

VAT and other indirect taxes (Lecture B1475 – 23.57 minutes)

Output tax on caravan sales

Summary – The taxpayer could apply a new apportionment method retrospectively as the difference between the old and the new method was substantial.

Abbeyford Caravan Company (Scotland) Limited sells caravans together with its removable contents whereby the supply of the:

- caravan was either:
 - reduced rated (Sch 7A Group 12 VATA 1994), or
 - zero rated (Sch 8 Group 9 VATA 1994)
- removable contents were standard rated

Historically, the company had apportioned the total price paid based on the relative costs of the two elements adopted by the manufacturer (the 'cost ratio method').

Where a caravan is bought for £10,000, with the manufacturer stating that £1,800 is attributable to the removable contents, 18% would be used as the cost ratio percentage.

If the company sold the caravan and removable contents for £20,000, the sales invoice would show £3,600 as attributable to the removable contents with VAT charged on this figure at the standard rate of 20%.

In practice, manufacturers' invoices produced a 'cost ratio method' range of between 16% to 27%. However, not convinced that this approach was appropriate, the company undertook a detailed independent valuation, undertaken by an independent party who had over 40 years' experience in caravan park valuations. The result of this exercise was that the correct range for removable contents was in fact between 5% and 9% of the invoice value. This was because the removable contents had their own sales value, which did not increase significantly when supplied to the final customer. For example, a dishwasher worth £250 was still worth £250 (or less) when it was sold on and not £750 as declared in some cases with the old method.

Realising that the old method wrongly included all contents as removable, rather than just the removable contents within the meaning of the case law, the company submitted an Error Correction Notice claim for overpaid output VAT for the periods 06/18 to 03/22 of £150,000 under s.80 VATA 1994, which limits claims to four years.

HMRC did not dispute that the new approach produced a fairer, more accurate figure for output VAT on the supply of the removable contents and agreed that this new method could be used going forward so with effect from 1 April 2022. However, HMRC rejected the claim for past periods on the basis that there was no error. The company had used the method that had been agreed at the time.

The company argued that HMRC's VAT Valuation Manual reference VATVAL04300 stated that a new method can be used retrospectively provided it achieves a more fair and accurate attribution of value. Simply being advantageous to the taxpayer was not enough. The manual states that the new method:

"must provide convincing evidence that the previous method was unfair or, at the very least, that the end result achieved by the proposed new method produces a substantially more accurate attribution of values than the old method."

Decision

As a result of this, by the time of the First Tier Tribunal hearing, HMRC accepted that the company did not need to show that there was an error in the old 'cost-ratio method' but rather that the new method produced a substantially more accurate attribution as compared to the old method.'

Both parties referred to the binding decision of the Supreme Court in the case of *CRC v KE Entertainments Ltd* [2020] STC 1402. There could only be one method that achieved 'fairness and equality' and that was the new method agreed with HMRC from April 2022.

Abbeyford Caravan Company (Scotland) Limited produced evidence showing that over the four-year period, by using the new rather than the old method, there would have been a VAT reduction from £296,907 to £150,458. The Tribunal stated that this was 'by any measure substantial'.

The appeal was allowed.

Abbeyford Caravan Company (Scotland) Limited v HMRC (TC09324)

Legitimate expectation

Summary – Despite applying to be VAT registered on a voluntary basis from 1 October 2022, the company had a legitimate expectation that it did not need to start charging output VAT on its invoices until registration was notified by HMRC.

Treasures of Brazil Limited, incorporated in March 2022, sold jewellery and bags. By September 2022, the company's director was concerned that the mandatory VAT registration threshold would be met in the near future and so instructed her accountant to apply for voluntary registration. The accountant requested an effective start date of 1 October 2022.

On 21 September 2022 the accountant received an email from HMRC stating that an identity check was needed and that the relevant documents should be sent to HMRC. The email went on to say that having received the documents, it would take about 30 days to complete the check and that the company should wait until the VAT registration was confirmed before charging customers for VAT. Consequently, the accountant informed the director that the company only needed to start collecting VAT once registration had been confirmed by HMRC.

The accountant regularly followed up the registration application throughout October and November 2022.

