal had to be dismissed. It appeared that he had been a member of a partnership with the deceased.

First Tier Tribunal (TC00340): *Stephen Allen*

6.2.6 New thresholds

With effect from 1 April 2010, the registration threshold rises by £2,000 to £70,000, and the deregistration threshold rises by the same amount to £68,000.

Budget Notice BN 45; SI 2010/920

6.2.7 Articles

There is an article in *Taxation* (7 January 2010) in which Neil Warren makes suggestions relating to VAT registration, including the decision on whether to register or not, and the claim for pre-registration VAT on expenses.

Taxation, 7 January 2010

There is an article in *Taxation* (25 February 2010) in which Mike Thexton reviews the importance of choosing the correct effective date of registration when filling in VAT 1, making sure that it is neither too late nor too early.

Taxation, 25 February 2010

6.2.8 Registration delays

At the end of March, HMRC wrote to members of the Joint VAT Consultative Committee warning of a computer problem which was delaying the issuing of VAT numbers. For the time being it will not be possible for HMRC to issue VAT registration certificates to agents.

6.3 Payments and returns

6.3.1 Payments by cheque

HMRC have made regulations to provide that, from 1 April 2010 onwards, payments of VAT made by cheque will no longer be regarded as made on the day on which the cheque arrives in the post, but rather by the day on which the cheque clears into HMRC's bank account. The full text of the Revenue & Customs Brief is reproduced below because it explains the change in full detail.

It should be noted that this is only aimed at the relatively small number of traders who are still allowed to pay by sending a cheque in the post – anyone who registers from 1 April 2010 onwards, and anyone already registered with an annual turnover of £100,000 or more, is now required to file and pay electronically. HMRC are apparently trying to force the others to pay electronically as well "voluntarily" by making it significantly disadvantageous to pay by post.

Initially the change was given minimal publicity on HMRC's website, but following protests from the professional bodies, a Brief was issued and notification will be sent to all traders in their VAT Notes.

From 1 April 2010 all cheque payments sent by post will be treated as being received by HM Revenue & Customs on the date when cleared funds reach our bank account - not the date when we receive the cheque. This means that businesses must allow enough time for their payment to reach us and to clear into our bank account no later than the due date shown on their VAT return. A cheque takes three bank working days to clear - excluding Saturdays, Sundays, and bank holidays.

To allow for possible postal delays (for which we are not responsible) businesses should allow at least three working days for a cheque payment to reach us and a further three days for the payment to clear our bank account.

A business may be liable to a surcharge for late payment if a cheque payment does not clear by the due date shown on their VAT return.

This change does not affect any cheque payments made by Bank Giro. Payments by Bank Giro are treated as electronic which means that businesses will get up to an extra seven calendar days for the cleared payment to reach us (unless they use the Annual Accounting Scheme or are required to make Payments on Account).

The reason for this change

From 1 April 2010 businesses with an annual turnover of £100,000 or more (exclusive of VAT) and all newly registered businesses must file their VAT returns online and pay any VAT due electronically. The purpose of the change to the cheque clearance rules is to encourage compliance with the requirement to pay electronically by removing the cash flow advantage currently enjoyed by businesses paying by cheque. This change is also intended to make electronic methods of payment more attractive to those businesses who are not required to file their VAT returns online and pay electronically from 1 April.

We recommend that businesses make their VAT payments electronically as this is safe and secure and in, most cases, gives up to seven extra calendar days to pay or, if paying by Direct Debit, at least ten extra calendar days. This extra time does not apply to businesses if they use the Annual Accounting Scheme or are required to make Payments on Account. Please remember that if a VAT return is filed online then any VAT due must be paid electronically. To find out more about how to pay electronically use the link at the end of this Brief.

The legal basis for the change

Section 58B of the VAT Act 1994 and section 95 of the Finance Act 2007 allow HMRC to make regulations to define when payments by cheque are regarded as made. The relevant regulation is regulation 5 of the Value Added Tax (Amendment) (No.4) Regulations 2009 which came into force on 1 December 2009 and applies to all cheque payments sent in the post to us on or after 1 April 2010.

R&C Brief 14/2010

6.3.2 Payments online

HMRC have now changed their bank accounts and all traders must check that their online payments go to the right destination. If they continue to use the old numbers the payments may be returned and default surcharges could ensue.

www.hmrc.gov.uk/payinghmrc/bank-account-mig.htm

6.3.3 Articles and podcasts

There is an article in *Taxation* (4 February 2010) in which Neil Warren comments on the practical issues facing businesses which will be required to file their VAT returns electronically after 1 April 2010.

Taxation, 4 February 2010

It has been reported that on 14% of organisations were filing VAT returns online in 2008/09, compared to 81% for PAYE. The first returns that must be filed online are those for periods starting on or after 1 April 2010, so the first significant deadline is 31 July 2010 (for a quarterly return). It remains to be seen how many businesses will not have registered for online filing in time to meet that deadline.

HMRC have launched what they call a “Super Podcast” to explain the changes to the filing and payment requirements for VAT, PAYE and corporation tax. It can be downloaded from the HMRC website using the link below.

www.hmrc.gov.uk/podcasts

6.3.4 Flat rate scheme: associated companies

A company registered for VAT in October 2007 and applied to join the FRS from the outset. HMRC subsequently investigated the situation and discovered the following circumstances:

- the company, R, was owned 50:50 by a married couple who each owned 25% of another company, B;
- B was the sole customer of R, which supplied it with management services;
- the other shares in B were owned by another married couple who had set up a similar separate company to charge it identical amounts for management services, but their company was VAT registered in the normal way and did not use the FRS.

HMRC decided that R was "associated with" B for the purposes of reg.55A SI 1995/2518, and was therefore ineligible to join the FRS under reg.55L. They issued a notice to terminate its authorisation to use the scheme under reg.55P and backdated the effect of that termination to the outset under reg.55Q. The directors were notified that HMRC wished to carry out interviews under the procedures laid down in Public Notice 160, which deals with allegations of dishonesty evasion, but in the end the assessment to recover the VAT was only accompanied by a s.63 misdeclaration penalty (not a s.60 evasion penalty).

A business is associated with another person for FRS purposes if it is "closely bound to it by financial, economic and organisational links". The Tribunal's jurisdiction is restricted to considering whether HMRC's decision has been arrived at in a reasonable manner, i.e. the officer took into account only relevant information and did not disregard any relevant information. Accordingly, the Tribunal considered in detail the factors that the officer had recorded as indicating the links.

(1) Financial Links:

a. The directors of RDF are shareholders of BBE. (25% of BBE shares are held by Mr Clay, and 25% by Mrs Clay (both also being directors of RDF).

b. RDF's charges are dependent on what directors of BBE decide it should get. BBE's directors consider what is reasonable depending on the economic viability of BBE. This is backed up by the fact that no written contract exists between BBE and RDF, there is no record of the time or resources used by RDF re supplies to BBE, charges are not based on the quality or quantity of work done by RDF, both RDF and another company (both having directors in common with BBE) have raised invoices for identical amounts although each supplies different services to BBE.

c. The charges do not, therefore, appear to be based upon commercial reality (ie BBE and RDF do not have a normal business relationship).

d. Fees to BBE are RDF's sole source of income at present.

e. BBE premises at New Street are owned by both BBE's director's pension fund (which is partly for the benefit of Mr Clay as a director of BBE as well as RDF) and by RDF's directors.

f. RDF's directors (Mr & Mrs Clay) receive rental income from BBE for use of the property

(2) Economic Links:

a. Economic links include activities where the activities of one party are ultimately for the benefit of another.

b. BBE benefit by RDF providing the expertise to run the production shop.

c. BBE also benefit by RDF's willingness to only charge fees as and when agreed with BBE, and the extended credit granted in respect of invoices raised.

d. RDF benefit from BBE by it supplying it with its sole source of income i.e. the economic viability of RDF is dependent on that of BBE.

e. Mr Clay of RDF stated he is also hoping to expand the work of RDF through the contacts he makes through BBE and the queries he receives at BBE.

