VAT update

March 2017

In this month's update we report on the Chancellor's announcement in the Spring Budget that he intends to "crack down" on VAT "missing trader" fraud within the construction industry, the Office of Tax Simplification's Interim Report on its review of VAT, and the EU's consultation on proposals to tackle VAT fraud. We also comment on three recent cases involving the VAT "Builders Block", the Advocate General's Opinion in relation to limitation periods for output tax, and the recovery of VAT input tax in the absence of self-billing arrangements.

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Budget 2017 – tackling VAT fraud within the construction industry

In his Spring Budget the Chancellor announced that a consultation to crack down on the increasing level of VAT "missing trader" fraud in the construction sector would take place. more›

The Office of Tax Simplification's Interim Report on its review of VAT

Following the announcement at Autumn Statement 2017 that the Office of Tax Simplification (OTS) had been asked to carry out a review on the simplification of VAT, on 28 February 2017, the OTS published its interim report on reform of VAT which comprised a progress report and a call for evidence following the completion of the first phase of its work. more›

EU consults on how to tackle VAT fraud

The European Commission has launched a consultation on improving administrative cooperation and increasing efforts to tackle cross-border VAT fraud. more›

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Taylor Wimpey – "builders block" compatible with EU law

In *Taylor Wimpey Plc v HMRC*, the Upper Tribunal (UT) dismissed the taxpayers' appeal in relation to its claim to recover input VAT incurred on the provision of certain white goods, kitchen appliances and carpets installed in newly built houses. more›

Compass Contract Services – limitation periods for output tax and deduction of input tax claims EU law compliant

In *Compass Contract Services Ltd v HMRC*, the Advocate General has opined that it is permissible under EU law for national limitation periods for claiming overpaid output tax to vary from those applicable to input tax claims. more›

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 Disputes 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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Housley – HMRC's failure to exercise its discretion held to be unreasonable

In *G B Housley Ltd v HMRC*, the Court of Appeal allowed the appellant's appeal and restored the decision of the FTT which had discharged HMRC's VAT assessment on the basis HMRC had failed to correctly exercise its discretion. more›

News

Budget 2017 – tackling VAT fraud within the construction industry

In his Spring Budget the Chancellor announced that a consultation to crack down on the increasing level of VAT "missing trader" fraud in the construction sector would take place. The fraud generally involves VAT debts accruing in a company which supplies labour services before that company goes "missing" without accounting for the VAT.

The consultation was published on 20 March 2017 and invites responses from construction businesses and those that supply predominantly labour services to those in the construction sector.

The consultation will consider a range of policy options to prevent supply chain fraud in the sector. In particular, it will consider applying a reverse charge mechanism so that those paying for a subcontractor's work must account for VAT having been paid and whether changes should be made to the qualifying criteria for gross payment status within the Construction Industry Scheme.

Subject to the consultation, the Government's intention is to legislate for this in Finance Bill 2017.

The closing date for responses is 9 June 2017 and should be sent to indirecttax.vatsncfteam@hmrc.gsi.gov.uk.

A copy of the consultation document can be found here.

The Office of Tax Simplification's Interim Report on its review of VAT

Following the announcement at Autumn Statement 2017 that the Office of Tax Simplification (OTS) had been asked to carry out a review on the simplification of VAT, on 28 February 2017, the OTS published its interim report on reform of VAT which comprised a progress report and a call for evidence following the completion of the first phase of its work. The eight areas it is specifically looking at are the high registration thresholds, VAT multiple rates, partial exemptions, options to tax, special accounting schemes, appeal procedures, formal ruling system and making tax digital.

In its call for evidence, it has asked for comments regarding how it can create a sustainable VAT system for the future that imposes minimal burdens on businesses. In particular, it seeks:

- evidence of how the above areas cause difficulties and complexities
- ideas for how to improve the position
- details of any areas for simplification that it has missed.

The OTS has asked for responses by 30 June 2017 and will publish its recommendations in autumn 2017.

A copy of the OTS's report can be found here.

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EU consults on how to tackle VAT fraud

The European Commission has launched a consultation on improving administrative cooperation and increasing efforts to tackle cross-border VAT fraud. The Commission intends to update rules in these areas to improve the functioning of the Single Market and to tackle the heavy losses to member states and EU revenues resulting from VAT fraud.

