VAT Voice©

The bi-monthly newsletter of VAT Solutions (UK) Limited

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NEW ADDRESS FOR DEREGISTRATION APPLICATIONS AND REGISTRATION DETAILS CHANGES

On 28 October 2008, the 'What's New' page of HMRC's website contained the followed noteworthy announcement:

From 7 November 2008, all postal correspondence to change existing VAT registration details or to apply for deregistration should be sent to:

Grimsby National Registration Service
HM Revenue & Customs
Imperial House
77 Victoria Street
Grimsby
DN31 1DB

It seems a bit curious that such an important change should be tucked away on a webpage in one of the lesser viewed bits of the VAT section of HMRC's website, but the key thing is that we saw it and have been able to let you know in good time!

HMRC TO EXPAND USE OF EC SALES LISTS TO INCLUDE B2B SUPPLIES OF REVERSE CHARGE SERVICES FROM 1 JANUARY 2010

On 22 October 2008, HMRC issued Revenue & Customs Brief 53/08, which announced that, for the first time, EC Sales Lists will be used to collect information on certain B2B supplies of taxable services as well as for B2B supplies of goods.

The new provisions will come in on 1 January 2010, and will affect all UK businesses that make taxable supplies of services to business customers in other EU countries where the customer is required to account for VAT under the 'reverse charge' procedure.

The new requirement is one of five measures in a package of changes adopted by EU Finance Ministers in February 2008. The package of changes will be phased in between 1 January 2010 and 1 January 2015, and can be summarised as follows:

- *changes to the rules on the place of supply of services for Business-to-Business (B2B) and Business-to-Consumer (B2C) transactions*
- *requirement to complete EC Sales Lists for supplies of taxable services to which the reverse charge applies*
- *introduction of an optional One Stop Scheme for B2C supplies of telecoms, broadcasting and electronically supplied services*
- *introduction of an electronic VAT refund scheme*
- *enhanced Administrative Co-operation between Member States to support these changes*

Brief 53/08 relates only to the second item above, and points out that EC Sales Lists will **not** be required for the following:

- *supplies which are exempt from VAT according to the rules in the Member State where the supply takes place*
- *B2B supplies where the recipient is not VAT registered*
- *B2C supplies*

HMRC say they are making the announcement now to give businesses plenty of time to put arrangements or systems in place to gather the information needed. At present, HMRC anticipate using the existing VAT101 form, which will require the following data:

- *country code*
- *customer's VAT Registration Number*
- *total value of supplies in sterling*
- *an indicator will also be required to identify services*

Under the VAT Package legislation adopted in February 2008, EC Sales Lists would still be due on a quarterly basis. However, Member States are currently discussing an EC anti-fraud proposal for all EC Sales Lists to be submitted on a **monthly** basis from 1 January 2010. HMRC have since received comments from a number of UK businesses objecting to a monthly requirement for supplies of services. HMRC say they are feeding those responses into the discussions and will report the outcome of the negotiations as soon as possible.

Latest VAT News

REVENUE & CUSTOMS BRIEF 44/08

VAT: Partial Exemption – VAT adjustments when house builders let their dwellings before selling them

Announcement of the issue of VAT Info Sheet 07/08, which gives guidance (and worked examples) on the VAT implications arising when housebuilders decide to temporarily let their new dwellings whilst trying to sell them.

The Brief says the Info Sheet is in response to recent enquiries from the housebuilding sector, and takes account of the High Court decision in the joined cases of *Curtis Henderson and Briararch [1992] STC 732,* which took place in the early 1990s.