(3) Organisational Links:

a. Deodata Clay - Company Secretary and director of RDF from 4/9/07

b. Deodata Clay - Co Sec and director of BBE prior to 30/10/91

c. Roy Clay - director RDF from 4/09/07

d. Roy Clay - director of BBE from pre 30/10/91

e. There is, therefore common directorship between BBE and RDF.

f. Shareholding in BBE is 50% Mr Gee (BBE), 25% Mr Clay (RDF), 25% Mrs Clay (RDF).

g. Mr Clay is actively involved in the day to day running of both RDF and BBE. Within RDF he is an active director, and within BBE he runs the production shop - BBE relies on his expertise to review orders received, quote for jobs, deciding which jobs will be undertaken, what to charge, what to buy to meet orders, and the overseeing production/supplies. Consequently Mr Clay has a significant role in how BBE and RDF works, and strongly influences the work undertaken by both.

The Tribunal considered the company’s arguments which attempted to counter these assertions, but decided that there was ample material to justify the officer’s conclusions. The assessment and the penalty were confirmed.

There was also a dispute about an invoice which had been raised before R was registered for VAT. Tellingly, it had been raised by B, because R did not have the facilities to raise invoices (suggesting the economic and organisational links between the two), but represented a sale by R to B. HMRC allowed B to retain the input tax shown on this invoice and sought to collect the output tax (in full) from R. The company argued that this was in some way an abuse of the rules by HMRC to strengthen their case on the association point, but the Tribunal could not see how that could be made out.

The assessment was also raised on the basis of invoice dates rather cash received. The company could not retrospectively apply the cash accounting scheme.

First Tier Tribunal (TC00387): *RDF Management Services Ltd*

6.3.5 Flat rate scheme: no retrospection

A plumber joined the flat rate scheme in 2004. In 2008 he decided that he was paying more VAT than he would do under the normal rules, and he applied to withdraw from the scheme with retrospective effect. HMRC allowed him to withdraw from the date of his application to do so, 28 May 2008.

The Tribunal held that this decision was not unreasonable and dismissed his appeal against it. Retrospection would only be allowed in exceptional circumstances, and simply paying more tax was not exceptional. The overall intention of the FRS is to be revenue neutral, so it is unsurprising that there are some losers as well as winners.

First Tier Tribunal (TC00354): *B Reynolds*

A company joined the FRS in March 2007, stating that it was carrying on an accountancy business (with one of the highest rates). In February 2009 it asked to be recategorised as "business services listed elsewhere" (about 3% lower). HMRC allowed this change to take effect from 1 December 2008 but refused to backdate it to March 2007. The trader appealed.

The Tribunal considered that the decision, freely taken by the appellant in March 2007, had not been unreasonable – it was not a mistake. It was therefore not possible to change it retrospectively, even though it was within the time limits for making a repayment claim. HMRC's refusal to allow retrospection had not been unreasonable.

First Tier Tribunal (TC00336): *Archibald & Co Ltd*

A trader registered for VAT in 1990. In March 2009 he applied to join the FRS, and asked for this to be backdated to 2003. HMRC backdated it only to January 2009, the beginning of the quarter in which the application was made. The Tribunal agreed with this approach, holding that it was entirely rational to refuse retrospection in such circumstances: the point of the FRS was to simplify the trader's records, not to save the trader money, and if the trader had chosen to file VAT returns in the normal "unsimplified" manner, the point of the FRS would not be achieved by allowing retrospective use. There were no exceptional circumstances in this case which should lead to any other conclusion.

First Tier Tribunal (TC00376): *DL Skinner*

Another trader succeeded in obtaining a small amount of retrospection. He had been registered for VAT for many years, and had been aware of the FRS from its outset. However, he believed that he would not benefit from using it because the trade category on his VAT registration certificate suggested to him that he would be treated as a software engineer with one of the highest flat rates. In April 2008, after correspondence with HMRC, he realised that he was not bound to choose that rate, and that his business was better described as "services not listed elsewhere" with a lower (and advantageous) flat rate.

He asked to be admitted to the FRS from the beginning of the scheme in 2002. He persuaded an officer that his misunderstanding over the significance of his registration categorisation was a sufficiently special circumstance to allow retrospection, but the officer only allowed him to go back three years.

On appeal, the Tribunal heard that HMRC did not accept that there were valid reasons to make the scheme retrospective in this case, but they would not argue the point as their officer had given a decision. However, they argued instead that the effect of the cap on repayments was that only 3 years' worth of VAT could be repaid. The trader disputed whether such a repayment fell within s.80 (and therefore would be subject to the cap), but the Tribunal agreed with HMRC – it did not make any difference whether the admission to the FRS was backdated to 2002 or 2005: only the "overpayment" arising between 2005 and 2008 could be recovered by the trader.

First Tier Tribunal (TC00386): *Christopher John Sims*

6.3.6 Manual update

HMRC have updated their online manual on the flat rate scheme, with important amendments to their policy on retrospective amendments among other things.

FRS3000 (www.hmrc.gov.uk/manuals/frsmanual/frs3000.htm)	This section has been re-written to clarify the policy on dealing with requests for retrospective admission to the scheme.
FRS4000 (www.hmrc.gov.uk/manuals/frsmanual/frs4000.htm)	This section has been re-written to clarify the policy on dealing with requests for retrospective withdrawal from the scheme.
FRS6500 (www.hmrc.gov.uk/manuals/frsmanual/frs6500.htm)	This is a new section that outlines how VAT is reclaimed on capital expenditure goods.
FRS7000 (www.hmrc.gov.uk/manuals/frsmanual/frs7000.htm)	This section is re-written to include details of the 1% reduction for businesses in the first year of registration. It also provides details of the flat rate percentages both current and historical.

www.hmrc.gov.uk/manuals/frsmanual/updates/updateindex.htm

6.3.7 Articles

There is an article in *Taxation* (4 March 2010) in which Neil Warren considers the reverse charge in general, and its interaction with the FRS in particular. Although purchases of goods from the rest of the EU must be accounted for by a FRS trader in Box 2 as an acquisition, purchases of services are not subject to the reverse charge. The use of service providers from outside the UK therefore appears to be a "legitimate" form of tax avoidance for a FRS trader.

Taxation, 4 March 2010

The slow progress of Mike Thexton's dispute with HMRC over the application of the FRS to a small business's bank interest received is described in an article in *Taxation* magazine.

Taxation, 4 March 2010

6.4 Repayment claims

6.4.1 Compound interest

The case in which a number of traders are claiming compound interest as restitutionary damages (i.e. under the common law rather than under the VAT Act) has reached the Court of Appeal, and the traders' case has been rejected again.

