VAT update

January 2017

In this month's update we report on new penalty legislation which the government intends to introduce for businesses participating in VAT fraud, HMRC's consultation on VAT grouping and proposed new legislation to tackle the exploitation of VAT relief on adapted cars for wheelchair users. We also comment on three recent cases involving VAT recovery on management buyouts, VAT recovery on insurance intermediary services and the VAT treatment of commission paid on redemption vouchers.

News

New penalty for participating in VAT fraud

On 5 December 2016, HMRC published its responses to its consultation dated 28 September 2016, on whether to introduce a new penalty for businesses participating in VAT fraud, specifically aimed at businesses caught up in Missing Trader Intra-Community (MTIC) fraud. more›

Scope of VAT Grouping: Consultation document

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Tackling exploitation of VAT relief on adapted cars for wheelchair users

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Cases

Heating Plumbing Supplies Limited – VAT recovery on management buyout fees

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Any comments or queries?

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About this update

The VAT update is published on the final Thursday of every month, and is written by members of RPC's Tax Dispute team.

We also publish a Tax update on the first Thursday of every month, and a weekly blog, RPC Tax Take.

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Unicom Insurance Services Limited – VAT on insurance intermediary services

In *Unicom Insurance Services Limited v HMRC*, the FTT held that the recipient of supplies made by the insurance broker Unicom Insurance Services Limited (Unicom), was the non-EU insurer, rather than the UK consumers taking out the insurance policies and allowed Unicom's appeal against HMRC's decision to deny recovery of input tax associated with those supplies. more›

Wiltonpark Limited and others – commission charges paid on lap dancing club vouchers are taxable supplies

In *Wiltonpark Limited and others v HMRC* , the Court of Appeal considered an appeal against the Upper Tribunal's (UT) decision that commission charges paid by dancers to lap dancing clubs for the provision and operation of a voucher scheme was a taxable supply for VAT purposes. more›

News

New penalty for participating in VAT fraud

On 5 December 2016, HMRC published its responses to its consultation dated 28 September 2016, on whether to introduce a new penalty for businesses participating in VAT fraud, specifically aimed at businesses caught up in Missing Trader Intra-Community (MTIC) fraud.

There is currently a misalignment between the MTIC fraud "knowledge principle" and the existing error penalty regime contained in Schedule 24, Finance Act 2017. HMRC currently delay issuing any penalty until after the case has been determined which can then cause a second round of litigation which increases the risk the penalty will be ineffective. The majority of respondents to the consultation were in favour of introducing a penalty for participating in VAT fraud at a ratio of around three to one.

Having considered the consultation, the government has decided to proceed with the introduction of the penalty and will legislate in Finance Bill 2017. The penalty will be imposed when HMRC denies a business the right to recover input tax or apply the zero rate to international supplies on the basis it has entered into a transaction connected with evasion of VAT by another person and it knew, or should have known, that the transaction was connected with fraud. The new penalty will be calculated at 30% of the potential lost VAT. The draft legislation provides no reduction for cooperation.

The new penalty will apply to transactions that take place after the legislation comes into force on Royal Assent.

A copy of the responses to the consultation can be found here.

A copy of the Tax Information and Impact Note can be found here.

A copy of the draft legislation (see clause 95) can be found here.

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Scope of VAT Grouping: Consultation document

HMRC has issued a consultation seeking views on whether to make changes to UK VAT grouping following the Court of Justice of the European Union's (CJEU) decisions in *Beteiligungsgesellschaft Larentia + Minerva mbH & Co KG v Finanzamt Nordenham* (C-108/14) and *Skandia America Corp (USA) v Skatteverket* (C-7/13). The main focus of the consultation is to review options around eligibility requirements for VAT group registration and the impact of policy changes following the decision in *Skandia*.

The CJEU in *Lirentia and Minerva*, indicated that a member state may not restrict VAT grouping to those entities which have legal personality, unless it is justified to prevent abuses, tax evasion or avoidance. HMRC recognises that one reading of this judgment is that member states may have to extend VAT grouping to a wider range of entities. Accordingly, HMRC are seeking views on the risks and opportunities for businesses if VAT grouping is widened to other entities, such as partnerships. In *Skandia*, the CJEU found Sweden's establishment only VAT grouping was consistent with Article 11 of the VAT Directive, and resulted in taxable supplies from the corporation's overseas head office to its Swedish branch in the VAT group. Following

the CJEU decision, HMRC put in place steps to recognise separate taxable persons created by establishment only VAT groups in other member states. HMRC is seeking views on how the policy changes have impacted businesses.

The closing dates for comments are 27 February 2017.

A copy of the consultation can be found here.