The key points to which the Information Sheet refers are summarised as follows:

- *if you temporarily let a dwelling before selling it, you may affect the VAT you can recover on your costs*
- *many house builders who temporarily let a dwelling will not be affected but you need to check this to avoid making VAT mistakes*
- *there is an easy way to check if you are affected by applying what we describe here as a 'simple check for de minimis'*

If you fail this check, you may have to:

- *adjust the VAT previously recovered on your submitted VAT returns*
- *restrict the VAT to be recovered on your current and future VAT returns*
- *both adjust your past VAT recovery and restrict your future VAT recovery.*

The Brief says that if a business needs to adjust VAT previously recovered, then exceptionally, and if so preferred, it may do so without contacting HMRC.

See VAT Information Sheet 07/08 on page 4 of this VAT Voice for further details.

REVENUE & CUSTOMS BRIEF 46/08

VAT: Court of Appeal decision in the case of Loyalty Management (UK) Ltd (LMUK) - HMRC position, pending outcome of appeal to the House of Lords

Confirmation that HMRC will be appealing to the House of Lords in the case of Loyalty Management (UK) Ltd ('LMUK'). The case involves the Nectar Loyalty Scheme, in which 'Collectors' can accumulate Nectar points when they buy qualifying goods or services from 'Sponsors'. Collectors are able to exchange these points for rewards of goods or services with specific suppliers, known as 'Redeemers'. The Redeemer notifies LMUK of the number of points redeemed on a monthly basis, and receives payment from LMUK for these points based on a contractually agreed amount for the points. This payment is described as the 'Service Charge'.

LMUK considered the Service Charge payment to be consideration for 'redemption services' supplied to it by Redeemers. As such, the supplies of services are standard rated, and Redeemers should issue tax invoices to LMUK. HMRC see the payment of the Service Charge not as consideration for the supply of redemption services to LMUK, but a third party payment for a supply by the Redeemers to Collectors. As the supplies have not been made to LMUK, none of the VAT charged by Redeemers is recoverable by LMUK as input tax.

HMRC state that the Court of Appeal decision represents the law as it currently stands. Therefore, Redeemers, although not party to the litigation, are nonetheless affected by it. As such, Redeemers need to ensure that the treatment of the Service Charge accords with that decision, and that LMUK can benefit from the decision. HMRC say they did not agree with the Court of Appeal's reasoning, which was the reason for the appeal to the HoL.

In the meantime, Redeemers are obliged to account for output tax due on the value of the full consideration received from LMUK, and those affected may wish to make protective claims for the additional VAT due, in the event that HMRC's appeal is ultimately successful. The Brief says LMUK is entitled to reclaim input tax on output tax charged to it by Redeemers to the extent that such claims are supported by the proper evidence, in which case HMRC will ensure assessments are in place to protect their position pending the outcome of the appeal.

REVENUE & CUSTOMS BRIEF 48/08

VAT: Exemption for fund management services
A reminder from HMRC that changes to the VAT exemption for fund management services from 1 October 2008 were announced at this year's Budget. The relevant changes were implemented in July by the The Value Added Tax (Finance) Order 2008 (SI 2008/1892).

HMRC say that, after further representations and consultation with stakeholders, the Order has been replaced to clarify certain aspects of the changes, and to introduce a de minimis provision. The amendments concern fund management services in respect of 'recognised overseas schemes' which are collective investment schemes established outside the UK, but are 'recognised' by the Financial Services Authority in order for them to be marketed within the UK.

The first change concerns funds which are constituted as 'umbrellas' containing a number of distinct sub-funds. In such cases, only management services provided in respect of each sub-fund marketed to UK investors are exempt. This follows the policy originally described in the now updated draft guidance, and has been made clear in the amended legislation.

The second change introduces a 'de minimis' mechanism, whereby the management of a recognised overseas scheme (or each sub-fund if an umbrella) which is not for the time being marketed in the UK, and has never been marketed in the UK or has less than 5 per cent of its shares or units held by, or on behalf of, UK investors, falls outside the VAT exemption.

