



VAT Voice[®]

The bi-monthly newsletter of VAT Advisers Limited

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BUSINESS PAYMENT SUPPORT SERVICE UPS ANTE ON 'TIME TO PAY'

Recent reports in the media suggest HMRC's Business Payment Support Service is turning down more requests from businesses for 'time to pay' instalments.

An article in Times Online on 10 May 2010 suggests that requests of more than £42 million were refused in the first quarter of this year, which, at 11.5% of total request is more than double the 5% of requests that were refused in the same period last year. The article also refers to a recent change under which any business requesting time to pay on debts of £1million or more must now undergo an '*independent business review*' by an approved accountant. These reviews cost thousands of pounds.

HMRC has responded to the reports by stating it had not tightened the eligibility criteria for time to pay proposals, and that each request was still considered on its own merits.

So who do you believe?

EUROPEAN COMMISSION TAKES NEXT STEP IN VAT GROUPING INFRINGEMENT BY REFERRING MATTER TO THE EUROPEAN COURT OF JUSTICE

Back in November 2009, the European Commission announced that it was taking infringement proceedings against the UK and seven other Member States for breaches of the EU VAT grouping rules. Under this procedure, the offending states have two months to change their legislation, after which, the Commission can refer the matter to the ECJ. To date, only Spain has complied, so the remaining seven States, including the UK, have now been referred to the ECJ per a Commission press release dated 24 June 2010.

By way of a quick recap, the VAT grouping rules derive from an administrative simplification in EU VAT law which gives Member States the option "*to regard as one single taxable person those who, while legally independent, are closely bound to one another by financial, economic and organizational links*". EU regulations on grouping have long been in place for Member States to follow.

The UK, Ireland, the Netherlands, Finland, Czech Republic, and Denmark are in breach of the regulations for allowing '*non-taxable persons*' to be in a VAT group. Sweden and Finland (again) are in breach for restricting grouping to financial and insurance services.

In European law, the term '*non-taxable person*' refers to entities that are not considered to be engaged in '*economic activities*', so dormant companies and '*passive*' holding companies (i.e. ones that merely hold shares) would be excluded from grouping. This would likely impact the corporate finance world, where acquisition vehicles are commonly grouped with the target company for VAT recovery. It might also impact charities where the parent entity only has non-business income and is grouped with a trading subsidiary for VAT recovery purposes. However, there is concern that the term could be extended to include corporate bodies making infrequent supplies, or start-up businesses where supplies are made some time after registration.

HMRC informed the Commission in January that it will defend its position, so the matter will now be resolved by an ECJ decision (which might take a year or more to happen). The smart money is on the ECJ siding with the Commission, so we can only imagine the amount of degrouping that will have to be done as a result. Moreover, this en masse degrouping would be an unforeseen compliance cost to businesses, as well as being a further strain on HMRC's already overstretched resources.



Latest VAT News

REVENUE & CUSTOMS BRIEF 21/10

VAT: Tour Operators' Margin Scheme and the treatment of 'hotel billback' transactions

This Brief gives details of a new invoicing arrangement for the booking of hotel rooms which has been agreed by HMRC following representations from representative trade bodies in the travel sector.

In order to fully comply with EU law, HMRC had to introduce several changes to the Tour Operator's Margin Scheme ('TOMS') effective from 1 January 2010. One of these changes was the removal of the 'opt out' concession, which allowed agents buying in and selling on hotel accommodation to business customers for their own consumption, to take such transactions out of TOMS and add output VAT in the normal way (known as 'hotel billback'). This enabled the business customer to reclaim that VAT as input tax. With the removal of the 'opt out', the input VAT that is no longer recoverable by the agent is passed on to the business customer, which now has no means of reclaiming it.

Under the arrangement agreed by HMRC, it is now possible for hotel booking agents to avoid passing on sticking tax to business customers by acting as a disclosed agent rather than a principal. The effect will be to take the supply back out of TOMS and allow the business customer to recover the VAT on the hotel bill.