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

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

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

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

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

The Court of Appeal has found no fault with the judge's reasoning. In particular:

- the "part payment" (i.e. paying simple interest under s.78) was not an acknowledgement of the "claim" by these traders which could restart the limitation period – it was made for completely different reasons and no claim had been made at that time;
- EU law allowed member states to impose a limitation period, as long as it was no less favourable to claims based on EU law than claims based on domestic law (which was the case here).

One of the appeal judges commented that the right of traders to make restitutionary claims under EU law ought to be referred to the ECJ for a preliminary ruling. However, it is not clear that this case will be referred, because the judges were satisfied that this claim could be settled in accordance with UK law.

Court of Appeal: *F J Chalke Ltd and another v HMRC*

6.4.2 More *Fleming* guidance

HMRC have published what they call "supplementary theme narratives" for use by officers to help consider *Fleming* repayment claims. This is a

fascinating 71-page document which goes through a large number of cases which may be the subject of claims – it may therefore not help HMRC, because it may give people ideas. Admittedly it should now be too late to make a *Fleming* claim going back to the 1990s, but there is still scope for making claims for overpayments within the capped period (currently from 1 April 2006 onwards). The cases listed and considered are:

- *Kretztechnik AG v Finananzamt Linz* (Case C-465/03): generally in relation to share issue costs, and also in connection with Authorised Unit Trusts and insurance v investments;
- *AB SKF* (C29/08) in relation to sales of subsidiaries;
- *Danfoss/Astra Zeneca* in relation to costs of entertaining foreign customers;
- *Compass Contract Services Ltd* in relation to catering;
- *Elida Gibbs*, mostly relating to car dealers and manufacturers;
- *TNT Post UK*, relating to delivery services;
- *GMAC* on HP and the treatment of re-possessed cars;
- *Linneweber* concerning gaming machines;
- *Lennartz* claims for part private use assets;
- *Mirror Group* concerning reverse premiums;
- *JP Morgan Claverhouse* concerning pension funds and management costs;
- *Italian Republic*, mainly concerning cars;
- *EMI*, concerning samples;
- *Scottish Equitable*, concerning the validity of the cap after 1996 (here HMRC point out that they won in the Court of Session and claims should be refused);
- *Wellington Private Hospital*, on the basis of which Fleming claims might be made for pre-1996 supplies to in-patients in hospitals – HMRC now think that the case was wrongly decided, and claims should be resisted;
- pension fund management – the traditional 70:30 split of input tax between administration and management costs;
- construction (white goods) – suggesting that the blocking order on non-building materials was ultra vires because it extended the block in the 6th Directive – also to be resisted;
- cultural exemption claims, including the suggestion that “professional wrestling is not sport but entertainment and therefore within the cultural exemption”;
- opticians – claims related to the *d’Ambrumenil* case;
- qualifying use of fuel and power by universities – to be resisted after HMRC won the *University of Cambridge* case;
- management of investment trust companies and venture capital trusts;

- sale of road fund licences included in the margin scheme for second hand cars and motor cycles;
- Bespoke Retail Schemes (BRS) and Daily Gross Takings (DGT) adjustments;
- fraudulent card/cheque transactions;
- claims concerning the issue and sale of face value vouchers or money-off coupons;
- *First National Bank of Chicago* (C-172/96) and *Willis Pension Fund Trustees Limited* (19,183) – input tax not claimed in respect of foreign exchange activities;
- construction industry volume rebates;
- claims that s.80 repayment claims and/or the related interest are not subject to corporation tax in the hands of the recipients;
- the use of sampling and extrapolation to calculate claims where the period concerned is so long ago that it is unreasonable to expect detailed records to be available;
- claims for staff expenses that were not made earlier;
- claims for VAT overpaid by travel agents on commission earned from tour operators, on the grounds that they funded discounts for travellers from their commissions and that only the reduced amount of commission should have been subject to VAT;
- claims involving the contents of caravans.

In each case, the document sets out HMRC's current policy and the action that officers should take if they receive a claim. Sometimes this is to refuse it, and in other cases to refer it to the "theme expert".

There appears to be several years' worth of work here for any VAT department.

http://www.hmrc.gov.uk/menus/fleming-kretztechnik.pdf

6.4.3 Care homes

Taxation magazine (18 February 2010) includes an interesting "Reader's Query" and answer about the possibility of making a claim to recover input tax on substantial costs of improving a residential care home between 1999 and 2002, following the *Kingscrest* decisions of the courts in 2005. Surprisingly, this is a case which is not on the "theme narratives" list, so it is not so easy to find out HMRC's current policy in advance.

Taxation, 18 February 2010

6.4.4 Repayment supplement rejected

The Tribunal has considered two claims by traders for repayment supplement and rejected both, holding that HMRC were entitled to "stop the clock". Both concerned extended verification in connection with HMRC's suspicion of carousel fraud; of course, the fact that a claim for supplement was made means that HMRC eventually accepted and paid the claims.

In one case, the return for the one-month period to 31 October 2003 was received by HMRC on 3 November, claiming a repayment of £28,665. It was selected for examination by HMRC's computer on 5 November, and referred to an officer on 13 November. He contacted the trader on 14 November and made an appointment to visit on 24 November. After the visit he conducted a number of follow-up enquiries before deciding that, while he was not completely satisfied that the transactions were free of all suspicion, the amounts were relatively small and there appeared to be no tax loss in the supply chain. He approved the payment on 8 December and it was credited to the company's bank account on 9 December.

The argument was straightforward:

- the trader believed that HMRC should only "stop the clock" for the one day on which they had visited the company – they had not asked any questions before or after that date, so the trader had done all in its power to answer HMRC's concerns and "restart the clock" on the one day;
- HMRC believed that, according to the letter of the law, their enquiry started on 5 November and ended on 8 December; however, their policy was not to stop the clock until the trader had been notified, i.e. on 14 November. In either case the period excluded would be enough to bring the repayment interval well below 30 days.

The Tribunal considered that an enquiry does not begin with the computer selecting the return for checks. In the view of the chairman, the enquiry actually began on 14 November (rather than this being a concessionary application of HMRC policy). In case the Tribunal was wrong and the enquiry really began on 24 November, as the trader argued, the Tribunal was nevertheless firm in the view that it did not end on 24 November. It was reasonable for the officer to carry out further checks on the answers that had been given, and the time taken was not unduly long. Excluding either period (14 November or 24 November to 8 December) meant that repayment supplement was not due.

First Tier Tribunal (TC00412): *Future Components Ltd*

The second case concerned a longer-running investigation into a larger claim. The refusal of repayment supplement had been made in 2003, but the appeal had become dormant until the company was wound up in 2008. The liquidator was allowed to bring an appeal to the Tribunal on the supplement point on the basis of an agreed schedule of facts.

The taxpayer's arguments were:

- HMRC's reason for refusing the claims and operating extended verification was their view at the time that transactions that were connected with carousel fraud were "not economic activity". As this approach had been later rejected by the ECJ in *Bond House*, the reason for the enquiry and the delay was false. The enquiry could not therefore have been "reasonable", and the clock should not have been stopped.
- The enquiries were not specific to the company but part of a general investigation into deal chains and related trading. This was routine at the time and should not have taken longer than the normal period for repayments to be made. Once again, enquiries which took so long could not be "reasonable" and should not stop the clock.

The Tribunal rejected these contentions. The enquiries were legitimate and full explanations had never been provided. In spite of that, the officers had decided to make repayments to the claimant, while the enquiry itself was still open seven years later. In the circumstances, no repayment supplement was due.