REVENUE & CUSTOMS BRIEF 52/08

VAT on fuel used for propelling private pleasure craft and private pleasure flying
An announcement from HMRC that the 5% reduced rate of VAT will continue to apply after 31 October 2008 to supplies of fuel oil, gas oil and kerosene used as fuel for propelling private pleasure craft, and kerosene used as fuel for private pleasure flying. The rate applies even though the derogations allowing reduced or nil excise duty rates have expired.

The Brief states that the reduced rate of VAT applies to supplies of fuel oil, gas oil and kerosene which are used for domestic or charity non-business purposes, provided that the goods benefit from a rebated rate of excise duty. This includes supplies of not more than 2,300 litres, which are deemed to be supplied for domestic use.

However, from 1 November 2008:

- *heavy oil (mainly red diesel, which is a gas oil) used as fuel for propelling private pleasure craft*
- *kerosene (avtur) used as fuel for private pleasure flying*

will effectively attract the full rate of excise duty (see Revenue & Customs Brief 49/08 and 50/08). HMRC say that, to enable the reduced VAT rate to continue, the excise duty criterion will be removed from these particular supplies. The relevant legislation is *The VAT (Reduced Rate) (Supplies of Domestic Fuel or Power) Order 2008 (SI 2008/2676*), which will come into effect on 1 November as mentioned above.

REVENUE & CUSTOMS BRIEF 53/08

VAT –new requirement from 1 January 2010 that businesses provide EC Sales Lists for taxable supplies of services to which the reverse charge applies
A significant announcement from HMRC that, from 1 January 2010, the scope of EC Sales Lists will be expanded to include reverse chargeable B2B services.

The contents of the Brief are the subject of the front page of this edition of VAT Voice.

REVENUE & CUSTOMS BRIEF 54/08

VAT – New zero-rated dwellings – whether arrangements are abusive
Details from HMRC of when a zero-rated sale undertaken by a house builder might be viewed as unacceptable VAT avoidance.

The Brief accepts that many housebuilders are finding that they are unable to sell newly built dwellings in the current economic climate, and are, instead, choosing to rent those properties in the short-term. This has VAT implications because, rather than making a zero-rated sale, the housebuilder receives VAT exempt rental income, which can remove VAT recovery rights in relation to costs previously incurred.

To avoid this problem, some housebuilders have considered selling dwellings to a connected company to achieve a zero-rated sale. Any exempt supplies are then made by the new owner, thus minimising any VAT recovery restriction for the original builder. HMRC have been asked whether they will challenge such arrangements as avoidance (on the basis that VAT recovery rights cannot be obtained by sales which have no commercial purpose and are undertaken with the sole aim of obtaining a VAT benefit).

The Brief says HMRC do not consider that such a transaction would be unacceptable VAT avoidance in most cases, but goes on to outline the basic criteria in which a sale with the sole aim of preventing VAT costs would be considered abusive (e.g. where repair and maintenance costs are knowingly picked up).

<u>Comment:</u> If you are considering short lets of newly constructed buildings, or making a major interest grant to a connected company, please contact us to discuss the options. The new guidance and the earlier HMRC Information sheet on the consequences of a short let do not deal fully with all situations, and in particular does not deal fully with mixed developments.

VAT INFORMATION SHEET 06/08

Electronically supplied services: Special scheme for non-EU businesses
Notice from HMRC that, with effect from 1 July 2008, Portugal has lowered its standard rate of VAT from 21% to 20% for electronically supplied services.

VAT INFORMATION SHEET 07/08

VAT: Partial Exemption – adjustments when housebuilders let their dwellings
As stated in R&CB 44/08, this Information Sheet contains a helpful revision in the way the VAT ‘clawback’ provisions operate where a house builder temporarily lets new dwellings before selling them.

