VAT update

May 2017

In this month's update we report on HMRC's revised guidance on holding companies' input VAT recovery, prelaunch trials for the online tribunal appeals service and draft legislation effecting the removal of the "use and enjoyment" rule for the supplies of B2C telecommunication services. We also comment on three recent cases involving the VAT cost-sharing exemption, the reduced rate of VAT and composite supplies, and VAT and electronic publications.

News

Revised guidance on holding companies' input VAT recovery

On 20 April 2017, HMRC published revised guidance on the extent to which holding companies may deduct input tax on costs incurred in acquiring, holding and managing subsidiaries. HMRC's review of its policy was instigated by the decision in *Larentia + Minerva & others*. The changes have been made to HMRC's Input Tax manual. more›

MoJ calls for taxpayers to test online service before launch

The Ministry of Justice (MoJ) is in the final stages of prelaunch trials for the online tribunals appeal services. This service will offer an alternative to the current notice of appeal or close enquiry paper forms. more›

Draft legislation: VAT "use and enjoyment" for B2C telecommunication services

At Spring Budget 2017, the Government announced that it would reduce the use and enjoyment provisions for B2C telecommunication services. On 21 April 2017, it published draft legislation to give effect to this statement, removing the "use and enjoyment" rule that currently applies to supplies of mobile phone services from business to individuals. more›

Cases

Grand Duchy of Luxembourg – VAT cost sharing exemption

In *European Commission v the Grandy Duchy of Luxembourg*, the Court of Justice of the European Union (CJEU) found that the Luxembourg provisions on cost sharing did not properly implement the Principal VAT Directive. 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.

Colaingrove Ltd – reduced VAT rate not applicable to electricity element of composite supply

In *Colaingrove Ltd v HMRC*, the Court of Appeal considered the correct VAT treatment of fuel and power provided in holiday accommodation. **more›**

RPO – VAT and electronic publications

In *RPO and others*, the CJEU confirmed that, as regard the current EU VAT Directive, Member States cannot apply a reduced rate of VAT to the supply of digital books. **more›**

News

Revised guidance on holding companies' input VAT recovery

On 20 April 2017, HMRC published revised guidance on the extent to which holding companies may deduct input tax on costs incurred in acquiring, holding and managing subsidiaries. HMRC's review of its policy was instigated by the decision in *Larentia + Minerva & others*[1]. The changes have been made to HMRC's Input Tax manual.

The updated guidance clarifies that in order for a company to recover input VAT on its costs it must:

- be the recipient of the supply
- undertake a business activity for the purposes of VAT
- be VAT registered/registerable at the time the cost was incurred
- have paid for it
- the cost must have a direct and immediate link to the taxable supplies.

Other changes include HMRC dropping its policy of requiring:

- input tax on acquisition related costs to be apportioned between the non-economic activity of holding the shares in the subsidiary and the economic activity of providing taxable services to the subsidiary
- the recoupment of acquisition costs, through charges for services, within a reasonable period.

The revisions are generally welcome and should assist in reducing disputes with HMRC in this area.

A copy of the revised guidance is available to view here.

MoJ calls for taxpayers to test online service before launch

The Ministry of Justice (MoJ) is in the final stages of prelaunch trials for the online tribunals appeal services. This service will offer an alternative to the current notice of appeal or close enquiry paper forms.

Before the system launches, the MoJ is looking for taxpayers to test the system and provide feedback to help improve the experience.

If you are interested in testing the service, please contact the MoJ by email at taxtribunals-helpdesk@digital.justice.gov.uk.

Draft legislation: VAT "use and enjoyment" for B2C telecommunication services

At Spring Budget 2017, the Government announced that it would reduce the use and enjoyment provisions for B2C telecommunication services. On 21 April 2017, it published draft legislation to give effect to this statement, removing the "use and enjoyment" rule that currently applies to supplies of mobile phone services from business to individuals.

1. Case C-108/14.

The draft legislation amends Schedule 4A of the Value Added Tax Act 1994 (VATA), to provide that from 1 August 2017 UK VAT will be charged on all telecommunication services used outside the EU by UK customers.

The draft legislation is available to view here.

Back to contents>

Cases

Grand Duchy of Luxembourg – VAT cost sharing exemption

In *European Commission v the Grandy Duchy of Luxembourg*[2], the Court of Justice of the European Union (CJEU) found that the Luxembourg provisions on cost sharing did not properly implement the Principal VAT Directive.

