VAT update

April 2017

In this month's update we report on HMRC's call for evidence on alternative methods for collecting VAT for online sales, HMRC's policy on historical VAT bad debt relief claims following the BT and GMAC decisions and the enactment of the insolvency VAT clawback concession. We also comment on three recent cases involving mistake-based claims for unjust enrichment, the VAT treatment of temporary workers and the apportionment of residual input tax for finance houses.

News

Call for evidence on VAT split payment method for collecting VAT for online sales

Following an announcement in the Spring 2017 Budget HMRC has requested evidence on alternative methods for collecting VAT for online sales. more›

HMRC confirms position on historical bad debt relief claims following the BT and GMAC decisions

On 28 March 2017, HMRC published Revenue & Customs Brief 1/17, which sets out its policy concerning historical VAT bad debt relief claims, following the Court of Appeal's judgments in *British Telecommunications Plc* and *GMAC (UK) Plc*. more›

Insolvency VAT clawback concession enacted

On 28 March 2017, an order was made to enact certain Extra-Statutory Concessions (ESC). This includes ESC 3.20, which disapplies the clawback of VAT input tax credit where a business has entered insolvency proceedings and has not paid (or has only partially paid) the consideration for the supply. more›

Cases

Investment Trust Companies (in Liquidation) – unjust enrichment for mistaken payments

In *HMRC v Investment Trust Companies (in Liquidation)*, the Supreme Court has held that the Investment Trust Companies (ITCs) were not eligible to further refunds on mistaken payments. more›

Adecco UK Ltd – VAT treatment of temporary workers

In *Adecco UK Ltd & Others v HMRC*, the Upper Tribunal (UT) has held that the taxpayers must account for VAT on the full value of the consideration they received for the supply of temporary workers. more›

Any comments or queries?

Adam Craggs
Partner
+44 20 3060 6421
adam.craggs@rpc.co.uk

Michelle Sloane
Senior Associate
+44 20 3060 6255
michelle.sloane@rpc.co.uk

Nicole Kostic
Associate
+44 20 3060 6340
nicole.kostic@rpc.co.uk

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.

To subscribe to any of our publications, please click here.

Volkswagen Financial Services (UK) Ltd – apportionment of residual input tax

In *Volkswagen Financial Services (UK) Ltd v HMRC*, the Supreme Court has decided that guidance is required from the ECJ in respect of HMRC's approach to the apportionment of residual input tax. **more›**

News

Call for evidence on VAT split payment method for collecting VAT for online sales

Following an announcement in the Spring 2017 Budget, HMRC has requested evidence on alternative methods for collecting VAT for online sales. This request follows measures introduced in the Finance Act 2016 which make operators of online marketplaces jointly and severally liable for VAT of overseas businesses.

HMRC is asking for evidence on how technology can be used to extract VAT in real time using payment technology and depositing it with HMRC (the split payment method). In particular, it is seeking details of experiences of VAT being extracted from payments in real time in other jurisdictions, the key challenges in developing a split payment model and enablers or new developments that could facilitate the development of a new collection mechanism. The closing date for comments is 30 June 2017.

A copy of the consultation is available to view here.

HMRC confirms position on historical bad debt relief claims following the BT and GMAC decisions

On 28 March 2017, HMRC published Revenue & Customs Brief 1/17, which sets out its policy concerning historical VAT bad debt relief claims, following the Court of Appeal's judgments in *British Telecommunications Plc*[1] and *GMAC (UK) Plc*[2].

The Brief confirms that claims for bad debt relief on pre-April 1989 supplies will be refused by HMRC. However, claims relating to bad debt relief on supplies between 1 April 1989 and 19 March 1997, will be paid subject to evidence that the bad debts occurred and the VAT has not been previously reclaimed.

If businesses cannot meet the evidential requirements then they will need to satisfy HMRC by other means that they did not previously obtain bad debt relief, but the onus is on the claimant business to show that it suffered the bad debt and that the amount claimed is correct.

A copy of the Brief is available to view here.

Insolvency VAT clawback concession enacted

On 28 March 2017, an order was made to enact certain Extra-Statutory Concessions (ESC). This includes ESC 3.20, which disapplies the clawback of VAT input tax credit where a business has entered insolvency proceedings and has not paid (or has only partially paid) the consideration for the supply.