Where a housebuilder defers its intended sales of new dwellings and temporarily lets them out instead, it is likely to become partly exempt, and so might have to:

- *adjust the VAT previously recovered on his submitted VAT returns (‘clawback’)*
- *restrict the VAT to be recovered on current and future VAT returns*
- *both adjust VAT previously recovered, and restrict current and future VAT recovery*

A housebuilder is required to make a clawback adjustment as soon as the actual or intended use of a property differs from the original plans against which input tax was recovered. A clawback adjustment is a one-off event, and a housebuilder would only make a second adjustment if the building is never let. There is no need to amend the adjustment if the actual period of letting proves to be longer or shorter than anticipated.

Latest VAT News (continued 3)

Housebuilders that are not already partially exempt must first apply a simple 'de minimis check'. If they do not fail this, there is no need to make an adjustment and no need to go on to the second stage. If the check is failed, however, it is then necessary to go on to the second stage to work out the actual clawback adjustment. Where a housebuilder already has a partial exemption method, it will need to apply its partial exemption method to check for de minimis.

The 'simple check for de minimis' is carried out by reference to the expected time period the housebuilder will let its building for as a proportion of the economic life of that building, which, for VAT purposes, is 10 years. Provided the total exempt input tax does not exceed £625 per month on average (up to £7,500 per year), and is not more than half of the total input tax, the input tax is de minimis, and the clawback is not required.

<u>Example of a 'de minimis' check</u>

A fully taxable housebuilder recovered £20,000 input tax on a house that it expected to sell for £300,000. After the end of the tax year, it decides to defer the sale by letting for two years and so becomes partly exempt.

A simple check for de minimis is:

> *£20,000 input tax x two-year lease/10-year economic life = £4,000 exempt input tax.*
>
> *The £4,000 exempt input tax is de minimis because over the tax year, it does not exceed £7,500 or 50% of his total input tax. The builder has no need to adjust the VAT previously recovered on his VAT returns. An important point is to note if the input tax was incurred over more than one tax year, the de minimis test should be applied to the input tax incurred in each of the tax years separately.*

If the de minimis test is failed, it will be necessary to make a clawback adjustment based on the housebuilder's realistic expectation, judged at the time the original plans were set aside. HMRC may ask for evidence to support this, such as:

- *the business plan showing the price originally expected*
- *reports of estate agents showing this price to be unobtainable, and maybe estimating when a sale will be achievable*
- *board minutes from the time of the decision to grant short leases, or any other commercial documentation backing up the estimated use*

The housebuilder calculates its clawback adjustment by comparing the input tax deducted with the input tax it would have deducted had it held its changed intention all along. If the housebuilder is already partially exempt, it calculates the input tax it would have deducted by using its partial exemption method at the time the costs were incurred. If it was not already partially exempt, however, it must apply the standard method unless it obtains HMRC approval to apply a special method instead. If the housebuilder so prefers, it can exceptionally base its clawback adjustment on an alternative calculation (and without prior approval), provided that calculation is fair.

A calculation based on the values of supplies is normally fair and straightforward provided it is based on reasonable estimates and valuations.

<u>Example of a 'value-based' fraction</u>

$$\frac{\textit{Estimated eventual sale value}}{\textit{Estimated eventual sale value + estimated short let premiums and rents}}$$

Worked example

A housebuilder expects to sell two houses for £500,000 each. The input tax recovered during the tax year was £50,000. After the end of the tax year, the decision is taken to rent them for a period of three years generating estimated rental income of £200,000. The housebuilder makes no other supplies.

Latest VAT News (continued 4)

£50,000 input tax incurred x <u>£1,000,000</u>
£1,200,000

= £41,667 recoverable input tax

£50,000 input tax previously recovered, so £41,666 = £8,334 to be repaid to HMRC

No adjustment should be made for potential bad debts during the letting period. If it is not possible to fairly estimate the values, a different calculation may be needed. Apportionments based on the expected time period of the rental or short-term lease are not recommended, except where used as a quick de minimis check.