Background

Under EU law, the services provided by taxable persons (companies or individuals) are usually subject to VAT. However, the VAT Directive 2006/112/EC provides, under certain circumstances, for an exemption for services supplied by independent groups of persons (IGPs) (commonly referred to as the cost-sharing VAT exemption).

Under Luxembourg VAT law, the services provided by an IGP to its members are exempt from VAT not only where those services are directly necessary to the non-taxable activities of the members, but also where the share of the members' taxed activities (activities subject to VAT) does not exceed 30% of their total annual turnover.

The Commission challenged the conditions of the VAT exemption in Luxembourg in relation to IGPs. In the view of the Commission, Luxembourg VAT law had failed to conform and was not compatible with the VAT Directive.

The Commission brought infringement proceedings against Luxembourg before the CJEU.

On 6 October 2016, Advocate General Kokott released her opinion, in which she agreed with the Commission that various aspects of the Luxembourg VAT rules were incompatible with European law.

CJEU's judgment

The CJEU agreed with Advocate General Kokott's earlier opinion that Luxembourg's VAT law on the cost sharing exemption in Article 132(1)(f), is ultra vires.

In reaching its conclusion, the CJEU said that the wording of the VAT Directive was clear, only the services rendered by an IGP and directly necessary for the exercise of the exempt activities of its members may fall outside the scope of VAT. Accordingly, by providing that the services rendered by an IGP to its members are exempt from VAT where the share of the members' taxed activities does not exceed 30% (or 45%) of their annual turnover, Luxembourg had not correctly transposed the VAT Directive.

The CJEU stressed that the IGP is an independent taxable person, which provides services independently to its members from which it is separate. In the light of this, members may not, contrary to what Luxembourg VAT law permitted, deduct from the amount of VAT which they are liable to pay, the VAT payable or paid in respect of goods or services provided to the IGP.

The CJEU said that, because of the IGP's independence from its members, any transactions between the IGP and one of its members must be regarded as a transaction between two taxable persons and thus as falling within the scope of VAT. It followed that Luxembourg had, in this respect, failed properly to transpose the VAT Directive by providing that the transactions carried out by a member in his name, but on behalf of the group, may fall outside the scope of VAT for the group.

2. Case C-274/15.

Comment

This is the first decision from the CJEU concerning IGPs and it has adopted a strict interpretation of the relevant provisions. The implications of this judgment will impact beyond Luxembourg as other EU Member States have interpreted and implemented the IGP rules differently.

The CJEU's judgment may lead to the remodelling of existing structures although further uncertainty for taxpayers is likely with three other pending cases awaiting judgments on the same subject matter (*Federal Republic of Germany*, *DNB Banka* and *Aviva*).

A copy of the judgment is available to view here.

Back to contents>

Colaingrove Ltd – reduced VAT rate not applicable to electricity element of composite supply

In *Colaingrove Ltd v HMRC*[3], the Court of Appeal considered the correct VAT treatment of fuel and power provided in holiday accommodation.

Background

The appeal concerned the supply of fuel and power in holiday accommodation. Customers paid a sum for the caravan accommodation and use of the facilities, including electricity. The amount paid for the use of electricity was a small part of the overall costs.

The supply of the accommodation is subject to VAT at the standard rate of 20%, whereas the supply of domestic fuel and power is subject to the reduced rate of 5% under Schedule 7A of VATA.

HMRC argued that the reduced rate of VAT did not apply as the electricity was supplied as part of a holiday let and accordingly, VAT was payable at the standard rate on the whole of the fee charged to customers (ie the sum for the caravan accommodation and use of the facilities, including electricity).

The taxpayer disagreed, arguing that CJEU jurisprudence had recognised that a single supply can be taxed at two separate rates (*Talacre Beach Caravan Sales Ltd* and *European Commission v France*[4]). On this basis, the taxpayer said the reduced rate of VAT should apply to the charge for electricity.

The First-tier Tribunal (FTT) agreed with the taxpayer that the reduced rate of VAT applied to the charge for the provision of electricity, even though it was found to be part of the consideration for a complex single supply (a link to our blog on the FTT's decision is available to view here).

The Upper Tribunal allowed HMRC's appeal and held that the charge for the electricity could not be 'carved out' from the supply of the accommodation. The whole charge for the accommodation, including the amount for the electricity, was therefore standard rated.

The taxpayer appealed to the Court of Appeal.

3. [2017] EWCA Civ 332.
4. C-251/05.

