VAT UPDATE
APRIL 2017

Covering material from January – March 2017

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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:

The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 16 December 2016 after a gap since 6 September.

Several of the "appeal will be dropped" items are still on the website list, but where they have already been reported in the update they are not reproduced below.

http://www.hmrc.gov.uk/vat/vat-appeal-update.pdf

1.1.1 UK appeals awaiting hearing or decision

- *BPP Holdings*: HMRC have been granted permission to appeal to the Supreme Court against the CA's ruling that the FTT was correct to bar HMRC from further participation in the proceedings.
- *Brockenhurst College*: CA has referred questions to CJEU about application of education exemption to meals supplied to third parties in order to train students in waiting and cooking (A-G's opinion in January 2017 update, favouring HMRC).
- *C Jenkin & Son Ltd*: both sides have appealed a FTT decision in which HMRC assessed to disallow input tax on the basis that the company made exempt supplies, but the FTT held that the assessment was invalid because it should have charged output tax.
- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; an oral permission hearing for an appeal to the CA is listed for 11/12 July 2017.

- *Coinstar Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's decision that machines which exchanged loose change for vouchers made an exempt financial supply.
- *Colaingrove Ltd*: HMRC's list used to contain four separate appeals, but this has been reduced to just TC02534 (fuel – UT decision in favour of HMRC that the lower rate did not apply because there was a compound supply of "caravan with electricity"); the company has been given permission to appeal to the CA, hearing set for February 2017. The cases about removable contents/definition, removable contents/apportionment and verandas are now resolved.
- *DPAS Ltd*: HMRC appealing points from FTT decision to Upper Tribunal, which decided to refer questions to CJEU after considering the judgments in *Bookit* and *NEC*.
- *Dynamic People Ltd*: HMRC sought leave to appeal Judge Bishopp's FTT ruling that a special method continued until it was cancelled, even though the company had joined a group; the FTT decided to set aside its decision and rehear the case.
- *E Buyer Ltd and Citibank NA*: HMRC are appealing to the CA against UT's confirmation of FTT ruling that HMRC's statements of case were inadequate – they have to explicitly plead fraud or not suggest it at all. Hearing listed 18 July 2017.
- *ETB (2014) Ltd v HMRC*: company is applying for leave to appeal to the CA against the UT's decision on its default surcharge of £972. The UT held that the FTT had not properly dealt with facts relied on by the taxpayer, but in remaking the decision also dismissed the appeal.
- *Hotels4U.com Ltd*: HMRC have applied for the time limit to appeal to be extended while waiting for FTT to rule on whether to refer questions to the CJEU.
- *Investment Trust Companies (in Liquidation) v HMRC*: after the CA effectively reversed the High Court's decision in relation to the companies' direct claims for overpaid VAT, both parties appealed to the Supreme Court (hearing concluded 19 May 2016, judgment reserved).
- *Iveco Ltd*: company has appealed UT's decision in favour of HMRC in case about repayment claim based on alleged "adjustment of consideration" (hearing date to be confirmed).
- *KE Entertainments Ltd*: HMRC have appealed FTT's decision in favour of taxpayer in case about adjustment of consideration in bingo (hearing date to be confirmed).
- *LIFE Services Ltd*: HMRC are appealing FTT's decision in favour of taxpayer in case about fiscal neutrality and conditions for exemption of welfare services by commercial company (hearing date to be confirmed).
- *Littlewoods Retail Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's decision in favour of the company on the question of compound interest on long-term

repayments. HMRC are appealing on both liability and amount, hearing listed for 3 – 6 July 2017.

- *Mercedes-Benz Financial Services*: HMRC appealed the UT decision that the company's product was leasing rather than HP to the CA, which decided to refer questions to the CJEU (CJEU hearing 19 January 2017).
- *Metropolitan International Schools*: HMRC appealed to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services (hearing February 2017).
- *Newey t/a Ocean Finance*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's decision that the FTT was correct to find that the appellant's offshore business arrangements were not an abusive practice, hearing listed for March 2017.
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC were granted leave to appeal to the UT, but it was agreed that the case would be remitted to a differently constituted FTT for rehearing.
- *SAE Education Ltd*: the company will appeal to the CA in June 2017 against the UT's ruling (in this update) that the FTT was wrong to allow exemption to the taxpayer as a "college of a university" (listed for 27/28 June 2017).
- *Taylor Clark Leisure plc*: HMRC are seeking leave to appeal against the Court of Session's ruling that the company was entitled to a repayment based on a claim made by a former member of its VAT group registration.
- *Temple Finance Ltd and Temple Retail Ltd*: HMRC have been granted leave to appeal against the FTT's ruling that, in the main, Sch.6 para.1 directions were not possible and the standard method override did not apply (UT hearing listed 5/7 June 2017).
- *The Chancellor, Masters & Scholars of the The University of Cambridge*: HMRC have been granted leave to appeal against the UT's decision that VAT incurred on investment management was residual input tax of the whole operation (hearing listed January 2017).
- *United Grand Lodge of England v HMRC*: taxpayer will apply for leave to appeal to the CA (commencing 9 November 2016) against the UT's confirmation of the FTT's decision that it did not qualify as a body with philosophical, philanthropic or civic aims.
- *Victor Dunlop*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's decision that part of a garage conversion qualified for a DIY claim. The list says "Upper Tribunal hearing vacated", so it is not clear what is happening.
- *Volkswagen Financial Services Ltd*: HMRC have been granted leave to appeal to the Supreme Court against the CA's ruling that VWFS's

proposed special method was more fair and reasonable than HMRC's proposal (hearing concluded 3 November 2016, judgment reserved).

- *Wakefield College v HMRC*: the college has applied for leave to appeal to the CA against the UT's ruling that it would use its building for a business purpose and therefore did not qualify for zero-rated construction (leave hearing listed for 27 April 2017).

1.1.2 Unresolved cases not on the list

The following cases have disappeared from the HMRC website list, but do not appear to be resolved yet:

- *HMRC v Bratt Auto Contracts Ltd and another*: taxpayer has been granted permission to appeal to the CA against the UT's ruling that its *Fleming* claims did not meet the statutory requirements for claims to be recognised, and therefore missed the 31 March 2009 deadline (hearing to commence 28 or 29 June 2017).
- *Copthorn Holdings Ltd*: HMRC were refused (by the FTT) leave to appeal against the FTT's decision that they should reconsider their refusal to allow retrospective grouping. They have decided not to apply to the UT for permission; it remains to be seen what will happen next, because the decision of the FTT required HMRC to consider again their original decision.
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision (now awaiting a Supreme Court ruling after the HC and CA both applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer).

1.1.3 Cases in the current update

The current update includes the latest developments in the following cases from HMRC's list or previous outstanding lists in this update:

- *Associated Newspapers Ltd*: HMRC's appeal to the CA was dismissed: the UT's decision that SI 1993/1507 did not apply was upheld.
- *Wheels Private Hire Ltd*: HMRC's appeal to the UT, against the FTT decision that a taxi firm made separate supplies of exempt insurance to drivers who paid taxable rent for radios, was dismissed.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Distortion of competition

The CJEU has reversed the opinion of the Advocate-General in a case about the taxable status of public authorities and the possibility of distortion of competition.

The National Roads Authority is the Irish body responsible for the construction and management of national roads. It is a body governed by public law, and as such is generally regarded as not a taxable person under art.13(1) PVD. However, where a body governed by public law makes supplies for a consideration, and treating those supplies as not made in the course of economic activity would lead to a significant distortion of competition, the exclusion in art.13 does not apply.

The NRA collects tolls on some roads, and regulates private operators who collect tolls on other roads in accordance with Irish statutory provisions. The Irish courts referred questions to the CJEU to clarify whether treating the NRA as outside the scope of VAT would lead to significant distortions of competition, given that it was not likely that there would be any direct competition between one road and another, or a private operator entering into competition with one of the NRA's roads. The question arose in relation to a repayment claim by the NRA, which has traditionally charged VAT on the tolls it has received.

A-G Szpunar gave an opinion that this would lead to significant distortion of competition. The opinion started with the comment that a major reason for not levying VAT on public bodies is that the money belongs to the government anyway – charging VAT leads to a movement of funds from one account to another, but no additional money is raised for a significant administrative complication. However, the universality of VAT makes for a presumption that everything should be charged and exceptions should be limited; and the principle of prevention of distortion of competition should apply where activities are carried on by public bodies on the same basis as they are or may be carried on by private bodies.

The A-G considered that the precedent case law did not establish that road tolls collected by a public authority are always collected in that capacity. It was possible that the "public authority" activity of the NRA was restricted to deciding to levy tolls on a particular road and setting the bye-laws for those tolls, but in collecting the tolls, it was acting in the same way as any private operator who might also be subject to those bye-laws. The A-G invited the referring court to reconsider its assumption that the NRA was acting in its public law capacity, because if that was wrong, the point of the question fell away.

Turning to the questions referred, the A-G considered that, where the same activity was carried on by public and private operators in the same state, there should be a presumption that distortion of competition would occur. The decision should be taken based on a consideration of the activity itself, rather than the circumstances of the particular market. To do otherwise would make VAT dependent on local conditions, which would offend against the principle of legal certainty.

The A-G reconciled the apparent anomaly between the need for there to be a real possibility of competition rather than a merely hypothetical one, and the need to consider the activity itself rather than the particular market-place. If there is no possibility of private operators engaging in the activity, there is no risk of distortion of competition. For example, in Germany tolls are only collected by a public body. Where private operators are commonly involved in the activity, as in Ireland, there is a risk of distortion that is not merely hypothetical, even if there cannot be competition in relation to an individual road.

The questions referred also asked how to determine whether there was a significant distortion, if there was not an absolute rule that public bodies making supplies would be taxable. The A-G said, "*The determination of whether the distortions of competition in a specific case are more than negligible is a finding of fact which obviously falls to the national authorities and national courts. I would simply point out that a finding that distortions of competition are negligible does not call into question the presumption that such distortions exist, but simply allows tax not to be levied on the activities of a public body despite those distortions.*"

The full court has not followed the Advocate-General's opinion. The Commission had raised doubts about whether the NRA was truly acting as a public authority in running the toll roads, but the referring court had unequivocally decided that it was, so the court proceeded on that basis.

The court reiterated the principles set out in precedent cases such as *Isle of Wight Council*. The Directive envisaged a situation in which a body governed by public law engaged in activities which may also be engaged in, in competition with them, by private economic operators. The aim was to ensure that those economic operators were not placed at a disadvantage because they were taxed while the public authorities were not. The application of the rule required an assessment of the economic circumstances of a particular case. The significant distortions of competition which treatment as non-taxable persons of bodies governed by public law acting as public authorities would lead to must be evaluated by reference to the activity in question, as such, without that evaluation relating to any particular market, and by reference not only to actual competition, but also to potential competition, provided that the possibility of a private operator entering the relevant market is real and not purely hypothetical. A purely hypothetical possibility of competition, not borne out by any matter of fact, objective evidence or analysis of the market, should be disregarded.

The court concluded that the mere presence of private operators in a market did not indicate that there were significant distortions of competition. The circumstances of the case were such that private companies could not compete with the NRA in relation to the roads it operated: only it could authorise their entry to the market under conditions that it would set, and it would be impractical for any private operator to construct roads that competed with those operated by the NRA. The court therefore concluded that the Directive did not require the NRA to be treated as a taxable person, because there was no significant risk of distortion of competition.

CJEU (Case C-344/15): *National Roads Authority v The Revenue Commissioners*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Direct effect of cultural exemption

The British Film Institute made a *Fleming* claim in respect of tickets to the National Film Theatre and some film festivals sold between 1990 and 1996. It had accounted for output tax, believing that it did not qualify for exemption under the cultural services provisions; but it subsequently realised that it should benefit from the *London Zoo* decision, as its main management was "essentially voluntary" in nature.

The Institute argued that from 1990, the UK was no longer entitled to tax cultural services which were covered by art.13A(1)(n) 6th Directive. A transitional provision which allowed taxation had expired, but the UK had not introduced the required amendments to Sch.9 VATA 1994. The Institute therefore claimed direct effect of the Directive in the absence of any domestic implementation of the provision.

When Group 13 was inserted into Sch.9 in 1996, supplies by cinemas were not included – even though they are envisaged in the Directive. There is therefore a further area of dispute between the Institute and HMRC concerning the availability of exemption after 1996 – now, the question is whether the UK is entitled to restrict the types of supply to which exemption applies.

The FTT (TC02490) considered a number of precedent cases, including several decisions of the VAT Tribunal which had supported HMRC's view that the UK was entitled to exclude cinema tickets from exemption because the Directive referred to "certain cultural services" (i.e. selected or restricted services, such selections or restrictions to be chosen by the member state). These decisions had been taken without reference to the CJEU decision in *Commission v Spain* (Case C-124/96), in which the Spanish government had argued a similar point in relation to the similar expression "certain services closely linked to sport". The Court had ruled that this did not entitle the state a wide discretion, but only related to the fact that such services had to be supplied by "the right sort of person".

The FTT concluded that the Directive was sufficiently clear and unequivocal to confer the benefit of direct effect on the Institute, and allowed the appeal.

HMRC appealed to the Upper Tribunal. It was accepted that admission to a cinema was capable of being a cultural service within the meaning of the Directive, and the BFI was a qualifying cultural body; the only question was whether, as the FTT held, the terms of Article 13A(1)(n) were (a) sufficiently clear and precise for it to have direct effect, and (b) not such as to permit the Member States any latitude or discretion in its application. The key question, therefore, was what was meant by "certain cultural services".

The Upper Tribunal considered the arguments again about the relevance of *Commission v Spain*, and also *Hoffmann* (Case C-144/00) which concerned the scope of the cultural services exemption; and *Canterbury Hockey Club* (Case C-253/07) and *Mesto Zamberk* (Case C-18/12), which examined the exemption for sport, which uses the same expression – "certain services closely linked to sport". The judges accepted that the word was capable of confusing the issue, but concluded that the CJEU precedents were clear that it did not allow Member States a wide discretion to limit the scope of the sporting exemption. It could not mean one thing in relation to cultural services and a different thing in the next sub-paragraph in relation to sporting services. Its effect was to restrict the exemption to those services mentioned in Annex H as cultural services eligible for the lower rate, when supplied by the right kind of organisation.

HMRC's appeal was dismissed again by the UT, but the CA decided to refer questions to the CJEU. Advocate-General Bot gave an opinion that use of the word "certain" (as opposed to "all") means that the legislature intended for Member States to be able to choose which supplies of cultural services should be exempt. Initially, it was proposed to draw up an exhaustive list of the supplies of cultural services subject to VAT exemption. That exemption related specifically to the supply of services by theatres, cinema clubs, concert halls, museums, libraries, public parks, botanical or zoological gardens, educational exhibitions, and operations within the framework of activities in the public interest of a social, cultural or educational nature. This list was not adopted in the Directive. There has been discussion in Commission reports on the operation of the Directive that this imprecision is not desirable, but Member States have resisted any change that would create a mandatory exemption.

The A-G suggested that "the exercise of the Member States' broad discretion is necessarily shaped by the objectives pursued by the Sixth Directive and the principles governing VAT." The objectives of the exemptions in art.13A(1)(h) to (p) must be "in the public interest", and Member States should only exempt such services in line with the principle of fiscal neutrality – if exemption would create distortion of competition, it should not be granted.

The A-G therefore stated that it was for the referring court to decide whether it would infringe fiscal neutrality to exclude the BFI from exemption. He specified as a comparison point "the supply, by public bodies or eligible bodies, of a right of admission to a theatrical, musical or choreographic performance of a cultural nature", rather than "the supply of cinematic performances by commercial operators".

The A-G then turned to the CA's first question, which was whether the provision had direct effect in the absence of any UK legislation on the subject. In his view, it did not, and therefore could not be relied on by a taxpayer in an action against the state. This was because the Directive did not give any indication of the nature of the cultural services that were to be covered by the exemption. It would have been different if the Directive had provided a definitive list of cultural services, but it contained no list at all.

The full court has agreed with the A-G on all points. The use of the word "certain", without an exhaustive list, deliberately left the choice to

Member States. This uncertainty meant that the provision could not have direct effect. The court rejected BFI's submission that exemptions should be regarded as universally applicable, independent concepts of EU law: the clear words of the law permitted variation in this situation. Such an extension of the scope of the exemption would be contrary to the principle that exemptions must be construed narrowly and precisely.

CJEU (Case C-592/15): *HMRC v British Film Institute*

2.4 Zero-rating

2.4.1 Caravans (or not)

A company accounted for output tax on supplies of motor homes. It then claimed a repayment of nearly £1.2m on the basis that the supplies should have qualified for the zero-rating traditionally allowed to caravans above a certain size.

The word "caravan" is not defined in the VATA. However, it is defined in one statute, the Caravan Sites and Control of Development Act 1960: "'caravan' means any structure designed or adapted for human habitation which is capable of being moved from one place to another (whether by being towed, or by being transported on a motor vehicle or trailer) and any motor vehicle so designed or adapted". The taxpayer argued that the motor homes it sold clearly fell within this definition. Although exceptions to the general rules of VAT should be narrowly construed, they also should be given their proper effect where they applied.

The First-Tier Tribunal (TC04445) did not consider the definition in the 1960 Act to be relevant. It was of limited application even in its own context, and was not applicable to the present dispute. The decision referred to an analogy from the 1995 *Colour Offset* case on the zero-rating of printed matter: "a cheque book is plainly not a book". Similarly, the fact that the vehicles might be called "motor caravans" did not mean that they were, in normal English usage, "caravans". The FTT judge considered that the context made it clear that the legislation was intended to refer to towed vehicles, not to motorised vehicles.

This was a significant distinction. The judge saw nothing in either UK or EU law to justify disregarding the distinction, just because both types of vehicle could be used for residential purposes. The taxpayer's appeal was refused.

The company appealed to the Upper Tribunal, arguing that the definition of a 'caravan' was a question of law. The Upper Tribunal disagreed: the meaning of an ordinary English word was not a question of law, and the finding that the company's vehicles were not caravans was a finding of fact. There was nothing in the text or context of the legislation to suggest that the word was being used in an unusual or technical sense, apart from the explicit requirement as to size. It was open to the FTT to conclude, as a matter of fact, that the vehicles were not 'caravans', and it could not be said that no reasonable Tribunal could have come to that decision.

Upper Tribunal: *Oak Tree Motor Homes Ltd v HMRC*

2.4.2 Edible flowers

A company claimed zero-rating for sales of plants, and seeds for plants, that produced edible flowers. HMRC's Notice 701/38 provides what they describe as an "exhaustive list" of plant varieties that can be zero-rated in this way, provided that they are held out for sale as food of a kind used for human consumption.

The company wrote to HMRC on 1 October 2009, commenting that it sold over 100 varieties of seeds that were not on the list but which it considered should be zero-rated. HMRC replied on 4 February 2010, accepting that such plants and seeds could be zero-rated provided they were "held out for sale" as food. The company wrote again on 16 November 2011 with a further list of plants; HMRC replied on 2 March 2012 reiterating that these could in principle be zero-rated, subject to the same condition (but noting that the list in the Notice would not be extended).

Further correspondence about the liability of seedlings ("plug plants") and mature plants led HMRC to the conclusion that many of the company's plants were sold for their decorative properties rather than as food. It was not enough to provide a leaflet explaining that they could be eaten. On 15 September 2014, they issued a decision that these varieties of plant do not fall within the ordinary meaning of the word 'food' and were predominantly used as garden plants for ornamental purposes. The ruling, which also extended to seeds, was stated to have effect from 1 January 2015, to give the company time to amend its VAT codes. The company appealed.

There was a dispute between the parties about the nature of the decision appealed against, and the nature of the ruling sought from the Tribunal. The company wanted a decision in principle, that HMRC's views on the conditions for zero-rating a sale of seeds or plants was wrong. HMRC's representative argued that the Tribunal should not consider a hypothetical question: the ruling related to the lists of the company's products, and the Tribunal should consider those specifically. That meant that the company would have the burden of proving that these particular products were "food" within the meaning of the legislation. The Tribunal agreed with HMRC's view.

HMRC accepted that the plants were all "edible" in the narrow sense that they could be consumed by humans without causing harm, but that would also apply to grass, and it did not make them "food". Their representative argued that "the ordinary man in the street" would regard food as something that is ordinarily, or typically, eaten. Moreover, in order to be "food", a product must be typically eaten rather than typically used for some other purpose. He accepted that the ordinary man in the street would pay attention to the way a product is held out for sale. However, the mere fact that a product is held out for sale as "edible" would not be enough: the ordinary man in the street would require a product to be held out as being for specifically culinary use before considering the product to be food.

The Tribunal set out four tests to be considered:

- the range of uses of the plant;

- the frequency with which the plant's flowers are consumed;
- the taste of the product (culinary uses could also be decorative, not as food);
- the way in which the product is offered for sale.

The Tribunal considered the available evidence and concluded that the company's evidence was too general to satisfy the burden of proof that its products were "food". They were held out as "edible", but a typical customer would not regard them as "food". The judge rejected an argument based on fiscal neutrality: he was not satisfied that the company's products were similar to those on the HMRC list of potentially zero-rated plants. The appeal was dismissed.

First-Tier Tribunal (TC05604): *Branded Garden Products Ltd*

2.5 Lower rate

Nothing to report.