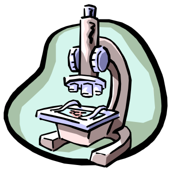
A housebuilder that decides to temporarily let before selling will need to apply a partial exemption method if it continues to incur exempt input tax in its current or future VAT periods. The exceptional treatment can only apply for the clawback adjustments. If the housebuilder is not already partially exempt, it must either apply the standard method, or else seek formal HMRC approval to apply a special method.

<u>Comment:</u> Given the obvious complexity of this issue, we would recommend that clients seek our VAT advice on the issue beforehand.

VAT INFORMATION SHEET 09/08

Electronically supplied services: Special scheme for non-EU businesses
Details of the latest currency exchange rates to be used in the Special Scheme for Non-EU Businesses relating to the supply of electronically supplied services.

(N.B. VAT Info Sheet 08/08 has not yet been issued)



In Focus

YOU RECEIVE A SECURITY DEMAND FROM HMRC - IS IT JUSTIFIED?

The number of security demands being issued by HMRC has risen dramatically in the last 12 months. In a lot of cases, the demand is issued on a routine basis without any background checks or information being considered. This article looks at what you should do if you receive a demand, and gives guidance on whether there is a reasonable defence in place to mount a challenge against it.

If a business goes under and owes VAT to HMRC, they have the power to demand a security (deposit) before they will let any new company trade. For example, Company A gets into financial difficulties because one of its largest customers goes bust owing them £500K. After a few months trying to trade through its difficulties Company A goes into liquidation owing HMRC £40k in unpaid VAT.

Two of the three directors of Company A buy the assets and take on a few of the staff of their old company and start trading as Company B. Within a couple of months of starting to trade they get a letter from HMRC demanding a security of £35k for between one and two years or they will not let them trade. This is the last thing a new business needs and in some cases they simply close down, but what can they do about it?

In these days of financial pressure on small business the Government has said it will do all it can to help them, but this has not got through to HMRC, who are imposing more security demands than ever.

There have been a number of Tribunal cases over the years which have shown that HMRC must make certain checks on the new business before imposing a security, however, these are rarely done. In most cases if a business can show that HMRC has been negligent, they will back down and withdraw the security.

So what are the sort of things you should look for?

Where a Director has been involved in a business that has gone into liquidation with debts outstanding to the Commissioners, but has not been directly responsible for the financial mismanagement of the previous company the Tribunal has ruled that it is unreasonable of HMRC to require security from a new company that he becomes involved with. For example, the old company was financially mismanaged by the Finance Director, and the new company is run by the old Sales Director and Personnel Manager. They did not have direct responsibility for the finances of the old company, so HMRC would be wrong to ask for a security.

In Focus (continued)

Tribunals have also ruled that where the liquidation of a company has occurred for reasons outside the control of those running a business, it is unreasonable for HMRC to require a security, as in the example of Company A above where their main customer went bust.

Tribunals have also indicated that where a new business is financially sound, and has rendered its VAT returns on time and with full payment of the tax due, it is not reasonable for HMRC to request security from the new company. If HMRC has not made these enquiries you should challenge any security that is imposed.

HMRC are also supposed to make detailed enquiries into the financial position of the new company. The failure to do this would indicate that HMRC are not in a position to accurately assess any potential risk to the revenue posed by the new company. If HMRC had taken this action, he would not, inevitably, have reached the same conclusion and so the imposition of a security would be unreasonable.

In many cases, HMRC will have made no enquiries into the new business at all and simply imposed a security requirement as a matter of routine. Any business that receives a security demand should take account of the above, and if they feel that they come under one of these examples, they should obtain professional advice and challenge HMRC.

Comment: *If, after reading this article, you feel you have a semblance of a defence to any HMRC security demand, do please get in touch with us. We are very proud of the fact that we still have a 100% success rate in these cases after more than 7 years of trading! A successful appeal would also see most or all of your costs being reimbursed by HMRC (at least until such time as the planned restructuring of the VAT Tribunal system goes through).*

VAT Cases

TRIBUNAL FINDS PARTLY FOR TAXPAYER ON SUPPLY OF INDOOR POOL COVERS FOR NEW HOUSES

This case concerned the supply of (optional) retractable insulated covers and moveable floors for indoor swimming pools. The basic position is that the construction of an indoor pool in a new house can be zero rated under Item 2 Group 5 Schedule 8 VATA 1994.