The Brief says the following conditions must be met in order for the arrangement to be properly applied:

- *Invoices from hotels will be addressed 'c/o' the hotel booking agent (which shows that the invoice has been issued to the hotel booking agent in its capacity as agent.)*

- *The booking field on the hotel invoice will identify the hotel guest, their employer and will ideally carry a unique reference number.*
- *The hotel booking agent will arrange for payment of the invoice(s) but will not recover the input tax on it.*
- *The hotel booking agent will send the customer a payment request/statement of the costs incurred on its behalf, separately identifying the value of supplies, VAT, etc.*
- *The payment request/statement should say something along the lines of 'The VAT shown is your input tax which can be reclaimed subject to the normal rules'.*
- *The customer will use the payment request/statement as its evidence for deducting input tax.*
- *The hotel booking agent will retain the original hotel invoices, and these will be made available if evidence of entitlement is required by VAT staff.*
- *The hotel booking agent will send a VAT invoice for its own services, plus the VAT. This may be consolidated with the statement of hotel charges, or it can be a separate document.*
- *The hotel booking agent will charge its client the exact amount charged by the billback supplier, as a disbursement.*

Hopefully, this arrangement will be something that most or all hotel booking agents can immediately adopt, as the sticking tax created by the 'opt out' removal has been causing some commercial difficulty for businesses in the corporate travel sector.

REVENUE & CUSTOMS BRIEF 25/10

VAT: pay-per-click charity advertisements

An announcement of revised HMRC policy on the VAT treatment of Internet pay-per-click ('PPC') charity advertising on sponsored links and other associated services.

The Brief explains that PPC is used by organisations to encourage web searchers to click on the organisation's link in priority to any other links on the results page following a search. The organisation pays the search engine provider an agreed amount each time their website is accessed through the sponsored link.

Previously, HMRC took the view that a PPC-sponsored link was not an advertisement (which is zero-rated when placed in a third party's website) but simply a means of access to the charity's website. As such, HMRC said the costs of providing PPC were excluded from zero-rating. However, following representations from charities that zero-rating should apply to PPC charity advertisements, HMRC reviewed its approach and has now decided to revise policy.

HMRC now accept that PPC-sponsored links appearing on search engine websites are advertisements for the purpose of Item 8 and 8A in Group 15 of Schedule 8 VATA, and qualify for zero-rating when supplied to a charity. Consequently, the supply of copyright and design services associated with such sponsored links also qualifies for zero-rating.

HMRC point out that services supplied by copywriters and designers for the purpose of search engine optimisation (i.e. structuring a website so that it contains as many keywords as possible) do not qualify for relief. Such services entail the optimisation of the charity's own website, and so are specifically excluded from Item 8 by Note 10B to Group 15.

HMRC also clarify that the listing of a charity in the results of a search engine ('natural hits')

does not constitute an advertisement, since the charity's name appears automatically, and merely highlights text from the charity's own website.

The Brief closes with an invite for reclaims of VAT paid on charity advertisements now considered to be zero-rated. Claims will be subject to the transitional 4-year time limit and 'unjust enrichment' provisions.

REVENUE & CUSTOMS BRIEF 26/10

VAT: Changes to the application of the zero-rate to new buildings intended to be used for a relevant charitable purpose

A reminder about the withdrawal of ESC 3.29 on 1 July 2010, which was first announced by HMRC in R&CB 39/09.

The concession enabled charities to zero-rate a new charitable building where non-qualifying use was no more than 10%, provided they got HMRC's formal agreement to use one of their three prescribed methods of calculation (which were based on floor space, headcount, or time). The new statutory policy only allows up to 5% business use, but now any reasonable calculation method can be used, and does not require HMRC's agreement.

R&CB 39/09 allowed charities to use the concession prior to 1 July 2010 provided the necessary certificate was issued before that date, and by 1 January 2011, either:

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

The Brief adds that in VAT Information Sheet 08/09, a consultation with charities was promised in order to provide guidance in identifying calculations methods that they could consider using under the new rules. This guidance has now been produced, and can be found in VAT Information Sheet 13/10.

REVENUE & CUSTOMS BRIEF 28/10

VAT: Liability of non-compliance carbon credits and carbon offsetting services

This Brief contains the further guidance which was promised in R&CB 52/07 on the VAT treatment of non-compliance carbon credits. The Brief also covers the VAT treatment of carbon offsetting services. HMRC clarify that, for the purposes of this brief, 'carbon offset providers' offer advice and/or the facility to reduce an individual's 'carbon footprint'.

Carbon Credits

These fall into two categories:

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

The Brief says that the difference between compliance market credits and VERs is that the former are capable of consumption of the type envisaged by the VAT system, but the latter are not. As VAT is a consumption tax, compliance market credits are subject to VAT, whilst VERs are outside the scope.