The Order came into force on 6 April 2017 and inserts a new section 26AA into the Value Added Tax Act 1994 (VATA 1994), which disapplies section 26A (disallowance of input tax where consideration not paid) where certain conditions are satisfied.

The Enactment of Extra-Statutory Concession Order 2017 is available to view here.

Back to contents>

1. [2014] EWCA Civ 433.
2. [2016] EWCA Civ 1015.

Cases

Investment Trust Companies (in Liquidation) – unjust enrichment for mistaken payments

In *HMRC v Investment Trust Companies (in Liquidation)*[3], the Supreme Court has held that the Investment Trust Companies (ITCs) were not eligible to further refunds on mistaken payments.

Background

The claimants were all closed-end investment trusts who had obtained investment management services from management companies (the managers) and paid VAT on the fees which they had paid. Under VATA 1994, these services were subject to VAT at the standard rate, although from 1990 there was an exemption for investment management services supplied to authorised unit trusts.

In June 2007, the Court of Justice of the European Union (ECJ) ruled that the exemption should apply to closed-end investment funds (*JP Morgan Claverhouse* C-363/05[4]). However, in breach of EU law, domestic law had failed to exempt such services. The VAT that the ITCs had been paying, therefore, should not have been paid.

The statutory scheme for repayment by HMRC of any undue VAT is set out in section 80, VATA 1994. As it was the managers who had, in fact, paid the money to HMRC, it was only they who could bring the claims under section 80. These claims against HMRC were successful and the managers reimbursed the ITCs.

The ITCs were, however, still out of pocket for two reasons. First, for reasons relating to the applicability of various time limits, there existed a period of time for which section 80 claims could not be made (the so-called "dead period"). Second, even for those periods for which a section 80 claim was successful, the sums refunded led to a shortfall. Under section 80, HMRC were obliged only to repay the VAT paid to them. As the managers had made deductions for attributable input tax, the amount repaid was less than the VAT suffered by the ITCs and they remained out of pocket for the difference. This sum was referred to as "the £25".

To recover the outstanding sums from HMRC, the ITCs brought claims for restitution at common law and for repayment under directly effective EU law rights.

At the High Court, Mr Justice Henderson found that HMRC had been unjustly enriched for the full amount (£100). However, he held that claims in the dead period were time-barred by section 80, VATA 1994 and therefore those claims failed. The outcome was that claims for the £25 in periods outside the dead period, succeeded.

The Court of Appeal reversed elements of the High Court's decision. It held that HMRC had not been enriched by the full amount (£100). The ITCs were only entitled to the notional £75 for the entire period, but not the £25s. Further, it held that section 80 did not extend to parties in the ITCs position, and therefore the ITCs could recover £75 paid in respect of the dead period.

Both parties appealed the judgment of the Court of Appeal to the Supreme Court. HMRC appealed in respect of the notional £75 paid in respect of the dead period and the ITC's cross-appealed in respect of the notional £25.

3. [2017] UKSC 29.
4. [2008] STC 1180.

The Supreme Court's judgment
HMRC's appeal was allowed and the ITC's cross appeal was dismissed.

On the question of enrichment, there was no dispute that HMRC was enriched to the extent of the notional £75. The issue before the Court was the notional £25. The Court held that the managers could not benefit from the exemption and exercise the right to deduct input tax. The £25 was therefore not an amount which HMRC owed to the managers, it was only deductible from output tax that was properly due. It followed that HMRC's enrichment was only to the extent of the notional £75.

With regard to whether HMRC's enrichment had been "at the expense of" the ITCs, there had been uncertainty around the approach to adopt. There was no doubt that in economic terms, HMRC was enriched "at the expense of" the ITCs, however, the Court was of the view that that did not in itself entitle the ITCs to restitution. The Court commented that, as a general rule, there has to be a direct transfer of value from the claimants to the defendants or in situations equivalent to direct transfers, for example, where an agent is interposed. In the present case there was none. The ITCs payment to the managers became part of the managers' general assets and was not impressed with a special purpose trust, while the managers VAT liability to HMRC arose independently of whether the ITCs actually paid VAT. The two transactions were separate and could not be collapsed into a single transfer of value. Accordingly, the ITCs did not have any right to restitution against HMRC.

Assuming, contrary to this conclusion, that a claim in unjust enrichment might otherwise be brought, the Court concluded that such a claim would have been excluded by section 80 in any event. It confirmed that the statute creates an exhaustive code of remedies not just for suppliers who have accounted to HMRC, but for ultimate consumers as well.