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

2.7.1 Rent rebate

An individual owned a property which he rented to a company that he controlled. He had opted to tax and charged VAT on the rent of £20,000 per month. On 25 February 2011, an administrator was appointed to the company, and on 26 April 2012 a liquidator was appointed to carry out an insolvent liquidation.

Under insolvency law, the liquidator reclaimed £1.4m paid to the owner of the company as a "preferential payment". After some negotiation, an agreement was entered into under which £300,000 was repaid, representing VAT-inclusive rent. A credit note was raised showing VAT of £45,958 (at the rates ruling at the time), and the owner claimed this from HMRC. HMRC refused the repayment claim, and also refused to allow a claim to bad debt relief.

HMRC argued that the £300,000 was not wholly a repayment of rent, but was a payment made to the liquidator in consideration for the liquidator not pursuing proceedings against the owner under the insolvency law; it was therefore payment of compensation to settle a claim and outside the scope of VAT. There was, on HMRC's case, no repayment of rent nor bad debt.

The judge (Barbara Mosedale) commented:

It is well-established that the settlement of a claim between two parties, whether or not legal proceedings have been issued, is outside the scope of VAT, so that the receipt of the £300,000 did not attract VAT in the hands of the company. However, that is not to say a settlement of a claim is without VAT implications where the underlying subject matter of the dispute is a VAT supply. So while [HMRC's representative] is correct to say that a settlement of a claim brought against [the owner] by the liquidator is not by itself something that creates VAT rights and liabilities, nevertheless the Tribunal must look at the VAT supplies underlying the dispute to see what effect the settlement of the dispute had on them.

The Tribunal considered that the agreement did represent a repayment of rent, and the issue of the credit note meant that the owner could not prove for the debt in the insolvent liquidation. The circumstances fitted the rules in PVD art.90, which had direct effect, and HMRC had not suggested that the appellant had not met the conditions of SI 1995/2518 reg.38.

If she was wrong in this, the judge considered that the rent would still have been due and had not been paid, so the bad debt relief claim would be valid. Either way, the owner's appeal succeeded.

First-Tier Tribunal (TC05622): *Terence Patrick Brady*

2.8 Compound and multiple

2.8.1 Optional insurance

A company ran a taxi business, providing a radio support service to a fleet of about 280 vehicles. Approximately 200 were owner drivers, the remainder being cars rented to the driver with the radio. The renting drivers were offered the option of taking third party insurance through the company. The company charged £120 per week for car plus radio, and an extra £45 for the insurance. HMRC ruled that the whole amount was taxable, and assessed for £66,859 of undeclared output tax in November 2011. The appeal reached the First-Tier Tribunal (TC04547) in May 2015.

Both parties relied on *Card Protection Plan*, in which customers of CPP were brought within its "block policy". The company argued that it was doing the same thing; HMRC responded that the facts were different, because CPP's customers became "named insured", whereas the drivers' names were not added to the policy. The appellant company could not legally bind the insurer, and was therefore not an insurer, nor an intermediary, nor in the same position as CPP.

The director and the company's tax adviser both complained that HMRC had allowed exempt treatment to a trade rival, and the appellant was being unfairly "singled out". HMRC argued that the onus of proof was on the appellant to prove such a thing, which they denied. The Tribunal noted this part of the dispute, but did not consider it particularly relevant.

The Tribunal noted the broad interpretation of "insurance" by the CJEU in *CPP*:

"*... art 13(b)(a) of the Sixth Directive is to be interpreted as meaning that a taxable person, not being an insurer, who, in the context of a block policy of which he is the holder, procures for his customers, who are the insured, insurance cover from an insurer who assumes the risk covered performs an insurance transaction within the meaning of that provision.*"

The Tribunal was satisfied that the optional extra payment by the drivers fell naturally within the extended sense of "insurance" set out by the CJEU in *CPP*. The judge was "unimpressed" by HMRC's attempts to differentiate between the drivers "being insured" and "being given the benefit of an insurance policy". The policy operated to make sure that the drivers were protected against prosecution for driving without insurance.

The appeal against the assessment was allowed by the FTT, and HMRC appealed to the Upper Tribunal. HMRC argued that the company could not make exempt supplies of insurance because it was not an insurance company; that it imposed a requirement for insurance which effectively created a compound supply; and that the drivers would have to rely on the company to enforce the cover that it had arranged on their behalf. The UT did not consider that any of these factors was conclusive. In particular, HMRC's restricted interpretation of *Card Protection Plan* – that it only related to "block" insurance policies – was not justified by the wording of the CJEU's decision, and it did not support the contention that a company in the position of this appellant could make supplies of insurance.

The UT referred to *BGZ Leasing sp zoo v Dyrektor Izby Skarbowej w Warszawie* (Case C-224/11) as authority for the proposition that a leasing service and the supply of insurance for the leased item cannot be regarded as being so closely linked that they form a single transaction. There must be some other factor beyond the obvious link between insurance and the item insured that makes them a compound transaction. The drivers had the choice between purchasing insurance from the company or arranging their own cover and that the supply of insurance was priced separately: this seemed indistinguishable from the circumstances in *BGZ*. The UT concluded that the supply of insurance was a separate supply, and HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Wheels Private Hire*

2.8.2 Lodges and contents

A company sold "lodges" – moveable wooden buildings – for which it granted licences to occupy on pitches on land it owned. The lodges qualified as "caravans" for the purposes of zero-rating. A dispute arose about the valuation of removable contents, which by statute are required to be excluded from zero-rating. The company appealed against a number of assessments to additional VAT that HMRC claimed was due.

The day before the hearing, the company delivered a skeleton argument that referred to one of the *Colaingrove* cases, that had not previously been included in its submissions, and also advanced a new argument that the assessment failed as a "global assessment" for a period part of which was out of time. The judge gave HMRC time to make written submissions on the case, and HMRC's representative agreed to speak to the time limit issue at the hearing. Further written submissions were received from both parties after the hearing.

The judge also noted:

The arguments in correspondence and before me were conducted by reference to VAT Notice 701/20. The version in the bundle was that of 27 December 2013 and it referred to the previous version of April 2012 though the change made was not relevant to this appeal. Neither party suggested that any earlier version in force during the periods of any assessments was relevantly different. Nor did either party suggest that any part of the Notice had the force of law.

I therefore asked the parties to tell me what the relevant law was, but neither knew. Mr Haley [for HMRC] was closest, referring to s 19(5) VATA, but the answer is s 19(4) VATA.

The company argued that it aimed to make a profit out of its land, and it passed on the discount it obtained from the suppliers of the lodges (and their removable contents) to the customers. The judge commented that the requirement of s.19(4) was that an apportionment of the total consideration had to be made on a "just and reasonable basis".

The judge considered an argument put forward by the appellant that the dispute in *Volkswagen Financial Services* was relevant: in that case, HMRC argued that "where the profit is made" is a relevant factor in apportioning consideration. However, the judge could not see any direct relevance, and also noted that the Court of Appeal had found against HMRC.

A licence had been granted over one plot without the sale of a lodge. The judge noted that the price charged supported the company's contention that it made all its profits from the sale of licences and the mark-up on lodges was zero; the fact that this was an arm's length transaction was good evidence of the way the business operated. The company's apportionment was therefore "fair and reasonable".

There was a separate argument about the plot sold without a lodge. HMRC ruled that it was standard rated as a "seasonal pitch". The company argued that there was a compound supply of "pitch with lodge", even though the lodge was supplied directly to the person who bought the pitch (he was connected to the supplier company). The company argued that the lodge was on site when the pitch was supplied, so it was a composite supply.

The judge concluded that the appellant's arguments on this point were confused and contradictory. There was no evidence that the lodge had in reality been supplied to and by the company; it did not account for input tax on it, nor account for the sale. The plot on its own should therefore have been standard rated.

On the time limit point, the company claimed that one of the assessments was a single document covering periods from 02/12 to 05/15, not made until 30 July 2015. HMRC responded that it was itemised by period and was not therefore a global assessment; it had been raised within one year of the officer obtaining all the information necessary to make it. The judge agreed with HMRC: on the evidence, the officer did not have all the evidence until February or March 2015 when the company's accountants responded to some specific queries. The assessment was not out of time. The judge made some critical comments about the way in which the

parties argued the time limit issue, as neither of them appeared to have focused on the correct sub-section of VATA 1994 s.73.

The end result was that the assessments for extra output tax on the basis of apportionment to removable contents were discharged, but the assessment in relation to the sale of the pitch was upheld.

First-Tier Tribunal (TC05576): *Cottingham Park Lodges Ltd*

2.9 Agency

2.9.1 Tripartite arrangements

A recruitment company (AUK) made a voluntary disclosure to claim back VAT charged on receipts from clients who employed temporary staff. The company argued that the decision in *Reed Employment* meant that it should only have accounted for output tax on its margins. A number of other claims were made by companies that were now in the same VAT group registration, but had not been at the time that the claimed overpayments had been made. There was therefore a separate issue about the identity of the appropriate claimant, but the FTT (TC04743) was not asked to rule on that.

First-Tier Tribunal

The judge (Barbara Mosedale) described three business models of AUK:

- employed temps, actually subject to contracts of employment with the company;
- non-employed temps, who were the subject of the appeal – treated as employees for various regulatory and tax purposes;
- contract workers, who would enter into an agreement directly with the client – the client would typically pay a one-off fee to the company, and the company did not employ or pay these individuals in any sense.

The second class of people were the subject of the appeal. AUK had paid VAT in full on the amounts received from clients in respect of such people. On 24 March 2011, Judge Berner released the FTT's decision in *Reed Employment*, holding that on the facts of that case, that employment agency was acting as an intermediary and only needed to account for output tax on its commission. AUK subsequently made various claims for overpaid VAT totalling over £11m. HMRC rejected the claims, and the company appealed.

Judge Mosedale summarised the issues as follows:

The question for the Tribunal was simple in essence. What did Adecco supply to its clients? However, that question was logcially indistinguishable from the question of to whom did the temps supply their work? If Adecco merely supplied introductory services to its clients, then it follows logically that the temps supplied their services direct to the clients and not via Adecco: if, however, the temps supplied their services to Adecco, then it follows that Adecco must have on-supplied these

services to its clients. So the question of what services Adecco provided to its clients is really indistinguishable from the question of to whom did the temps supply their services.

The parties agreed that the Tribunal should examine four representative contracts to cover all supplies during the relevant period (with two exceptions). The Tribunal examined the terms of the contracts between the temps and the company, and between the company and its clients, as well as considering the differences between those arrangements and the situation of employed temps.

The judge concluded that the company was liable to pay the temp the agreed payment for its services in undertaking the assignment for the client. The client had no contractual obligation with either the temp or AUK to pay the temp for its work in undertaking the assignment. The client's only obligation to pay for the work was an obligation to pay AUK the agreed fee. The appellant's interpretation of the contract was inconsistent with the company's standard temp contract and inconsistent with the lack of legal obligation between the temp and the client. Looking at the contract in its context, HMRC's interpretation was clearly to be preferred.

Two client companies used their own standard contracts rather than those normally put forward by AUK. The judge had to consider whether the different wording of those contracts led to a different conclusion. The first certainly included clauses that suggested AUK was making payments to the temps on behalf of the client. It was clear that it had been drawn up with VAT in mind: it appeared to be an attempt to invoke the "staff hire concession under BB 10/04. However:

"*The problem for the appellant is that this contract clearly anticipated that VAT would only be charged on the commission element: if in fact VAT was only charged on the commission element then Adecco has no claim in respect of it because, even on the appellant's case, no VAT was actually overpaid. On the other hand, if VAT was charged on the full fee, then the only conclusion can be that the parties did not in practice fully operate the terms of the contract.*"

There was nothing in either of the clients' contracts to change the legal relationships. In each case, AUK was contracting with the temp and with the client as principal, not as an intermediary or agent.

After coming to that conclusion, the judge went on to cite the *Newey* decision of the CJEU: the contracts were not absolutely determinative of the VAT position. In *Aimia*, the Supreme Court had commented that a tripartite arrangement had to be considered "having regard to all the circumstances in which the transaction or combination of transactions takes place".

The company argued that this supported its case: the "reality" was that it introduced the temps to the clients, and the temps did their work for the clients. This was the decision of the FTT in *Reed Employment*: although HMRC had appealed that case, they had not done so in respect of this particular aspect of the decision. The company suggested that this "almost" created an issue estoppels, preventing HMRC arguing the point in the current case. The judge rejected this, stating that issue estoppel only exists between the same parties. It was "undesirable" that HMRC

would abandon a particular argument in one case and then take the same view in a dispute with another taxpayer just three years later, but there was nothing to stop them doing so.

The judge therefore had to consider the decision in *Reed* and whether she agreed with it. She identified three key paragraphs in the *Reed* decision (at 84, 85 and 88) in which Judge Berner appeared to base his conclusion on the fact that Reed had no control over the temps. Because it could not exercise any control, it was not really capable of "supplying their services". It must therefore be making a more limited supply, one involving introductory services.

Judge Mosedale did not agree with this conclusion. It was perfectly possible for a supply to involve the following: "*If A agrees with B, in return for money, to do what C tells it to do, that is doing something in return for consideration and there is no reason in logic why that cannot be a VAT supply by A to B, even though at no time does A agree to work under B's direction. Yet the conclusion in Reed Employment seems to have been that A can't supply its work to B if what A agrees to do for B is to work at C's direction. I simply can't agree.*"

Nevertheless, that was not the end of the matter. It was possible that *Reed* could be distinguished on the facts, in which case the current decision might be different (i.e. AUK might win, even though Reed should have lost, in Judge Mosedale's opinion). The judge therefore examined a number of precedents about supplies of staff: the 1995 *Reed Personnel Services* case; *Hays Personnel Services*; and the more recent case of *Wendy Lane* from 2013. She did not regard any of them as comparable. She then turned to precedents about tripartite arrangements in general, reviewing *Redrow*, *Tolsma*, *Loyalty Management/Aimia* and *Baxi*. She paraphrased the *Redrow* principle as "follow the liability to pay", which favoured HMRC in the present case.

There is an interesting section in which Judge Mosedale considers the difference between the CJEU and Supreme Court decisions in *Aimia*. She comments that the majority of the Supreme Court concluded that the CJEU had been asked the wrong question and had therefore given an answer that did not apply to the facts. She also reconciles the different decisions in *Baxi* (which sold boilers and gave "points" away free) and *Aimia* (which bought and sold "points", and was therefore more involved in the supply chain involving the redemption of those points).

It was more difficult to reconcile the decision in *Redrow* with that in *WHA*, where the Supreme Court had come to the opposite conclusion – the person who paid for the supply (the insurance company) did not receive it, but rather the garage made its supply to the owner of the car. It was difficult for a Tribunal judge to know which Supreme Court precedent to apply. She summed up the principle she derived from these cases as follows:

"*My analysis of the situation is therefore that the Tolsma/Redrow/Aimia 'follow the liability to pay' rule is the default rule under which the VAT supply will follow the contracts and that rule applies in tripartite situations unless the economic reality is inconsistent with the contractual position. And the economic reality is inconsistent with the contracts where final consumption takes place without a contract (or other legal relationship) supplying the thing to be consumed to the final consumer.*"

Lastly, she considered the *Airtours* decision, commenting that the majority decision of the CA was "*difficult to understand as they appeared to find that there was no contract [between Airtours and PwC]: this is because they said PwC owed no liability to the company to provide the report to the bank, yet nevertheless the company was liable to pay for the report.*" Nevertheless, that case could be distinguished on the facts, and had no effect on the present appeal.

Finally, she concluded "*I take from consideration of all these cases that a VAT supply, ordinarily at least, requires a legal relationship between the supplier and recipient under which the supplier is obliged to make the supply and the recipient is liable to pay for it, whether or not that liability arises under an enforceable contract (Tolsma, Redrow, Town & County Factors). Nevertheless, where the economic reality of the legal relationship is such that it results in final consumption of goods or services by a consumer in circumstances where in effect there is no VAT charge on that consumption then this normal rule is overridden because the ultimate purpose of the Principal VAT Directive is to tax final consumption...*

"*In conclusion, in a situation where B agrees to pay A to provide goods and/or services to C, and C agrees with B to pay for the goods and/or services provided by A, then a Redrow 'follow the liability to pay' analysis applies to decide to whom A's supply is made. This is because the legal relationships reflect the economic reality and the outcome is consistent with the Principal VAT directive because final consumption is taxed. In other words, A's supply is to B, and B makes an on-supply to C.*

"*But where a Redrow 'follow the liability to pay' analysis does not lead to tax on final consumption, because although A makes a supply to B (of providing goods/services to C), B does not on-supply A's services to C, then C's consumption will be untaxed, and, applying Baxi/Aimia/WHA, economic reality requires the supply to be seen as made to the final consumer.*"

Here, it was clear that the clients were the final consumers of the work of the temps, and they also had the legal liability to pay for what they consumed. The day-to-day control over what the temps did was not relevant to the contractual position. The economic reality was consistent with the contractual position: that was that the temps had agreed with AUK to do what the client told them to do. The clients were the final consumers of the services, and they paid for them, and that final consumption ought to be taxed.

As a postscript (at paragraph 313), Judge Mosedale noted that her decision was consistent with fiscal neutrality: there was little difference from the client's point of view between the supply of an employed temp and the supply of a non-employed temp, so it would be surprising if there was a fundamental difference between the VAT treatments of those supplies.

Upper Tribunal

The companies appealed against the decision to the UT. The judges noted that the issue (who received the supply from the temps) was similar to that in *Airtours*, where the FTT did not have the benefit of the Supreme

Court's judgment. The UT had to construe the contracts, and then consider whether they represented economic and commercial reality.

The UT was clear that there were contracts between the temps and the appellant, and between the appellant and the clients, but no contracts between the temps and the clients. That was strongly suggestive that the temps were being supplied by the appellant to the clients. The appellant argued that the commercial and economic reality was that the temps did their work only for the clients, and could not therefore "be supplied" by the appellant, but the UT did not consider that to be a correct statement of VAT principle. It was clear from the terms of the contract that it was not a mere introduction; if it had been, there would have been no need for provisions about the appellant's obligations if the temp failed to turn up through sickness or unauthorised absence. The UT also agreed that the position of the employed and non-employed temps was so similar that they should be treated in the same way for VAT.

The UT noted that Judge Mosedale had expressed the hope that there would be guidance from a higher court to clarify what she considered to be the incorrect decision in *Reed Employment*. As that case was not the subject of an appeal before them, the UT judges declined to make any such comment, and emphasised that the present decision related to the particular facts of the case, its own contracts and economic reality.

The appeal was dismissed.

Upper Tribunal: *Adecco UK Ltd and others v HMRC*

2.9.2 Amazon sales

HMRC raised assessments on a partnership totalling nearly £140,000, plus a penalty at 18%, covering periods from 12/10 to 09/12. In HMRC's view, amounts paid by Amazon to the partnership represented consideration for supplies of goods by the partnership; the partnership contended that it received the proceeds on behalf of a separate business, and it should only be taxed on its own income.

The partnership of two Ukrainians had a close personal relationship with the supplier, also a Ukrainian. There was an "investment and development agreement" under which the partnership paid $60,000 interest-free to the supplier, this loan to be repaid out of the proceeds of sales. These proceeds continued to be paid to the partnership even after the loan had been fully repaid, which HMRC took as evidence that they were in reality trading as a single business.

The Tribunal considered that the receipt of money by the partnership was prima facie evidence that it was making the supplies for which the money was consideration. However, it was necessary to take into account contrary evidence. The witness statements of the partners and the various documents available were credible and consistent. There were various reasons for the arrangement that went beyond any VAT effect – for example, the supplier needed dollars to pay Far East suppliers but had revenues from Amazon in sterling; the partnership needed sterling for its expenses but had available personal funds in dollars. The arrangement therefore suited both parties and allowed them to avoid currency conversion costs.

The judge was satisfied that the appellant partnership was not the person selling the jewellery; that it was not acting as part of a larger partnership with the supplier; that its funding of the supplier was a financing transaction; and that it was not selling as an agent acting in its own name. He noted that the question of whether VAT had been accounted for on the sales of the jewellery had not been answered, and that was unsatisfactory from HMRC's point of view – but he concluded that any VAT liability was not due from the appellant partnership.

First-Tier Tribunal (TC05611): *Avalaya.com Partnership*

2.10 Second hand goods

2.10.1 Cars and parts

A Danish business buys "end-of-life" vehicles and strips out useable parts for resale. The purchases are not subject to VAT. Questions were referred to the CJEU to determine whether the company was eligible to use the margin scheme for its sales, given that it was not selling the things it bought in the same form.

Advocate-General Bot gave an opinion that the margin scheme should extend to such activities, in accordance with the EU's fundamental principles of encouraging the reuse and recovery of waste. This would be undermined if taxable dealers were required to account for output tax on the full selling price without any deduction in relation to their costs.

The Danish government argued that the wording of art.311 required the second-hand goods to be sold in the same state: "movable tangible property that is suitable for further use as it is or after repair". The A-G did not agree that this implied a requirement to exclude goods originating from a single whole which could be separated.

The A-G had to consider how the margin should be calculated, given that the transactions are more complex than those normally involved in second-hand margin schemes. In his view, "*the profit margin would be calculated for a given period. It would be equal to the difference between the sum of sales of spare parts effected during that period and the sum of purchases of such spare parts. The latter sum could be calculated by deducting from the sum of purchases of end-of-life motor vehicles the value of environmental and waste treatment, services for which Sjelle Autogenbrug charges a standard price, and the value of sales of scrap or any other services. Consequently, what would be left after deducting all those amounts from the purchase price of the vehicles would be a sum corresponding to the purchase price of all the parts taken from each vehicle for the period in question*."