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Tackling exploitation of VAT relief on adapted cars for wheelchair users

As announced at Autumn Statement 2016, the government intends to legislate in Finance Bill 2017 to tackle abuse of VAT relief on adapted cars for wheelchair users. Currently wheel chair users obtain a VAT zero-rate relief on vehicles. It was found that people were abusing the legislation by obtaining a VAT zero-rate relief on vehicles with minor adaptions and later reversing the changes to sell the vehicle on for profit. A consultation in 2014 set out options to amend the scheme. Respondents were supportive of the need to make changes in order to tackle such abuse.

The legislation will limit the number of vehicles that can benefit from the relief in a given period and make mandatory the requirement to submit written declarations to HMRC. Those in breach of these new requirements may be denied the benefit of the zero rate or may be subject to a section 62, Value Added Tax Act 1994, penalty if the declaration they make is incorrect. The changes will take effect from 1 April 2017.

A copy of the draft legislation (see clause 43) can be found here.

A copy of the Policy Paper published on 5 December 2016 can be found here.

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Cases

Heating Plumbing Supplies Limited – VAT recovery on management buyout fees

In *Heating Plumbing Supplies Limited*[1], the First-tier Tribunal (FTT) allowed a VAT group's appeal against HMRC's denial of input tax recovery on advisory fees incurred in a management buyout.

Background

Heating Plumbing Supplies Limited (HPSL), carried on a business of the wholesale distribution of domestic heating and plumbing appliances to trade and the public.

In November 2010, HPSL's Board of Directors decided to look into a management led buyout. The structure adopted as the means of giving effect to the buyout was for HPSL to be acquired by a new holding company, Heating Plumbing Supplies Group Limited (HPSGL), which was owned by the management and staff. The purpose of the buyout was to enable HPSL's employees to acquire a stake in the business.

Following the buyout, HPSL (as the representative member) and HPSGL, were registered as a VAT group. HPSL claimed an input tax deduction in respect of professional services supplied in connection with the buyout and invoiced after the VAT group had been established.

HMRC denied the input tax claimed on the professional fees. The issue was whether input tax incurred on the services provided by the advisors was recoverable. HMRC argued that joining a VAT group does not allow costs that would otherwise be irrecoverable under a single registration to be recoverable as part of the group. HMRC took the view that the buyout company had no economic activity and that, as such, it should not be entitled to reclaim the VAT charged on professional fees. HMRC cited *BAA*[2] as authority for the proposition that costs associated with the takeover, by a holding company, of the shares in a company that itself made taxable supplies, were not costs of that underlying business. HPSL argued that it was a VAT group and that, as a 'single taxable person', it was entitled to reclaim the VAT in full.

FTT's decision

The FTT allowed the appeal. It was of the view that the input tax was incurred by the HPSL VAT group in the course of an economic activity and the professional advisors services had a direct and immediate link to the taxable supplies made by the representative member (or VAT group) as they were incurred for the purposes of that economic activity.

The FTT agreed with HPSL that when a VAT group is formed, the identities of the individual members of the group disappear and there is a single taxable person for VAT purposes. Supplies of goods or services by, or to, a member of a VAT group must therefore be treated as supplies of goods by, or to, the VAT group.

The FTT distinguished *BAA* on the facts as HPSGL was formed for the purpose of furthering HPSL's business by motivating staff. The FTT agreed that had the services been provided solely to facilitate the acquisition of shares with a view to receiving a dividend (as in *BAA*), there would have been no direct and immediate link with the taxable supplies of HPSL. However, the services were provided for the direct benefit of HPSL's business and could be viewed as overheads.

1. [2016] UKFTT 753 (TC).
2. [2013] EWCA Civ 112.

Comment

This is an important and interesting first instance decision for businesses regarding the difficult area of VAT recovery on professional fees in relation to management buyouts where a holding company is inserted into a group structure. The FTT does, however, appear to distinguish a management buyout from a third-party takeover and it is therefore likely that in the case of a third-party takeover, the holding company will have to make taxable supplies. It will be interesting to see whether HMRC appeal this decision.

A copy of the decision can be found here.

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Unicom Insurance Services Limited – VAT on insurance intermediary services

In *Unicom Insurance Services Limited v HMRC*[3], the FTT held that the recipient of supplies made by the insurance broker Unicom Insurance Services Limited (Unicom), was the non-EU insurer, rather than the UK consumers taking out the insurance policies and allowed Unicom's appeal against HMRC's decision to deny recovery of input tax associated with those supplies.

Background

Unicom carries on business in the UK as an insurance agent providing introductory services via its website. Unicom does not write insurance policies itself but effects an introduction between 'consumers' (in the UK) and insurance companies for a commission. Unicom collected the gross premiums from the insurance customers, retained 25% as commission and passed the remaining 75% to the insurer. 95% of its intermediary services were supplied to Tradewise Insurance Company Limited (TWIC) which belongs in Gibraltar and therefore Unicom claimed input tax recovery on these supplies under Article 3 of the Value Added Tax (Input Tax) (Specified Supplies) Order 1999.