The Brief then gives background details on the nature and trading of compliance market credits and verified emission reductions.

Carbon offset services

The Brief says that although there is a wide variety of carbon offsetting services, the VAT treatment of any individual transaction will depend on the particular arrangements. As these arrangements are so varied, it is not practical for HMRC to provide anything more than general advice in the Brief.

HMRC says that when a member of the public makes a payment to a carbon offset provider, there is often no supply for VAT purposes because there is no identifiable, direct benefit being received by the member of the public in return for their money (i.e. outside the scope).

The Brief goes on to give examples of where no supply is being made, with one common arrangement being where an airline offers its passengers the facility to offset the carbon emissions generated by their flights. The Brief also gives examples of where a taxable supply can be made.

With regard to input tax recovery, HMRC say that whether you are an offset provider, or simply a business incurring VAT in order to offset your own carbon emissions, you must follow the usual rules to determine whether any VAT incurred is recoverable input tax.

REVENUE & CUSTOMS BRIEF 29/10

VAT: DIY Housebuilders and Converters VAT Refund Scheme – treatment of holiday homes

Following HMRC's recent loss at Tribunal in *Mrs Irene Susan Jennings* (TC00362), the Brief advises of a change in policy for DIY claims received in respect of holiday homes.

In light of the Tribunal decision, HMRC now accepts that the DIY Scheme applies both to the construction of new holiday homes, and to the conversion of non-residential buildings into holiday homes.

HMRC had never applied the DIY Scheme to holiday homes as their supply by a developer was standard rated. However, the Tribunal found in *Jennings* that the existing law allows the same recovery of VAT on holiday homes constructed by individuals for a non-business purpose. As such, HMRC will now accept claims for VAT incurred on building materials for holiday homes. HMRC will also allow claims for a VAT refund on building materials and building service for the conversion of a non-residential building into a holiday home.

HMRC say that where a claim for a holiday home has not been submitted in the past due to the previous policy, it can be submitted now provided the completion certificate was issued within four years and three months of the date

Latest VAT News (continued 3)

of the Brief. Where the completion certificate is older than that, HMRC 'regret' that the claim is now out of time.

If a holiday home claim was submitted in the past and was either partially or wholly rejected under previous policy, it may now be resubmitted with the original claim form (even though it has since been withdrawn).

Comment: *this policy change does not sit well with HMRC's stance in the Lower Mill (TC00016) Tribunal case, where they successfully challenged a corporate structure which was enabling the construction of new holiday homes to be zero-rated. The case is now on appeal to the Upper Tribunal.*

VAT INFORMATION SHEET 11/10

Electronically supplied services: Special scheme for non-EU businesses

On 1 July 2010, the standard rate of VAT in Spain increases from 16% to 18%.

VAT INFORMATION SHEET 13/10

Calculating qualifying use for a charitable or a communal residential building

As advised in R&CB 26/10, this Information Sheet provides guidance to charities on the various methods of calculation that can be used to determine whether the non-qualifying use of a new charitable building is within the new statutory limit of 5% (i.e. a minimum of 95% qualifying use). HMRC's permission is no longer needed, but the method used has to be 'fair', which HMRC define as follows:

- *it accurately reflects the extent that the building is used for a qualifying purpose*
- *it can be carried out and checked without undue difficulty or cost*

HMRC say that the three methods stipulated under ESC 3.29 (floor space, headcount, or time) can still be used, and should produce a result which HMRC consider 'fair'. HMRC add that there is no longer a restriction to just using time-based methods where only a part of a building is concerned.

The Information Sheet then goes on to give five examples of other methods that could be used, the first two of which are as follows:

- *Compare the full time equivalents of staff engaged on qualifying activities with the total number of staff.*
- *compare commercial funding of the use of the building to the total funding of the use of the building (although HMRC say the result is only likely to be fair where the costs of non-business use are similar to those for business use).*

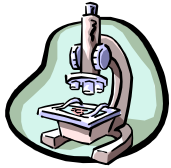
Following the five examples, HMRC then go to explain what they mean by 'use', which is defined as either of the following:

- *physically occupying the building and carrying out an activity or activities there*
- *leasing or letting the building*

HMRC say that for the purposes of the zero rate for construction services, you must not only use the building solely for a qualifying purpose, you must also be the recipient of the supplies in question. Any other user of the building must also use it for a qualifying purpose. However, for the purposes of the zero rate for acquiring a building, you need not be the person using the building solely for a qualifying purpose - it can be another party (or parties). HMRC point out that you are **not** using a building (or a part of a building) if you do not occupy the building (or part), but allow another party to occupy the building (or part) for free.