The full court has agreed with the opinion. There was no reason to exclude this kind of operation from the margin scheme, and good reasons to include it – to encourage recycling and to avoid distortion of competition. The Directive permitted the margin to be calculated on a "total" basis (global accounting in the UK) under art.318. Any practical difficulties in applying the scheme were not a sufficient reason to exclude a category of second-hand dealers from its benefits.

CJEU (Case C-471/15): *Sjelle Autogenbrug I/S v Skatteministeriet*

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Gifts of vouchers

The Court of Appeal has given its judgment in the *Associated Newspapers* case. The dispute arose out of a promotion for the Daily Mail and Mail on Sunday in which the company purchased Marks & Spencer vouchers – some directly from M&S, and some from an intermediary – and gave them to customers who changed to taking the paper for a set period (and to retailers who signed them up). The promotion was very successful.

The invoices relating to the purchase of the retailer vouchers showed an amount of VAT at a "blended rate". This is permitted by VATA 1994 Sch.10A: the retailer will account for output tax on redemption of the vouchers, and if the retailer sells a mix of standard and zero rated items, it can quote its average output tax rate for intermediaries to use when they sell vouchers. The company claimed an input tax deduction for the VAT shown on the invoices.

HMRC put forward two initial arguments to the FTT:

- that the input tax was not deductible because it was related to giving the vouchers away for no consideration, which was a non-business activity;
- that the gift of the vouchers was subject to output tax, equal to the input tax claimed, as a gift of services under SI 1993/1507.

The FTT rejected both of these arguments. The promotion scheme was clearly a business purpose, and the cost of the vouchers was linked to the sale of newspapers. It was incorrect to consider only the direct use of the vouchers: their purchase was linked to the economic activity of the company as a whole. It was also incorrect to say that the vouchers had been "put to a purpose other than the purposes of the business", as required for the output tax charge under SI 1993/1507. The purpose of the customer redeeming the voucher was not what the law was referring to; it was the use made of the voucher by the trader, which was clearly for the purposes of the business.

The FTT questioned whether there should be input tax at all, given that VATA 1994 Sch.10A provides that the issue of a retailer voucher is a disregarded transaction. The FTT judge concluded that the rules of fiscal neutrality and the application of the principles of the PVD required the purchase of the vouchers to be regarded as a VATable transaction, which meant that there must be input tax to deduct. So the FTT allowed the company's appeal on all grounds.

The Upper Tribunal disagreed about the issue of retailer vouchers. In the view of the UT judge, the clear words of Sch.10A meant that there was no VAT on the purchase of the vouchers directly from the retailer, and therefore it could not be deducted. Vouchers purchased from an intermediary were subject to VAT, and the VAT shown on the invoices (at the blended rate) could be deducted. Although this appeared to offend

against fiscal neutrality, it was in accordance with the clear words of the law. The UT agreed with the FTT on the link between the inputs and the business, and the non-applicability of SI 1993/1507.

HMRC appealed to the Court of Appeal, where the leading judgment was given by Patten LJ. He started with the input tax issue, as the UT had done. He considered first whether the purchase of the vouchers represented a cost component of a taxable supply, examining precedents such as *Rompelman*, *BLP Group*, *Midland Bank*, *AB SKF*, *Abbey National* and *Sveda*. He contrasted *BLP*, in which costs associated with making an exempt supply could not be treated as linked to the wider activities of the business, with later decisions, and made the following comment:

It seems to me that the CJEU has clearly moved away in these recent decisions from any disregard of the ultimate economic purpose of the relevant expenditure in considering whether it should be treated as linked to the taxpayer's wider economic activities. This is not a question of subjective intent but requires an objective analysis in terms of the taxpayer's identifiable economic activities of why the input supplies were acquired. Although there must, I think, be some evidence that the cost of the input supplies was passed on as part of the cost of the supplies which the taxable person subsequently makes, the absorption of those costs as part of the expenditure of running the business is not to be ignored merely because they also facilitated the making of supplies which in themselves were either exempt or outside the scope of the PVD.

HMRC sought to rely on the *Mayflower Theatre Trust* decision, in which the CA had identified a link between the production costs and the sale of tickets and had dismissed the more tenuous "but for" link with the sale of refreshments. Patten LJ suggested that a different approach seemed to be required in the light of *Sveda*. The fact that services in the form of the vouchers were acquired in order to make non-taxable output supplies of the same items to the company's customers was not determinative if the cost of those supplies was in fact a component of the company's taxable business. He therefore decided that point in favour of the company.

He turned next to SI 1993/1507. HMRC argued that the FTT had applied the wrong tests in construing art.26 PVD. They sought to rely on *Danfoss* and *Julius Filibeck* to show that the circumstances in which services could be provided free without an output tax charge were very limited, based on business necessity rather than a business choice. The judge explained that this was a misrepresentation of those cases:

...as the Upper Tribunal has explained, there is an obvious difference between the need to demonstrate that the meals have been provided for strictly business-related purposes in the sense of being exclusively provided for that purpose and a requirement that they should be strictly necessary in order for the business purpose to be carried out. The fact that the removal of the element of choice was sufficient to establish a business use in the context of a meeting suggests that a strict test of the kind contended for by Mr Beal is not warranted by the legislation. What one is looking to identify is a provision of services made in order to fulfil a business purpose and nothing else. In Danfoss the distinction between private and business use in relation to the meals served to employees turned solely on the fact that when attending business meetings they were required to accept the set meal provided. As the Court acknowledged, the

provision of a meal by the employer had the effect, from the employer's point of view, of reducing the scope for interruptions in the meeting and so furthered the business purpose of the occasion. This will be a question of fact in every case. But the issue is whether the supply of services better fulfils a business purpose and no other purpose rather than whether it is a sine qua non for the achievement of the business purpose at all.

The judge concluded that the vouchers were purchased for a commercial purpose, and giving them to the customers achieved that commercial purpose. There was nothing to engage art.26 PVD or SI 1993/1507.

Lastly, the judge considered the question of whether Sch.10A para.4(2) meant that there was no input tax in the purchase of the vouchers from M&S. The company argued that treating this transaction as outside the scope of VAT offended against EU legal principles, and the court should apply the *Marleasing* principle. The judge said that this would only be appropriate if it was clear that the UK law was not consistent with some specific piece of EU legislation; however, the PVD did not directly address the treatment of vouchers. The UK was therefore at liberty to choose how to tax them, and Sch.10A did not offend against any EU law.

It was not relevant that the price charged by the retailer for the issue included an amount of money that would enable it to account for the output tax when the voucher was redeemed. The law treated the transaction as not VATable, and the company's appeal had to be dismissed.

The judge concluded that all the appeals of both parties should be dismissed: the UT had been correct. Black LJ and Jackson LJ agreed.

Court of Appeal: *Associated Newspapers Ltd v HMRC*

2.12.2 Article

In an article in *Taxation*, Michele Harris discusses the potential problems for hairdressers undergoing an investigation. If the appropriate contracts are not in place for "chair rent", HMRC could attack the VAT treatment used in various different ways. The writer suggests that tax advisers should consider their clients' trading environments and paperwork in order to safeguard them from unexpected VAT liabilities in the future.

Taxation, 26 January 2017

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Holiday accommodation

An individual applied to register voluntarily from 20 June 2007 until 1 July 2012, when he deregistered. He was visited in December 2011 by an officer who raised questions about a particular property that was rented to a hotel for £2,000 per week. The officer did not receive replies to requests for information over a very long period; when the taxpayer's agents finally provided details of the licence agreement in October 2012, HMRC responded a week later with a decision that the rent was VATable as relating to furnished holiday accommodation. Further delays in correspondence followed, and in November 2013 the officer issued an assessment for £30,848 covering a two-year period. A failure to pay the assessment led to further delays, culminating in a hearing in January 2017 without the taxpayer present or represented.

The taxpayer's arguments were taken from the grounds of appeal submitted by a firm of tax agents who had taken over since 2012. They pointed out that the recipient of the supply was also a VAT-registered business. The uncertainty over the liability of the supply, followed by deregistration, meant that no VAT invoices had ever been issued; the underdeclaration by the appellant had been matched by an overdeclaration by the licensee. The agents suggested that the officer should have issued a warning rather than an assessment, and applied a "nil net tax" concession.

The Tribunal agreed with HMRC that the assessment was issued to best judgement. There appeared to be no dispute about the categorisation of the supply. The Tribunal had no jurisdiction to require HMRC to issue a warning or to apply a concession; each taxpayer's affairs must be looked at separately, and the question of whether a different taxpayer could have deducted the VAT as input tax was not relevant to the present case.

The appeal was accordingly dismissed.

First-Tier Tribunal (TC05663): *Mohamed El-Baghdadi*

3.2 Option to tax

3.2.1 Article

In an article in *Taxation*, Neil Warren discusses the recent Tribunal decision in *Water Property Ltd* (TC05450). He expresses surprise that HMRC chose to ignore their own published guidance, and indeed argued in the FTT that the Tribunal had no jurisdiction to force the department to follow it. He is less surprised that the taxpayer won.

Taxation, 16 February 2017

3.3 Developers and builders

3.3.1 Retrospective planning permission

HMRC ruled that a builder had to charge VAT on construction services supplied to an individual between March and 9 August 2015, because planning permission was only granted for the construction of a new dwelling at the later date. Initially the Tribunal listed the building company as appellant, but by the time of the hearing it was only the individual who appeared. There was no financial consequence for the builder, who would be able to charge the buyer VAT for the initial period.

The project started as an extension of an existing property. The buildings inspector had drawn attention to problems with the existing structure that necessitated it being completely demolished and rebuilt. This new project was started in March 2015, but was only recognised in a revised planning consent in August. Invoices for £220,000 + VAT were issued to the appellant in the period before the revised consent was obtained.

The FTT judge (Rupert Jones) reviewed a number of precedent cases, and commented that the decision was not straightforward. There was precedent confirming that the VAT on a construction supply depended on the situation at the time of the supply, which favoured HMRC; the appellant's representative argued persuasively that this produced an absurd result, as the finished dwelling satisfied all the requirements of Group 5 Note 2 but would be partly standard rated. He made the point that earlier decisions on retrospective consent dealt with approval after the whole project had finished, whereas this project was approved while it was still in progress.

Although the precedent decisions largely concentrated upon the DIY scheme, which was not applicable to this case, the points of principle were persuasive. The judge preferred to follow the line of reasoning contained in *Northside* and *Thomas Brennan* to that in *Watson* and *Francis*. The conditions for zero-rating had to be met at the time of supply. The judge noted that the appellant had only applied for the revised consent two months after construction commenced; he had risked not only the payment of VAT, but also the possible refusal of consent, with a requirement to destroy the property. The appeal was dismissed.

First-Tier Tribunal (TC05571): *Nigel Williams*

A similar decision was reached in a case about an unusual development. A "recreational island" was constructed in the middle of a lake on a gravel extraction site. Various structures might have qualified as dwellings on general principles, but planning permission was not granted until after the project was completed, and HMRC also questioned whether separate use or disposal was permitted.

The Tribunal noted the precedents, and also the above decision, which was informative but not binding. It concluded that the appeal had to be dismissed for the same reasons. The judge (Amanda Brown) noted that it was therefore not necessary to come to a decision on the "separate use" point, but she considered it in some detail anyway. The fact that Note 2 defines "dwelling" and yet also includes the same word in the definition was confusing and created doubt about its application; the judge was glad not to have to reach a conclusion on the point.

HMRC also argued that the builder had a once-for-all opportunity to zero-rate some of its supply when it raised the invoice, and could not go back and adjust the liability after the event. The builder complained that it had been told to do this by the Advice Line, although HMRC had no record of this conversation. The Tribunal did not consider that there was a statutory basis for HMRC's assertion: a s.80 claim could have been made to correct the liability, if it had been found to be wrong.

First-Tier Tribunal (TC05624): *Master Wishmakers Ltd*

3.3.2 Discharge of planning condition

A company was assessed to underdeclared VAT of £305,000 in respect of a construction project. It traded as a hotel, and had acquired additional land and buildings in 2007 on which a dwelling-house was constructed. The planning consent stated that disposal of the dwelling house could only be linked to disposal of the hotel.

A building company initially charged no VAT on the construction costs invoiced in 2011 and 2012. The appellant's VAT adviser pointed out that this was incorrect, and supplementary invoices were issued in April 2013 charging £210,000 of VAT. The adviser also pointed out that an onward supply would be required for the appellant to recover this, and an invoice was raised to the owner of the company, also in April 2013, for £1.5m plus VAT. The output tax was accounted for. In June 2013, the company applied for the planning condition to be discharged, and this was done on 2 August 2013. On 30 September 2013, as advised by the VAT adviser, the company issued a credit note for the VAT of £305,000 to the owner, and reversed the output tax charge in Box 1 of that period's VAT return.

The builders issued further invoices to the appellant after 2013, but these were zero-rated.

HMRC issued a decision in March 2014 that the adjustment for the credit note was incorrect, and the company paid an assessment. In 2016, it made a s.80 claim to adjust the return in which the output tax had originally been accounted for, and it was HMRC's refusal of this claim that came before the Tribunal.

The company argued first that it had not made a supply of the house until 2016, when it was actually transferred to the owner. It had issued the invoice in April 2013 because it had been advised to do so, but there had been no agreement between the parties at the time, and afterwards only the company had any interest in the land. If there was no supply, there could have been no VAT. Alternatively, the supply should have been zero-rated.

The judge (W Ruthven Gemmell) came to the opposite conclusion to the English FTT on the application of Note 2(d). In his view, it was only possible to determine whether a building satisfied Note 2 when the building was complete, and there was nothing unusual about later determination of facts changing a VAT liability. HMRC were correct that there was a supply in April 2013 – there was substantial contemporaneous evidence for it – but it was zero-rated. The appeal was allowed.

First-Tier Tribunal (TC05694): *Quitie Ltd*

3.4 Input tax claims on land

3.4.1 DIY claims

A couple made a claim for £25,534 under the DIY scheme in relation to the conversion of a barn into a "live/work unit" – a 4-bedroom residential property and workshop. HMRC refused the claim on the grounds that the planning consent restricted occupation to someone who worked in the workshop, and prohibited occupation of the residential part until the workshop had been brought into use.

The Tribunal agreed with HMRC that this constituted a prohibition on separate use or disposal, and the building was therefore not "designed as a dwelling". The appeal was dismissed.

First-Tier Tribunal (TC05591): *Anthony Treanor; Mrs Philippa Treanor*

HMRC refused a DIY claim for £7,776 on the basis that the planning consent required the occupant to be solely employed by a livery business a quarter of a mile away. The claimant appealed, arguing that this did not prohibit separate disposal, because he could sell the property to someone who worked in that business, and the condition was therefore a "mere occupancy restriction" rather than falling foul of the statutory provisions. On review, HMRC decided that the project was not "otherwise than in the course of business" and therefore failed on those grounds as well.

The Tribunal concluded that the wording of the planning condition was identical to that held to constitute a restriction on separate use or disposal by the Upper Tribunal in *Burton*. The later removal of the condition could make no difference. The appeal was dismissed.

First-Tier Tribunal (TC05621): *Jason Campbell*

A refund claim for £30,142 was refused on similar grounds. The planning consent for a new house built on some inherited farmland contained "occupancy restrictions" which were agreed not to be a problem, but there was also a covenant given by the claimant to the local council that the property would only be disposed of together with the 19.7 hectares of land on which it stood.

The appeal against a decision made confirmed in 2012 was stayed behind the *Burton* case. The appellant's tax adviser tried to make something of a permission in the covenant for letting up to 25% of the property for a year at a time, but the Tribunal did not think this related to the house itself, nor was annual letting a "disposal" within the normal meaning of the word. The terms of the covenant and the law were clear, and the appeal was dismissed.

First-Tier Tribunal (TC05626): *Richard Swindell*

A further case on the same point led to the same result in relation to a Scottish croft. The planning consent required that the house should only be disposed of with the 2.5 acres of land around it; although the consent described this as an "occupancy restriction", it nevertheless clearly contravened note 2(c). The appeal was dismissed. The judge expressed sympathy for the claimant's unexpected financial hardship arising from not being entitled to an expected refund of some £12,500.

First-Tier Tribunal (TC05687): *James Redman*

A different issue arose in a case where HMRC accepted that the basic conditions for a claim were satisfied. The total claim made was £38,339, and the amount in dispute before the Tribunal was £5,460. HMRC had repaid £25,600 but refused the balance on the grounds that suppliers had charged 20% rather than 5% on qualifying conversion works. The claimant obtained credit notes for some of the difference, and HMRC repaid the 5% on the basis of amended invoices. Where no credit notes were obtained (and therefore the claim was based on invalid invoices still showing 20%), HMRC repaid 5% on a concessionary basis.

The appeal was allowed in respect of some expenses that HMRC refused on the basis that they were landscaping that was not required by the local authority. The Tribunal accepted the claimant's oral evidence that this had been a requirement. The invoice was marked "pro-forma", but the Tribunal appears to have accepted that it nonetheless represented a taxable supply and was eligible for repayment.

The claimant's arguments about the difference between the 5% and 20% rates were rejected. He submitted that it was reasonable for him to have relied on tradesmen to charge the right amount, and HMRC should warn DIY claimants about the risks of paying too much VAT to someone who then deregisters or becomes insolvent. The judge did not consider that these were strong enough arguments to go against the clear wording of the law. The appeal was therefore allowed in part.

First-Tier Tribunal (TC05704): *Philip Hargreaves*

3.5 Other land problems

3.5.1 Article

In an article in *Taxation*, Karen Bullen summarises the rules for VAT liability of land and buildings. The article is aimed at students preparing for ATT or for CTA Awareness, so it is a "high level" review of principle rather than detailed or difficult.

Taxation, 9 February 2017

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 HMRC MOSS guide

HMRC have updated their "guide to VAT on supplies of digital services to private consumers". They have added a link to the VAT Supply and Consideration Manual (VATSC80000), for information on determining whether service packages should be treated as a single, bundled, supply, or multiple separate supplies.

The guide remains essential reading for anyone selling services to consumers over the internet, although the attention given to this area when the rules changed in January 2015 has not been reflected in cases or high-profile enforcement action since then.

www.gov.uk/government/publications/vat-supplying-digital-services-to-private-consumers

4.1.2 Exchange rates

HMRC have published the usual table of VAT MOSS exchange rates to be used for returns covering the quarter to December 2016.

VAT Information Sheet 1/2017

4.1.3 VAT rates

HMRC announced that the standard VAT rate for Romania fell from 20% to 19% with effect from 1 January 2017.

VAT Information Sheet 2/2017

HMRC announced that the VAT rate for internet access services within Hungary fell from 27% to 18% with effect from 1 January 2017. The VAT rate applicable to any other kinds of telecommunication, broadcasting or electronic services is still 27%.

VAT Information Sheet 3/2017

4.2 Where is a supply of services?

4.2.1 Recruitment fees

The FTT has heard a lead appeal representing a large group of similar disputes. It concerns recruitment fees paid by UK universities to foreign agents who recruit non-EU students to the university's courses. Commission is paid to the agents; HMRC contended that output tax was due on a reverse charge in respect of services received from abroad.

The university put forward two arguments against the reverse charge liability:

- first, that there was a split supply that should be apportioned: part of it was the recruitment supply to the university, and part was a supply

of student support services to the student. The university's payment to the agent was in part third-party consideration for that supply to the consumer, which would be outside the scope of VAT as the supplier and consumer both belonged outside the EU.

- second, that the general rule for intermediary services up to 1 January 2010 applied to the part of the supply to the university, again placing the supply outside the scope where the agent was established. The agents did not act in the name of and on behalf of the university, so the exception to that general rule provided by (old) art.44 PVD did not apply.

There was a further dispute about whether the university would be entitled to input tax credit for part of the reverse charge, to the extent that it was due, on the grounds that the costs were an overhead of the university.

The university accepted that there was a reverse charge after the changes to the place of supply rules on 1 January 2010, but maintained that it should continue only to apply to part of the supply.

The Tribunal reviewed the history of the payment of commissions to agents. Student numbers in total were 22,874 in 2013; the number of non-EU students had increased from 2,327 in 2005 to 5,855 in 2013. Commissions paid to agents rose from £1.034m in 2008 to £2.214m in 2012. The Tribunal considered the nature of the relationship between the university and the agent, and the agent and the student. It was noted that foreign students do not have the same amount of information about UK universities available to them as home students, and the university expected the agents to act in the best interests of the students in placing them on the right course and helping them through the application process. The terms of the agency contract, which were standard throughout the UK university sector, were considered, and one particular Malaysian agency was examined in detail as representative.

The following information on accounting detail is interesting:

48. It is clear that the University is financially dependent on tuition fees from non-EU students. Tuition fees from full-time non-EU students were 8% (£29m) of the University's total income in 2008/09, rising to 13% (£52.3m) of total income by 2012/13. This reflects an increase in the number of non-EU students studying at the University. Until recently universities were restricted in the number of UK students they could recruit, but there were no such restrictions on the number of non-EU students, subject to meeting entry requirements. In 2014/15 full time tuition fees from UK and EU students for the University's courses ranged from £4,320 – £10,950 whilst tuition fees for non-EU students ranged from £14,890 –- £21,455.