The Court concluded that the application of section 80 in this way was compatible with EU law. The ECJ has accepted that a system under which only the supplier is entitled to seek reimbursement of VAT from the tax authorities and the consumer can seek restitution from the supplier, meets the requirements of EU law. In cases where the reimbursement of the consumer by the supplier would be impossible or excessively difficult, the principle of effectiveness would require that the consumer be able to bring a claim directly against the tax authorities. This was not the case here (the managers retained the £25 and were not insolvent), and the Court did not think it was appropriate for it to consider what the position would be in a hypothetical case where a supplier was insolvent.

Comment
This judgment will have wide-ranging implications, limiting the circumstances for recovery of indirect taxes charged in breach of EU law. It is also significant in that the Court has confirmed that section 80(7), VATA 1994, limits the rights of persons other than those accounting to HMRC for VAT.

The comments of the Court concerning the question of whether enrichment is "at the expense of" the claimant are welcome. Until now there has been limited guidance on this point, which has led to uncertainty as to the approach to be adopted. Unfortunately, the Court declined to provide a definitive statement on the circumstances in which the "at the expense of" requirement will be satisfied.

A copy of the judgment is available to view here.

Back to contents>

Adecco UK Ltd – VAT treatment of temporary workers

In *Adecco UK Ltd & Others v HMRC*[5], the Upper Tribunal (UT) has held that the taxpayers must account for VAT on the full value of the consideration they received for the supply of temporary workers.

Background

Adecco UK Ltd (Adecco) provides non-employed temporary workers to its clients in return for payment. When a worker took on an assignment, they did so under a contract with Adecco for temporary placements. There was no contract between the client and the worker. Adecco was contractually obliged to pay the worker an agreed hourly rate. Clients paid Adecco for the work the workers carried out and a commission for their services. Adecco accounted for VAT on the total amount received from its clients (ie the workers' remuneration and Adecco's commission).

Following the decision in *Reed Employment Ltd v HMRC*[6], in which the First-tier Tribunal (FTT) confirmed that VAT was chargeable only on the commission element, Adecco sought repayment of VAT paid on the remuneration element. HMRC rejected the claims.

On appeal, the FTT confirmed HMRC's decision and concluded that VAT was due on the full amount paid to Adecco by its clients, including the amounts paid out by Adecco to the workers.

Adecco appealed to the UT. It argued that it was providing only introduction and payment services and that it could not be making an onward supply of the workers' services because it was not consuming those services itself.

The UT's decision

The UT dismissed Adecco's appeal.

The UT followed the two-stage process for determining the nature of a supply set-out by the Supreme Court in *Airtours Holiday Transport Ltd (formerly My Travel Group) v HMRC*[7]. The contractual position is the starting point and in this case, the position between both Adecco and the workers, and Adecco and its client, meant the FTT's decision was correct.

In reaching its decision, the UT placed a great deal of emphasis on the agreements between the parties and the fact that there was no contract or other agreement between the client and the worker. The workers gave no undertakings to the clients that they would perform the work, and the clients were not contractually obliged to pay the workers.

The UT concluded that the contractual arrangements were consistent with the economic and commercial reality. There was no question here that the arrangements were artificial or a sham. The reality was that Adecco supplied the workers. It was irrelevant that the workers were the only ones who could provide their skills to the clients, they could not work for the clients except through their agreements with Adecco. Significantly, the agreements between the workers and Adecco recognised that any unauthorised absence by the worker could result in Adecco being in breach of its obligations to its client. If those obligations were limited to the introduction and payment for services it was difficult to see how such absence could place Adecco in breach.

5. [2017] UKUT 113 (TC).
6. [2011] UKFTT 200 (TC).
7. [2016] UKSC 21.

Comment

In the view of both the FTT and the UT, the contractual obligations between the parties were key to resolving this dispute. Unfortunately, little general guidance can be obtained from this decision as the UT stressed that its decision was based on the individual facts and circumstances of the case and should not be seen as establishing any general rule in relation to similar cases. This is disappointing, particularly given the inconsistency of its decision with the FTT's decision in *Reed Employment*.

A copy of the decision is available to view here.

Back to contents>

Volkswagen Financial Services (UK) Ltd – apportionment of residual input tax

In *Volkswagen Financial Services (UK) Ltd v HMRC*[8], the Supreme Court decided that guidance is required from the ECJ in respect of HMRC's approach to the apportionment of residual input tax.