The company's VAT registration was finally confirmed by letter stating that registration was effective from 1 October 2022. The letter was dated 10 October but HMRC's systems indicated that it was actually not issued until 17 December 2022. The director claimed that the letter was not in fact received until 28 December 2022, the date from which the company started charging output VAT.

On 7 February 2023, Treasures of Brazil Limited submitted its VAT return for period 12/22, but did not account for VAT on outputs from 1 October 2022. Input tax was claimed of £4,502.02.

HMRC raised best judgment assessment seeking output VAT for the period and amending the input VAT figure slightly.

Decision

On appeal, the First Tier Tribunal found that:

- There was no explanation as to why it took almost three months to process the VAT registration;
- HMRC's e-mail included a clear, unambiguous instruction not to collect VAT or any sums 'for VAT' until notified of registration;
- Treasures of Brazil Limited had a legitimate expectation that it was not required to collect any VAT pending registration;
- The best judgment assessment was unfair as it effectively required the company to fund the VAT from its resources.

The tribunal suggested to HMRC that the wording of emails to taxpayers in a similar situation be revised in order to make the position absolutely clear.

Treasures of Brazil Limited v HMRC (TC09325)

Fraudulent input VAT claim

Summary – Input VAT claims were rejected as the taxpayer knew or should have known that the transactions were connected to a fraudulent loss of VAT.

In 2018, Ms Harries had registered for VAT as a sole trader, trading under the name Glam Tan. When HMRC denied claims for input tax, she deregistered in August 2020.

With £825,000 loaned by the Welsh government, Alex Harries, formerly Laura Elizabeth Harries, set up and traded as Glam Tanning and Beauty, with the address on her VAT1 being her residential address. She became registered for VAT on 1 September 2020.

Marc Simpson was the sole director of Aware Limited, a construction company. Ms Harries knew the director from previous business ventures. She engaged him to carry out refurbishment and renovation work on her premises, paying Aware Limited substantial sums of money to do so (£516,000 on 15 December 2020, £491,493.84 on 28 April 2021, £321,507 on 31 May 2021 and £164,400 on 31 July 2021). Aware Limited failed to complete the work and Mr Simpson disappeared at the end of June 2021.

With the work completed by other builders, the salon finally opened in August 2021. However, experiencing serious cashflow difficulties, the business ceased trading.

Following its compliance work, HMRC stated the invoices from Aware Limited for periods 04/21, 05/21 and 07/21 were invalid as they did not include a valid VAT number. Further, the July 2021 invoice did not contain a breakdown of what was supplied or a valid invoice number. Ms Harries provided HMRC with a new invoice for period 07/21, but this was completely different in terms of font used, invoice number and description. Having looked also at records relating to Aware Limited, the input tax Ms Harries was claiming was different to the output tax declared by Aware Limited.

In a decision dated 1 November 2021 HMRC denied a claim for the deduction of £221,499 of input tax in respect of her 12/20, 04/21 and 05/21 VAT accounting periods. This was on the grounds that she knew or should have known that transactions that she had entered into during those accounting periods were connected to a fraudulent loss of VAT ("Kittel principle"). At the same time, HMRC issued a notice denying input tax recovery for the period 07/21 as it related to the falsified invoice. In February and March 2022, HMRC issued penalty notices for the period affected on the basis of deliberate concealed and behaviour.

Decision

On appeal, the First Tier Tribunal found in HMRC's favour. Ms Harries, Mr Simpson and Aware Limited were involved in fraudulent activity.

Ms Harries put forward an excuse which makes interesting reading. She claimed that having taken a step back from the business, Glam Tan was being run by her twin sister, with whom later she fell out with when she discovered that her sister had stolen and used her identity to acquire and expand the Glam Tan business for herself. She claimed that it was her twin who had registered the business for VAT and it was her sister, not her, that dealt with HMRC in relation to that VAT registration. She claimed that her twin "was able to do this because she knew 'everything about her' and, for personal reasons, wanted to ruin her life."

The Tribunal stated that it was possible that the it might have come to a different conclusion if either her twin or father had given evidence. However, they did not.

The appeal was dismissed.