HMRC denied Unicom the input tax claimed, on the basis the supply was made to the consumers who belong in the UK for VAT purposes. Since those services were exempt supplies, HMRC was of the view that Unicom could not recover input tax associated with making those supplies. The basis of HMRC's argument was that, by means of its website and other documents, Unicom referred to consumers as its clients. Accordingly, HMRC argued that when consumers asked Unicom to approach insurance companies for cover, the presumption should be applied that Unicom did so as agent for the consumers.

It was common ground between the parties that the services provided by Unicom fell within the insurance exemption and therefore the only issue the FTT had to determine was whether Unicom was supplying its intermediary services to TWIC or to consumers in the UK.

FTT's decision

The FTT allowed the appeal and held that Unicom provided services to the insurer, not to the insured. The FTT reviewed the contractual terms between Unicom and TWIC and between Unicom and the consumers and concluded that they pointed to the conclusion that Unicom was supplying its intermediary services to TWIC as it was acting as agent of TWIC, pursuant to the service agreement and prevented Unicom from acting as the insured's agent. Further, only TWIC had the contractual right to compel Unicom to provide those intermediary services and the consumers only had a limited contract with Unicom. The FTT considered the contractual arrangements reflected the economic reality and unhelpful statements on Unicom's website and in the service agreement referring to the insured as "customers" or "clients" did not detract from that.

3. [2016] UKFTT 782.

Comment
The FTT focused on a review of the contractual arrangements to ascertain the correct VAT treatment on supplies made. The importance of considering contractual documents and the consequent VAT position at the outset of supply relationships cannot be underestimated to ensure input tax recovery and to minimise the risk of a dispute arising with HMRC.

A copy of the decision can be found here.

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Wiltonpark Limited and others – commission charges paid on lap dancing club vouchers are taxable supplies

In *Wiltonpark Limited and others v HMRC*[4], the Court of Appeal considered an appeal against the Upper Tribunal's (UT) decision that commission charges paid by dancers to lap dancing clubs for the provision and operation of a voucher scheme was a taxable supply for VAT purposes.

Background
The Appellants operate table and lap dancing clubs in London. The clubs' dancers were self-employed and were paid directly by customers. While cash payments were accepted by the dancers, customers would occasionally run out of money. To mitigate this, the clubs had established a system whereby customers could purchase vouchers from them using credit or debit cards. The dancers would then encash the vouchers at the end of an evening, paying a commission of 20% on their face value.

The clubs had sought the repayment of VAT on the commission on the basis that it was an exempt supply within the Value Added Tax Act 1994, Schedule 9, Part II Group 5 Item 1: "The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money". The parties were agreed that, unless the payments were exempt supplies falling within Group 5 Item 1, the commission would be subject to VAT at the standard rate.

HMRC had rejected the Appellants' claim that the commission charges were exempt supplies and the FTT dismissed the clubs' appeals against that determination. On appeal to the UT, which upheld the FTT's decision, the UT found that the 20% commission payment charged by the clubs when dancers redeemed the vouchers was a payment in return for services going significantly beyond the simple "receipt of, or any dealing with, money" for the purposes of Group 5 Item 1.

The crucial point to be decided by the Court was whether the UT had been correct to decide that the provision of the clubs' facilities (which enabled a dancer to obtain income from non-cash customers) should be treated as part of the services supplied in return for the commission payable on encashment of vouchers. If this was not correct, it would follow that the supply was exempt and that VAT was not payable on the commission.

Court of Appeal's decision
The Court focused on the precise supply or supplies being made by the Appellants rather than general descriptions of the commercial opportunities arising from the voucher scheme.

4. *Wiltonpark Limited and others v The Commissioners for HM Revenue & Customs* [2016] EWCA Civ 1294, Case No: A3/2015/3123.

In the view of the Court, the present case could be distinguished from cases such as *Kingfisher v HMRC* [1989][5], where the retailer, equivalent to the dancers in this case, traded from its own premises (and where supplies made were held to be exempt supplies under Group 5 Item 1). In the present case, the dancers traded at the clubs and not from their own premises.

The Court went on to examine the economic reality of the transactions which, in effect, was that both the clubs and the dancers were dependent on each other for success and profitability. The dancers could not provide their services in exchange for vouchers without the facilities provided by the clubs. For the dancers to be able to exploit the non-cash customer market, they needed not only the voucher scheme but also the clubs premises and facilities. In those circumstances, the Court concluded that the UT's analysis that the provision of the clubs facilities formed part of the consideration for the commission on encashment of the vouchers, was a legitimate interpretation of the constituent parts of the services supplied by the clubs in return for the commission. It reflected the economic reality from the perspective of the dancers and the analysis was an evaluative judgment that a Court should be slow to overturn.

The appeal was therefore dismissed.

Comment
This decision provides useful guidance in this complex area and highlights the importance of determining precisely what is supplied for the consideration provided.

A copy of the decision can be found here.

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5. *Kingfisher and Customs and Excise Commissioners v Diners Club Ltd* [1989] 1 WLR 1196.

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