The purpose of the consultation is:

- to gather views from stakeholders, other than tax administrations, about their experience of the current rules governing administrative cooperation and the fight against cross-border VAT fraud
- to bring new insights for the on-going evaluation of Regulation (EU) 904/2010
- to provide information about possible improvements including to the on-line service for verifying VAT numbers for intra-EU transactions
- to collect quantitative data on possible reduction or increase of regulatory costs/benefits (administrative burden and/or compliance costs) for businesses (in particular SMEs).

The deadline for making submissions is 31 May 2017.

A copy of the consultation document can be found here.

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Cases

Taylor Wimpey – "builders block" compatible with EU law

In *Taylor Wimpey Plc v HMRC*[1], the Upper Tribunal (UT) dismissed the taxpayers' appeal in relation to its claim to recover input VAT incurred on the provision of certain white goods, kitchen appliances and carpets installed in newly built houses.

Background

Taylor Wimpey Plc (the Appellant) was the representative member of a large construction group. It made claims for recovery of historic input tax amounting to over £51m incurred in relation to the installation of various items in new-building housing including ovens, surface hobs, extractor hoods, washing machines, microwaves, dishwashers, refrigerators, freezers and carpets.

HMRC denied the Appellant's claim for input tax on the basis the items fell within the scope of the builder's block which was introduced by Input Tax (Exceptions) No. 1 Order[2], so that any input incurred on these items was not recoverable (the Builders Block).

The Appellant's appeal to the First-tier Tribunal (FTT) was unsuccessful and it appealed to the UT.

The Appellant contended that the Builders Block was unlawful under EU law and that as the relevant items were not "incorporated" into the building, the Builders Block did not apply. Alternatively, it argued that the goods were "ordinarily installed as fixtures".

UT decision

The UT found that the Builders Block was not unlawful under EU law. The Second Directive, Article 17 and the Sixth VAT Directive, Article 28(2)(a), authorised the UK to provide the Builders Block system in relation to new builds which allows input tax recovery in respect of the listed exceptions and denies input tax recovery in respect of other goods incorporated into the building.

The UT considered the meaning of "incorporated" and concluded that it was not the same as "installed as fixtures". It was possible that an item could be incorporated into a building without also being a fixture. The relevant test is whether it has any material attachment to the building.

In considering the various items, the UT noted that a built-in oven, a surface hob, an extractor hood, a wired and plumbed-in washing machine and a wired and plumbed-in dishwasher would all be installed fittings, but that stand-alone washer driers and tumble driers would only be installed as fittings if either "they were attached in a non-temporary manner to ventilation or were installed in a location with some reasonable expectation of permanence". The UT found that fitted carpets were fittings.

The UT adjourned the hearing to allow the parties to agree the extent of the claim that relates to goods that are not fixtures in light of the guidance it had provided. If the parties cannot agree, further arguments will follow.

1. [2017] UKUT 34.
2. SI 1972/1165, art 3.

Comment
The UT has provided some helpful guidance on the test to be applied when deciding whether goods have been incorporated into a building and therefore are within the scope of the Builders Block. White goods may be outside the scope of Builders Block where they are not sufficiently attached to the building.

A copy of the decision can be found here.

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Compass Contract Services – limitation periods for output tax and deduction of input tax claims EU law compliant

In *Compass Contract Services Ltd v HMRC*[3], the Advocate General has opined that it is permissible under EU law for national limitation periods for claiming overpaid output tax to vary from those applicable to input tax claims.

Background
Compass Contract Services Ltd supplied cold food. It discovered in 2006 that it had wrongly accounted for output tax in respect of certain cold food items and made historic "Fleming" claims[4] for repayment of output tax and deduction of input tax. HMRC rejected parts of these claims on the basis that the relevant limitation period had expired. At the relevant time following the Fleming litigation, claims for overpaid output tax were limited to periods ending before 4 December 1996, but input tax claims could be made for periods ending before 1 May 1997.

Compass contended that the less favourable limitation period on output tax was contrary to EU law.

The FTT referred the question to the Court of Justice of the European Union (CJEU).

Advocate General's opinion
The Advocate General's view was that the domestic limitation period was permissible under EU law. The Advocate General said that there was a conceptual difference between a person claiming a late deduction of input tax to a person claiming a refund of overpaid VAT. The right to deduct input tax being a fundamental principle of VAT established by the VAT Directives, was designed to achieve the neutrality of taxation of all economic activities. In contrast, the right to recovery of overpaid VAT did not derive from VAT Directives, but rather from general EU law.