The Appellant argued that the covers and floors were zero-rated under Item 4 Group 5, as they fell within the definition of 'building materials' in Note (22) of Group 5. HMRC said the covers were electrical appliances, which are excluded from zero-rating, and that the floors were not '*ordinarily incorporated*' into a building, and so were similarly excluded.

At hearing, the Tribunal saw the electrically-powered, fully-retractable insulated swimming pool covers as '*building materials*' because the covers were built into the pool structure; and were '*ordinarily incorporated*' within new indoor swimming pools (the Tribunal noted that in *Leisure Contracts Limited (VTD 19,392),* these covers are often required under building regulations). HMRC argued the point that electrical appliances are excluded from zero rating. However, the Tribunal concluded that "*it is purely incidental to their description that they are electrically powered*", making the analogy that "*curtains are curtains even though some in offices and luxury houses may be drawn electrically*".

The moveable floors, a new and interesting invention designed to enable the level of the swimming pool floor to be altered to create varying depths, was regarded as an exceptional item not 'ordinarily incorporated' in buildings of any description. To that extent, the appeal was partly allowed.

Rainbow Pools London Limited (VTD 20,800)

TRIBUNAL FINDS THAT OPTION TO TAX WAS NOT SUBJECT TO THE HMRC ANTI-AVOIDANCE MEASURE

The Appellant wanted to acquire a self-storage facility. The vendor had opted to tax the building but the Appellant did not want to opt to tax as it wished to keep its charges to customers down. In order to acquire the building VAT free under the TOGC rules (the vendor also operated a self-store business from the site) The Appellant would have to opt to tax. Therefore, it sought to create the conditions under which the vendor's option to tax would be disapplied by the anti-avoidance rules, as that was the only way for it to achieve its aim of acquiring a VAT free building without having to opt to tax and charge its customers VAT.

The Appellant's plan involved making the building a capital goods scheme asset that would be occupied for exempt purposes by the vendor, financier of the development or someone connected with either. As the Appellant and the vendor were not 'connected', the only way to do this was to make it the financier of a capital refurbishment of the building by the vendor that was subject to VAT and cost over £250k, and hence would bring the building within the capital goods scheme. The Appellant would be in occupation of the building for exempt purposes. Both parties were keen that the business should not be disrupted during the refurbishment process.

The Appellant was granted a licence to occupy the premises, free of charge, before the works were carried out. At that stage, the vendor was no longer running the storage business, and the income from it went to the Appellant. The freehold of the building was sold a few days after the refurbishment was completed. The works were carried out to meet the Appellant's specifications on Fire and Health and Safety matters.

VAT Cases (continued 1)

The Appellant argued the disapplication conditions were met as it had financed the development, which had cost over £250k, and the intention was that the building would be occupied for exempt purposes. HMRC argued that the disapplication conditions were not met. The expenditure did not create a capital item that was used in the course of the vendor's self-storage business. The expenditure was incurred to sell the property, it was not a cost component of any supplies of self-storage by the vendor, and it was incurred after the vendor had ceased to operate a self-storage business. It was also not capital expenditure as the refurbishment was not a durable asset. This last comment raises some interesting questions in its own right.

The Tribunal agreed with HMRC. It is unusual to see HMRC arguing against its own anti-avoidance rules. This is a long case, but it is interesting. The Tribunal accepted that there is a subjective and an objective test for the disapplication. The objective test is whether the asset is a capital item in a capital goods scheme (CGS). The subjective test is whether the intention is that it will become a capital item within CGS (in both cases there must also be significant exempt or non business use of course). HMRC did not pursue any abuse arguments, and withdrew the misdeclaration penalty it had issued, (no reason for this is given). HMRC also accepted that the sale of the other business assets could be a TOGC, so VAT was only due on the building. The appeal was thus dismissed.