Where a certificate has been issued on the back of a method which HMRC considers to be unfair, and no alternative method can be found to support the certificate, the charity will have a liability to a penalty under s.62 VATA unless a reasonable excuse can be given.

The final part of the Information Sheet relates to 'change of use'. Where the use of a building zero-rated under these provisions changes to non-qualifying within 10 years, a standard-rated charge will arise. The charge is on a sliding scale based on the balance of the 10 years still remaining, and HMRC give an example calculation as a guide.



GET THE VAT BACK BY MAKING YOUR PENSION SCHEME THE LANDLORD

It is common practice for trading companies to transfer their commercial property into a pension fund for the shareholder directors. In most cases, the property is rented back to the trading company to generate income for the pension fund. However, the VAT implications of the transfer, and the potential savings and pitfalls involved are rarely considered.

The first thing to do is to establish the VAT liability of the property being ‘transferred’, as the transfer is effectively a sale for VAT purposes. Remember that if the property is still ‘new’ (i.e. up to three years old), the freehold sale will be compulsorily standard rated. If the property is no longer new, the freehold sale (or any length of leasehold sale) will be exempt from VAT *unless* an option to tax has been made, which involves submitting a written notification to HMRC that you wish charge VAT on rents or freehold sale. If the property is ‘new’, or the option to tax has been exercised, the trading company will charge the pension fund VAT on the full selling price of the property. If it is an exempt sale, the trading company may not then be able to recover all the VAT incurred on the costs of the sale. The possible impact of an exempt sale is that if the property cost £250,000 or more plus VAT when acquired, or it has been extended or refurbished at a cost of £250,000 or more plus VAT, you may also have to make an adjustment to any VAT already claimed under the Capital Goods Scheme (CGS). The rules for the CGS are complicated to say the least, and proper VAT advice should be sought if the property falls within the scheme. Suffice to say that if you do not consider the VAT position fully, the pension fund may be left with a large VAT charge that it cannot recover, or the trading company may have its own input VAT restricted.

The good news is that there are ways to minimise any potential costs that are easy to put in place, provided you consider the VAT position at an early stage. The first thing to do is to ensure that you do not end up with a VAT restriction in the trading company. You can do this by making sure the sale of the property is subject to VAT, so opt to tax if it is not a ‘new’ commercial property. As mentioned above, you opt to tax by writing to HMRC and giving details of the property you want to opt.

Having made sure there will be no VAT costs in the company, you then have to look at the pension fund. First of all, you should register it for VAT as a property rental company, and opt to tax the property. The pension fund will then be able to recover the VAT on the transfer of the property, and any associated costs. As the pension fund has opted to tax the property, it will have to charge VAT on the rents to the tenant trading company. The tenant will be able to recover the VAT on the rents, provided it is VAT registered and ‘fully taxable’ (i.e. it charges VAT on all its sales invoices). As a bonus, if you are to be flexible with the transfer date, you can also obtain a cash flow advantage by timing the transaction so that the pension fund is able to recover the VAT it is charged on the purchase of the property before the trading company has to account for it to HMRC.

Should you have a pension fund which already owns the property tenanted by your trading company, it is still not too late to improve its VAT position. The pension fund is going to incur costs each year on which VAT is charged (e.g. repairs and maintenance, audit fees etc). If it is not registered for VAT, it cannot recover the VAT on these costs. The remedy is to register the pension fund for VAT and opt to tax the property, as this would allow it to recover the VAT on all its ongoing costs – something that could easily amount to a few thousand pounds each year. It must be noted, however, that in these particular cases (i.e. where exempt rents have been previously collected), you have to obtain the formal prior permission of HMRC to opt to tax.

SUMMARY OF THE EMERGENCY BUDGET CHANGES

1. Increase in the standard rate

From 4 January 2011, the standard rate of VAT will increase from 17.5 % to 20%. The change will be effected through legislation to be included in the Finance Bill 2010. HMRC state in BN43 that existing zero-rated supplies, exempt supplies, and supplies subject to VAT at the reduced 5 per cent rate, are not affected by this change.

