VAT update

September 2019

In this month's update we report on (1) changes to the reduced rate for energy-saving materials; (2) the VAT rule changes for higher education; and (3) new regulations amending the rules on when VAT adjustments may be made following a change to the price of goods and services. We also comment on three recent cases relating to (1) the refusal of a claim for the repayment of under-recovered input VAT; (2) the repayment of input VAT charged on the acquisition of single farm payment entitlement units; and (3) a notice of security issued with no explanation for the demand.

News items

Changes to the reduced rate for energy-saving materials

HMRC has published a policy paper entitled "VAT changes to the reduced rate for energy-saving materials", together with a summary of responses to its consultation document published in April 2019. more›

VAT rule changes for higher education

HMRC has published Revenue and Customs Brief 5 (2019), which provides an update on Revenue and Customs Brief 11 (2018) and sets out the VAT rule changes for higher education and VAT rules for education providers, which came into effect on 1 August 2019. more›

New regulations amending the rules on when VAT adjustments may be made following a change to the price of goods and services

Regulation 38 of the VAT Regulations 1995 (the Regulations), has been amended to put it beyond doubt that reductions in the amount of VAT paid to HMRC can only be made when a refund is given to customers. The revised rules also clarify when and how VAT adjustments must be made. more›

Cases

Phoenix Life Holdings – High Court quashes "outrageous" HMRC decision to deny claim for repayment of under-recovered input VAT

In *R (oao Phoenix Life Holdings Ltd and others) v HMRC* [2019] EWHC 2043 (Admin), the High Court has quashed HMRC's decision to refuse a claim for repayment of under-recovered input VAT. more›

Any comments or queries?

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About this update

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

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

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Smart & Son – Supreme Court confirms VAT incurred on funds raised for business purpose was recoverable

In *HMRC v Frank A Smart & Son Ltd* [2019] UKSC 39, the Supreme Court has held that a farming company was entitled to repayment of input VAT charged on its acquisition of single farm payment entitlement units which were related to its overall economic activities and future taxable supplies. **more›**

Pachangas Mexican Restaurant – Tribunal allows appeal against notice of security as no reasons for the notice given

In *Pachangas Mexican Restaurant Ltd v HMRC* [2019] UKFTT 436 (TC), the First-tier Tribunal (FTT) allowed the taxpayer's appeal against a demand for security as HMRC had failed to communicate the reasons behind its decision to demand security. **more›**

News items

Changes to the reduced rate for energy-saving materials

HMRC has published a policy paper entitled "VAT changes to the reduced rate for energy-saving materials", together with a summary of responses to its consultation document published in April 2019.

The consultation and policy paper relate to changes to the scope of the reduced VAT rate of 5% for energy-saving materials in residential accommodation, to ensure consistency with EU law. These changes were effected by the Value Added Tax (Reduced Rate) (Energy-Saving Materials) Order 2019 (SI 2019/958) (the Order), made on 20 May 2019 and coming into force on 1 October 2019.

The government has confirmed that the outcome of the consultation has not resulted in any changes to the Order. Instead, the government intends to use the comments received in preparing guidance.

The policy paper can be viewed here.

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VAT rule changes for higher education

HMRC has published Revenue and Customs Brief 5 (2019), which provides an update on Revenue and Customs Brief 11 (2018) and sets out the VAT rule changes for higher education and VAT rules for education providers, which came into effect on 1 August 2019.

The changes remove the VAT exemption for English higher education providers who were designated as eligible to receive support from central funding, or are higher education corporations. The VAT exemption will apply to those providers who are registered with the Office for Students in the Approved (fee cap) category.

VAT Notice 701/30 and the VAT Education Manual have been amended to reflect this change.

The Brief can be viewed here.

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New regulations amending the rules on when VAT adjustments may be made following a change to the price of goods and services

Regulation 38 of the VAT Regulations 1995 (the Regulations), has been amended to put it beyond doubt that reductions in the amount of VAT paid to HMRC can only be made when a refund is given to customers. The revised rules also clarify when and how VAT adjustments must be made.