Shurgard Storage Centres UK Ltd (VTD 20,797)

TRIBUNAL SAYS ROOFSPACE IN BLOCK OF FLATS IS ELIGIBLE FOR 'NON-RESIDENTIAL' TREATMENT

A short but interesting case involving an appeal by a developer against HMRC's refusal to grant voluntary VAT registration.

The Appellant applied for VAT registration on the basis that it intended to make zero-rated supplies by constructing new flats within the roofspaces of blocks of flats, and then granting a 'major interest' in each new flat. However, HMRC refused its application to register for VAT, arguing that the roof space being converted was integral to the residential part of the building, and therefore the sale of the new flats was an exempt supply.

On the face of it, you might reasonably think that HMRC had a fairly good case here, but the Tribunal found strongly in favour of the Appellant. It took the view that the Appellant was actually converting a 'non-residential' part of a building into a number of dwellings within the meaning of item 1(b) in Group 5 of Schedule 8, VATA 1994.

Merlewood Estates Ltd (VTD 20,810)

COURT SAYS HMRC MUST ISSUE MONTHLY RETURNS TO TAXPAYER PENDING OUTCOME OF THE CASE

This case is a long-running battle concerning HMRC's refusal to grant the use of monthly VAT return periods.

In May 2008, the Appellant won a Judicial Review of HMRC's withdrawal of monthly accounting for some export companies in the automotive industry. The High Court reviewed in detail HMRC's decision to withdraw monthly VAT accounting for the Appellant's export company. In reaching its decision, the Court ruled that whilst HMRC do have the power to direct quarterly returns, it granted permission for the Appellant to apply for an order to quash HMRC's decision letter on the basis that HMRC's decision-making process was flawed. Later, in June 2008, HMRC were given permission to appeal this decision and a 'stay' of the judge's decision was ordered.

The 'stay' essentially means that HMRC could continue to issue quarterly returns until the case is concluded (due in the Court of Appeal in December 2008). The Appellant applied to the Court of Appeal to have this 'stay' lifted, which is the centre of this dispute.

HMRC argued that the lifting of the stay would create a significant administrative burden for both sides. HMRC went to great length to detail the issues around the reissuing of historic monthly returns, the recalculation, adjustments and manual interventions on systems and payments etc. HMRC even pointed out that any previously issued assessments would be invalid and may be time barred. The Appellant, however, a repayment business, was suffering the cash flow disadvantage of quarterly returns, and successfully argued the accepted principle that a successful litigant is entitled to receive the fruits of his success. The court, whilst accepting HMRC would suffer an administrative burden, and would have to spend time which '*it might wish to devote to other activities*', ordered the stay to be lifted.

BMW AG, Court of Appeal ***[2008] EWCA Civ 1028***

ECJ SAYS SPORTS CLUB CAN INTERPRET THE TERM 'PERSONS' AS INCLUDING BOTH CORPORATE AND NON-INCORPORATED BODIES

The ECJ has recently released its judgment in a case concerning whether the Appellant, a hockey club, could treat its affiliation fees to England Hockey (a non-profit-making body) as exempt under EU law. This was on the basis that the term 'persons' was not limited to natural persons. HMRC argued that these fees were not consideration for supplies to the persons taking part in sport, but for supplies to the club.

The ECJ has broadly found for the taxpayer, concluding that the sporting services exemption can include services supplied to corporate bodies and non-incorporated associations, provided that:

- the services are closely linked to and essential for sport,
- the supplier is a non profit making body, and
- the true beneficiaries of the services are persons taking part in sport

The UK court must now decide if the services supplied by England Hockey to the club meet the conditions for exemption. The Court may well decide that some do and some do not, but nevertheless, the ECJ has clearly indicated that the UK's approach of limiting the exemption to supplies to individuals is wrong and overly restrictive. In answer to the second question, the ECJ made it clear that the discretion afforded to Member States in applying the Article 13A exemptions is limited to the conditions set out in Article 13A(2) (now Article 133), and can not encompass any discretion about who can receive the exempt supplies.