2. Increase in the standard rate – Anti-Forestalling

Following the announcement to increase the standard rate of VAT 20%, anti-forestalling legislation will be included in the Finance Bill 2010 to prevent the 17.5% rate being applied to supplies of goods or services provided on or after 4 January 2011, subject to certain conditions. Where appropriate, a supplementary 2.5% VAT charge will become due on or after 4 January 2011.

3. Flat Rate Scheme

As a consequence of the increase in the standard rate to 20%, the Flat Rate Scheme (FRS) sector flat rates have been recalculated accordingly. The new rates will be effective from 4 January 2011, and are set out in a table in BN45, which also advises that the current £225,000 turnover threshold for having to leave the scheme will increase to £230,000. Similarly, the current £187,500 turnover threshold for one-off breaches will be increased to £191,000. The changes will be introduced through the amendment of secondary legislation later this year.

4. Lennartz Accounting

From January 2011, a measure is being introduced to implement changes to the recovery of VAT on immoveable property, boats and aircraft where there is private use of the asset. From that date, VAT recovery will be restricted only to the business use of the asset. In addition, the measure will ensure that revenue is protected in respect of existing Lennartz accounting arrangements. BN42 states that the change will render the existing legislation for recovery of VAT on directors' accommodation redundant, and so will be removed. The legislation for the measure will be included in the Finance Bill 2010.

5. Postal Services

From 31 January 2011, a measure will be introduced which restricts the VAT exemption for postal services to the supply of public postal services by a universal service provider (USP). It will also update the zero-rating for passenger transport services to reflect the status of the provider of a passenger transport service supplied in conjunction with its postal services.

Currently, VAT exemption applies to the conveyance of postal packets, and services connected to the conveyance of postal packets, by the Post Office company, including any wholly owned subsidiary of the Post Office company. In practice, this means all postal services provided by Royal Mail (including Parcelforce) are exempt from VAT. In future, the exemption will only apply to supplies of services made under a licence duty, including those where, pursuant to a licence duty, the USP allows private postal operators access to its postal facilities. Royal Mail is the only USP in the UK. The legislation for the measure will be included in the Finance Bill 2010.

6. Change in the zero-rating of 'qualifying' aircraft

A new measure is being introduced from 1 January 2011, which will amend the criteria for the zero-rating of supplies of aircraft and associated supplies. From that date, the basis for zero-rating will change from one based on weight and usage to one based on the status of the customer. Supplies to State institutions will not be affected.

7. Place of supply of gas, electricity, heat and cooling

Another new measure being introduced on 1 January 2011 will implement EU changes to the place of supply rules for natural gas and electricity. From that date, the existing rules will be amended so as to:

- cover supplies in all types of natural gas pipeline, but they will no longer apply to natural gas in pipelines located outside the EU unless they are linked to EU pipelines;
- extend relief from VAT at importation for all natural gas imported via a network (including liquefied natural gas by tanker); and
- extend the scope to include heat and cooling supplied through networks.

The measure will come in by amending primary legislation and introducing secondary legislation this year.



VAT Cases

HIGH COURT SAYS STRUCTURE WAS 'ABUSIVE' AND REDEFINES SUPPLIES PER HALIFAX PRINCIPLE

The Appellant company is a profit-making body running a sports club. Being profit-making, it makes standard-rated supplies to its members. The Appellant previously had a non-profit making body so that it could make exempt supplies to its members and remain competitive with local competitors. However, when the 'commercial influence' rules came in on 1 January 2000, the structure no longer worked, so on the advice of a tax adviser, an unconnected company was formed to take over the running of the club. The Appellant granted this newco an exempt non-exclusive turnover licence to occupy the premises which was designed to strip out its surpluses. There were also additional small taxable charges for equipment hire and use of the club name.

The earlier Tribunal had found that the newco was not an 'eligible body' because it aimed to make surpluses which, but for the turnover licence agreement, would have been retained and enjoyed. However, the Tribunal also found that it was newco rather than the Appellant which was liable for VAT as the supplier. As such, the Tribunal found that this did not result in a tax advantage, and so the principle of 'Halifax' did not apply. Due to its subsequent liquidation, newco could not pay the assessment. HMRC appealed on the basis of *Halifax*, arguing that the supplies should be redefined so that the supplies by the club were made by the Appellant, thus making it liable for the VAT.