49. Accounting information suggests that in 2011/12 the University made a surplus of £18.1m from non-EU students compared to a surplus of £8.5m from UK students. The surplus generated by non-EU students compensates at least in part for reductions in Government funding of the University. The accounting information comes from a system known as TRAC ("Transparent Approach to Costing") whereby income and expenditure are allocated to different activities, for example between teaching and research. Some 75% of costs incurred are not directly

attributable to particular activities and must be apportioned. In that context, Mr Dale described the University as a "unitary business".

In relation to the split supply argument, the university relied on the general principle that consideration does not have to come from the recipient of a supply, as set out in cases such as *Baxi* and *Airtours*. The old case of *Town & County Factors* confirmed that it was not necessary for there to be a contractual relationship between agent and student for there to be a supply. It was also clear from *Airtours* that third party consideration did not require that the third party met a payment obligation that would otherwise fall on the recipient.

However, the judge (Jonathan Cannan) considered that the economic reality was that the agent was making a supply only to the university. The students were the indirect beneficiaries of the agent's obligation to put forward suitably qualified candidates to the university; the contract with the university imposed obligations to advise and assist students, but that was for the benefit of the university, not the students.

In relation to the intermediary argument, the judge considered a wide range of precedents, including a number relating to insurance. His conclusion was that the agents had no right to bind the university in any way, and they were not intermediaries acting in the name of and on behalf of their principal within art.44 PVD. He further considered an argument that the exception to the general place of supply rules only applied to intermediary services in relation to an underlying supply of goods: this was unclear, but not critical to the decision because of the conclusion that the exception did not in any case apply.

Turning to the input tax argument, the judge noted that the university recovered 7 – 8% of its overhead input tax under its partial exemption method. To recover any of the reverse charge, it would have to show a link to some taxable income. The precedent cases of *Chester Zoo*, *Mayflower Theatre Trust* and *Royal Agricultural College* were considered, and the judge concluded that there was no such link. In *Chester Zoo*, there was a clear link between the animals and the taxable supplies made by the zoo; here, "there was no evidence... as to how the outputs made economic use of those students". Any link between commission paid to agents and the University's taxable supplies and/or its economic activity as a whole is indirect and not immediate.

The appeal was therefore allowed in principle, on the grounds that the intermediary services were supplied where the supplier belonged; but this would only apply up to 31 December 2009. After that, there would be a reverse charge that would not be recoverable at all.

First-Tier Tribunal (TC05639): *University of Newcastle Upon Tyne*

4.3 International supplies of goods

4.3.1 'Split payments'

The Government has published a "call for evidence" to assess whether it would be appropriate (and feasible) to introduce a new method of collecting VAT on online sales in order to combat abuse by certain overseas businesses. The idea would be to introduce a new VAT collection mechanism in respect of online sales using technology that enables VAT to be collected and remitted directly to HMRC at the time the sale takes place. This is commonly referred to as the 'split payment' method: the supplier receives the net amount and the output tax is paid directly to HMRC. The government believes that this will be another step that could be used to tackle VAT avoidance by overseas online suppliers selling goods to UK consumers.

www.gov.uk/government/consultations/vat-tackling-fraud-on-goods-sold-online-update-on-split-payment

4.3.2 Conditions for exemption

A Netherlands company supplied tyres to its Spanish branch for distribution in Spain and Portugal. The branch was registered for VAT in Spain, but had not been recognised as an international operator, and was not subject to the system for accounting for acquisitions of goods (which appears to be separate from the standard VAT return, unlike the UK system). It had not been entered in the VIES system that is used for checking the validity of foreign VAT registrations. Nevertheless, the Netherlands company treated supplies of tyres to its branch as exempt intra-community despatches.

The Portuguese tax authority objected to the exemption of these transactions on the basis that the local law required VIES registration. Questions were referred to the CJEU, which held that exemption could not be denied on these grounds alone. It was necessary for the recipient of a despatch to be a person in business, which was undoubtedly the case: it was registered for VAT. Recognition as an international operator and entry in VIES were formal requirements, not substantive requirements. In the absence of fraud, evasion or abuse, a breach of a formal requirement was not enough to deny the trader its rights under the law. The supplier was convinced that the purchaser would subsequently be registered for acquisitions with retroactive effect. The imposition of the extra formal requirements was not a proportionate response to the risks of fraud.

CJEU (Case C-21/16): *Euro Tyre BV v Autoridade Tributária e Aduaneira*

4.3.3 Exemption of New Means of Transport

Questions were referred to the CJEU about the rules for exempting an intra-community supply of new means of transport. A Portuguese trader sold a car to an Angolan national for personal use in Spain. The purchaser took the car to Spain and registered it for use there. The applicant therefore took the view that it was an exempt sale. However, the Spanish law did not treat temporary use by a non-resident as qualifying for NMT treatment.

Advocate-General Mengozzi has issued an opinion in favour of the taxpayer. In his view, NMT treatment cannot be made conditional on the purchaser being resident in the destination state, nor on the registration being permanent rather than temporary. A trader who has acted in good faith and taken all reasonable steps to be satisfied that the transaction satisfies all the substantive conditions for exemption (in art.138(2) PVD) must be granted the exemption. The essential issue is to determine the Member State in which the final, permanent use of the means of transport will take place: that is not dependent on residence or on the temporary nature of the particular registration.

It would be for the referring court to ascertain whether the vendor had acted in good faith and had taken all reasonable measures within its powers to ensure that the supply of the new vehicle to the purchaser would not result in a breach of the substantive conditions required to classify that transaction as the intra-Community supply of a new means of transport. If that was the case, and there was no suggestion of collusion with the purchaser to avoid tax, the exemption must be granted.

CJEU (A-G) (Case C-26/16): *Santogal M-Comércio e Reparação de Automóveis Lda v Autoridade Tributária e Aduaneira*

4.3.4 Samples relief

A dispute arose concerning the availability of duty and VAT relief for commercial samples in respect of a consignment of jewellery imported from California. The jewellery was valued at £18,842, the duty was £753 and the VAT was £3,919. The trader appealed against the decision to deny the relief.

HMRC relied on their policy in Public Notice 367, which imposes conditions including rendering samples incapable of use for any other purpose, and requires that they should be of "negligible value". The company argued that this could not literally apply to jewellery, or it would not be possible to use it for the intended purpose of publicity photographs in magazines.

The appellant also argued that it was not in the business of importing jewellery – it was a PR agency. The goods had been shipped by its client, and had been returned abroad without ever being available for sale in the UK.

UPS had requested confirmation that the consignee was aware of the provisions of Notice 367 before delivering the goods as "samples". The appellant argued that the form had been signed by a secretary who would have assumed that it was merely an administrative matter – she would not have read the Notice. She was not available to give evidence.

The judge expressed some sympathy for the trader, who had genuinely believed that the goods were to be used as samples. However, they did not qualify under the legislation, which required "negligible value". Although that was not defined, it was hard to see how it could apply to this jewellery. Against that background, the trader's argument that HMRC had acted unreasonably could not succeed: HMRC were only applying the law. The appeal was dismissed.

First-Tier Tribunal (TC05649): *M & M Management Ltd*

4.3.5 Import agent

A company acted as shipping agent on behalf of two importers who became insolvent. The company had paid import VAT of £127,000 on their behalf. The goods had been delivered to the final customer who had sold them on, so the agent could not exercise a lien over the goods in respect of its unpaid VAT. The agent claimed repayment of the VAT on the basis that HMRC would be "unjustly enriched" by receiving output tax from the end consumer without repaying the import VAT to anyone.

The Tribunal examined the law, which is in the Customs Code. The only legal basis for a claim for remission of the import VAT appeared to lie in art.899 of the Implementing Regulation, which provides that "the decision-making customs authority shall itself decide to grant repayment or remission of the import or export duties where there is a special situation resulting from circumstances in which no deception or obvious negligence may be attributed to the person concerned." There is no definition of "special situation", but the Guidance describes the expression by reference to "exceptional" circumstances compared with other operators engaged in the same business.

The Tribunal considered the law in detail, the precedent case law, and each of the company's arguments. It concluded that the loss arose from the commercial arrangements it had entered into with the importers, and there was no basis in law, policy or guidance for any remission. The appeal was dismissed.

First-Tier Tribunal (TC05636): *Grange Shipping Ltd*

4.3.6 Updated Notice

HMRC have issued an updated version of their Notice *Imports*. It includes some changes to reflect the introduction of the Union Customs Code from 1 May 2016, and to update relevant addresses for two HMRC offices.

Notice 702

4.4 European rules

4.4.1 Consultation on cross-border fraud

The European Commission is consulting until 31 May 2017 on updating the rules governing administrative co-operation in tackling cross-border VAT fraud in the EU. This is the latest in a group of four consultations forming part of the Commission's action plan on VAT, launched in April 2016.

ec.europa.eu/taxation_customs/consultations-get-involved/tax-consultations/public-consultation-functioning-administrative-cooperation-and-fight-against-fraud-field-vat_en

4.4.2 Levy on recording media

Under Polish law, producers and importers of recording media have to pay a levy to an organisation which collects the money and distributes it to copyright holders. The Polish authorities ruled that the organisation would have to account for output tax on the receipts, and questions were referred to the CJEU.

The court ruled that there did not appear to be any legal relationship between the organisation and those who paid the levy, nor any reciprocal performance. The right to collect the levy arose from the law, and did not relate to any particular benefit provided by the organisation or obtained by the payers. It was simply intended to finance fair compensation for holders of reproduction rights. That did not constitute consideration for any supply of services, because it was linked to harm resulting from unauthorised reproduction rather than from anything done for the payers.

The levy was therefore outside the scope of output tax.

CJEU (Case C-37/16): *Minister Finansów v Stowarzyszenie Artystów Wykonawców Utworów Muzycznych i Słowno-Muzycznych SAWP*

4.4.3 Bankruptcy

An Italian individual was declared bankrupt in 2008. After that, the tax authorities issued an assessment for VAT in relation to taxable activities in 2003. Questions were referred to the CJEU: Member States are required to collect VAT, and it was considered possible that writing off debts of a bankrupt individual to allow them to make a fresh start might contravene that obligation.

The CJEU ruled that fiscal neutrality was not infringed: people who did not benefit from the bankruptcy write-off were not in a comparable situation to a bankrupt. Nor could the write-off be classified as State aid. EU law did not therefore preclude VAT debts from being declared irrecoverable under national legislation.

CJEU (Case C-493/15): *Agenzia delle Entrate v Identi*

4.4.4 Reduced rate

A company supplied oxygen concentrators and accessories for oxygen treatment. The Belgian authorities considered that this was a standard rated supply; the company argued that it should be entitled to use a

reduced rate of 6% for medical or pharmaceutical products, which is applied to medical oxygen in tanks. Questions were referred to the CJEU.

The A-G gave an opinion that the concentrators were not "pharmaceutical products" under the third item of Annex III. They could therefore only qualify under the fourth item, which required them to be for the relief of disability. Although some of the patients might fit that description, some would not. This meant that they could not fall under either heading.

The A-G also considered that the principle of fiscal neutrality could not be applied to extend the categories and allow lower rating of these devices on the basis that oxygen in tanks did qualify. The principle could not override the clear wording of the law.

The full court has agreed with the opinion. The fact that consumers might regard oxygen concentrators as similar to oxygen cylinders could not determine the VAT treatment.

CJEU (Case C-573/15): *Etat belge v Oxycure Belgium SA*

4.4.5 Long shelf life

Polish law applies a reduced rate to food with a "best before" or "use by" date less than 45 days after production. A company that produces baked goods with a longer shelf life has appealed against the imposition of standard rated VAT, and questions have been referred to the CJEU on the application of the principle of fiscal neutrality in this circumstance.

CJEU (Reference) (Case C-499/16): *AZ v Minister Finansów*

4.4.6 Catch-22

Questions have been referred to the CJEU by the Polish court in relation to a situation in which it appears that a company was unable to exercise a right to claim a repayment of VAT until after the limitation period had expired, and the delay was caused by actions of the national authorities.

CJEU (Reference) (Case C-500/16): *Caterpillar Financial Services Poland sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie*

4.5 Foreign VAT reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Holding company

A state-owned holding company operated in the energy sector. It had a number of subsidiaries and actively managed them, providing them with a range of services. There was no group VAT registration. The holding company incurred costs in relation to managing the subsidiaries, but did not charge for its services. It had other economic activities, but the Hungarian authorities ruled that the costs incurred in relation to its subsidiaries were non-economic and therefore not deductible. Questions were referred to the CJEU, which issued an order rather than a ruling, because it considered that the case dealt with established principles rather than breaking new ground.

The court referred to various precedents in holding that:

- holding shares without being actively involved in management is not an economic activity;
- being actively involved in management is potentially an economic activity;
- it is only an economic activity if it involves transactions chargeable to VAT, which requires consideration.

The costs that related to management of subsidiaries did not therefore have a connection to the economic activities as a whole, as in *Larentia + Minerva*; they also did not relate to the other economic activities of the holding company (leasing), so they were not deductible. It would be up to the member state to decide how the costs should be allocated, because the Directive did not provide a specific set of rules for the "business/non-business" split.

The company argued that fiscal neutrality ought to provide it with a deduction. The court commented that the result arose from a choice the company had made (not to charge for the services). Fiscal neutrality did not allow a company to choose one course of action and be taxed as if it had taken another; it only required two traders following the same course of action to be taxed in the same way.

CJEU (Case C-28/16): *Magyar Villamos Művek Zrt. (MVM) v Nemzeti Adó- és Vámhivatal Fellebviteli Igazgatósága*

5.2 Who receives the supply?

5.2.1 Self-insurance

A self-drive car hire company was of such a size that it effectively self-insured third party risks. It set up a captive insurance company to provide fleet insurance; the FTT (TC04785) considered that the contractual position was that "*the insurer became liable to indemnify UDL's customer in the event UDL's customer damaged property belonging to a third party while driving the car*". The premiums paid to the captive insurer were directly related to claims made; as a result, the company sometimes paid for repairs to third party vehicles directly, without making a claim.

In order to minimise costs, hirers were given a "bump card" to hand to the owner of any car with which they might be in collision. This encouraged the driver to contact UDL directly, rather than going to its own insurance company; UDL would then seek to manage the repairs, contracting directly with the car repair workshop, and so minimise the cost. UDL made a claim to recover input tax on the cost of these repairs, which HMRC rejected.

The FTT noted that neither the appellant nor HMRC had considered the legal position in any detail, but the judge considered it to be crucial. The situation arose when UDL believed that the customer was liable to pay compensation to the third party, and this compensation was covered by the indemnity from the captive insurer. There was no contract between UDL and the third party, but it was understood that the third party could not both claim compensation and have its repair paid for by UDL.

The Tribunal considered that the contractual position was straightforward: the garages contracted with UDL to repair the cars. However, it was not so easy to determine to whom the supply of repair services was made. That required consideration of the legal and economic reality, in accordance with precedent cases including *Newey*, *SecretHotels2 Ltd*, *Redrow*, *Baxi, Aimia, WHA* and *Airtours*. After an extensive review of these decisions, the judge (Barbara Mosedale) concluded:

We take from consideration of all these cases that a VAT supply, ordinarily at least, requires a legal relationship between the supplier and recipient under which the supplier is obliged to make the supply and the recipient is liable to pay for it: Tolsma and Redrow. Nevertheless, where the economic reality of the legal relationship is such that it results in final consumption of goods or services by a consumer in circumstances where in effect there is no VAT charge on that consumption then this normal rule is overridden because the ultimate purpose of the Principal VAT Directive is to tax final consumption.

She explained how she intended to apply this as follows:

In conclusion, in a situation where B agrees to pay A to provide goods and/or services to C, and C agrees with B to pay for the goods and/or services provided by A, then a Redrow 'follow the liability to pay' analysis applies to decide to whom A's supply is made. This is because the legal relationships reflect the economic reality and the outcome is consistent with the Principal VAT Directive because final consumption is taxed. In other words, A's supply is to B, and B makes an on-supply to C.

But where a Redrow 'follow the liability to pay' analysis does not lead to tax on final consumption, because although A makes a supply to B (of providing goods/services to C), B does not on-supply A's services to C, then C's consumption will be untaxed, and, applying Baxi/Aimia/WHA, economic reality requires the supply to be seen as made to the final consumer.

Applying these principles to the facts, she concluded that either the company did not itself consume the garage's services, or if it did, it then supplied them on to the owner of the car (in which case an equivalent amount of output tax would have been due). She preferred the conclusion that the economic reality was that the services were consumed by the owner, and the contractual liability to pay constituted third party consideration. This was very similar to the *WHA* case, and the judge did not accept (or, in her words, understand) the distinction that the company attempted to make with that decision.

The judge included an alternative analysis as a postscript, setting out the conclusion if there was an implied contract between the company and the car owner: that would lead to a valid input tax claim, but a matching output tax charge on the barter supply. In either case, the appeal had to be dismissed.

The company appealed to the Upper Tribunal, where the judges considered the precedents of *Redrow* and *WHA* again, as well as the Supreme Court's judgment in *Airtours*, which had not been available to the FTT. The judges concluded "*that it is clear from Airtours and the cases referred to in that case that determining who is receiving a supply is a two-stage process. The starting point is to consider the contractual position and then consider whether, taking account of all the circumstances, the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from that person or a third party then there is, subject to the question of economic reality, a supply to that person for VAT purposes.*"

The judges applied this principle to the facts. Although there were no written contracts produced in evidence, the UT was satisfied that there was a legal relationship between the repairers and the appellant pursuant to which there was reciprocal performance, and therefore the repairers supplied services to the appellant. There was no contract between the car owner and the repairer, nor between the appellant and the car owner.

The contracts were not artificial, but they could still not reflect the "economic and commercial reality". The UT agreed with the FTT that this was that the appellant agreed to pay for the repair of the car owner's vehicle in order to discharge the captive insurer's liability to indemnify the hirer who was liable to compensate the car owner for damage to the vehicle. The appellant did not have any liability to pay for the repair until after the damage had already occurred and the car owner had agreed to use the bump card procedure rather than make an insurance claim. This procedure was used by the appellant because it calculated that it would ultimately pay less (even disregarding the VAT) than if the car owner made a claim through his or her own insurer. In the event of such a claim, the car owners (or their insurers) would arrange to have the vehicle repaired and the captive insurer (and thus indirectly the appellant) would

bear the cost of that repair. In such circumstances, there would be no question of the captive insurer or the appellant being entitled to deduct the VAT included in the cost of the repair.

Taking account of all these circumstances, it appeared to the UT that, in economic reality, the appellant simply agreed to pay for the repair of the car owner's vehicle. The appellant had no interest in the repairs other than as a means by which to meet (at reduced cost) a liability that would otherwise be incurred through the captive insurer. The fact that the appellant contracted to pay the repairers direct did not, in all the circumstances, make the appellant the recipient of any supply by the repairers.

The company's appeal was dismissed. The UT stressed that this was a decision based on the facts, and should not be taken as establishing any generally applicable principle in relation to any superficially similar cases.

Upper Tribunal: *U-Drive Ltd and others v HMRC*

5.2.2 Rewards points

A company belonging in the USA ran a rewards points scheme involving hotels. A customer staying in a participating hotel was awarded points, and the hotel was charged by the company for those points. When the customer had collected enough points, he was entitled to a free stay in a redeeming hotel, which would be paid for the stay by the company. A dispute arose between the redeeming company, the promotion company and HMRC about the VAT treatment.

HMRC ruled that the promoter (MR) was not entitled to 13th Directive repayment claims from 2010 onwards because it was paying 3rd party consideration for supplies of accommodation to the customers, and was therefore not receiving a supply.

HMRC also ruled that it was correct for the redeemer (W) to have accounted for output tax in relation to various periods that were the subject of historic repayment claims (12/99 to 12/02 and 03/03 to 05/05).

There were therefore three different arguments to be considered:

- HMRC's contention that the supplies were in reality made to the consumer, which would be fatal to both companies' claims;
- MR's contention that the supplies were subject to UK VAT after 2010 and properly received by it, and would contradict the basis of W's claim (although for different periods);
- W's contention that the supplies were advertising, which would be fatal to MR's claim throughout.

The Tribunal considered that, even in the absence of a direct legal relationship between the company and the redeeming hotel (stays were arranged through intermediaries), the company was paying for the stay. In line with the decision in *Aimia* (and rejecting HMRC's attempts to distinguish the situation from that case), the FTT considered that the hotel made two supplies:

- one, of accommodation, to the customer, for consideration that amounted to no more than the presentation of a certificate;

- one, to the company, a service of agreeing to provide the member with the reward on terms that the member was not obliged to pay for it. This was not a supply of accommodation.

The economic reality was that MR was receiving supplies of the second service, and was therefore in principle entitled to recover input tax in relation to them. The next question was the place of that supply. Before 1 January 2010, W wanted a repayment of VAT on the basis that it was supplying advertising services and should therefore have treated the supplies as outside the scope of UK VAT. The Tribunal disagreed: the service was not advertising but a different kind of service relating to the essential structure of the promotion scheme (the agreement of redeemers to provide rewards). That was supplied in the UK and subject to output tax.

From 1 January 2010 onwards, MR argued that it should be entitled to a repayment under the 13th Directive, because the services were land-related. Again, the Tribunal disagreed: the supplies that MR paid for were not specific to particular land, as a "central and essential element" of the supply. It was a generic service of agreeing to provide reward stays in general. The services supplied to the US company were not subject to any of the exceptions in Sch.4A VATA 1994, so they were outside the scope of UK VAT. There was no entitlement to a 13th Directive repayment.