First Tier Tribunal (TC00417): *Major Micros Ltd (in liquidation)*

6.4.5 New Notice

HMRC have issued an updated version of their Notice on *Treatment of VAT repayment returns and VAT repayment supplement*. It has been updated to reflect the changes to the review and appeals procedures after 1 April 2009.

Notice 700/58

6.4.6 Time limit reminder

HMRC have issued a Brief to remind taxpayers that time limits for assessments and claims are generally moving to four years in April 2010. In VAT this has represented an increase from the 3 year cap, and this necessitated a transitional period from 1 April 2009 to 31 March 2010 (when the cap was set at 1 April 2006 rather than 3 or 4 years). For the other affected taxes, the change generally represents a reduction in time limits from six to four years.

The Brief also includes a reminder of HMRC's elegance with a phrase. The time limit for "deliberate behaviour" is still 20 years. Presumably this means "a tax underpayment that has arisen deliberately".

R&C Brief 16/2010

6.4.7 Museums and galleries

Six new museums and galleries have been added to the list of those that are allowed to reclaim VAT incurred on expenses under s.33A VATA 1994.

SI 2010/608

6.5 Timing issues

6.5.1 Cash accounting

The Council has approved a continued derogation in favour of the UK (and Sweden) which allows small traders to use cash accounting (as described by the decision, "to postpone the right of deduction of value added tax (VAT) until it has been paid to the supplier of goods or of services").

The decision refers to the possible entry into force of a directive authorising all member states to do the same. The derogation will apply until that time, or until 31 December 2012 "at the latest". It seems likely that cash accounting will be extended again beyond that date if the general VAT rules have not been amended by then.

The derogation also permits the UK to raise the limit for cash accounting from the current level of £1.35m turnover to £1.5m, but it does not appear that the government has yet taken advantage of this.

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:325:0062:0063:EN:PDF

6.6 Records

6.6.1 Corrections

A company manufactured UPVC window units. It provided authorised dealers with promotional examples of the product to display in their showrooms. These items were not for sale, and the dealers would only have to pay for them if they breached conditions attaching to the dealership agreement (e.g. ceasing to sell exclusively this manufacturer's products). To record the delivery of the items to the dealers, the company raised an invoice, but it was understood that the invoice would not be payable unless the conditions were breached.

A director of the company realised in December 2003 that the invoices had been processed in the ordinary way and output tax had been accounted for on them. He obtained a schedule of the items concerned and adjusted the VAT account for the December 2003 return, reducing output tax in Box 1 on the basis that no supplies had been made. No credit notes were sent to the customers.

HMRC enquired into the return and ruled that the adjustment was not correct. After lengthy argument, the trader appealed an assessment reversing the adjustment.

The Tribunal examined the history of the dispute and concluded that the assessment was correct. The company had two arguments to support its case:

- the adjustment was a valid use of reg.38 SI 1995/2518 on the correction of errors;
- the company had made a valid voluntary disclosure.

On the use of reg.38, the Tribunal concluded that it was not possible to use that regulation where an invoice had been incorrectly issued for something that was not a supply at all. It referred to the cancellation of a supply or a change in the consideration for a supply, but that presupposed that there had been a supply. Further, the company had not issued credit notes to the customers, so even if there had been a supply, the conditions of reg.38 were not met.

It appears that the only way to cancel a wholly invalid invoice is to make a voluntary disclosure to HMRC (it is presumably also necessary to inform the customer that the invoice should not be used to support input tax deduction). In this case, the full details of the make-up of the adjustment had never been given to HMRC. A voluntary disclosure requires the company to provide the information: it should not be necessary for HMRC to piece it together over a period of time from partial answers and further enquiries.

First Tier Tribunal (TC00430): *Starglaze Windows & Conservatories Ltd*

Note that the company could not have claimed bad debt relief for invoices unpaid after 6 months. The conditions of s.36 VATA 1994 also require that there has been a supply in the first place, and it is also necessary for the due date for payment to have passed.

6.6.2 Online returns

ICAEW *Taxline* helpfully points out that HMRC's online filing system only appears to retain past VAT returns for about 15 months. Traders need to keep their own soft or hard copies for future reference.

TaxLine February 2010

6.6.3 Reader's query

A Reader's Query in *Taxation* asked what penalties would be due if a trader simply reversed a VAT underpayment in a subsequent quarter without following the proper procedures for making a correction. The answers suggested that a charge could arise, but it would not be self-assessed. It would only follow from HMRC making a discovery, but it would then potentially be subject to the higher rates of penalty because it would be "deliberate".

Taxation, 11 March 2010

6.6.4 Tax help

HMRC have issued the first in a series of factsheets branded "Tax Help". This deals with the records that a person is required to keep if in business. It starts with the general reasons for keeping good records:

- keep track of your expenses
- ask for a bank loan or credit if you need to
- see quickly what you are owed by others and how much you owe them
- save time and accountancy costs
- pay the correct amount of tax

- receive the correct amount of benefits or credits
- avoid paying any extra tax or penalties;

and then goes on to specific tax rules which require specific records, and the tax penalties which can be levied for failing to keep proper records. The required VAT records are separately listed from PAYE and other accounting records.

One useful comment is on "reasonable care" as a get-out for penalties:

Some of the ways in which you can show you've taken reasonable care include:

- keeping full and accurate records which are regularly updated and saved securely
- checking with HMRC or an agent or accountant if there is something that you don't understand.

One point of interest is that the document still advises that traders should keep their records for six years, even though the time limit for most assessments is now four.

www.hmrc.gov.uk

6.6.5 Invoicing

The Council has agreed on a general approach to a draft directive on simplifying VAT invoicing requirements, in particular with relation to electronic invoicing. At present the rules allow a number of options to member states, with the result that different countries have different requirements.

The Commission estimates that businesses will save annual costs of €18bn if the rules were simplified. The opinion of the Parliament has to be obtained before proceeding with the directive.

7132/2/10 REV 2

6.7 Assessments

6.7.1 Inflated assessments

A barrister was registered for VAT in 2001. It appears that several of his early returns were not filed at the proper time, and in April 2006 HMRC issued a "central assessment" for the period to February 2004 (this is what the Tribunal decision says: the operation of the computer and the relevant time limits does not appear quite correct). The barrister filed this return in July 2008, showing a much lower figure for VAT liability, and he appealed against the assessment. HMRC objected that the appeal was out of time, and this was upheld by the Tribunal.

However, the Tribunal expressed concern over the lack of transparency in the raising of the assessment in the first place. HMRC use s.73(8) VATA 1994 as justification for an "inflated assessment regime" – that is, if a person appears happy to pay centrally issued assessments and still not file returns, the assessments will be increased to try to reach the point when

the taxpayer will object and file. HMRC's policy on this was put before the Tribunal as an explanation of why the assessment was raised in the amount stated in the first place.

The chairman concluded as follows:

There are three matters which have arisen which give cause for unease and which merit consideration by the Commissioners.

The first is that the assessment was both stated to be centrally issued and also said to have been made to best judgment. Are these compatible?

The second is that the Commissioners' own guidelines provide under paragraph 9.12 that traders will not be advised separately of their entry onto the Inflated Assessment Regime and the inflation amount will not appear on assessments or computer outputs, therefore had Mr Dear been in time with his appeal, he still would not have been put in full possession of all the facts regarding the quantum of the assessment and would not have been able to mount a proper challenge to it.