Turning to the *Halifax* principle, the Court considered the Tribunal's view that no tax advantage had arisen. HMRC felt the Tribunal had been wrong to only consider the position of newco rather than the overall benefit of the scheme. The Court noted that under the new

scheme, not only did the Appellant avoid VAT on the membership, it also received newco's profit free of VAT under an exempt turnover licence agreement. The Court saw this as a tax advantage on the basis that the payment to strip out the profit created a situation which was contrary to the purpose of the exempting provisions of the Sixth Directive. It then looked at the impact of the fact that the scheme did not work as the Appellant's supplies were not in fact exempt. The Court concluded that the Halifax principle should not be ruled out just because an individual step did not succeed.

The Court agreed with the Tribunal that the essential aim was to implement a scheme under which the net proceeds of a business continued to accrue with the benefit of exemption from VAT. HMRC argued that any redefinition should result in treating the supplies as by the Appellant. The Tribunal also referred to an aggregation of payments between the Appellant to newco to deprive the turnover licence of its status of being connected to immovable property, and make it a standard-rated supply by the Appellant. The Court said there was no direct authority for such a redefinition, but was happy with either method, preferring the one put forward by HMRC. The Court thus found for HMRC, and allowed the appeal.

The Atrium Club Limited, High Court Chancery Division, 5 May 2010

TRIBUNAL SAYS VAT DUE ON UK ACQUISITION WITHOUT ANY RIGHT TO CORRESPONDING INPUT TAX

This case concerned the Appellant's purchase of toilet rolls from an Italian supplier. No VAT had been charged by the supplier as it had used the Appellant's UK VAT number on the invoices. However, the goods were delivered

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to an address in Spain, and on discovering this fact, HMRC assessed the Appellant for the output tax on the UK acquisition. At the same time, HMRC said the Appellant was not entitled to input tax credit because there was no evidence of any corresponding taxable supplies being made.

The Tribunal first looked at whether there was an acquisition. On examining the evidence, it was satisfied that there was an acquisition on which VAT was due under s.10(2) VATA. This was because the Appellant had made use of its VAT number to avoid Italian VAT. The Tribunal then turned to the issue of input tax recovery. HMRC argued the burden was on the taxpayer to show the goods were acquired for the purposes of taxable supplies. However the only evidence produced by the Appellant, was, by its own admission, fabricated. The Tribunal found that in absence of objective proof that the goods were used or to be used for making taxable supplies, there was no entitlement to input tax.

The Tribunal ignored the Appellant's claim that HMRC were 'cherry picking' and not looking at the transactions as a whole. The Appellant also argued that there was no acquisition because this was in fact triangulation. However, on the same basis that there was no evidence of the onward supply, this argument was also unsuccessful.

Mexcom Limited (TC00468)

COA FINDS MAINLY FOR HMRC IN DENYING INPUT TAX IN MTIC CASE

This MTIC case comprises three joined appeals from the High Court, two of which were by the taxpayer and the other by HMRC.

The Court began by noting that there are over 800 live MTIC appeals, involving more than £2billion of VAT. In all these cases, HMRC refused input tax recovery on the basis that the taxable person 'knew' or 'should have known' that he was involved in transactions connected with the fraudulent evasion of VAT.

The Court had to decide whether knowledge of a risk that a transaction was more likely than not connected to fraud, was sufficient to justify a refusal of input tax.

The Court said the right to deduct VAT was fundamental to the VAT system, and any derogation or move away from this must be interpreted strictly. The earlier *Optigen* case (C-354/03) found that the right to deduction cannot be affected where the taxable person had no means of knowing fraud has been taking place somewhere else in the supply chain. The *Kittel* case then went on to say that input tax deduction could be denied '*where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT*'. On the back of *Kittel*, the Court found that a person who has no intention of undertaking an economic activity, but pretends to do so in order to make off with the tax he has received on his supposed supply, does not meet the objective criteria which determines the basis of the right to deduct. Equally, a taxable person who knows or should have known that the transaction he is undertaking is connected with VAT fraud, is to be regarded as a participant, and thus fails to meet the objective criteria on the right to deduct. The Judge stated '*once the approach of the Court in Kittel is understood, centred as it is on the scope of VAT and of the right to deduct, as measured by the objective criteria, many of the objections raised by traders fall away*'. As such, the Appellants' challenges on legal certainty and human rights were dismissed.