Alex Harries t/a Glam Tanning and Beauty v HMRC (TC09316)

Unsuccessful reasonable care defence

Summary – Although the taxpayer's late appeal was allowed, the company did not have a reasonable excuse for repeatedly paying their VAT late.

ABG Fibre Services Ltd installed telecommunications equipment.

HMRC issued a surcharge liability notice on 14 August 2020 for the quarter to 06/20 as, although the return was submitted on time, the VAT was paid late.

The company continued to submit their VAT return on time each quarter but for each of the return periods 09/20, 12/20 and 03/21, paid the VAT late such that the surcharge was payable at 2%, 5% and 10% respectively.

The company appealed their position late. It had no issue as to the validity of the surcharge notices but argued that the company had a reasonable excuse for the late payments.

Decision

On the late appeal, the First tier Tribunal noted that there was a sequence of repeated further review applications by the company and review conclusions by HMRC and it stated:

“It may be that the further reviews (fell) outside the statutory framework such that HMRC were not strictly correct to carry out such reviews (and that the time limit for making an appeal to the Tribunal began to run from 1 March 2022, or some other date). However, HMRC nonetheless carried out such further reviews.”

It was clear that both parties were attempting to resolve the dispute up until a letter dated 25 September 2023. The company appealed to the Tribunal on 25 October 2023, ie promptly after the end of that correspondence. Accordingly, in all the circumstances of the case (and bearing in mind the approach suggested in *Martland v HMRC* [2018] UKUT 0178 (TCC)), the Tribunal granted permission for the late appeal to be heard.

On appeal, ABG Fibre Services Ltd stated that it had intended to use repayments of credits generated as a result of the Construction Industry Scheme to pay its VAT liabilities. However, HMRC were late repaying these credits, taking over 12 months to process the repayment claims. This had a serious impact on the company's cashflow. Had the company's claims been processed more quickly, the default surcharges would not have arisen.

Referring to *Christine Perrin v Revenue and Customs Commissioners* [2018] UKUT 0156 (TCC), the Tribunal stated that for an excuse to be considered reasonable, it must be objectively reasonable, taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found themselves in at the relevant time or times. In summary, was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?

The First Tier Tribunal referred to *NSF Utilities Ltd v HM Revenue and Customs* [2018] TC06288 where Judge Gammie stated:

“a taxpayer who believes that it is due a repayment of tax from the Respondents on one account, may think it galling that the Respondents can insist on payment of tax on another account by a particular date, and impose a penalty for the taxpayer's failure to do so, when the Respondents face no equivalent sanction. Nevertheless, this alone is plainly not enough to entitle the taxpayer to delay payment of VAT or to attempt to set off one amount against the other.”

And further in the case:

“a prudent taxpayer would have sought to take some steps to guard against the possibility that the VAT fell due before the repayment was received.”

Although the First Tier Tribunal sympathised with the company, its actions were not reasonable. It was common knowledge that HMRC take a long time to process CIS claims. That being the case, the company should have taken reasonable steps to avoid late payment. Indeed, it appeared that the company has now taken action by subsequently moving to gross payment status.

The Tribunal noted that in this appeal, it was not provided with evidence as to:

- the exact cash position of AFSL at the material times,
- what liabilities it had to meet other than VAT,
- what steps were taken to seek time to pay the VAT liability, or to defer payment of other liabilities in order to enable the VAT liability to be paid.

Further, the Tribunal stated the company could have sought gross payment status sooner, thereby avoiding the cash flow impact of CIS.

The company did not take reasonable steps to meet the liabilities and so did not have a reasonable excuse for the late payment. The appeal was dismissed and the surcharges upheld.

ABG Fibre Services Ltd v HMRC (TC09315)

Application for costs on complex case

Summary – The company’s application for costs to be paid by HMRC was refused as HMRC had not acted unreasonably in bringing, defending or conducting the proceedings up to the point that HMRC withdrew from the hearing.