Thirdly, s.73(8) provides for what might be considered to be a penalty, and both the fact that an assessment contains that penalty and the amount of that penalty is concealed from the taxpayer. These however are not matters with which this Tribunal can deal in this appeal, but of which taxpayers should be aware.

First Tier Tribunal (TC00422): *Ian Dear*

6.7.2 Deflated assessments

An Indian restaurant was assessed to underdeclared output tax amounting to £116,359 plus interest and a misdeclaration penalty. There was no direct evidence for any underdeclaration: the assessment was based solely on calculations of expected sales based on evidence of inputs, based on estimated figures for wastage, mark-up etc.

The Tribunal concluded that the calculations of the officer were flawed, but not so much so that the assessment was not raised to best judgement. The assessments were reduced to £17,067, with consequent reductions in the interest and the penalties, but no award was made for costs.

The case report is interesting for anyone who is involved in such a dispute, because it goes through the procedures for establishing the basis figures for an extrapolation exercise.

First Tier Tribunal (TC00307): *Lancers Restaurant Ltd*

6.8 Penalties and appeals

6.8.1 Judgments in litigation

HMRC have announced a change in policy in relation to liabilities of traders which are in dispute. Where HMRC have received a judgment in their favour, they will now insist on collecting the tax, even if there is a further appeal. They will apply this policy to all decisions of Tribunals or courts on or after 1 April 2010.

HMRC have always repaid tax when a decision has gone against them, even if they are appealing further. However, they have not adopted a consistent approach where they have won. They will not enforce payment in cases where an agreement not to do so has been made with the appellant before 9 December 2009 (the date of the announcement of the new policy in the Pre-Budget Report). HMRC will also not enforce payment in cases where to do so would be likely to drive the taxpayer into liquidation or bankruptcy.

It is still possible for a trader in a VAT appeal to apply to postpone the tax due by persuading either HMRC or the Tribunal that the trader would suffer hardship if the tax had to be paid before the appeal was heard.

HMRC Release 12 March 2010

6.8.2 A heated argument

Following the Tribunal decision in *European Independent Purchasing Company Limited and Sub Retail Unit* (20,697), an HMRC were given the task of making sure that all the Subway franchises in the country complied with its conclusion that toasted sandwiches were hot takeaway food. Many of the franchisees appealed, and a large number of cases are being co-ordinated by a single firm of solicitors. A Tribunal hearing was held to decide some preliminary matters.

The judge commented that he thought the approach of the appellants' counsel was excessively confrontational. This may be related to the fact that the appellants objected to his involvement as he had decided the earlier Tribunal decision, and might therefore be biased in favour of HMRC's argument. He started his decision in this hearing by setting out a justification for his continued involvement in managing the case.

The appellants' counsel had made allegations of criminal conduct against HMRC officers without giving any notice that they intended to do so. The judge considered that such an allegation would have been the subject of strenuous objection by the taxpayers' counsel if HMRC had raised it for the first time at the hearing, and he suggested that HMRC should be given the same consideration.

HMRC had applied for the appeal to be struck out on the grounds that a letter from an HMRC officer was not an appealable decision. The Tribunal judge disagreed: he refused the application for strike-out. The letter appeared to be a considered and concluded decision that toasted sandwiches should be standard rated.

HMRC also objected to the appellants' requests for the appeals to be grouped together behind a "lead appeal". They argued that the decision would depend on the subjective intention of the individual trader in heating the sandwiches, and that would depend on the individual facts.

The Tribunal chairman considered that the cases turned on the same law and the facts would be similar in most of the cases. The prospect of 200 appeals being heard separately was not attractive. He rejected HMRC's objections to the allocation of a "lead appeal", and also refused their suggestion that the lead appeal should be the earlier Tribunal decision which HMRC had won. The earlier decision had been reached under the old Tribunals Rules, which did not have provision for a direction making a lead appeal binding on all parties.

The appellants also asked for costs to be dealt with under the "old rules", i.e. they would be entitled to costs if they won. The judge did not accept this. Some, but not all, of the appellants had filed their notices of appeal in late March 2009, but he did not think that this was enough to bring a consolidated appeal by all franchisees together within the "old rules". The new basis should apply.

First Tier Tribunal (TC00320): *Subway*

6.8.3 A rare success

After many others have tried, finally a trader has succeeded with the argument that default surcharge can produce a result so unfair that it is "disproportionate" and therefore contrary to EU law. The company submitted a return one day late and was subjected to a surcharge at 5% of £131,881. This had been reduced from a 10% penalty after HMRC accepted that the company had a reasonable excuse for an earlier default.

The Tribunal did not consider that there was any excuse for the current default, but the chairman considered instead whether a Tribunal would impose such a high penalty if it was free to choose the amount. He concluded that this was "inconceivable". There was in general a public interest in the surcharge system which contributed to the prompt payment of taxes, but there were a number of features to the system that have "led to criticism":

It does not discriminate between the trader who, as in this case, has made a trivial slip and the trader who deliberately pays late; and the system equally does not cater for degrees of culpability in between those extremes. The potential hardship caused to the trader by the imposition of the penalty is not a relevant factor. The penalty is the same no matter how long the delay. If a trader has a reasonable excuse for not sending in his payment on time, but the excuse then comes to an end, he suffers no penalty however much longer he delays. The correlation between the size of the trader and the size of the penalty is far from exact. For example, two manufacturers may have similar levels of turnover and profit, but if the major cost component of the products of one is attributable to standard-rated raw materials, he will have a smaller exposure than the other, whose product has a high labour content, since the former will, and the latter will not, have a large amount of input tax to set against his output tax, leaving a smaller net liability-the penalty being assessed by reference to the net liability. And a repayment trader (that is, one whose input tax consistently exceeds his output tax) is never exposed to a monetary penalty.

The chairman referred to the decision of the ECJ in *Louloudakis v Greece* (Case C-262/99), in which it observed that an essentially fixed (but high) penalty "*is compatible with the principle of proportionality only in so far as it is made necessary by overriding requirements of enforcement and prevention, when gravity of the infringement is taken into account*". As he could not impose a lesser penalty, he discharged the surcharge altogether.

First Tier Tribunal (TC00335): *Enersys Holdings UK Ltd*

6.8.4 Open goal

It is quite common for the trader to fail to appear at a Tribunal hearing. It is much rarer for HMRC not to be represented. In a recent case about default surcharge, the chairman decided to proceed in the absence of HMRC, and found for them anyway: the trader had clearly misunderstood the rules on the 7-day extended deadline for making electronic payments, and had no reasonable excuse for the failure to pay on time.

There were two "good" reasons for the trader's lack of understanding:

- previous surcharges had not been collected, because they were below the level at which they would be enforced at the 2% or 5% rates, but they nevertheless increased the rate for the next surcharge to 10% – which would always be enforced;
- previous liabilities had been settled in instalments using a "time to pay" agreement, but at that time this still counted as a default for surcharge purposes.

The Tribunal had some sympathy with the trader's situation and requested HMRC to consider whether the surcharge could be paid in affordable instalments, but the appeal against it was dismissed.

First Tier Tribunal (TC00372): *E&M Pankhurst t/a Mays Terracotta*

6.8.5 Defaults

A trader was resident in Australia, making communications with HMRC difficult. He was regularly in default, and was liable to default surcharge at 15%. On the day before the extended due date for the return to 31 May 2006, 6 July 2006, he rang the National Advice Service to say that he was waiting for payment from his principal client. He was told that this might constitute a reasonable excuse for late payment, but that he should wait until he had received the surcharge assessment and appeal against it then. In due course, HMRC refused to accept that it was a reasonable excuse. He asked for a reconsideration, which confirmed the original decision, but the trader did not receive the letter telling him that he could appeal.