On the meaning of '*should have known*' is concerned, the Court found that a trader who fails to deploy means of knowledge available to him does not satisfy the objective criteria which must be met before his right to deduct arises. The Appellants had argued that the lack of taking every reasonable precaution did not mean there was an automatic participation in fraud. The Judge said '*It profits nothing to contend that, in domestic law, complicity in*

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fraud denotes a more culpable state of mind than carelessness, in the light of the (ECJ) principle in Kittel'.

One of the key questions is whether denial of the right to deduct is on the grounds that the trader knew or should have known that (a) it was more likely than not that the transactions were connected to fraud, or (b) they were connected with fraud. The Court said it was not sufficient that there is merely a risk that a purchase is connected with fraud. However, a trader may be seen as a participant where he should have known that the only reasonable explanation for the circumstances in which his transaction took place was that it was connected with such fraudulent evasion.

On one of the taxpayer appeals, the Court saw that there were findings of actual knowledge, and dismissed their appeal. The other taxpayer appeal concerned whether the trader should have known that it was more than likely that the purchases were connected with fraud. The Court thought the correct question was actually whether the taxpayer should have known the transactions were connected with fraud. Either way, the correct decision was reached and that appeal was also dismissed. For the HMRC appeal, the Court agreed with the High Court that the relevant knowledge which would deny input tax recovery is that the taxpayer *ought* to have known by its purchases that it was participating in transactions which were connected with VAT fraud; that such transactions might be so connected is not enough. HMRC's appeal was dismissed.

Mobilx Limited (in Administration), Calltel Telecom Limited, and Blue Sphere Global Limited, Court Of Appeal, 12 May 2010

TRIBUNAL SAYS JERSEY VAT STRUCTURE WAS NOT 'ABUSIVE' AND HALIFAX SHOULD NOT APPLY

The Appellant was a well known UK debt finance business which had incorporated a wholly-owned subsidiary in Jersey to mitigate

the effect of irrecoverable input tax incurred on advertising relating to exempt loans to UK customers.

HMRC challenged the structure, arguing that the Appellant was providing the loan broking services, and that the advertising was actually supplied to the Appellant and that it should have accounted for VAT under the reverse charge. HMRC's secondary argument was that the structure was abusive. The Appellant said the subsidiary provided the loan broking services to the UK customer and received the advertising from a Jersey supplier.

On looking at the nature of the supplies, the Tribunal found that the subsidiary supplied the loan broking services to lenders and also received the advertising services. Though not determinative, it noted that the construction of contracts is one of the factors that should be taken into consideration. The Judge saw that the subsidiary received and paid for the advertising services itself for the purposes of its business, under a genuine contract. The Tribunal also noted that even though the Appellant had provided its subsidiary with an initial loan, this was repaid by the material time. The Judge said that even though the arrangements were not at arm's length, it did not mean that the Appellant was responsible for payment.

The Tribunal then considered the principle of 'abuse' as defined in the *Halifax* case. On whether the scheme achieves a result contrary to the VAT Directive, HMRC argued that a principle of the tax is that someone making exempt supplies should suffer the tax incurred in making those supplies. HMRC added that the 'insertion' of the subsidiary meant the purpose of Community Law could not be achieved. The Tribunal disagreed that the subsidiary had been simply inserted. There had in fact been a wholesale reorganisation and not just a simple offshore loop as in the *WHA* case. The Judge added that HMRC were incorrect to compare the results achieved by this structure to a situation where exempt supplies were made in the UK. The transactions should be seen by reference to

the actual facts and circumstances. In this case, there was no UK exempt supply, and it was inappropriate to compare what was done with what could have been done.

After finding for the Appellant on the first condition, the Judge went on to look at whether the essential aim of the Jersey structure was to obtain a tax advantage. The Tribunal found that the essential aim was to obtain a tax advantage, but as it did not result in an outcome contrary to the Directive, abuse did not apply. However, on the issue of the redefinition, the Tribunal said that if it had found abuse it would be required to neutralise the tax advantage by redefining the supplies, and agreed with the recent *Atrium Club* decision that any such redefinition could create a hypothesis outside the real world that was not bound by real world constraints.

Paul Newey t/a 'Ocean Finance' (TC00487)

TRIBUNAL SAYS REPOSESSED GOODS ARE BEING SOLD IN SAME STATE, SO NO OUTPUT VAT IS DUE

The Appellant sells repossessed goods such as televisions, washing machines and fridges. The dispute concerns the 'same condition' test specified in the VAT (Special Provisions) Order 1995 for selling repossessed goods free of VAT.