TRIBUNAL FINDS FOR HMRC ON THE RATIO OF ZERO-RATED SALES MADE BY NEWLY-OPENED CAFE

On set-up, the Appellant, a cafe selling crepes, beverages and smoothies, established its split of sales as being 25% standard-rated and 75% zero-rated, by comparison with take-away sandwich and bagel bars. However, after a visit from HMRC, in which, till receipts were analysed found that the true apportionment was 49.56% standard-rated sales for the period examined. HMRC therefore raised an assessment for the difference in VAT.

The Appellant disputed the typicality of the period analysed, but examination of two further periods at different times of year showed that eat-in sales alone accounted for 47.9% of till receipts in one week and 62% in another. As such, HMRC felt that the assessment of 49.56% was not only fair and reasonable, but generous. The Appellant continued to dispute the accuracy of this assessment, arguing in favour of the initial 25:75 split, but crucially, it failed to provide any evidence in support of this to either HMRC or the Tribunal. This left the Tribunal with little alternative but to uphold HMRC's assessment, and dismiss the appeal.

VAT Tips

Claiming the VAT back on legal costs

In is usually fairly obvious for a business to know if it can recover the VAT on legal costs that it incurs. The basic rule is that if the legal costs relate to your taxable business, you can recover the VAT. If they relate to a VAT exempt activity, or if they are a person's or third party's costs, you cannot recover it.

Example 1 – *Your business sues a debtor or incurs legal costs in purchasing a building for use as offices, these clearly relate to your business and you can recover the VAT.*

Example 2 – *You are a sole trader and incur legal costs suing a motorist who crashed into your private car. This is clearly a private action, and your business cannot recover the VAT.*

However, there are many cases when things are less clear-cut, so here are some actual examples of what counts as a business purpose, and what does not.

Defending criminal charges against an individual is unlikely to be for the purpose of a business, even if conviction of that individual would lead to serious difficulties for, or even the closure of, the business. This principle was upheld in the High Court judgement in the case of *Frederick William Rosner,* who was prosecuted for criminal fraud. The VAT on his legal costs was held to be non-recoverable.

The 'Rosner' case confirmed the principle that, for legal services to be regarded as having been obtained for the purpose of a business, there must normally be a direct connection between the substance of the legal action and the activities of the business - not merely that it would benefit the business by keeping the owner out of jail. Conversely, in *P & O European Ferries*, the legal costs for the defence of employees charged with manslaughter following the Zeebrugge disaster were held to be recoverable on the basis that the charges resulted from their normal employment.

The above principle is equally applicable to legal costs in civil actions where VAT is incurred on legal costs of a partnership dispute or a director's dispute with a previous company. In a court case, the court may order one party to pay costs to the other party, usually the winner. This is a contribution towards the winner's expenses in bringing the case. Although the loser has to foot the bill, the services were not supplied to him, so he cannot recover the VAT on those costs. This principle also applies where a prospective tenant pays the legal costs of the landlord. The supply was to the landlord, not the tenant, so the tenant cannot recover the VAT it has paid.

Tip - HMRC will take a careful look at any VAT recovered on legal costs to see if they are proper to the business and relate to its business activities, so make sure you have claimed the VAT back correctly and have answers to any questions they may ask you. If you get it wrong, you could end up having the VAT disallowed, and being charged penalties and interest.

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Our consultants are all former Officers of HMRC who were also previously employed by 'Big Four' accountancy firms. If you have a query about this leaflet or VAT in general, please contact Steve Allen or Andrew Needham at either of our offices listed below:

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