He only discovered that the surcharge was still outstanding when he incorporated the business and was told that he could not transfer the VAT registration because two amounts were owing - £612.02 in surcharge for 05/06 and £91.80 for the following period.

The Tribunal did not rule on whether the late payment constituted a reasonable excuse. Instead, the chairman focussed on the advice given by the Advice Service. He ruled that the failure to suggest a part payment on account rendered the advice misleading. The trader said that he would have done this to reduce the surcharge if the rules had been explained to

him, and the chairman thought it possible that he might have borrowed enough to pay the whole liability.

No appeal had been lodged against the smaller penalty, but the chairman calculated that it was exactly 15% of the first one. So the payment for 08/06, which had been paid on time, had been allocated by HMRC's computer first to the disputed default surcharge, leaving £612.02 of the VAT liability outstanding to be surcharged again. The chairman ruled that the cancellation of the first surcharge by the reasonable excuse of the NAS's misleading advice necessarily led to the cancellation of the second surcharge.

First Tier Tribunal (TC00388): *Hipisol Ltd*

A company was in default for several periods, and claimed a reasonable excuse because of cash flow difficulties. Although there was a specific problem with the bank suddenly reducing the amount it would advance against discounted invoices issued, the Tribunal believed that the shortage of funds arose from the normal hazards of trade and there was nothing in the situation that could constitute a reasonable excuse.

It is worth noting that the company was too large to operate cash accounting, so it was unable to defer payment of VAT while it collected its debts from its customers.

First Tier Tribunal (TC00411): *H&I Toiletries Ltd*

6.8.6 Sales list penalty

A company started a new business with customers in the Netherlands and Belgium. It was repeatedly late filing EC Sales Lists. The penalty regime under s.66 VATA 1994 requires that the first late return triggers a penalty notice, which will lead to a penalty of £5 per day (to a maximum of 100 days or £500) if another return is late within the next 12 months. As with default surcharge, in practice HMRC usually send a "help letter" after the first sales list is late, so only the third late submission incurs the penalty.

The trader had submitted three successive sales lists in 2008 84, 84 and over 100 days late, and therefore received a penalty assessment of £500. On appeal, according to the Tribunal report, "*The Respondents say that the Appellant had had more than adequate time, and warnings, to complete its returns timorously* [sic]". The Tribunal agreed that there was no reasonable excuse and confirmed the penalty. A reasonable trader would, on receiving repeated warnings, take steps to resolve the problem. This trader had not done so.

First Tier Tribunal (TC00365): *Corriform Ltd*

6.8.7 Costs

A company appealed against decisions which related to allegations of MTIC fraud. Eventually the appeals were withdrawn on 17 July 2009, and shortly after that HMRC applied for costs. The Tribunal had to consider whether HMRC were entitled to do so under the transitional appeals rules, and concluded that they were.

First Tier Tribunal (TC00290): *Surestone Ltd*

6.8.8 Late evidence

A company appealed against the rejection of repayment claims which HMRC suspected were connected with MTIC fraud. As the hearing approached, HMRC sought to have admitted evidence which had not been disclosed within time limits previously set. The company objected to the admission of the evidence, so the Tribunal considered whether to admit it as a preliminary issue.

The chairman decided that it would not prejudice the appellant's case for the evidence to be admitted. As the overriding purpose of the rules was to ensure fairness, there was no reason to deny HMRC the opportunity to put the extra material before the Tribunal at the substantive hearing.

First Tier Tribunal (TC00382): *Megantic Services Ltd*

6.8.9 Appealing out of time

A company managed investment funds. In May 2005 it filed a voluntary disclosure applying for a repayment on the grounds that some of its services should be exempt under EU law. This was subsequently confirmed by the ECJ's decision in the *JP Morgan Claverhouse* case, released on 28 June 2007. On 5 November 2007 HMRC issued BB 65/07, confirming that it would concede that case rather than return to the Tribunal, but restricting the concession to management of investment trust companies. During 2008 further concessions were made, and in August 2008 HMRC announced that management of venture capital trusts would also be treated as exempt with retrospective effect. This appeared to cover the whole of the 2005 voluntary disclosure.

During this time, HMRC had issued a formal decision to refuse the claim to exemption for VCT management on 5 February 2008. No appeal or formal request for reconsideration was made against this decision until 30 June 2009. A further voluntary disclosure was made in September 2008 covering periods from March 2004 to June 2008, and this was rejected as being out of time. That rejection is the subject of a separate appeal.

The Tribunal had to consider whether to allow the June 2009 appeal even though it was well outside the normal 30-day time limit. It seemed that the discussions between the taxpayer's advisers and HMRC had continued over an extended period without the accountants noticing that time was running against them. They had apparently advised against appealing too early as this might be regarded as confrontational.

The Tribunal examined the principles of precedent cases on the issue, and did not think that there was any reason to accept the late appeal. The application was refused.

First Tier Tribunal (TC00418): *NVM Private Equity Ltd*

A trader was assessed to recover input tax that he had claimed in spite, according to HMRC, of only making exempt supplies. He appealed over a year after the decision, and when told that only the Tribunal could allow such a late appeal to proceed, took nearly another two years to pursue that course. In the correspondence he claimed to be appealing against a default surcharge and a misdeclaration penalty, even though the assessment was only for VAT and interest.

The Tribunal saw no reason to allow the appeal to proceed. There was no evidence of any good reason for the delay, nor any indication that the appeal had any chance of success.

First Tier Tribunal (TC00302): *Obhloise Benjamin Ogedegbe*

6.8.10 Publicity for wrongdoing penalties

HMRC have issued a new leaflet entitled "Tax care to avoid a VAT and Excise wrongdoing penalty". It explains the background to the new penalties which apply from 1 April 2010, and explains the levels of penalties and possible defences.

www.hmrc.gov.uk

6.8.11 Manual updates

HMRC have updated their manual on civil evasion to show the broader basis for dishonest conduct, the effect of centrally assessed amounts, and to provide up-to-date information on the appeals procedure.

VATCEP2030 (http://www.hmrc.gov.uk/manuals/vatcep/vatcep2030.htm)	Revised interpretation of s 60(2) and s 60(3) VAT Act 1994 inserted, which provides a broader basis for what can be considered dishonest conduct for the purposes of s 60.
VATCEP3020 (http://www.hmrc.gov.uk/manuals/vatcep/vatcep3020.htm)	Added that centrally assessed amounts not to be included in calculations of net amount of VAT evaded.
VATCEP6010 (http://www.hmrc.gov.uk/manuals/vatcep/vatcep6010.htm)	Inserted up-to-date details on appeals procedure.
VATCEP6020 (http://www.hmrc.gov.uk/manuals/vatcep/vatcep6020.htm)	Added one case to table (*Stadeco*) [2009] All ER (D) 83 (Sep)

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

HMRC have updated their manual on civil penalties to reflect recent changes.