Background

Volkswagen Financial Services (UK) Limited (VFS) is a subsidiary of the Volkswagen Group. The company exists solely to provide prospective buyers of the Volkswagen Group's vehicles with a hire purchase finance option. Where a customer purchased a vehicle on hire purchase, VFS would acquire the vehicle from a dealer and then supply the vehicle to the customer, charging the customer the same price as it had paid the dealer.

For VAT purposes, VFS was treated as making two separate supplies: a taxable supply of the vehicle (in respect of which it accounted for output tax on the price of the vehicle) and an exempt supply of finance. However, VFS could only deduct input tax in respect of the taxable supplies. Although some of its expenditure was directly attributable to the taxable supplies, some, such as expenditure on general business overheads, could not be directly attributed to specific supplies.

Given the difficulty in assessing which expenses could be deducted, HMRC agreed a partial exemption special method with VFS for valuing the proportion of the residual input tax attributable to the exempt transactions. VFS interpreted that method as enabling it to recover 50% of the input tax on its overheads on the basis that the overheads were wholly attributable to both the taxable and exempt supplies. However, HMRC considered that the overheads were wholly attributable to the exempt supplies of finance, and the input tax in respect of such supplies was therefore irrecoverable.

The FTT and the Court of Appeal found in favour of VFS, concluding that the overheads could be treated as cost components of both the taxable and exempt supplies. The UT supported HMRC's approach that as the taxable supply was at cost, the overheads could only be attributable to the exempt supply.

The Supreme Court's decision

With regard to the main issue in the appeal, whether any of the residual input tax in respect of general overheads was deductible, the Supreme Court decided that guidance was needed from the ECJ in order for it to reach a conclusion and it therefore made a reference to the ECJ.

8. [2017] UKSC 26.

The Court's judgment is therefore predominantly concerned with a secondary issue, which HMRC raised on appeal. This concerned whether HMRC had asked the FTT to consider, as an alternative to its principal argument, whether a lower figure than 50% should have been attributed to the taxable supplies and whether the FTT had failed to consider that question.

The Court dismissed this ground of HMRC's appeal. When the FTT, as in the instant case, is dealing with substantial litigants who are represented by experienced counsel, it is entitled to assume that the parties will have identified the relevant issues for determination. Having examined material, including the judge's notes of the hearing in the FTT, it concluded that the FTT's understanding and approach was consistent with the lack of any specific reference to the issue in HMRC's written submissions or witness evidence. The Court found no material which could justify going behind the position as the FTT understood it. If, however, there had been any doubt, and if the FTT was thought to have misunderstood HMRC's position and failed to deal with a significant issue, the matter should have been raised and dealt with at the time.

Comment

In general, it takes approximately 18 months from a reference being made to the ECJ to that Court delivering a judgment. Whilst this means the ECJ may provide its judgment before the UK leaves the EU (assuming the UK does leave the EU within two years of Article 50 being triggered), it will be some time before the Supreme Court is in a position to determine what proportion of residual input tax is recoverable by finance houses.

A copy of the judgment is available to view here.

Back to contents>

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 83 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

"... the client-centred modern City legal services business."

At RPC we put our clients and our people at the heart of what we do:

- **Best Legal Adviser status every year since 2009**
- **Best Legal Employer status every year since 2009**
- **Shortlisted for Law Firm of the Year for two consecutive years**
- **Top 30 Most Innovative Law Firms in Europe**

We have also been shortlisted and won a number of industry awards, including:

- **Winner – Overall Best Legal Adviser – Legal Week Best Legal Adviser 2016-17**
- **Winner – Law Firm of the Year – The British Legal Awards 2015**
- **Winner – Competition and Regulatory Team of the Year – The British Legal Awards 2015**
- **Winner – Law Firm of the Year – The Lawyer Awards 2014**
- **Winner – Law Firm of the Year – Halsbury Legal Awards 2014**
- **Winner – Commercial Team of the Year – The British Legal Awards 2014**
- **Winner – Competition Team of the Year – Legal Business Awards 2014**

Areas of expertise

- Competition
- Construction & Engineering
- Corporate/M&A/ECM/ PE/Funds
- Corporate Insurance
- Dispute Resolution
- Employment
- Finance
- Insurance & Reinsurance
- IP
- Media
- Pensions
- Professional Negligence
- Projects & Outsourcing
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Technology

17164

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000