The FTT was referred to the Explanatory Notes issued by the Commission in relation to the 2017 amendments to the rules on place of land-related supplies. The judge said that he had come to his decision on general principles, and therefore did not need to rule on whether those Notes were an admissible aid to construction of the law.

First-Tier Tribunal (TC05634): *Marriott Rewards LLC and another*

5.3 Partial exemption

Nothing to report.

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Tax avoidance scheme

A company paid tax advisers £50,000 plus VAT in relation to the implementation of a tax avoidance scheme involving the purchase of investment gold to be placed in an Employee Benefit Trust for the sole director and shareholder. HMRC ruled that the VAT was not deductible: the invoice was marked "pro forma", and there was insufficient evidence to show that the invoice related to a proper business expense. The "pro forma" argument was dropped before the hearing.

The FTT considered that the key questions were:

- having regard first to the contract and then economic reality, to whom were the tax adviser's services supplied, and
- was there a link between the expenditure incurred by the Appellant and the taxable supplies of the Appellant?

As regards the first question, the contract was in the name of the company, and the director had no rights under it. HMRC argued that he received benefits under the arrangement, but that did not affect the economic reality. As a matter of contract law and economic reality, the company received the supply.

The judge rejected an argument that it was the taxpayer's state of mind that determined whether the input related to the business; an objective assessment was required, in accordance with the CJEU judgment in *Newey*. The judge sought to clarify the issue by describing what the expenditure was incurred on: it was not part of the cost of the gold, but for advice on how to reward the sole employee with the least possible liability to tax and NICs.

The judge accepted the company's arguments that tax advice, including advice relating to remunerating employees, is an overhead incurred for the purposes of the business. "*The advice directly relates to the Appellant's own tax and NICs liabilities, and the reduction of these liabilities will increase the Appellant's profits. The additional benefit which Mr Doran may derive personally, even if it is considerable, does not enable us to draw a distinction between this type of advice and advice which might be given to the Appellant in respect of operating its payroll or the mitigation of any other business expense.*" The appeal was allowed.

First-Tier Tribunal (TC05554): *Doran Bros (London) Ltd*

5.7 Bad debt relief

5.7.1 Bad debt claims after *GMAC*

HMRC have published a Brief acknowledging that they will pay claims for historic bad debt relief after the Court of Appeal judgments in *British Telecommunications plc* and *GMAC*. The Brief sets out HMRC's understanding of the limitations imposed by the judgments and the conditions they will require to be met before paying a claim.

The decision in *GMAC* was that the UK legislation was not in compliance with the EU law, but claims should only be admitted for supplies that were made between April 1989 and March 1997. Businesses will have to supply evidence that VAT has not been reclaimed already, which may be difficult to achieve. The evidence will need to accord with Notice 700/18 on bad debt relief.

The Brief points out that the Notice made clear that title had effectively passed to the debtor, so bad debt relief could be claimed even before 1997, where the goods in question had been sold on to a third party by the debtor or the supplier chose to write to their customer and give up title in the goods to them. It is therefore possible that businesses may have previously claimed relief during this period under these terms. HMRC consider this unlikely to be the case in circumstances where businesses routinely repossessed high value goods following default by the customer. It is more likely that VAT bad debt relief may have been claimed where, for example, goods were supplied to customers who purchased the goods for resale.

HMRC refer to the conditions 1 – 5 in para.2.2 of the Notice:

1. You must already have accounted for the VAT on the supplies and paid it to HM Revenue and Customs.

2. You must have written off the debt in your day to day VAT accounts and transferred it to a separate bad debt account.

3. The value of the supply must not be more than the customary selling price.

4. The debt must not have been paid, sold or factored under a valid legal assignment. (See paragraph 3.12).

5. The debt must have remained unpaid for a period of six months after the later of the time payment was due and payable and the date of the supply (one year after the date of supply for supplies made from 1 April 1989 to 31 March 1992).

If a business cannot meet these requirements it will need to satisfy HMRC by other means that it didn't previously obtain bad debt relief. HMRC will consider alternative evidence for amount and methodology. The responsibility is on the claimant to show:

- that they suffered bad debts on supplies of goods made under retention of title terms;
- they didn't previously claim relief;
- the amount claimed is correct.

Claims already with HMRC will be dealt with in line with this brief although they may need to contact claimants for further information. New claims should be made in writing to the address given in the Brief.

R & C Brief 01/2017

5.8 Other input tax problems

5.8.1 Input tax on fuel

A summary of a decision concerning input tax on road fuel has been published, but the details are not yet available on the Tribunals website. The dispute concerns the Reimbursement by Employers of Employees' Business Use of Road Fuel) Regulations (SI 2005/3290). These were introduced after the UK was taken to the CJEU by the Commission for allowing employers to claim input tax on the deemed VAT element of mileage allowances paid to employees: the Commission's view, accepted by the court, was that the taxable supply of fuel was made to the employee, not to the employer, so there was no input tax in the payment made by the employer to the employee (by definition, not a taxable person). The regulations provide that the employer must obtain and retain VAT receipts to back up the input tax claimed, showing at least as much as the VAT claimed (Notice 700/64 para.8.10). It has never been explained how this would legally overcome the clear effect of the CJEU decision, but VAT on mileage claims has been allowed on this basis since 2005.

The summary of the decision suggests that some claimants failed to obtain the required VAT receipts, and therefore had their input tax claims disallowed. It appears that the appeal rested on two grounds:

- that the regulations were not validly made – this might undermine the specific requirements in the regulations, but ought not to assist the claimants, because in their absence the application of general principles and EU law ought to deny a claim anyway;
- that the absolute requirement for a VAT invoice, without the normal discretion afforded by reg.29 SI 1995/2518 to accept alternative evidence, was unreasonable.

The Tribunal dismissed the appeal. It seems that the Tribunal was not persuaded that the regulations were validly made, but to the extent that they were, supported the exclusion of discretion. Even if there was discretion, refusing to exercise it in the circumstances of the case was not unreasonable.

First-Tier Tribunal (TC05643): *Marsh (Bolton) Ltd and others*

5.8.2 Missing traders

A wholesaler of electronic games and games consoles was denied input tax credit totalling nearly £500,000 for the periods 04/10 and 05/10 in relation to the purchase of games consoles, televisions, satellite navigations systems and computer memory on the grounds that the transactions in respect of which input tax was claimed were connected to fraud and that the appellant knew or ought to have known of that connection. There were 32 transactions in issue; in respect of nearly all, the trader accepted that HMRC had identified the supply chain correctly and had shown that there was a tax loss, but denied that there was either actual knowledge or means of knowledge.

The company clearly had a substantial genuine trade – the directors argued that it had carried out 68 similar transactions in the same periods

with which HMRC had no issue. However, HMRC had carried out a series of visits to check the company's due diligence from the time of its incorporation in 2007 up to June 2010. There was regular contact to verify VAT numbers and confirm that MTIC fraud was not occurring. The directors were fully aware of Notice 726 and the warnings contained in it.

The judge was not convinced that the evidence was enough to show, even on the balance of probabilities, that the directors had actual knowledge of fraud. The similarity between the fraudulent deals and the genuine business was sufficient to establish the possibility that the directors could have believed the transactions were honest.

The judge considered that the directors' reliance on personal knowledge of the industry, alleged assurances about low risk from a particular HMRC officer, and "tick box" due diligence were all misplaced. However, the fact that the transactions were so similar to other deals that were not linked to fraud meant that it was not proved that the directors had the means of knowledge. There were two exceptions: in one deal the credit report on the trader was so bad that it ought to have raised questions about how it could finance a high value deal, and in relation to the other HMRC had issued a specific warning that the status of the counterparty was being verified. In relation to these two deals (total VAT approximately £60,000) the appeal was dismissed; it was allowed in relation to the other 30 deals.

First-Tier Tribunal (TC05587): *Link Distribution (UK) Ltd*

A Northern Irish car dealer was denied input tax credit totalling just over £90,000 on 18 transactions during 2012 and early 2013 that were considered by HMRC to be connected with fraud, and on 1 further purchase where the invoice was considered invalid. HMRC alleged that all 18 transactions could be traced back to defaulting traders; that 16 of the purchases were directly from defaulters; that 15 were "back to back" purchases and sales on the same day; and payments were made by third parties rather than the apparent counterparties of the transactions. The trader responded that these were normal transactions that had been carried out in compliance with all the regulations, and that any absence of paperwork such as purchase orders and written contracts was simply in accordance with common practice. It was said that the trader was illiterate and relied heavily on his wife and business advisers, although neither of these gave evidence to the Tribunal.

Tribunal directions had required the parties to submit witness statements in advance. The trader's statement did not deal in any detail with the transactions, but rather made general observations. The Tribunal refused requests for further "questions in chief" or calling additional witnesses: the directions had required each party to disclose the nature of their case in advance, and to be fair to HMRC, the appellant should not be allowed to introduce new material that had not been disclosed.

As a result of the extreme brevity of the trader's witness statement, he had to be cross-examined for a total of 16 hours over 3 days. The Tribunal described him as "an individual of courtesy and charm" and "a highly intelligent and skilled businessman", but nevertheless "a very unsatisfactory witness" who gave evidence that was "hopelessly vague". The Tribunal concluded that his case entirely turned on whether he was an

"innocent dupe", and it did not appear that he was. In the light of his experience in the motor trade, that seemed inherently unlikely; and his inability to explain many documents that were put to him in cross-examination suggested that he could not be relied on as a witness of truth.

The Tribunal considered that the key questions were, as usual in such cases:

- was there a tax loss?
- did this loss arise from fraudulent evasion?
- were the disputed transactions connected with that evasion?
- did or should the appellants have known that the transactions were so connected?

The Tribunal examined each question in the light of the evidence and the inability of the trader to provide explanations, as well as what the judge described as his surprisingly nonchalant attitude, and concluded that all four tests were satisfied. The actual or constructive knowledge went well beyond the "merely knowingly running some risk that there might be" a connection to fraud.

The Tribunal also dismissed the appeal against the disallowance of input tax on the basis of an invoice that did not comply with reg.14. The alternative evidence was contradictory, and there was no reason for HMRC to exercise discretion to accept it. The appeal was dismissed in its entirety.

First-Tier Tribunal (TC05681): *Anthony Mullan and others*

A differently constituted Tribunal (although with the same judge) heard a separate appeal by the same trader in relation to a further 21 transactions during 2013. The judge stated that he had treated the two appeals as independent of each other, and had considered each entirely on its own merits.

The decision starts with a statement that it concerns denial of input tax, but it appears rather to be about denial of zero-rating on the basis that there was insufficient evidence that the vehicles had been removed to the Republic of Ireland. HMRC did not allege fraud or knowledge of fraud; they only argued that the evidence did not satisfy the statutory requirements of Notice 725.

Once again, the Tribunal was not satisfied with the reliability of the appellant as a witness. There were disputes about the way in which the appeal was conducted, with the appellant "suddenly remembering" that he had been told that one of the counterparties was related to the HMRC visiting officer, which his representative tried to make into a serious problem with HMRC's conduct of the appeal; the representative also tried to introduce an argument about the time limits for raising an assessment in closing, when it had not been included in the grounds of appeal or explicitly mentioned at any earlier stage. The time limit point was considered and dismissed.

The judge was highly critical of the representative, who suggested that HMRC had raised the assessments in this case as "insurance" in case they lost the other one. As the officer concerned had given explicit evidence that the two matters were not connected, this amounted to an insinuation

of fraudulent conduct by her. The judge rejected this completely. There was ample reason in the inadequate documentation for the officer to refuse zero-rating, and the appeal was dismissed.

First-Tier Tribunal (TC05693): *Anthony Mullan and others*

A company appealed against a refusal of input tax amounting to £1.4m in relation to April and June 2006. The company had in 2001 been involved in a criminal prosecution for conspiracy to cheat the revenue which was struck out in 2005 because HMRC had withheld vital evidence from the defendants, so there had been an abuse of process. The FTT (TC03059) concluded in late 2013 that, at the very least, its directors would therefore have a detailed knowledge and understanding of the risks of MTIC fraud. There were a number of features that confirmed the usual decision, that the directors knew or ought to have known that their later transactions were connected with fraud.

The company appealed to the Upper Tribunal on the basis that the FTT did not properly set out its reasoning. The UT agreed: although the FTT had listed 12 factors that HMRC said indicated that the company's trading was "too good to be true", it did not explain why it had considered that those factors were satisfied, and had not explained the inference (if any) it had drawn from the absence from the hearing of one of the directors.

The UT considered whether it could remit the case to the same FTT to set out its reasoning more clearly, but decided that the length of time since the original hearing made this impractical. Instead, it would remit the case to a differently constituted FTT for rehearing, with specific directions on case management to make sure that a proper decision was reached this time.

Upper Tribunal: *Synectiv Ltd v HMRC*

5.8.3 Museums

HMRC carried out a consultation until 21 April 2017 on a draft order adding 29 new bodies, and two new museums connected with existing bodies, to the list of museums and galleries entitled to claim refunds of VAT incurred in providing free admission to their collections. Some of the specified dates pre-date the order and refund claims will be permitted in respect of VAT incurred before the date on which this order comes into force, expected to be 1 June 2017.

A Tax Impact and Information Note has been issued in connection with the proposed changes.

www.gov.uk/government/consultations/draft-legislation-the-value-added-tax-refund-of-tax-to-museums-and-galleries-amendment-order-2017; www.gov.uk/government/publications/vat-refund-scheme-for-museums-and-galleries

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Who claims?

In late 2015, the FTT (TC04674) considered a case on the issue of the identity of the correct claimant where:

l) the representative member of a VAT group accounted to HMRC for VAT for a prescribed accounting period and brought into account an amount as output tax that was not output tax due;

2) the company whose trading activities gave rise to that overdeclaration of output tax ("the generating member") was a member of that VAT group during the relevant prescribed accounting period;

3) that VAT group remains in existence, but the generating member has ceased to be a member of that VAT group.

In HMRC's view, it is the representative member of the VAT group that has overpaid the VAT, and the "generating member" cannot make a claim. The company in the case argued that it had transferred the amounts due to the representative member to be paid on to HMRC, so it ought to be entitled to claim them back.

The claim related to mechanised cash bingo (MCB) and main stage bingo (MSB). The claimant company was the representative member of an extant VAT group that was formed in 1997; the group now contained companies that had operated MCB and MSB in the past at times when they were not members of the VAT group – they had been in a different VAT group, or had been separately registered.

HMRC accepted that a right to claim could have been transferred to the current representative member on acquiring the generating member, as long as the former registration (group or individual) had ceased, the entire trade and assets had been transferred, and a valid claim was made. However, this could not apply if the company had been a member of a different group which still exists now; only the representative member of that other group could claim.

The hearing of this FTT appeal had started in March 2014 and had been adjourned so that the parties could make submissions based on three other cases which were decided on similar issues: *Standard Chartered plc/Lloyds Banking Group plc* (TC03450); *MG Rover Group Ltd* (TC03461); and *Taylor Clark Leisure plc* (UT 2014). The first two of these cases were appealed to the UT (after reaching contradictory conclusions); in March 2015 at a directions hearing, the parties to this appeal asked the FTT to make its own decision rather than waiting for those appeals.

The FTT adopted a summary of the earlier decisions from the company's representative's skeleton argument: in *MG Rover*, Judge Mosedale had decided that the generating member was entitled to claim; in *Standard Chartered*, Judge Berner had concluded that it should be the representative member of the group that had overpaid the VAT; and in *Taylor Clark*, Lord Doherty said he preferred the *Standard Chartered* approach.

The company advanced a number of arguments, principal among them that the s.43 group "fiction" should not survive when a company left a group. Once it had left one group and joined another, the "generating member" should no longer be regarded as part of the old representative member. If it had in the past borne the cost of an overpayment of VAT, it should be entitled to reclaim it. If a company remained in the same VAT group and the representative member made a claim, it would hold the repayment for the benefit of the generating member; if that generating member left the group, it should take the benefit of the claim with it. This argument was development with a detailed analysis of what was right about Judge Mosedale's approach and what was wrong with Judge Berner's decision.

HMRC's representative responded to these arguments line by line, and suggested that the *Taylor Clark* decision was the best starting point – a more recent, more authoritative decision that favoured their point of view. He also suggested that the *Skandia Corp* decision of the CJEU emphasised the primacy of the single taxable entity fiction as against the individual members of a group.

Judge Demack carried out a detailed analysis of the law and the arguments, and came down completely on the side of HMRC and Judge Berner. He stated that Judge Mosedale had not properly understood the EU law concept of the single taxable person. He rejected the company's claim that the generating member bore the burden of the overpaid tax. In his view, the burden was borne by the group of which it was a member at the time; that group could make any arrangements it wanted to share the burden of the tax, and it was therefore "neutralised". The person who should make any relevant claim would in all cases be the representative member that made the overpayment, regardless of the time elapsed between the supplies being made and the claim being submitted. The appeal was dismissed in its entirety.

The company appealed to the Upper Tribunal, which noted that *Taylor Clark* had been decided by the Court of Session in September 2016 and *MG Rover* by the Upper Tribunal in October 2016. The parties agreed the following points:

- On the basis of *Taylor Clark* and *MGR*, Gala accepted for the purposes of the appeal that the right to reclaim repayment of overpaid VAT was the right of a single taxable person, and that those rights were vested in the representative member. Therefore, save in an exceptional case, VAT could only be reclaimed by the representative member and not by the real world supplier (RWS).
- HMRC accepted that, although the case where a group has been dissolved and the representative member has been irrevocably dissolved is the paradigm example of an exceptional case where it was virtually impossible or excessively difficult for wrongly paid tax to be recovered through the representative member, it was not the only case, since it is not possible to define, in advance, all cases which could be regarded as exceptional.

The company argued that the "special circumstances" applied, so it would be entitled to claim the repayment. However, the company had no

evidence of fact to support the assertion of special circumstances. Its arguments were as follows:

1. there were no competing claims (unlike in *MGR*), so a failure to repay the tax would constitute an unjustified windfall for HMRC, and the representative member would have been virtually unable to make a repayment claim in March 2009.
2. the fact that the claim went back to 1973 meant that it was excessively difficult to determine which parts of the claim might be made by which representative member in each period.
3. the RWS would be the person with the best records of transactions, making it excessively difficult for the representative member to claim.
4. it was unreasonable to expect that the members of a group would have agreed at the time they left that group who would be entitled to a VAT repayment, when there was no expectation that VAT had been overpaid.
5. the companies would not have known the representative member of the group at the time the claim was made, so it would have been excessively difficult to arrange for that representative member to claim for them.

Each of these contentions was rejected in turn:

1. overpaid tax should not simply be paid to the wrong person. There was no evidence that the correct claimant could not have claimed in March 2009, and HMRC did not accept that this was so.
2. in the absence of evidence (or, apparently, enquiry by the appellant), this was pure speculation.
3. again, there was no evidence about who kept the records, nor about arrangements made on leaving the group.
4. HMRC published guidance in September 2008, before the claim was made, stating their view that it was the representative member who should make the claim.
5. the name and address of a representative member could have been obtained using VIES. There was no evidence about the state of knowledge of companies leaving the groups.

The UT did not consider these arguments, either individually or cumulatively, made this case exceptional.

The company sought to introduce a new ground of appeal, relying on the Court of Session judgment in *Taylor Clark* that the claim made by the subsidiary was made on behalf of the representative member and was therefore valid (but would have to be paid to the representative member, rather than to the company that claimed it). The UT rejected the company's application to amend its grounds of appeal for two reasons: this was something that had not been argued before the FTT and the UT did not agree that it was a pure point of law; and if the appellant was not entitled to any of the repayment, it did not appear to have sufficient interest in the matter to bring an appeal in the first place.

In case it was wrong on this point, the UT also considered the arguments. In *Taylor Clark*, the claim had been made by the RWS, but it had stated

the representative member's VAT number. This was key to the Court of Session's decision that the claim was made on behalf of the other company. In the present case, there was no indication of any kind that the claim was being made for someone else. The only VAT number given was that of the present registration.

The UT also declined to make a reference to the CJEU. The appeal was dismissed.

Upper Tribunal: *Gala 1 Ltd v HMRC*

6.2 Other registration rules

6.2.1 Registration

HMRC issued a notice of compulsory registration with effect from 10 July 2015 on the basis that the business had been transferred as a going concern. The company argued that it should only have to register from 1 October 2015. The company's representative notified the Tribunal that he had been unable to take instructions from his client and would not appear. It was possible that the company had ceased to trade, and it did not appear at the hearing either.

The Tribunal examined the evidence presented by HMRC. The trader's representative had notified HMRC of the registration liability on 17 March 2016 (giving the effective date of 1 October 2015). HMRC had instigated an investigation into the identity of the person running a fish and chip shop/takeaway at the premises occupied by the company, and had concluded that it was a business trading above the registration threshold; the company claimed that it had not taken over a business, but had just signed a five-year lease of the premises with effect from 10 July.

The judge was satisfied with HMRC's evidence that fixtures and fittings were transferred, and the trading name and type of business remained the same. If there was a break in trading, it was relatively brief. The previous business was above the threshold, so the provisions of s.49 and Sch.1 VATA 1994 applied. The appeal was dismissed.