Generator Power Limited was a generator hire specialist that hired out generators, and also supplied red diesel fuel for the generators under a number of different plans as follows:

1. Customer provided their own fuel, returning the generator with a full tank.
2. The customer provided their own fuel for the duration of the hire, but either the generator tank and/or bulk fuel tank were not returned full.
3. The customer chose Generator Power Limited’s “fuel management” option, with the appellant providing the fuel throughout the hire period.
4. The customer provided their own fuel for the duration of the hire but required a one-off delivery at some point during the hire period.
5. Generator Power Limited supplied fuel only to customers for their own generators.

The issue to be determined was whether the contracts entered into were for two separate supplies of generator hire (standard rated) and fuel (reduced rated), or as HMRC contended, there was a single composite supply that was standard rated. Scenario 1 above was outside the scope of the appeal as it had not been included in the assessments raised by HMRC.

On 13 October 2021, the First Tier Tribunal notified the parties that the appeal had been allocated to the complex category. Such appeals are normally subject to a 'loser-pays' costs regime, where the losing party pays their own costs and those of the successful party.

However, the taxpayer can choose to opt out of this cost regime (Rule 10(1)(c)(ii) of the Rules) provided that they do so within 28 days of receiving the notification. Generator Power Limited opted out on 10 November 2021 so within the 28-day period allowed.

The case moved forward with HMRC accepting that the customers were not obliged to purchase fuel from Generator Power Limited, but on the company's own evidence more than 99% of their customers did so. Consequently, HMRC argued that on any objective view there was therefore a single supply of generators with a power source included to enable use of the supply.

Following the decision reached in the case *GAP Group Ltd v Revenue and Customs* [2023] UKFTT 970 (TC), where the First Tier Tribunal had found that the supply of plant hire with red diesel were separate supplies for VAT, Generator Power Limited filed and served a further witness statement. On the same date in January 2024, the company also made an application for the appeal to be reinstated within the costs regime, or alternatively, for costs to be paid under rule 10(1)(b) of the Rules. The company later withdrew their application to be reinstated within the costs regime and it was decided by the parties that any application for costs under Rule 10(1)(b) would be made after the Tribunal had given its decision on the appeal.

Decision

During the appeal, both the Tribunal and Generator Power Limited challenged HMRC's argument that customers had little choice but to buy red fuel from the company:

- The Tribunal asked "whether it was not the case there must be a network of red diesel sellers covering the entire country to supply farms that use red diesel, and that these suppliers are required to be registered with HMRC such that HMRC must know of their existence." If so, the Tribunal questioned whether the Appellant's customers would not have been able to obtain red diesel from any one of them.
- Counsel for the Appellant introduced new evidence during the appeal, in the form of printouts from the internet. These were said to show "the existence of a highly developed nationwide network of suppliers of diesel, red and white", and "pages and pages of people claiming to offer 24/7 service".

At this time, counsel for HMRC said that she was not in a position to cross-examine and needed time "to properly consider and review the evidence received" as this was all new evidence. The First Tier Tribunal granted HMRC 28 days to consider this evidence.

Having reviewed the new, late evidence, HMRC notified that it no longer wished to defend the appeal.

Moving to the application of costs, Rule 10 of the Rules provides:

- (1) The Tribunal may only make an order in respect of costs (or, in Scotland, expenses)—
- (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings ...

The taxpayer applied for a costs order against HMRC, arguing that HMRC should have realised much earlier that its defence would not succeed and that it therefore acted unreasonably in not withdrawing earlier.

The First Tier Tribunal summarised the case law on costs for unreasonable conduct and refused the application as the Tribunal was not convinced that HMRC's case 'was bound to fail'.

The Tribunal (found) that:

1. "The reason for the withdrawal of HMRC from the appeal was that material new evidence was introduced at the hearing, which led HMRC to reconsider its position.
2. Having regard to that reason, the earliest time at which HMRC could have withdrawn was on the third day of the hearing, when the last of the additional evidence was presented.
3. It was reasonable for HMRC to take a further 28 days before deciding to withdraw from the appeal. The Tribunal had directed, after discussion with the parties at the hearing, that HMRC should be given 28 days after the hearing to decide whether it wished to cross-examineHMRC clearly needed and were entitled to time to consider the new evidence, and 28 days was a reasonable period."

The application for a costs order was refused.

Generator Power Limited v HMRC (TC09353)