VCP10500 (www.hmrc.gov.uk/manuals/vcpmanual/vcp10500.htm)	Default Surcharge – Whole section amended to take into account new reviews and appeals processes
VCP10961 (www.hmrc.gov.uk/manuals/vcpmanual/vcp10961.htm)	Reviews and appeals: Reviews of penalties for failure to submit EC sales statements – Page updated with new reviews and appeals guidance
VCP11051 (www.hmrc.gov.uk/manuals/vcpmanual/vcp11051.htm)	Reviews and appeals: Review of inaccuracies in EC Sales Statements – Page updated with new reviews and appeals guidance

www.hmrc.gov.uk/manuals/vcpmanual/

6.8.12 Inaccuracies

HMRC have updated their leaflet "Take care to avoid a penalty" to reflect changes on 1 April 2010. The document explains when penalties can be levied, how they can be avoided and what the levels of penalty are.

The change in 2010 is that penalties can now be levied on a third party who deliberately withholds information from or deliberately supplies false information to another person who has to complete a return or send HMRC a document. HMRC have to demonstrate that the third party intended to cause that other person's return or document to be inaccurate.

The provision for publication of the names of defaulters is also highlighted as a new rule for 2010.

HMRC Release 12 March 2010

6.8.13 Future penalties

The Budget included the announcement that penalties for late filing and late payment are to be reformed across all the taxes so that they are more consistent. This is likely to mean that the regime for PAYE will become more stringent, but the proposals represent a considerable relaxation in comparison with default surcharge as it currently operates. The Budget Notice includes the following outline of what we can expect:

Under the new rules, there will be an escalating series of penalties depending on the number of failures within a set penalty period. Failure to file a quarterly return by the filing date will trigger a penalty period of one year and an immediate £100 penalty. Increased fixed penalties will then apply to subsequent failures within the period, and the period itself will be extended accordingly. Additional penalties of 5% of the tax on the return will be charged for continuing failure six and twelve months after the filing date. Penalties of up to 100% of the tax will be charged where the failure is intended deliberately to withhold information to prevent HMRC correctly assessing the tax.

Failure to pay tax due quarterly will also trigger a one-year penalty period although no immediate penalty will apply. A second failure in the period will attract a penalty of 2%, a third failure a 3% penalty and further failures a 4% penalty. Again, the penalty period is extended with each failure. Additional penalties of 5% of the tax will be charged for continuing failure six and twelve months after the due date.

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6.9 Other administration issues

6.9.1 Working with tax agents

HMRC have published draft legislation to follow up their consultation on "working with tax agents". The idea is to address deliberate wrongdoing by tax agents. This is one element of the programme of reforms that they believe is necessary to improve the administration of tax. The deadline for comment was originally 3 March, but this was extended to 28 April to give interested parties more time to respond. Perhaps HMRC expected more interest than for normal consultations.

The latest document contains the following explanations:

1.6 HMRC proposes new powers to address deliberate wrongdoing by tax agents. The aim is not root and branch reform, but rather a modernisation of existing powers which already apply to direct taxes to, in future, apply across taxes and duties. The proposals would:

- *enable HMRC to access the working papers of tax agents who engage in deliberate wrongdoing which leads or is intended to lead to a loss of tax; and*
- *make a tax agent who has been involved in deliberate wrongdoing liable to a sanction which acts as an effective deterrent.*

1.7 The trigger to access working papers and for liability to penalty will be the same. It will be deliberate wrongdoing by the tax agent intended to cause a loss of tax. This is broadly the same test as applies for direct taxes currently under sections 20A and 99 of the Taxes Management Act 1970. The new powers are underpinned by appropriate safeguards to ensure they are used only in such cases.

1.8 HMRC is also consulting on:

- *publishing the names of tax agents who are penalised for deliberate wrongdoing, but draft legislation is not being published at this time.*
- *new powers to address revenue losses caused by high volume agents, that is the type of tax agent who makes claims for repayment on behalf of many clients, most of which are invalid or significantly wrong, but draft legislation is not being published at this time.*
- *revised procedures for disclosure to professional bodies in the case of misconduct, for which no new legislation is required.*

The draft legislation also contains provisions about penalties to be levied on tax agents:

2.10 The maximum penalty (based on that which could apply to a taxpayer who did a similar act) is 100 per cent of the tax understated by their clients as a result of the deliberate wrongdoing, subject to the following:

- *Where the tax agent makes prompted or unprompted disclosure of the deliberate wrongdoing to HMRC, the penalty may be reduced to reflect the quality of the disclosure. The "quality" could include helping HMRC to identify clients who have underpaid tax as a result of the deliberate wrongdoing, and helping to collect the unpaid tax from those clients. The penalty may not be reduced below 50 per cent of the tax due, in the case of prompted disclosure and 30 per cent for unprompted disclosure.*

- *Where the penalty that would be calculated in respect of all the tax agent's clients for tax periods ending in a calendar year exceeds £50,000, the penalty for that year will be capped at £50,000.*

2.11 There is also a minimum penalty. This takes into account that in some cases, the tax liability which results in an act of deliberate wrongdoing may be wiped out by a loss or credit from elsewhere. It also reflects that another party may prevent the tax agent's wrongdoing from leading to a loss of tax (such as a client refusing to act on the agent's advice). In such cases it would still be necessary for HMRC to demonstrate both the behaviour of the tax agent, and the intent for it to cause a loss of tax, in order to charge a penalty.

2.12 The minimum penalty is set at a level of £5,000 subject to reduction for disclosure. The penalty may not be reduced below £2,500 in the case of prompted disclosure and £1,500 in the case of unprompted disclosure.

HMRC 8 February 2010; http://www.hmrc.gov.uk/consultations/index.htm

6.9.2 Complaints

HMRC have issued a new factsheet on what to do if unhappy with their service. It replaces the August 2008 version. It sets out the procedure as follows:

What information we need

Please include as much information as you can to help us investigate and understand your complaint.

For example:

- *what went wrong*
- *when it happened*
- *who you dealt with*
- *what effect our actions had on you*
- *how you'd like us to put things right*
- *your full name and address*
- *any relevant reference numbers (your National Insurance number, tax reference, VAT number, employer reference, etc.) so that we can quickly identify your records.*

What we will do

We will treat you fairly and be impartial when you make a complaint. Making a complaint will not affect how we treat you in the future. When you make a complaint, we will:

give you the name and contact details of the person dealing with your complaint

- *look into your complaint thoroughly*
- *handle your complaint confidentially*
- *try to solve the problem and give you a response as quickly as we can*
- *let you know who to contact if you are still unhappy.*

Putting things right

If we've done something wrong, we will apologise, explain what happened and put things right as quickly as we can.

We will consider refunding you for any reasonable costs directly caused by our mistakes or unreasonable delays. Costs can include postage, phone call charges or professional fees. Please keep your receipts if you would like us to make a refund to you.

If you think our actions have affected you particularly badly, causing you worry or distress, tell us straight away. In some cases we may be able to make a small payment to acknowledge this and apologise.

Where we make a mistake or delay using information you have given us, and we send you a late tax bill or pay you too much tax credits, we may not collect the full amount you owe. There are some very strict conditions in these situations, so please ask the person who deals with your complaint for more information.

C/FS Complaints; www.hmrc.gov.uk

6.9.3 E-mail contact

HMRC have changed their policy on dealing with e-mail queries relating to VAT. In addition to the usual information (VAT registration number, address, telephone number, nature and full details of query), the sender must now confirm acceptance of the security risks of sending personal information electronically.

The policy states that e-mails take some time to answer and the sender should wait at least 14 days before chasing one up. If the reply has to include any personal or confidential information, HMRC will not reply by e-mail – they will only be able to use post or phone.

http://www.hmrc.gov.uk/vat/managing/problems/getting-answers.htm

6.9.4 Phone contact

The National Audit Office has commented on HMRC's performance at answering telephone queries during 2008/09. This was well below the department's own targets and industry standards. Only 57% of 103 million call attempts were answered, compared with 71% in the year before and an industry benchmark of over 90%.