First-Tier Tribunal (TC05691): *Deezer Ltd*

6.2.2 Deregistration

A company appealed against a September 2015 decision to deregister it with effect from 29 May 2009, to reduce a repayment claim for 03/12 to nil and to issue an assessment for other periods to recover VAT reclaimed. The owner had originally set up a "single person company" operating as a musician and composer. In 2009 a decision was taken to expand into music production as an independent record label, and the business was transferred to a new company, which was incorporated on 28 May 2009. It was registered for VAT from that date.

The company acquired a lease of industrial premises in Wantage and engaged builders to convert them into a recording studio. There were difficulties with the project, and the clients identified by the original owner eventually pulled out. The owner tried to find other clients, but

was unable to generate any income because of the severe economic downturn in the industry. The company ceased to trade in 2012 and forfeited its lease.

The appellant argued that it had been in business, but had been unable to commence sales. It was in the same position as *INZO*, and should not lose its entitlement to input tax. This was not a "hobby", but a commercial enterprise that had failed. The majority (60%) shareholder, which was an independent company, as well as another 5% investor, had put in money in the expectation of a commercial return. Unlike the original owner, they had no personal interest in the music business.

HMRC put forward their view of the *Lord Fisher* tests as applied to the business. They considered that none of the six tests were satisfied, relying heavily on the fact that no supplies had ever been made.

The Tribunal stated its decision "shortly". Although there were some unsatisfactory aspects in the invoices produced by the appellant, they did tend to support rather than contradict the key elements of his evidence. The venture was a commercial one, and the appeal was allowed. The possibility that some of the invoices were unsatisfactory was noted, but given that the company had ceased to trade and was possibly insolvent, the judge appeared to recommend that HMRC simply cancel the assessments and not enquire further into the company's affairs. The repayment of the 03/12 input tax claim was left for agreement between the parties.

First-Tier Tribunal (TC05598): *Gravel Road Records Ltd*

A trader appealed against a decision issued in 2012 to deregister his business with effect from 1 October 2008, disallowing input tax for various periods totalling about £13,000, and also a further decision to refuse a further registration application from 1 August 2014 and to deny input tax claims in relation to that registration amounting to about £55,000.

The individual had registered as a concert and event promoter. From the outset, there was a dispute with HMRC about ticket sales that HMRC considered had been underdeclared; an assessment was later vacated when HMRC accepted that the calculation was fundamentally flawed. An appeal against that assessment was formally allowed by consent, apparently having wider consequences than HMRC realised, because they issued further decisions that appeared to affect periods covered by the earlier appeal.

The Tribunal had to pick through the consequences of HMRC's confusion after the earlier decision, and noted that the effect of their new decision appeared to take "another bite at the cherry" in relation to periods on which an appeal had been allowed and no further appeal had been made by HMRC within the time limits. Further, it appeared to the Tribunal that the trader was in business and intending to make taxable supplies on the chosen deregistration date, 1 October 2008, so the decision could not stand.

This meant that the second registration could not be valid, because the trader was already registered and could not have two registrations at the same time. HMRC may need a further decision, because apparently the input tax claimed on the second registration included input tax refused in

relation to the first, together with the trader's calculation of interest and penalties (it is not clear from the decision whether this is the trader clawing back penalties that he had suffered, or an attempt to penalise HMRC). Presumably there will have to be an accounting exercise to reconcile all the numbers going back over many years.

First-Tier Tribunal (TC05617): *Arthur Edwyn Turner t/a Wicked Wang Promotions*

An individual incorporated and registered two companies. HMRC deregistered both and refused VAT repayment claims totalling £6,000 (plus penalties of £1,700) for the first, and a repayment claim of £1,300 for the second.

The VAT1 for the first company disclosed its main activities as "Internet adverts, magazine, photography – distribution market and printing T-shirts, telephone skills". The first repayment claim was queried, and the individual sent in a letter with 73 pages of enclosures and 41 till receipts. The officer formed the view that much of this material had been submitted in relation to four previous VAT registrations applied for by the same individual. He sent a letter explaining why many of the items were not allowable. There was no evidence that a business was being carried on. The officer asked what the activities described on the VAT1 comprised, and no satisfactory explanation was received. The officer appears to have given a very detailed and courteous response to what appeared to be based on a huge misunderstanding of how VAT works.

The decision to deregister was confirmed on review, and the individual appealed. Meanwhile, a penalty was raised on the "deliberate but not concealed" scale. This was later downgraded by the officer after he had discussed a possible mental health issue with his manager. This issue had been mentioned by the appellant in earlier correspondence.

The judge commended the officer for his meticulous care in dealing with a case that had used up a great deal of departmental and judicial time and expense. She was satisfied that all of the claims and appeals were without any merit: there was no evidence at all of any business activity or intention, and most of the "input tax" claimed was spurious. She appreciated that the penalty category had been downgraded due to special circumstances, but she was not convinced that this was appropriate: the individual had shown a certain level of knowledge and competence in making applications and filing returns, and in her view, "deliberate" was the correct category. Nevertheless, she simply confirmed the penalties that had been levied.

First-Tier Tribunal (TC05702): *Nicholas Gayle t/a Photogen Promo Music Adverts Ltd*

6.2.3 Registration thresholds

The registration threshold has increased from £83,000 to £85,000 with effect from 1 April 2017, and the deregistration threshold has increased from £81,000 to £83,000 from the same date. The limit for Sch.3 registrations in respect of acquisitions has also risen by the same amount.

The following comment in the Explanatory Notes is of interest:

The impact on business, charities or voluntary bodies is that revalorisation of the threshold will prevent around 4,000 small businesses from having to register for VAT by the end of the 2017/2018 financial year. If the threshold remains at the current level, this would result in a one-off implementation cost in the first year to those 4,000 businesses entering the VAT system, estimated to be around £150,000 and significant ongoing administrative burdens, estimated to be around £1.35m.

SI 2017/290

6.2.4 Racehorse owners

HMRC have issued an updated version of their Notice *Registration scheme for racehorse owners*, replacing the January 2002 version. The only listed changes are an update to the procedure for registering (recognising online processes) and a change to the contact address. There has been some concern that the recent CJEU decision in *Odvolací finanční ředitelství v Pavlína Baštová* (Case C-432/15), concerning the recoverability of input tax on expenditure on a trainer's own horses, might affect the scheme, but that does not appear yet to have been taken into account.

Notice 700/67

6.3 Payments and returns

6.3.1 Articles

In an article in *Taxation* in January, Neil Warren discussed the changes to the Flat Rate Scheme, and possible ways around them – including arranging to meet the conditions for expenditure on goods by setting up a secondary trade.

Taxation, 12 January 2017

In a further article in *Taxation* in March, Mike Thexton reported on discussions with HMRC about the changes, and explained that Neil's suggestions would not work because HMRC would bring in specific rules to stop them. HMRC have accepted that one of the problems with the changes is that they gave no explanation of why they were changing the scheme in the first announcements at the Autumn Statement: they are in response to widespread and highly organised abuse, and HMRC are convinced that charging an effectively penal FRS rate to "limited cost traders", as defined, is the only way to stop this.

The article sets out various options for affected traders, including how to account for VAT in a period straddling 1 April. It also notes the procedure for leaving the FRS: the trader is required to write to HMRC to tell them they are leaving the scheme (or the trader can send an e-mail to frsapplications.vrs@hmrc.gsi.gov.uk).

Taxation, 2 March 2017

In a further article in *Taxation* in March, Neil Warren considered further the impact of the changes, including the likelihood that many FRS traders

below the registration threshold will deregister. He pointed out a number of catches that have to be considered when deregistering, including the fact that a trader leaves the FRS the day before deregistering altogether (i.e. there is one final day as a "normal" trader), and the fact that an application for deregistration cannot be backdated.

Taxation, 16 March 2017

6.3.2 Flat Rate Scheme final amendments

The Value Added Tax (Amendment) Regulations 2017 have implemented the promised changes to the FRS from 1 April. There are no significant changes to the proposals announced at the Autumn Statement:

- limited cost traders, as defined, will have to use a flat rate of 16.5% (15.5% in the first year of registration), almost certainly negating any benefit under the scheme;
- the decision on whether a trader is LCT must be made at the end of each return period;
- a LCT is one who spends less than the higher of £1,000pa and 2% of gross turnover on the gross cost of "relevant goods";
- "relevant goods" are goods bought exclusively for the business, but excluding certain categories, and obviously excluding services.

Two further categories have been added to the exclusions from relevant goods. The original list was:

- vehicles, parts and fuel except where the business qualified for the "transport" category;
- food or beverages for consumption by the trader or employees;
- capital expenditure goods.

The additional categories, to deal with suggested ways around the rules, are:

- goods for resale, leasing, letting or hiring out except where the main business activity of the FRS trader ordinarily consists of those activities;
- goods for disposal as promotional items, gifts or donations.

SI 2017/295

The Explanatory Notes appear to promise an updated TIIN, but it has not appeared by 30 March. HMRC have developed an "online tool" to assist traders in making the decision about whether the LCT rules apply. The first version was put out for consultation and was plainly inadequate, but the final version appears to work reasonably well. However, it is not clear that the message – that FRS status is likely to be disadvantageous to anyone who falls within the definition of a LCT – has reached many of those affected. HMRC promised to send out a letter about the changes to all VAT-registered traders, and those letters have been arriving in the last week of March. Against that background, it is to be hoped that HMRC will allow traders to opt out of the FRS with retrospective effect, at least back to the start of a return period once they realise that they will have to pay more VAT as a result.

A new version of the FRS Notice has been issued, incorporating the final amendments to the LCT rules. However, it does not (yet) include the exclusion of “promotional goods” from “relevant goods” (possibly indicating that this was a last-minute change before the issue of the Statutory Instrument).

Notice 733

6.4 Repayment claims

6.4.1 *Fleming* claim

A series of appeals by Scottish Health Boards reached the FTT in 2014 and 2015. *Dumfries & Galloway Health Board* succeeded with a repayment claim in 2014 (TC03381), which does not appear to have been overturned on appeal or listed on HMRC’s roster of “cases appealed”; *Lothian Health Board* failed at the FTT (TC03397), and the Board’s appeal was rejected again at the Upper Tribunal in 2015. The *Greater Glasgow & Clyde* case relates to input tax incurred in relation to dining-room expenditure (£1.5m), residual revenue expenditure, and capital expenditure, over an extended period from April 1974 to 1994. The total amount claimed was just under £3.5m.

The claim made on 30 March 2009 had covered the period up to April 1997 and was for a slightly higher amount, but the last three years were removed by an amendment in 2011. HMRC argued that the amendments meant that a new claim had been made after the *Fleming* deadline. The Board contended that this was simply an amendment of an existing valid claim.

The FTT (TC04324) heard evidence about the preparation of the claim. For example, input tax on dining-room expenditure was attributable to business activities in respect of staff and visitor catering; patient catering was non-business. The claim was based on extrapolation from current evidence of the amount of costs that were standard rated (about 20%) and zero-rated (80%), and the estimated proportion of business meals.

The FTT noted that both parties were public bodies; they were agreed about a number of principles, including that input tax had been underclaimed, but the areas of disagreement amounted to a very significant difference in calculation. The uncertainties in the evidence, in particular in relation to the exclusion of all “contracted out services” VAT, were difficult for the appellant to overcome: with misgivings, reflecting the conclusion in the *Lothian* case, the Tribunal dismissed the appeal.

The Board appealed to the Upper Tribunal. It argued that:

- the FTT had not given sufficiently clear reasons for its decision;
- given that it had concluded that input tax had been underclaimed, it should have exercised its jurisdiction to find a solution, allowing part of the claim rather than refusing the appeal outright;

- the FTT had come to an unreasonable decision, given that it had concluded that a substantial amount had been underclaimed;
- the FTT had been wrong to conclude that part of the claim relating to a predecessor authority was time-barred on the basis that figures had not been included in the 30 March 2009 submission.

The appeal was rejected on all counts. The FTT's decision was clear that it was not satisfied with important parts of the evidence. It had acknowledged that its jurisdiction extended to awarding a lesser amount if it was persuaded that a significant amount had been underclaimed, but nevertheless had decided not to do so, because the taxpayer had not convinced the Tribunal on the balance of probabilities that even a reasonable estimate could be made. It had been agreed before the UT that the FTT had been wrong to record that a HMRC officer had conceded that "a substantial repayment was due" – HMRC had not made such a concession, and they disputed it. Lastly, it was correct that no figures relating to the predecessor authority had been included in the *Fleming* claim. It appeared that the FTT had applied the correct legal tests and had reached conclusions that it was entitled to reach. The appeal was dismissed.

Upper Tribunal: *NHS Greater Glasgow and Clyde Health Board v HMRC*

6.4.2 Directly effective rights?

A construction company reclaimed £33m, later increased to £60m, in relation to goods installed in new homes between April 1973 and April 1997, arguing that the "builders' block" on such input tax was contrary to EU law. Judge Mosedale refused the claim in 2014 (TC03700). The "builders' block" probably did contravene EU law, in that it made the supply of items incorporated in new homes effectively exempt; however, the claim to rely on directly effective EU rights required the company to treat the outputs as standard rated. They could not rely on the EU law to make the input tax deductible and also take the benefit of the UK law to make the outputs zero-rated.

Judge Mosedale asked for further submissions on the following issue:

HMRC accepted that if the Claim Items were not incorporated and not part of a single supply and that therefore the supply of the Claim Items was a separate, standard rated supply it would automatically follow that the appellant would be entitled to recover the claimed input tax in principle. Nevertheless, HMRC considered the claim would have to be netted off against the output tax that should have been, but was not, accounted for on the standard rated sale of the Claim Items. I refer to this as [the] 'set off' question.

HMRC, like the appellant, however, had not come to Tribunal prepared to put their case on …whether input tax must be netted off against output tax when it was many years too late for HMRC to assess the output tax. …

Back in the FTT in 2015 (TC04281), the judge examined a number of precedent cases, in particular *MDDP* (Case C-319/12), in which the taxpayer provided education and training to customers. The CJEU ruled that it could not take the benefit of an EU right to deduction at the same time as enjoying a domestic right to exempt its outputs. This was directly in point, and decided the case for HMRC.

If the company had not accepted that its output tax would have been greater than the input tax incurred, the judge would have referred the case to the CJEU to determine whether she was right to regard the "effective exemption" in the builders' block to be contrary to EU law. However, as the company had accepted that its output tax would have been greater than its input tax, there was no remaining issue to be determined. The appeal was dismissed.

The company appealed to the Upper Tribunal on 6 grounds:

(1) Ground 1. Having identified the Builder's Block to be unlawful, the FTT erred in finding that the supplies of the Claim Items made by Taylor Wimpey would (looked at alone) be standard rated supplies with a right to recover input tax rather than zero rated supplies with a right to recover input tax.

(2) Ground 2. The FTT erred in finding that, following the matters addressed in relation to Ground 1, and in circumstances where (a) the provision of the Claim Items is a part of what would otherwise be a single zero-rated supply of a home and (b) there is no UK statutory limit on the scope of the relevant zero rate, the supply by Taylor Wimpey is nevertheless capable in part of being taxable at the standard rate as regards the Claim Items.

(3) Ground 3. In any event the FTT erred in finding that as a matter of general principle any right on the part of Taylor Wimpey to recover input VAT in respect of sums caught by the unlawful Builder's Block is a right to recover an amount net of an output VAT liability irrespective of national time limits.

(4) Ground 4. In the alternative, in the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that the Claim Items were all "incorporated" in the buildings for the purpose of the Builder's Block.

(5) Ground 5. In the alternative, in the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that the relevant Claim Items were not "ordinarily installed as fixtures" by builders in dwellings during the years in question.

(6) Ground 6. In the event that the Builder's Block is lawful as a matter of EU law then the FTT erred in finding that there is nothing in Article 17(6) of the Sixth VAT Directive to prevent the extension of the scope of the Builder's Block after 1 January 1978.

The UT considered the first question at some length, and disagreed with the conclusion of the FTT: the Builder's Block was not contrary to EU law. Rather than being equivalent to the exemption of something that was not covered by art.13 6th Directive, it was rather an integral part of the UK's zero-rating system, permitted by derogation. The UT compared it to the *Talacre Beach Caravan Sales* decision, in which the CJEU found that the partial zero-rating of a supply was not contrary to EU law; the effect of the Builder's Block was similar in removing the right of deduction for certain items. Because it was not an input tax block within art.17 6th Directive, extending it was not contrary to the Directive either. The UT expressed "complete confidence" in this conclusion, and declined the company's request to consider a reference to the CJEU.

The UT went on to consider whether the Claim Items were "incorporated" in the building. It discussed at length the difference between "fixtures" and "fittings", and concluded that the word "incorporated" had a wide meaning. However, it was not the same as the *CPP* test for a single supply: it was a physical test, rather than a test of the relationship between one part of a supply and the others to which it might be ancillary. The UT decided that the mere attachment of an item to the electrical supply would not be enough to "incorporate" it: there must be some feature or features of installation, whether by housing the item in a particular structure, or by fixing the item in a manner designed to be other than temporary either to a physical part of the structure or to a supply of electricity, gas or water or means of ventilation or drainage.

The UT was not able to draw a conclusion on which items would, according to its understanding, not be "incorporated". Fixtures generally would be: the UT disagreed with the FTT that carpets merely held down by gripper rods would be "fixtures" (they should be "fittings"). "Installed fittings" would be incorporated if they were not merely free-standing white goods plugged into the electricity supply. The parties were invited to go away and agree the outcome based on these principles.

The UT went on to consider arguments about what was "ordinarily installed" or "ordinarily incorporated" at the time. The word "ordinary" permits exceptions (it is not "invariably"); it is also too strong to say that exceptions would have to be "exceptional". The test, according to the UT, was whether the installation or incorporation of the item by builders was at the relevant time commonplace or not out of the ordinary. There is a range of frequency between something that is exceptional and something that is ordinary: the UT disagreed with the conclusion of the Tribunal in *Rainbow Pools* that "the mere fact that swimming pools are sometimes included in luxury dwelling houses means that they must be regarded as ordinarily installed in such houses".

Considering the range of probability of installation, the UT disagreed again with the FTT: it was not necessary for something to be "more likely to be installed than not". It was also necessary to consider whether the comparator should be "all dwellings" or a sub-category (e.g. luxury dwellings, as in *Rainbow Pools*). The UT concluded that the intention of Parliament was to consider the "core items" in a building, so there should be a comparison with other dwellings of similar size and use – apartment blocks, family homes, bungalows, maisonettes, sheltered homes. The question should be considered at the time of installation, not at the time of legislative change: a change in the meaning of the expression would not amount to an unlawful extension of a block (or zero-rating) covered by a standstill clause.

The UT invited the parties to agree the matter based on the principles it had set out in the decision. It would be necessary to identify first those items that were neither fixtures nor installed fittings; when there was a list of specific items, if agreement could not be reached, the Tribunal would hear further argument. This might cover the issues of single or multiple supply, the potential offset of output tax due on a supply that should have been standard rated, and whether such goods were ordinarily incorporated at the time.

The company's argument that the FTT's findings of fact were unreasonable was also left for consideration at the next stage, if agreement could not be reached.

Upper Tribunal: *Taylor Wimpey plc v HMRC*

6.4.3 Repayment supplement

A company claimed a repayment of £18,322 for its 01/16 period. The return was filed on 1 February. HMRC contacted the company on 29 February to ask for further information, which was provided. On 1 March, HMRC confirmed that the enquiry was concluded and that the repayment had been forwarded for authorisation. On 3 March, HMRC issued an internal instruction to make a VAT repayment, and added repayment supplement. This was received by the company through BACS on 8 March.

On 10 March, HMRC issued an assessment to claw back the repayment supplement, which they claimed had been issued in error. The company appealed, arguing that a repayment received on 8 March could not have been the subject of a "written instruction to pay" before 4 March (a Friday), and HMRC therefore were correct to add supplement.

The FTT considered contrasting earlier decisions: in *Vogrie Farms* (TC04681), the FTT considered that any form of instruction (including electronic communications) would count; in *Marlico Ltd* (TC04678), the FTT considered that the law referred to the "last action necessary to make the payment".

Judge Brooks preferred the decision in *Vogrie Farms*. The law did not specify to whom the instruction had to be issued, only that there should be one. This meant that the internal instruction was sufficient to satisfy HMRC's obligations under the law, and the fact that BACS might not have received the instruction until the following day was not relevant. The appeal was dismissed.

First-Tier Tribunal (TC05619): *Tarn-Pure AG Ltd*

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Time limits

HMRC assessed RBS to over £86m in relation to emissions allowances missing trader fraud in periods 06/09 and 09/09. RBS was the representative member of a VAT group that included a carbon credit trading subsidiary. The assessment covered a very short period: 8 June 2009 (when the French exchange closed down, raising awareness of the risk of fraud) to 21 July 2009 (when RBS ceased to trade in the allowances until the reverse charge was introduced).

The Tribunal had to consider a preliminary issue: whether the assessments, raised on 20 September 2012, were made in time. This was clearly over 2 years after the end of the relevant accounting periods, so the question was when "evidence of facts sufficient to justify the making of assessment" was in the hands of the Commissioners (s.73(6)(b) VATA 1994).

There was an interesting point of dispute: the officer stated that he had been aware of some facts at an earlier point from other sources, but waited to receive confirmation of them directly from RBS. RBS argued that the time limit depended on when HMRC knew the information, from whatever source. The judge disagreed: the law refers to "evidence of facts", not simply "facts". HMRC might think in some cases that a particular fact is only evidenced to the degree necessary to justify an assessment if it is confirmed from more than one source: whether that is a reasonable view will depend on the circumstances. On the other hand, it was what HMRC knew, and not merely what the particular officer knew, that mattered.