Court of Appeal's decision
The Court of Appeal dismissed the taxpayer's appeal.

The Court agreed with Mr Justice Vos' comments in *WM Morrison Supermarkets plc v HMRC*[5], that there would have to be specific wording in order for the legislation to apply to a composite supply.

Section 29A, VATA, applies the reduced rate to supplies which are "of a description" specified in Schedule 7A. The court concluded that the fuel charge is defined not on "use", as the taxpayer contended, but by reference to the supplies.

It was acknowledged that within Schedules 7A and 8, there are a number of provisions for apportionment, but none apply where the fuel is part of a composite supply of fuel and other goods or services. If Parliament had intended the reduced rate to apply to an element of a supply, it would have inserted similar provisions in relation to apportionment.

In the court's view, there was no reason why Parliament should have applied the fuel charge to composite transactions. Its purpose may have been limited to helping people in their homes rather than subsidising the prices of self-catering accommodation for holidaymakers. Such a distinction was rational and enables a purposive interpretation of the relevant statutory language.

Finally, the court accepted HMRC's submission that the doctrine of fiscal neutrality was not infringed. The supply of holiday accommodation is a different transaction from the supply of fuel to the owner of a caravan parked on a pitch owned by the taxpayer.

Comment
Many supplies consist of a number of different elements and there has been a slowly developing body of case law which considers the correct analysis to be applied. This latest judgment from the Court of Appeal confirms that it is still necessary to determine first whether there was a composite supply according to the principles established in *Card Protection Plan*[6]. Once you have identified the nature of the overall supply, you move on to consider whether there is express wording in the legislation to apply a reduced rate to a "concrete and specific" aspect of that single composite supply.

A copy of the judgment is available to view here.

Back to contents>

RPO – VAT and electronic publications

In *RPO and others*[7], the CJEU confirmed that, as regard the current EU VAT Directive, Member States cannot apply a reduced rate of VAT to the supply of digital books.

Background
Under the VAT Directive, Member States may apply a reduced rate of VAT to printed publications such as books, newspapers and periodicals. By contrast, digital publications must be subject to the standard rate of VAT, with the exception of digital books supplied on a physical support (eg a CD-ROM).

5. [2013] UKUT 0247 (TCC).
6. Case C-349/96.
7. Case C-390/15.

The Polish Constitutional Court (PCC) doubted the validity of this difference in VAT treatment. The PCC asked the CJEU first, whether that difference was compatible with the principle of equal treatment and secondly, whether the European Parliament was sufficiently involved in the legislative procedure.

The Advocate General rejected the challenge. In his view, this difference in treatment was valid.

CJEU's judgment
The CJEU dismissed the PCC's challenge.

In reaching its conclusion, the CJEU acknowledged that there is a difference in treatment between the supply of digital books electronically and the supply of books on all physical means of support. However, in its view this is not contrary to the principle of equal treatment.

The CJEU also considered whether that difference is justifiable. It decided it was, on the basis that it aims to create legal certainty in an area which is subject to constant developments. The CJEU considered it was necessary to make electronic services subject to clear, simple and uniform rules in order that the VAT rate applicable to such services may be established with some certainty. By precluding the application of the reduced rate of VAT to electronic services there is no need to examine all electronically supplied services to determine whether they were within the terms of the exemption or not. The measure is therefore appropriate and achieves the objective of the regime for e-commerce.

As regards whether the European Parliament was sufficiently involved in the legislative process, the CJEU noted that due consultation with Parliament was an essential requirement. In circumstances where the final text adopted differs in essence from the text which Parliament has considered, Parliament must be consulted again. The only exception to this rule is where the amendments substantially correspond to the wish of Parliament itself. In this instance the CJEU said that the text did not differ from the text which was approved by Parliament and the provision was valid.

Comment
The CJEU's decision in this case concerns the correct application of the provisions in the current VAT Directive, however, change is on the horizon. The European Commission has acknowledged technological advances and on 1 December 2016 set out proposals to amend the VAT Directive and grant all Member States the possibility to apply the same VAT rates to electronically supplied publications. This is in line with the Commission's 2016 Action Plan on VAT and its commitment to keep pace with the challenges of today's digital economy. The date for the proposals to take effect has not yet been confirmed.

Brexit may also have a significant impact on developments in this area in the UK. Following exit from the EU, the UK Government will be able to independently legislate on zero and reduced rates of VAT.

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

17283

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