HMRC argued that adding things like a new remote control or new water hose meant the goods were not in the 'same condition' when sold on, and so VAT was due on the full sale price. The Tribunal disagreed with HMRC, but said that there was a separate supply of a new remote control etc. on which VAT was due, so the sale price had to be apportioned. As such, the *Card Protection Plan* principles were not applied, even though the remote control and other items were all for the better enjoyment of the main item. There was no composite standard-rated supply of an item in a different state from when repossessed, but two supplies; one of second-hand 'same state' goods, and one of new goods, with a different VAT treatment applying to each one. The new

items were clearly distinct and separate from the second hand goods, and could be bought separately. The Tribunal added that if had it been minded to treat the supply as composite, it would have exempted the whole supply from VAT as the second-hand goods would have comprised the dominant item.

HMRC tried to argue that doing things like replacing batteries in a repossessed remote control, or putting a dust bag in a repossessed vacuum cleaner, meant the item was not sold on in the 'same state'. However, the Tribunal found this inappropriate, as they were just consumables. The test should only apply where the item had been repaired or reconditioned before resale, such that its condition had changed from broken to working, or unusable to usable. Examples of this would be replacing a faulty TV tube or broken fridge drawer, such that the 'same condition' was not met and VAT would then be due on the full second-hand sale price.

Buy As You View Limited (TC00486)

TRIBUNAL SAYS TAXI ACCOUNT WORK RETENTIONS NOT TAXABLE

This case concerned the treatment of monies retained by the Appellant relating to services supplied to account customers where it acted as principal. The Appellant invoices and collects money from the account customers, retaining either 20% or 26% as 'Account Work Discount' and passing the balance to the drivers. HMRC saw this discount as taxable consideration for a supply of services to the drivers, and raised a £167K assessment.

The Tribunal found there was no supply by Appellant to the drivers other than of XDA equipment, for which a separate charge was made, and VAT declared upon. The Tribunal cited *A2B Radio Cars* and *Camberwell Cars* in support of its view that a flat rate deduction is not consideration for a supply of services. The Judge distinguished *RJ & CA Blanks* and *Argyle Park Taxis* on the basis that no separate charges were made for equipment.

Parker Car Services (TC00528)



VAT Tips

VAT Voice – July/August 2010

THINK CAREFULLY ABOUT THE DATA YOU STORE ON YOUR COMPUTERS!

A recent judicial review case has once again raised the issue of the data kept on business computers, and HMRC's right to access it in the course of their enquiries.

In *Glenn & Co (Essex) Ltd*, the High Court rejected an application to judicially review HMRC's powers to 'inspect' computers. The Appellant was a registered dealer in excise goods, and was visited by a team of HMRC officers. The visit was unannounced, and no warrant had been obtained for it.

Relying on inspection powers granted under the Customs & Excise Management Act 1979 (CEMA), the Officers decided to remove a number of computers and a server to enable the hard drives to be interrogated. All but one of the computers were returned the next day, with the remaining computer and the server being returned the day after. The Appellant sought judicial review of the scope of HMRC's powers to inspect 'documents' under CEMA, alleging that it did not extend to computers, despite the fact that s.114 Finance Act 2008 widened HMRC's powers to inspect computerised records. The High Court rejected the Judicial Review application and confirmed that HMRC'S inspection powers do apply to computers.

At first glance, it seems surprising, if not plain worrying, that the absence of a search warrant seemingly had little or no bearing on the outcome of the case. However, it should be noted that the Appellant originally requested a review on two grounds; the first was on the absence of a warrant, and second that the powers do inspect 'documents' do not extend to computers.

For reasons not clear, the Judge only gave the hearing on the basis of the second one.

This case should serve as a timely reminder to all businesses to think carefully about the information being kept on their computers. This is said not just in terms of your business records, but also in relation to private information, given that we live in an age where many people have computers at home which are used for both business and private purposes.

The reality is that the chances of an HMRC Officer inadvertently getting access to private files as a result of his VAT enquiries have clearly increased. In short, if you do not want such data to be seen, either remove it from the computer, or else transfer all the business records (to a wholly business computer) so that the computer becomes wholly private.

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Our experienced consultants are ex-Officers of HMRC that were previously employed by 'Big Four' accountancy firms. If you have a query about this leaflet or VAT in general, please contact Steve Allen per the contact details below:

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