The judge also noted that it was necessary to consider the information that would justify the assessment that was actually raised, not the possibility that a different assessment could have been raised at an earlier stage on the basis of less information. The officer had known the precise amount of the assessment over a year before it was raised, but was waiting for further information relating to "knowledge or means of knowledge". That was key to justifying the raising of an assessment.

The tests were differently presented by the two sides:

38. The appellant stated that the three stage test was:

(a) Did HMRC discover anything new within last 12 months?

(b) If they did, did the officer who made assessment actually rely on any of these new factors in reaching his decision to assess?

(c) And even if he did, did the officer act unreasonably in not making the assessment on the information held before?

39. HMRC's formulation of the test was:

(a) Decide if officer did rely on any facts discovered in last 12 months when making assessment?

(b) Decide if any of these new facts were new to HMRC and of sufficient weight to justify assessment?

(c) Decide if officer unreasonable in not making assessment on information already held.

As can be seen the tests are really the same, just with (a) and (b) reversed.

Judge Mosedale examined each of these propositions in relation to the evidence in great detail. She concluded that there were new facts in a letter received in 5 October 2011, that were relevant to the assessment raised, that were actually relied on by the officer in raising it. The assessment was in time, and the preliminary issue was decided in favour of HMRC.

First-Tier Tribunal (TC05713): *The Royal Bank of Scotland Group plc*

6.7.2 Best judgement

A Chinese restaurant appealed against an assessment for £85,594 in underdeclared output tax. The Tribunal considered at length allegations that racist bias was one of the factors underlying the assessment, but dismissed them.

The Tribunal considered a number of other more technical criticisms of HMRC's approach and calculations in considerable detail. The judge noted that the assessments appeared to be high, but the company had not presented a detailed picture of its own finances to displace them. The Tribunal could not take into account a mere impression that the assessments were higher than they ought to be: the company had to provide evidence and satisfy the burden of proof on the balance of probabilities, and instead it had attacked the good faith of HMRC and the underlying basis of extrapolation. The one finding that assisted the appellant was that HMRC's calculations were based on 128 transactions on the observation day when there were in fact only 109, and the assessment should be recalculated on that basis. The appeal was therefore allowed in part.

First-Tier Tribunal (TC05579): *Morrella Ltd*

6.7.3 Liable but no longer liable

HMRC assessed a takeaway business on the basis that it had been liable for registration from 1 March 2010 to 12 May 2013. The liability was calculated at just under £35,000, with a penalty of just over £5,000. The trader disagreed with the officer's calculations, and suggested that the night that HMRC had chosen for an observation was so exceptional that it was "like winning the lottery".

The Tribunal noted that the trader's wife had previously run the business, and it had at the time regularly exceeded the registration threshold. When the husband took over, it appeared to suffer a 36% reduction in turnover. The judge examined the basis of the officer's estimates in detail and concluded that he had if anything been excessively favourable to the trader. The trader had not produced any remotely credible evidence to displace the assessments, and the appeal was dismissed.

First-Tier Tribunal (TC05661): *Chun Wah Lok*

6.7.4 Second hand scheme

A trader appealed against assessments for VAT of £26,503 and a penalty for £4,571. He had registered for VAT voluntarily in 2009 as a second hand car dealer. Over the next 5 years he declared trading losses of £140,000 and claimed VAT repayments of £27,508. For the periods from 03/11 to 03/14, to which the assessment related, he had shown a net loss on his VAT returns of £95,865. Every return was a repayment return. The Tribunal noted that this indicated that he was likely to be incurring VAT on the purchase of some vehicles and should therefore not operate the margin scheme on them. However, if that was the case, the output tax liability would be expected to be higher.

Two officers visited the trader in November 2014. He told them he now traded in second-hand lawnmowers. He had suffered a fire that had destroyed all his business records. He had ceased to sell cars some 18 months previously. The officers asked how the trader had managed to finance the substantial trading losses over the past 5 years, but no convincing explanation was provided.

Over the next two years the officers tried to reconstruct the records from bank statements and other explanations. They remained sceptical about the completeness of the business records. Explanations such as “some of the sales do not appear in the bank statements because they were for cash” are unlikely to have increased their confidence.

The Tribunal heard oral evidence from the trader. The judge commented that his account was confusing, contradictory and incomplete, and there was very little documentary or other evidence to corroborate it. In the absence of an alternative explanation, the judge concluded that the assessments were raised to best judgement and the trader had done nothing to displace them. His appeals against both the assessment and the penalty were dismissed.

First-Tier Tribunal (TC05690): *Keith Allen*

6.8 Penalties and appeals

6.8.1 Default surcharge

A group of hotels appealed against a series of surcharges. They argued that they had a reasonable excuse; that HMRC had incorrectly allocated various payments, so increasing the surcharges unjustly; and the penalties were disproportionate.

In respect of the allocation of payments, HMRC had generally allocated amounts paid to the oldest debt first, which meant that the current debt was always paid late. As default surcharge is a fixed amount regardless of how late the payment is, it would be beneficial to the taxpayer to settle the current debt on time and leave an old debt outstanding. Under common law, debts can be allocated by the debtor to particular debts, but only if this is done before the money changes hands. The taxpayer argued that HMRC ought to have acted proportionately and fairly, and allocated the money in a way that was advantageous to the taxpayer. HMRC argued

that, in the absence of any allocation by the trader, they were entitled to allocate all receipts to the oldest debt.

In 2015 the FTT (TC04466) examined arguments and precedents about allocation of debts, and could find no evidence that HMRC had failed to allocate payments in respect of existing debts in accordance with any wishes expressed by the appellants. There is a problem: until the due date for a particular period, the debt for that period is not in fact due. So it is theoretically only possible to request an allocation of a payment to the current period's debt, as opposed to previous debts outstanding, if the payment is made on that last day. Any payment made before the last day cannot be allocated to a debt that is not yet due.

The reasonable excuse argument was based on a shortage of funds arising from problematic financing arrangements entered into on the advice of bankers – interest rate hedging instruments that proved disadvantageous. Although the problems caused might not have been anticipated in detail, they were broadly predictable. They did not constitute a reasonable excuse within *Steptoe*. The rest of the argument about insufficiency of funds failed to produce any other defence.

Some adjustments to the surcharge amounts were made, at HMRC's request, because payments had been reallocated during the course of the dispute, reducing the outstanding amounts on which surcharges were based. However, apart from that, the appeals were all dismissed.

The companies appealed to the Upper Tribunal. The grounds were twofold:

- whether the company had the right to allocate payments to VAT debts that were not yet strictly due;
- whether HMRC were nevertheless obliged to allocate the payments in the most favourable way.

The second ground was presented as an argument about proportionality: it was contended that a penalty would be disproportionate if a different allocation would have produced a lower figure.

The UT noted that there had been a lack of clarity about the companies' attempts at allocation before the FTT. The companies had produced a schedule, but HMRC had pointed out various errors and the FTT concluded that it could not be relied on.

The UT considered a number of non-VAT precedents in relation to the allocation question. It was necessary to answer several questions. First, is there a debt before the due date for payment to which an appropriation can be made? In the absence of input tax, the UT was in no doubt: it was reasonable to recognise a debt due to HMRC as soon as a supply had been made, even during the return period, because it was known that the output tax would be due to HMRC. The UT then had to consider the impact of input tax: as there was a right, but not an obligation, to claim input tax, the UT concluded that there was an entitlement to allocate a payment to the cumulative output tax that has arisen on supplies in the current period, even though the due date for payment has not arrived and regardless of the possible reduction of the debt by an input tax claim.

If a current payment exceeded the current liability, and the trader had asked for it to be allocated as a payment on account of current liabilities,

the UT were less clear about the consequences in accordance with precedent case law on debts. However, the judge commented "*If HMRC accept such payments (and we have difficulty seeing that HMRC would ever have a good reason not to) then having accepted the payment as a payment towards the current period's liability, HMRC cannot allocate it as a payment to a historic liability.*"

The judge also noted that the structure of the legislation supported these conclusions. Input tax is only claimed by being put on a return, so it does not reduce the output tax debt until that happens. The law clearly contemplates that VAT payments may be made before the due date, and also before a return is filed. The words of s.59 VATA, referring to VAT "liable in respect of that period", appear to contemplate the possibility of allocation by the taxpayer to different periods. Early payment is encouraged by the penal nature of default surcharge, which makes payment on the last available date a dangerous exercise. All of these indicated that the FTT had made errors of law in determining that the trader could not choose to allocate payments made earlier than the final due date.

The Tribunal was not convinced that HMRC's allocation of payments could make the surcharge disproportionate, if it was open to the trader to make a different allocation. It might appear harsh in some cases, but it would not be "plainly unfair". The UT reached no conclusion on this argument if it was wrong on the principle that the trader could allocate payments made before the due date.

The UT decided that the FTT's decision contained errors of law, but because of the nature of that decision, it had not made findings of fact that would enable the UT to remake the decision. The case was remitted to the FTT to make findings about the amounts and dates of relevant VAT payments and the allocations made by the appellants in respect of those payments.

Upper Tribunal: *Swanfield Ltd and others v HMRC*

A company appealed against a surcharge of £2,200 for its 08/15 period. The return was filed electronically, and payment was not made until 20 October. The trader had relied on a firm of chartered accountants to ensure that his VAT affairs were brought back into compliance, and in respect of 11/14 they had acknowledged responsibility and paid his surcharge for him. The Tribunal considered that their service had been deficient in respect of the 08/15 period when their client was on holiday, but s.71 VATA meant that this could not constitute a reasonable excuse. With some regret, the appeal was dismissed.

First-Tier Tribunal (TC05561): *Stephen McPartlin Plumbing & Central Heating Ltd*

A company appealed against a surcharge of £588 for the period 03/16. The company had had an unusually large VAT liability for the quarter, and was unable to pay it in one instalment. The balance was a day late. The director stated that he was not aware that a surcharge liability period applied.

HMRC reported that the company had been in the surcharge regime since 03/14, and had paid late in 3 previous quarters. This was the first surcharge at 10% and the first exceeding £400. SLNs had not been

returned by the postal system. The trader's offered excuse amounted to "reliance on another", as he claimed that his usual bookkeeper had been away.

The Tribunal could find nothing to constitute a defence against the penalty, and dismissed the appeal.

First-Tier Tribunal (TC05567): *Turner Electrical & Alarm Ltd*

A company appealed against a 15% surcharge of £3,770 for its 01/16 period. It had been in default for 5 previous periods starting with 01/14. The essence of the appeal was reasonable excuse based on continuing late payments by NHS Trust clients. The Tribunal noted that this was broadly similar to *Steptoe*, and also commented that it had not been suggested that the trader was eligible for the cash accounting scheme. A schedule of aged debtors showed considerable amounts overdue.

However, the trader could have applied to HMRC for Time To Pay, and apparently had not done so. The late payments by clients had become worse in the last two years, but they had arisen before, and were a normal hazard of trade. A second defence based on unfairness could not succeed. The appeal was dismissed.

First-Tier Tribunal (TC05573): *Assista Consulting (UK) Ltd*

A sole trader appealed against a 2% surcharge of £445 levied for his 07/16 period. The grounds of appeal were essentially that the penalty was unfairly large for a single day's delay at a time of year when it is difficult to obtain the relevant information because people are on holiday. This was about fairness, and could not succeed. In addition, HMRC said that the facts contradicted the defence, as the trader had made a part payment on the due date by Faster Payments, and the due date was a Wednesday, not a Sunday as he had stated. The return had been submitted on time.

The appeal was dismissed.

First-Tier Tribunal (TC05578): *Francis Anthony White*

A company appealed against a 5% surcharge of £443 for its period 03/16. It argued that as the due date was a Saturday, and the payment arrived on the following working day, it was on time. The Tribunal rejected this argument at a paper hearing. There is no provision in the law, nor a practice or convention, that allows for weekends. A reasonable excuse had been accepted for late payment in a previous period, but there was none here. The appeal was dismissed.

First-Tier Tribunal (TC05607): *Fashionizer Ltd*

A trader made arrangements to pay the VAT liability for 03/16 in two instalments on 10 May and 24 May. This did not prevent a £714 surcharge at 5% because the application for TTP was only made on 10 May, after the due date. There was insufficient material before the Tribunal to show any reasonable excuse, in particular in relation to the underlying reasons for a claimed insufficiency of funds. The appeal was dismissed.

First-Tier Tribunal (TC05608): *Hortus Blackheath Ltd*

A company appealed against four surcharges for successive periods to 06/15 totalling £2,830. The trader claimed poor cash flow as an excuse, but the judge did not consider there was sufficient evidence to show a position comparable to *Steptoe*. In three of the four periods, it appeared to have sufficient funds, but did not manage its payments to settle the VAT debt on time. The appeal was dismissed.

First-Tier Tribunal (TC05613): *JTS Plumbing & Mechanical Services Ltd*

A company had made two earlier appeals about surcharges for periods from 02/13 to 02/15. It made a further appeal against surcharges for 05/15 and 08/15 of £47,602 and £17,704. The company was within the payments on account regime, and was suffering ongoing cash flow difficulties. The director had notified HMRC that it would have to pay some VAT late, but had not formally applied for TTP. He said that he had hoped that refinancing arrangements would have been concluded earlier than turned out to be the case.

The judge considered that a reasonable trader would have realised earlier that the refinancing would not be completed, and would have asked for TTP. No evidence had been presented to the Tribunal concerning insufficiency of funds for either period. The appeals were dismissed.

First-Tier Tribunal (TC05670): *Fogarty (Filled Products) Ltd*

A company appealed against surcharges for periods 03/12 to 12/13 (excluding 06/13). The total, which had to be reconciled by a second judge after the hearing judge (Kenneth Mure) sadly died, amounted to £7,081.

The replacement judge (Anne Scott) noted that Judge Mure had suggested that a complaint should be made about HMRC's handling of the trader's affairs, and she quoted extracts from the letter upholding that complaint. The judge also noted that the traders had made considerable efforts to pay the VAT – the husband had taken full-time employment elsewhere, and the wife had also taken another job, they had obtained personal loans and they had put the business on the market and eventually found a buyer.

Looking at the totality of the evidence, and taking into account the shoddy service from HMRC, the judge considered that there was – in the very unusual circumstances of the case – a reasonable excuse. The appeal was allowed.

First-Tier Tribunal (TC05672): *MOC (Scotland) Ltd*

A trader appealed against a 15% surcharge of just over £2,100 for its 01/16 period. HMRC requested a direct debit on 10 March, and it was rejected by the bank for insufficient funds. The trader said that he relied on the bank to tell him that he did not have sufficient funds to meet the call, so that he could transfer funds from another business. The judge did not consider this to be a reasonable excuse: it was the trader's responsibility to know when the money would be called for, and to make sure that there was enough money in the account to pay it. The appeal was dismissed.

First-Tier Tribunal (TC05689): *The Baker Street Kitchen*

A company appealed against a 15% surcharge of £3,861 for its 06/16 period. The VAT was due on Sunday 7 August and was paid on Monday

8 August. The director complained that this was unreasonable for a day's delay, but also claimed not to have been aware of more than one previous surcharge. The judge found against him at the hearing, but because he expressed dissatisfaction and an intention to "take the matter up with a number of people" (presumably his MP, the Adjudicator etc.), she set out the details of her decision at length. The evidence suggested that he ought to have known about the earlier surcharges (as the company had paid them, and had some correspondence about them). The defence of unfairness could not succeed. The appeal was dismissed.

First-Tier Tribunal (TC05695): *Right International Ltd*

A company appealed against a 15% surcharge of £775 for its 06/16 period. The problem was the same: the director had intended to pay on Sunday 7 August, but had been "distracted by a family matter" and had paid by 0800 on Monday morning. He argued that such a penalty for being 8 hours late was unreasonable. HMRC asked what the family matter was, and was told that it was his mother-in-law being diagnosed with cancer and his brother-in-law suffering a heart attack. That would clearly be capable of being a reasonable excuse, so HMRC asked for some medical evidence, but none was forthcoming. HMRC also pointed out that the SLNs contained warnings, and there were two other directors who could have taken responsibility for making sure the payments were made on time. The Tribunal agreed; as it was a paper hearing, it was not possible to question the director about his excuse, so the defence was effectively only the allegation of unfairness. The appeal was dismissed.

First-Tier Tribunal (TC05701): *Composite Technologies Ltd*

6.8.2 Other penalties

HMRC imposed a penalty of £36,271 on a director of a company in respect of inaccuracies in the company's 10/11 and 11/11 periods. The inaccuracies related to underdeclared output tax. The penalties were charged at 50% on the "deliberate and concealed, prompted disclosure" scale, reduced for co-operation.

The trader claimed that his company had been effectively "hijacked" by his business partner, and that he had been unaware of any illegitimate transactions with missing traders. The partner had disappeared as soon as HMRC had started asking questions, leaving him to face the consequences.

HMRC said that the trader had not mentioned the business partner at the first meeting with enquiry officers, and there was no evidence that he even existed. Even if he did, it appeared that the company was a vehicle for dishonest trading, and as the sole director he had to be responsible for that. The company itself did not appeal against the penalty assessment, but rather went into insolvent liquidation.

The Tribunal had to consider whether it was open to the individual to appeal against the penalty itself, or just against its attribution to him. The judge concluded that he should be able to appeal, even if the company had not. The best that could be said about the omission of transactions from the returns was that the director had decided not to ask questions about the activities of the business partner; the judge held that an intentional failure

to exercise oversight of a business partner can amount to a deliberate act of concealment.

The Tribunal acknowledged that it might appear harsh to levy such a penalty on someone who has been duped by a conman, but the legislation was clear and the maximum mitigation had been allowed: the penalty was attributable to the director's failure in his duties to the company and to HMRC. The appeal was dismissed.

First-Tier Tribunal (TC05559): *Shafiq Rehman*

A company appealed against a penalty of £1,472 for late notification of liability to register. The company had completed a VAT1 online on 26 January 2015, disclosing that the registration threshold had been exceeded in the 12 months to 31 July 2014. The company was therefore registered with an effective date of 1 September 2014. HMRC noted that the company was nearly 5 months late notifying and sent a letter asking for more information in order to determine whether to levy a penalty. The company did not pass this on to its tax agent, and no reply was sent to HMRC.

The agent found the letter in October 2015 and responded to it. HMRC levied a penalty, charged at 30% but mitigated by 55% to give an effective penalty percentage of 13.5% of potential lost revenue of £10,910. The agent entered into correspondence, pointing out that the notification had been unprompted and within 12 months, and the penalty ought therefore to be mitigated to zero. He pointed out that he had completed the registration application and was appointed agent so that the client's tax affairs would be dealt with promptly – if HMRC had sent the penalty notice to him in February, he would have responded immediately. HMRC upheld the penalty assessment on review. The reviewing officer stated that such notices are only sent to the taxpayer, and are not copied to the agent. It had stated on it "if you have an agent show them this letter immediately".

The Tribunal noted that a failure to notify on time cannot be entirely remedied, and HMRC are entitled to charge a penalty. Reduction to zero depends on a number of factors, such as the reasons for the failure, the seriousness of the failure, the circumstances in which it is corrected and the degree of co-operation. In this case, HMRC had allowed 10% for "telling", 15% for "helping" and 30% for "giving access" (the maximum, because access had not been requested). The judge decided that "telling and helping" should be increased from 25% to 35%, giving an overall penalty rate of 10.5% and reducing the penalty to £1,145. The appeal was allowed to that extent.

First-Tier Tribunal (TC05612): *Taylor Construction Ltd*

HMRC assessed a company to a penalty of £461 for failing to point out an underassessment for its 11/15 period. This was the company's first VAT return, and the director had been in the process of appointing a new accountant. He was unfamiliar with VAT and claimed to have been unsure what to do.

HMRC regarded the situation as "prompted disclosure", with a minimum percentage of 15%. They allowed 80% mitigation of the difference between the minimum and maximum, resulting in a penalty at 18%. The

potential lost revenue was the difference between the assessment (£332) and the amount due under the VAT return (£2,897), being £2,565.

The judge commented that a reasonable taxpayer would have taken more urgent steps to hasten the appointment of the accountant and to notify HMRC that the assessment was too low. The appeal was dismissed.

First-Tier Tribunal (TC05589): *Dharex Ltd*

A company was assessed to a "careless" penalty of £27,800 for its 09/12 period, and to "deliberate" penalties of £17,724 and £27,660 for 06/14, separately for underdeclared sales invoices and for other errors. The Tribunal reviewed the history of a company accountant who appeared to make careless errors of a substantial size over a long period, and covered them up – including concealing earlier penalty charges from the directors. Her behaviour was inexplicable, as she did not appear to benefit personally; the directors had subsequently discovered more huge errors and shortfalls that were not related to VAT.

The Tribunal considered that the decision to levy a careless penalty, and not to suspend it, for 09/12 was a reasonable one. In respect of 06/14, the Tribunal decided that the behaviour was still careless rather than deliberate; this meant that it was open to HMRC to suspend the penalty, now that the directors were aware of what had been going on and had put in place measures to prevent it happening again. The parties were encouraged to go away and agree what should happen next; failing an agreement, they could return to the Tribunal for a further hearing.