Comment
It remains to be seen whether the CJEU will follow the Advocate General's opinion. The decision will be keenly awaited for those taxpayers who have submitted claims spanning these dates.

A copy of the Opinion can be found here.

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3. Case C-38/16.
4. "Fleming claims" are claims for under-declared or overpaid VAT, potentially going back as far as the inception of VAT in 1973. They followed the House of Lords judgments in January 2008 in the cases of *Fleming* and *Condé Nast* (*Fleming (t/a Bodycraft) v HMRC* and *Condé Nast Publications Limited v HMRC* [2008] UKHL 2) which concerned the way that the three year time limit on making claims had been introduced.

Housley – HMRC's failure to exercise its discretion held to be unreasonable

In *G B Housley Ltd v HMRC*[5], the Court of Appeal allowed the company's appeal and restored the decision of the FTT which had discharged HMRC's VAT assessment on the basis HMRC had failed to correctly exercise its discretion.

Background

G B Housley Ltd (the Appellant) was a scrap metal dealer who operated informal self-billing arrangements in relation to supplies of scrap metal received.

The Appellant claimed an input tax deduction relying on the self-generated VAT invoices.

HMRC considered the self-billing arrangements to be invalid as some of the Appellant's suppliers were not registered for VAT and were not at the address of the self-billing invoice. HMRC was also of the view that the Appellant had failed to correctly notify HMRC that it would be operating a self-billing arrangement.

The Appellant requested HMRC to exercise its discretion under Regulation 29(2) of the VAT Regulations 1995 (the Regulations) to accept, in the absence of proper self-billing invoices, alternative evidence in support of the input tax deductions. This request was refused.

HMRC denied the deduction and issued an assessment to the Appellant under section 73, Value Added Tax Act 1994, in the sum of £337,381, which was appealed.

The FTT held that HMRC had not exercised its discretion properly and the assessment was discharged and the appeal allowed. HMRC appealed to the UT.

The UT found that HMRC had failed to properly exercise its discretion under the Regulations. However, in the course of its decision, the UT raised the issue as to what were the consequences of HMRC's failure to exercise its discretion, in particular, whether the assessment should be discharged or should stand. A further hearing was held to consider this issue. In the UT's second decision, it held that the FTT should not have discharged the assessment. The UT considered that the FTT could only discharge the assessment if one of the following applied:

- HMRC revisited its decision and decided to exercise its discretion in the taxpayer's favour, or
- the FTT (or UT) determined that, on the basis of the evidence before it, HMRC could not reasonably have reached the decision it did.

The UT therefore decided to remit the matter to HMRC to remake its decision and if HMRC decided not to exercise the discretion in the Appellant's favour, remit the matter to the FTT to determine whether HMRC had properly exercised its discretion.

The UT reached this decision on the basis that its role in determining whether HMRC had properly exercised its discretion was supervisory.

The Appellant appealed the UT's decision to the Court of Appeal on the basis that once it was established that HMRC had acted unreasonably in exercising its discretion, the appeal should have been allowed.

5. [2016] EWCA Civ 1299.

Court of Appeal's decision

The Court of Appeal allowed the Appellant's appeal applying the approach adopted by the Court of Appeal in *John Dee Limited v HMRC*[6].

In *John Dee*, the court concluded that the powers of the FTT in cases dealing with the exercise by HMRC of its discretion under the Regulations are appellate and not supervisory. Therefore, once it is found that HMRC has misdirected itself, the appeal should be allowed. HMRC would then be free to issue a new assessment on the basis of a proper exercise of its discretion.

In this case, HMRC had misdirected itself in applying its discretion under the Regulations because of a misapprehension as to the necessity of a billing agreement. It was not a case where HMRC could demonstrate that if it had properly exercised its discretion, it would have inevitably come to the same conclusion and denied the input tax. Once HMRC's decision to raise the assessment had been found to be flawed, the appeal against the assessment should have been allowed and the assessment discharged.

Comment

This case provides further confirmation that the powers of the FTT in cases dealing with the exercise by HMRC of its discretion under the Regulations are appellate and not supervisory.

This is also an important decision for businesses regarding the evidence required to support input tax reclaims where there is not a valid VAT invoice. The Court of Appeal put significant emphasis on alternative evidence to justify the claim of input tax. HMRC is required to consider any such alternative evidence pursuant to the Regulations before issuing an assessment.

A copy of the judgment can be found here.

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6. [1995] STC 941.

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