The Department has responded by improving its management of caller demand. In the first half of 2009/10, the percentage of calls answered has risen to 73%. There is a plan to answer 90% of calls at 30% lower costs by March 2012.

National Audit Office Press Release 03/10 15 January 2010

6.9.5 Security

As usual, traders appealing against a notice of requirement to deposit security have both failed to convince the Tribunal that HMRC's decision was unreasonable. In both cases, the appellants stressed that they were currently running their businesses in a solvent manner and meeting their VAT liabilities as they fell due; the Tribunals had to point out that this was irrelevant, because the case was about whether the decisions to impose the requirement were reasonable when the notices were issued. In both cases, they were, based on the previous records of those involved in running the two businesses.

First Tier Tribunal (TC00329): *SA Clark t/a Maxim*; (TC00385): *Mercieca Ltd;* (TC00407): *Brenchley Civil Engineering Ltd*

6.9.6 Charges over carbon and appeals over MTIC fraud

It has been reported that three British carbon traders and one from the Netherlands have been charged with money laundering by Belgian authorities in connection with an alleged attempt to defraud the Belgian exchequer of €3m.

Daily Telegraph, 21 January 2010

Two individuals appealed against their conviction for involvement in a carousel fraud. It appeared that the rules of evidence placed some of the defendants in a better position than others. However, the Court of Appeal did not consider that the convictions were unsafe as a result. Parliament had laid down the rules to follow in such a situation, and it appeared that they had been adhered to.

Court of Appeal: *R v Hamidi and another*

6.9.7 Naming and shaming

1 April 2010 was confirmed as the operative date for HMRC's new power to publish the details of deliberate tax defaulters.

www.hmrc.gov.uk

6.9.8 Tax health plan

Following the invitation to those with undeclared offshore bank accounts to take advantage of the "disclosure facility" and "new disclosure opportunity", HMRC have invited health professionals to come forward and put their tax affairs in order. They do not suggest that all doctors have undeclared liabilities, but it seems that they have information which suggests that substantial numbers of doctors have failed to declare money received from insurance companies and others. The arrangement is called the "Tax Health Plan", and it is described in detail with FAQs on the HMRC website.

As most of those affected are likely to be exempt from VAT, this disclosure scheme will probably mainly deal with direct taxes. However, it seems likely that further disclosure arrangements will follow, and some of them may become relevant to VAT.

www.hmrc.gov.uk; http://www.hmrc.gov.uk/tax-health-plan

There have been numerous articles about the Tax Health Plan in the professional press, including *Taxation* magazine (21 January, 11 February, 11 March 2010) and *Tax Adviser* (February 2010).

6.9.9 Business Payment Support Service

By 3 March 2010, HMRC reported that the BPSS, introduced in the PBR in November 2008, has now helped 160,000 defer over £5bn of tax and VAT. The level of payment is described as "very high". Although use of the BPSS is supposed to be a one-off, the press release refers to 300,000 time to pay arrangements being agreed with 160,000 businesses, so some of them must have used it more than once.

However, a business which wishes to defer over £1m must, from April 2010, obtain an independent business review carried out by a qualified professional adviser to support the application. According to HMRC, "*Typically, an IBR will include a review of a number of important areas, including: current trading and financial position; profit and cash flow projections; business and financial strategies; management systems; and funding and banking arrangements*".

www.hmrc.gov.uk; HMRC (NAT) 22/10

6.9.10 Manual update

HMRC have updated their compliance manual so that various checklists reflect the changes made by FA 2008 Sch.36, 37 and 39.

CH200000 (www.hmrc.gov.uk/manuals/ch1manual/CH200000.htm)+	Changes have been made throughout the compliance checks guidance to reflect the extension of Sch 36 FA08 (information and inspection powers) by Sch 48 FA09 Sch 37 FA08 (record keeping) by Sch 50 FA09 and Sch 39 FA08 (assessment time limits) by Sch 51 FA09 to other taxes and duties.
CH201000 (www.hmrc.gov.uk/manuals/ch1manual/CH201000.htm)+	This guidance has been reorganised and rewritten, including detailed guidance about factsheets (CH201600 www.hmrc.gov.uk/manuals/ch1manual/CH201600.htm) previously in Business Guidance Note BGN083/09
CH205000 (www.hmrc.gov.uk/manuals/ch1manual/CH205000.htm)+	This is now about the type of compliance checks you may carry out
CH206000 (www.hmrc.gov.uk/manuals/ch1manual/CH206000.htm)+	This is now about starting a compliance check
CH207000 (www.hmrc.gov.uk/manuals/ch1manual/CH207000.htm)+	This is now about establishing the facts, asking for information using an informal approach, and deciding when a visit may be necessary
CH208000+	Guidance about pre-return checks is now at

	CH205300 (www.hmrc.gov.uk/manuals/ch1manual/CH205300.htm)
CH223000 (www.hmrc.gov.uk/manuals/ch1manual/CH223000.htm)+	This guidance about taxpayer notices has been reorganised and rewritten
CH225900 (www.hmrc.gov.uk/manuals/ch1manual/CH225900.htm)	NEW Guidance about involved third parties
CH229100 (www.hmrc.gov.uk/manuals/ch1manual/CH229100.htm)	NEW Guidance about using information powers on behalf of the Valuation Office Agency
CH229250 (www.hmrc.gov.uk/manuals/ch1manual/CH229250.htm)	NEW Guidance about what to do if you have difficulty serving an information notice
CH250000 (www.hmrc.gov.uk/manuals/ch1manual/CH250000.htm)+	This guidance about inspection powers has been reorganised and rewritten.
CH256000 (www.hmrc.gov.uk/manuals/ch1manual/CH256000.htm)+	NEW Guidance about your role if the Valuation Office Agency (VOA) carry out a tribunal-approved inspection and if the VOA's tribunal-approved inspection is deliberately obstructed.
CH300000 (www.hmrc.gov.uk/manuals/ch1manual/CH300000.htm)+	NEW This expanded and updated guidance about the Human Rights Act and HMRC penalties replaces guidance previously at CH433000+
CH400000 (www.hmrc.gov.uk/manuals/ch2manual/CH400000.htm)+	Changes have been made throughout the inaccuracy penalties guidance to reflect the extension of Sch 24 FA07 by Sch 40 FA08 to new taxes and duties.
CH433000+	This guidance is now at CH300000 (www.hmrc.gov.uk/manuals/ch1manual/CH300000.htm)+
CH451600 (www.hmrc.gov.uk/manuals/ch2manual/CH451600.htm)	This guidance has been replaced by Business Guidance Note BGN076/09
CH460000 (www.hmrc.gov.uk/manuals/ch2manual/CH460000.htm)+	NEW Guidance about authorisation levels for inaccuracy penalties
CH500000 (www.hmrc.gov.uk/manuals/ch2manual/CH500000.htm)+	NEW Guidance about charging penalties for failure to notify (Schedule 41 Finance Act 2008)
CH600000 (www.hmrc.gov.uk/manuals/ch2manual/CH600000.htm)+	NEW Guidance about charging penalties for VAT & Excise wrongdoing (Schedule 41 Finance Act 2008)

www.hmrc.gov.uk/manuals/chmanual/updates/updateindex.htm