First-Tier Tribunal (TC05654): *Promo International Ltd*

The Government announced in Autumn Statement 2016 that legislation will be included in Finance Bill 2017 introducing a penalty for participating in VAT fraud. This will allow HMRC to impose a penalty at a single rate where someone "knew or ought to have known" of a connection to fraud, rather than having to choose one or the other (deliberate or careless). The objective is to be able to deal with appeals against the penalty at the same time, and using the same evidence, as the appeal against the tax itself.

The Government consulted on the draft legislation and as a result they have made some minor amendments to improve clarity of the measure and to limit the naming of a company officer to instances where the amount of tax due exceeds £25,000. The new penalty will come into effect from the date of Royal Assent to the Finance Bill.

6.8.3 Appealing out of time

A company was denied input tax of £550,000 by a decision of 22 May 2015, and charged a penalty of £82,500 by a further decision on 11 September 2015. The company notified the Tribunal of appeals on 18 December 2015, and HMRC objected to the main assessment appeal on the grounds that it was out of time.

The company put forward a number of arguments to justify or excuse the delay, including the fact that HMRC had carried out a raid and removed much of the company's paperwork just after the original deadline for appealing; but the judge considered it to be serious and without good reason. HMRC raised no objection to an appeal against the penalty

assessment, but that will require much less evidence – once the liability is established, presumably the 15% misdeclaration penalty follows automatically (unless the company can show a reasonable excuse).

First-Tier Tribunal (TC05648): *JTC Environmental Ltd*

A golf club made "*Bridport* claims" for £436,877 (covering 01/1990 to 12/1996) and £342,726 (covering 2005 to 2008) on 27 March 2009. The claims were received by HMRC on 30 March 2009. On 28 March 2009, HMRC refused an associated claim for compound interest. On 24 June 2009, the *Fleming* claims team notified that the claims had been rejected, and set out the statutory review and appeal rights. There was no further correspondence from 24 June 2009 to 22 February 2014.

The appellant made further claims for 2009 and 2010 between 22 February and 14 May 2014. The 2009 claim was rejected for being out of time, and the 2010 claim was returned to be resubmitted in the correct format. This was done on 14 May 2014. A further claim was made for 2011 on 28 January 2015.

The *Bridport* decision was handed down by the CJEU on 19 December 2013. HMRC issued R&C Brief 25/2014 on 25 June 2014, and Information Sheet 01/2015 on 9 February 2015. The club's representative wrote to ask for a full list of correspondence about the *Fleming* claims, which HMRC provided; on 18 December 2015, the representative wrote to ask for a review of the decision of 24 June 2009, which HMRC refused.

The club secretary had apparently prepared a regular monthly report on 17 July 2009 which included the following statement:

"VAT

Have now received an initial response turning down our claim and in accordance with procedure have requested that the matter is reviewed."

The club therefore claimed to have believed that the matter had been properly dealt with and they were waiting for HMRC. The secretary was called to give evidence, and the Tribunal found his account unsatisfactory. It appeared that he had not kept the records of a crucial letter relating to a claim for three quarters of a million pounds, and had taken no action in relation to that matter for several years. Although he claimed to be conversant with the VAT law in relation to such claims, he did not appear to appreciate the difference between a review and an appeal, and he thought the club's claim stood behind *Bridport* even though no appeal to the Tribunal had been made. On the balance of probabilities, the Tribunal concluded that he had not even requested a review.

The Tribunal considered the usual criteria for allowing an appeal out of time, of which the last is whether there will be prejudice to either party if the application is allowed or refused. Clearly, given the sum involved, there would be prejudice to the club in refusing it. It was probable that a significant amount of the claim would succeed. However, HMRC argued that the records appeared now to be incomplete, and after so long it would be difficult to establish the amount of the claim, even if it were held to be valid. On balance, the judge decided to strike the appeal out.

First-Tier Tribunal (TC05671): *Gullane Golf Club*

6.8.4 Amending grounds

The *Wheels* case was about the possibility that defined benefit pension funds could be characterised as "special investment funds" and therefore receive investment management services within the exemption. This was rejected by the CJEU. The trustees applied to change their grounds of appeal to reflect a different argument being put forward by United Biscuits in another case: that fund management services supplied by an insurer would be exempt, and fiscal neutrality therefore required the exemption to be extended to similar supplies made by a non-insurer. United Biscuit's case is being advanced in the High Court as a restitution claim. Wheels' original grounds of appeal had been filed in 2008.

The question before the FTT was whether this constituted a mere amendment to the existing appeal, or a new claim, in which case it would be out of time. The FTT considered the precedents of *Reed Employment* (2013) and *Vodafone Group Services* (2016) in the Upper Tribunal. In *Reed*, the judge said that the question of whether there was a new claim was one of fact and degree depending on all the circumstances; in particular, whether the later claim arises out of the same subject matter as the original claim, without extension to facts and circumstances that fall outside the contemplation of the earlier claim. In *Vodafone*, the UT had concluded that it is the amount and the method of calculation which define the claim; amendments of that kind do not alter its fundamental character. It is possible for amendments to increase the amount of a claim, but it should not be permitted to add a further claim arising out of similar but not the same circumstances.

The judge in the present case commented that "*The elements of the Appellants' claim, i.e. the output of tax claimed and supplies to which it relates, are unchanged. Unlike the claimants in Reed Employment and Vodafone, the Appellants are not seeking to enlarge the original claim by extending it to supplies that were not originally included in it. The supplies in respect of which the Appellants claim a repayment remain the same as does the method of calculating the amount of the repayment. It is clear that if the Appellants are allowed to amend their grounds of appeal then the arguments in support of their claim and, possibly, the evidence necessary to make good those arguments will have changed.*" He accepted that there was some prejudice to HMRC in allowing the change and requiring them to prepare for a hearing that they might not have considered necessary; but if he refused the application, it would mean that the taxpayers' appeal would fail without any chance to consider the new arguments.

On balance, he considered that it was in line with the overall objectives of the FTT to allow the application, and he directed the parties to submit agreed draft directions in relation to a stay of proceedings to await the *United Biscuits* judgment of the High Court.

First-Tier Tribunal (TC05555): *Wheels Common Investment Fund Trustees Ltd and others*

6.8.5 Procedure

A MTIC appeal started in 2014 (TC04097) but had to be adjourned because the appellant's representative (a director of the three companies concerned) was taken ill after presenting opening submissions but before any evidence was considered. The earlier Tribunal decided to proceed with the case on the basis of written submissions, given that the director might never be well enough to carry on presenting the case in person.

The total VAT in dispute was £12.7m. It related to alleged contra-trading by three companies in the periods 05/06 and 06/06. The FTT (TC04614) examined the evidence put forward by HMRC and the explanations put forward by the appellant, and came to the usual conclusion: the appeal should be dismissed, in this case because the director actually knew that all the transactions were connected with fraud.

The company appealed to the Upper Tribunal, arguing that in refusing the fourth request for an adjournment, the FTT had denied the right to a fair trial. There were detailed grounds about hearing evidence without representation from the appellant and failing to consider that the allegation of fraud required the defendant director to be available to give evidence and be cross-examined. Presumably a successful appeal to the UT on these grounds would have required a rehearing of the substantive appeal by the FTT.

The UT examined the history of the dispute and the FTT decisions leading up to the application for adjournment, and its conduct of the appeal afterwards, in detail. It acknowledged that the situation was difficult, but presented with a range of unsatisfactory choices, the FTT had acted properly in all the circumstances. The appeal was dismissed.

Upper Tribunal: *Westminster Trading Ltd and others v HMRC*

As reported in January 2017, the Upper Tribunal refused a taxpayer a "Protective Costs Order" in *HMRC v TGH (Commercial) Ltd*. In TC04851 (April 2016), the FTT had been highly critical of the way in which HMRC presented their case, suggesting that if they appealed to the Upper Tribunal and won, the Upper Tribunal should not award costs to HMRC because they ought to have presented their arguments better in the FTT and settled the matter there. After winning in the FTT, the taxpayer applied to the Upper Tribunal for a Protective Costs Order, determining in advance that they would not have to pay HMRC's costs even if they lost in the Upper Tribunal. Judge Sinfield considered the application in detail, and reviewed the law and practice in relation to various types of costs order, and declined to make any order. He awarded HMRC the costs of resisting the appellant's application.

HMRC also appealed the substantive conclusion of the FTT to the Upper Tribunal. After the application for the Protective Costs Order was refused, the company sought to withdraw from the appeal under rule 17 of the Tribunals Rules, with the consequence that HMRC's appeal would be allowed by consent.

HMRC wrote to the Tribunal in February 2017, accompanied by a skeleton argument for the substantive appeal, each of which were settled by counsel and dated 1 March 2017. HMRC submitted that notwithstanding the withdrawal by TGH from the proceedings, first that the UT retains jurisdiction to hear the appeal, secondly that there was a

live issue to be determined, and thirdly that the point under consideration involved an issue of general importance, which HMRC considered merited a reasoned decision by the UT, even if the UT was minded to allow the appeal.

Judge Berner considered the matter and disagreed. There were precedents from non-VAT law in which the Upper Tribunal had heard an appeal even though a party had withdrawn, but these were in different and unusual circumstances. The proper course in this case would simply be to end the proceedings with HMRC's appeal being allowed by consent. It was not necessary, or even possible, to set aside the FTT decision or to remake it. The decision of the FTT would have no effect in relation to the tax in dispute, and the original decision of HMRC would be restored.

It appears that HMRC are unhappy that the original decision remains on record without being overturned, but anyone relying on it does so at considerable risk. It is in principle not binding on any other Tribunal, and the fact that the company decided not to defend it in the UT must cast doubt on its reliability.

Upper Tribunal: *HMRC v TGH (Commercial) Ltd*

A golf club VAT arrangement was found to be ineffective on *Halifax* grounds by the FTT and Upper Tribunal in 2013/2015, and the Court of Appeal refused leave to appeal. The companies concerned have complained to the European Commission that the FTT and UT misunderstood the *Halifax* decision and have asked the Commission to take infringement proceedings against the UK. Meanwhile, different arrangements were put in place in 2007, also subject to HMRC assessments and taxpayer appeals, and the conclusion of the UK appeals litigation on the "first iteration" of the planning meant that this "second iteration" should go forward for FTT hearings.

The FTT had to consider case management directions. The judge (Barbara Mosedale) had to consider which party had the burden of proof in a *Halifax* dispute, because that would affect the way the parties prepared their cases. After considering a wide range of precedents (as usual), she concluded that the burden of proof in this second case should be on HMRC. She also considered whether it would be appropriate to refer questions to the CJEU at this stage, but concluded that there was not yet a referable question of EU law before the substantive hearing.

HMRC were given time to consider whether to appeal against the decision on burden of proof before having to submit a statement of case for the substantive appeal.

First-Tier Tribunal (TC05707): *Hilden Park LLP*

6.8.6 Strike out

A company appealed against a decision of HMRC to issue a Post Clearance Demand Note for £360,240. HMRC refused to review the decision because the request was made out of time. The C18 was issued on 10 April 2015; the review request was made on 17 July; the refusal was issued on 23 July; and the appeal to the Tribunal was made on 5 October. The demand related to a failure to comply with the conditions for Onward Supply Relief.

The company failed to comply with Tribunal directions in five respects, and HMRC applied for its appeal to be struck out on the grounds that it had failed to cooperate with the Tribunal to such an extent that the Tribunal cannot deal with the proceedings fairly and justly. The judge reviewed the history of the appeal, and concluded that the application was well-founded. Although strike-out was a draconian remedy, it seemed that the appellant had done so little to engage with the appeals process (not even attending to oppose the strike-out application) that this state of affairs would continue. The appeal was struck out.

First-Tier Tribunal (TC05610): *XG Concept Ltd*

6.9 Other administration issues

6.9.1 Brexit

A House of Commons Library briefing note commented that the tax implications of Brexit are likely to be less significant compared with other policy areas; the exception is indirect tax, particularly VAT, on which there is a substantive body of EU law establishing common rules across Member States. The briefing has set out the balance of competences between the UK and the EU with regard to tax law.

House of Commons 7 February 2017: "UK tax after the EU referendum"

The House of Commons Northern Ireland Affairs Committee has called on the government to investigate whether powers over VAT can be used to boost tourism in Northern Ireland (NI). The current NI VAT rate is more than twice that of the Republic of Ireland (9% reduced rate for tourism businesses), which the committee argues puts NI at a 'competitive disadvantage'. Although EU law prevents Member States from setting different levels of VAT for different regions, following Brexit the committee believes the UK government will have the power to reduce tourism VAT in NI and enable it to compete with the Republic of Ireland.

Northern Ireland Affairs Committee 21 March 2017

6.9.2 Making Tax Digital

At the March Budget, the government announced that it would delay the mandatory introduction of Making Tax Digital until April 2019 for unincorporated businesses and landlords that have a turnover below the VAT registration threshold. This delay is intended to give these businesses sufficient time to prepare for keeping their records digitally and providing quarterly updates.

The April 2018 introduction affects income tax only. VAT itself is to be brought within MTD from April 2019, but VAT-registered businesses are in general already used to making quarterly online reports to HMRC, so there is less difference for them.

6.9.3 Budget

The March Budget included some longer-term proposals that are noted here but are not yet in effect.

The government stated that it intends to remove the use and enjoyment provisions that alleviate the need for UK VAT to be charged on B2C mobile phone services provided to a UK resident person travelling outside the EU. The change is "intended to resolve the inconsistency where UK VAT is applied to mobile phones used by UK residents when in the EU, but not when the mobile phone is used outside the EU". The changes are intended to prevent telecommunication providers from using the inconsistency to avoid accounting for UK VAT and it will "bring the UK into line with the internationally agreed approach". Secondary legislation and a TIIN will be published before the summer recess.

The government announced that it intends to hold a consultation on possible options to combat missing trader fraud in the provision of labour in the construction sector. One option would be to extend the scope of the domestic reverse charge mechanism to include labour provided in the construction industry so that the recipient accounts for any VAT due. A consultation document was published on 20 March.

www.gov.uk/government/consultations/vat-fraud-in-labour-provision-in-construction-sector

6.9.4 Disclosure

The government announced in Autumn Statement 2016 that legislation will be introduced in Finance Bill 2017 that is intended to strengthen the regime for disclosing indirect tax avoidance arrangements. The provisions will make scheme promoters primarily responsible for disclosing schemes to HMRC and the scope of the legislation will be extended to include all indirect taxes. These measures will become effective from 1 September 2017.

6.9.5 Enactment of ESC 3.20

Following consultation, and as part of the continuing process of either withdrawing or enacting extra-statutory concessions, a statutory instrument was issued to take effect from 6 April 2017. The VAT concession affected is ESC 3.20, which disapplies s.26A VATA 1994 where a debtor has entered an insolvency proceedure. This means that an input tax claim made in respect of a supply received before the commencement of the insolvency procedure, which remains unpaid 6 months after the due date, does not have to be reversed under s.26A if the commencement of the procedure occurred between the time of the claim and the trigger date for s.26A. This change is given effect by introducing a new s.26AA, which lists a large number of possible insolvency procedures, and amending reg.172H SI 1995/2518.

SI/Draft The Enactment of Extra-Statutory Concessions Order 2017

As a separate exercise, HMRC consulted up to 7 March 2017 on the withdrawal of four more ESCs from April 2018, three of which concern VAT:

- zero-rating of the central processor in a computer system (Notice 701/7);
- composite rate for computer systems sold to disabled people (Notice 701/7); and

- affiliation fees for profit-making commercial sports clubs (Notice 701/45).

www.gov.uk/government/consultations/withdrawal-of-extra-statutory-concessions-2017

6.9.6 Office of Tax Simplification

The OTS has published an interim report on the eight broad areas identified for its VAT simplification review and has issued a further call for evidence around a number of specific questions. Comments should be sent by 30 June 2017 and the OTS aims to publish its final report in the Autumn.

The eight areas under consideration are:

1. Identifying the implications of a high registration threshold – The UK VAT registration threshold, at £83,000, is much higher than most other countries' (generally closer to £20,000 across all countries with a VAT system or equivalent). This influences and distorts business behaviour. Would it be less distortive if the UK's threshold were lowered to bring in more businesses? If so, how would those small businesses cope? What would be the impact of raising the limit to remove more businesses from VAT? Or could the 'cliff edge' of registration be managed better?

2. Multiple rates: Causes of complexity – The UK currently has in effect four different VAT rates: the standard 20% rate, the 5% reduced rate, a zero-rating, and exempt goods and services. The definitions – and practical application of definitions – of items within each rate cause a lot of complexity. How might this be simplified?

3. Partial exemption, option to tax and capital goods scheme – These have been raised as some of the most complicated areas of VAT. Many more businesses now seem to be affected. Can they be simplified? Or are there ways to amend them to reduce their range and impact?

4. Special Accounting Schemes – There are several schemes, including the flat rate scheme, retail schemes, tour operators margin scheme and annual accounting scheme, generally designed to simplify the VAT regime. Business practices and technology have changed significantly since they were designed, so are these schemes working appropriately today? Do they need improving – or are any in fact no longer needed?

5. VAT admin, penalty and appeals processes – Many have reported complications ranging from unclear guidance to opaque penalty regimes and resource-consuming appeals processes. We've begun identifying specific complexities in the VAT machine and are open to any suggestions on how this might be simplified, increasing certainty for businesses.

6. Formal ruling system – We've already had suggestions that uncertainties around VAT treatment can delay or prevent many business decisions, especially when bringing a new product to market. A rulings system sounds a possible route but how would it work? Would it provide enough simplification to justify its introduction, given the demands it would place on HMRC?

7. VAT and Making Tax Digital (MTD) – HMRC's MTD plans encompass VAT so that brings opportunities and risks. Which areas of the VAT regime need to be simplified to better fit into MTD? And what

simplification could MTD bring to the VAT regime – how would the special accounting schemes be affected?

8. Further areas for investigation – We have also identified some further issues including sector specific considerations. What other complexities are out there that we need to address?

There are detailed examples of the problems and detailed lists of questions under each heading.

www.gov.uk/government/publications/ots-publishes-interim-paper-on-review-of-value-added-tax; www.gov.uk/government/collections/ots-review-of-value-added-tax

6.9.7 Compliance checks

HMRC's factsheet *Compliance checks: penalties for VAT and Excise wrongdoing* has been updated in relation to the criteria for a reasonable excuse defence against a penalty.

CC/FS12

6.9.8 Appeal against sentence

A company director was one of three men prosecuted and convicted for involvement in a missing trader fraud. The other two were sentenced to 6 and 8 years; this director appealed against a sentence of 5 years, arguing that insufficient allowance had been made for personal mitigation and the amount of money involved (£11.7m) was "at the lower end of the guideline range". The Court of Appeal ruled that the judge had been uniquely placed to assess the level of the defendant's culpability, and had been entitled to draw the conclusions he had come to. The sentence could not be said to be manifestly excessive, and the appeal was dismissed.

Court of Appeal: *R v Chada and others*

6.9.9 Extradition

An individual appealed against orders for his extradition to Sweden to face allegations that he and others were involved in a fraudulent missing trader VAT scheme relating to the purported purchase and sale of mobile telephones, which risked the loss to the Swedish state of approximately 25m Swedish kroner. The defendant's case was that the European arrest warrants had been issued for the purposes of interrogating and investigating him, rather than arresting and prosecuting him. The High Court disagreed. His rights under articles 3 and 5 of the European Convention on Human Rights had not been infringed, and his appeal against extradition was dismissed.

High Court: *Ahmed v Swedish Economic Crime Authority*

6.9.10 Emissions trading fallout

The liquidators of a company (Bilta (UK) Ltd) issued proceedings against the directors and a third party company, alleging that they had caused the company loss by entering into a fraudulent conspiracy to obtain VAT repayments through the European Emissions Trading Scheme. The company had been left with losses of some £38m when HMRC refused to

repay its input tax claims, and was put into liquidation after HMRC presented a winding-up petition in 2009.

The directors put forward the defence that the company itself was party to the fraud, and a party to a wrong cannot sue in relation to it. This is referred to as "ex turpi causa non oritur actio". They also argued that claims by the liquidators under s.213 Insolvency Act 1986 had to fail because some of the defendants were resident abroad.

The Supreme Court agreed with the High Court and the Court of Appeal that the directors' defence failed. Where a company has been the victim of wrong-doing by its directors, the wrong-doing or knowledge of the directors could not be attributed to the company so as to prevent it suing the directors. This is sometimes referred to as "the fraud exception", but could be more widely described as "the breach of duty exception". In addition, the Insolvency Act provision applied internationally.

Supreme Court: *Jetivia SA and another v Bilta (UK) Ltd and others*

A further case involving the same company related to pre-trial procedures in relation to changing grounds of claim and disclosure of evidence.

High Court: *Bilta (UK) Ltd (in liquidation) and others v SVS Securities plc and others*

6.9.11 Security

A company appealed against a decision to require deposit of security of £75,723 if it made quarterly returns and £66,323 if it made monthly returns, based on a six month liability for quarterly returns (£28,150) and a four month liability for monthly returns (£18,750) together with the £47,573 outstanding liability at the time the notice was served.

The director claimed that for most of the time that HMRC claimed it was in arrears, the company had a credit balance. He argued that HMRC had failed to take that into account, and had taken irrelevant matters into account. The officer who made the decision disagreed with the company's analysis of the ledger balances; he said that it was not in dispute that the company had filed its VAT returns on time but had consistently paid late, and was subject to 15% surcharges.

The decision does not record the evidence in detail, but says that the judge considered it carefully and concluded that the decision was reasonably made. The appeal was dismissed.

First-Tier Tribunal (TC05560): *Linwest Ltd*