The reason for the change is to prevent businesses using the Regulations to gain a tax advantage by making VAT adjustments for reductions in price without refunding their customers. HMRC claims it has evidence that some businesses have been doing this. In addition, HMRC claims it is aware that some businesses have incorrectly attempted to treat errors as price adjustments for the purpose of avoiding the relevant time limits.

HMRC has issued Revenue and Customs Brief 6 (2019), which explains the implications of the change and the new rules which came into effect on 1 September 2019.

The Brief can be viewed here.

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Cases

Phoenix Life Holdings – High Court quashes "outrageous" HMRC decision to deny claim for repayment of under-recovered input VAT

In *R (oao Phoenix Life Holdings Ltd and others) v HMRC* [2019] EWHC 2043 (Admin), the High Court has quashed HMRC's decision to refuse a claim for repayment of under-recovered input VAT.

Background

The claimants are members of the Phoenix Group of companies, which was known as the Pearl Group until it was renamed in 2010. The claimants applied for judicial review of the decision of HMRC, made on 9 November 2017 (the Decision), upholding HMRC's rejection of a claim made on 9 November 2007 (the Claim) by the second claimant (Pearl) and the fourth claimant (PGSL).

The Claim was for repayment of significant amounts of under-recovered VAT input tax paid by Pearl in the period 1973 to 1997 (the Claim Period). Pearl was the representative member of the VAT group with registration number (VRN) 234 9868 22 (the 234 VAT Group) throughout the Claim Period and submitted VAT returns in that capacity. HMRC accepted that £6,999,207 was under-recovered by Pearl on those returns. In 2003 PGSL replaced Pearl as the representative member of the 234 VAT Group.

Pearl and PGSL both left the 234 VAT Group in April 2005 and joined a newly formed VAT group numbered 860 2114 63 (the 860 VAT Group), PGSL becoming the representative member. When the Claim was made it was made by both Pearl and PGSL.

On 30 April 2008, the 860 VAT Group was dissolved, Pearl joining VAT group 369 4465 10 (the 369 VAT Group), of which the third claimant, Pearl Group Management Services Ltd (PGMS) was and remains the representative member. From that date, the Claim was pursued in the name of PGMS.

The Claim was submitted in advance of 31 March 2009, the date by which such claims (known as Fleming claims) were required to be made pursuant to section 121, Finance Act 2008. However, it was not until 2012, that HMRC objected that PGMS was not the correct claimant, and not until December 2013, that HMRC explained that none of the Phoenix group had a valid claim as (i) the right to repayment belonged to the 234 VAT Group, through its representative member at the time the Claim was made; (ii) Pearl had ceased to be the representative member of the 234 VAT Group by the time the Claim was made and (iii) any claim by or on behalf of the correct company would be out of time.

The alleged issue arose because, in December 2004, the Pearl Group and its life assurance business, then part of the Henderson group of companies, had been sold to new owners, thereby separating the two groups. In March 2005, following completion of the sale, Henderson Administration Ltd (HAL) had become the representative member of the 234 VAT Group and, about one month later, Pearl ceased to be a member of that group, joining the 860 VAT Group. HMRC asserted in 2013 that HAL (and not Pearl or PGSL) was the correct claimant when the Claim was made in 2007, as HAL was then the representative member of the group which had the Claim.

Pearl argued that the entitlement to claim the repayment of VAT was retained by it pursuant to the terms of the 2004 sale, so PGSL was entitled to claim as the representative member of the VAT group of which Pearl was a member when the Claim was made. Further, the Henderson group had confirmed that any recovery of input tax relating to the period prior to 2004 was due to Pearl/Phoenix and not to HAL or any other member of the Henderson group, and that any payments due to HAL should be paid to the Phoenix group.

HMRC rejected the argument that it has (and should exercise) a discretion: (i) to permit Pearl's claim for repayment of VAT Pearl under-recovered, to be made other than by the representative member of the 234 VAT Group; or (ii) to treat the Claim as having being made on behalf of HAL; or (iii) to allow HAL to claim out of time.

HMRC formally rejected the Claim on 24 July 2017. Following a review, HMRC made the Decision, upholding its earlier rejection of the Claim. The claimants applied to the High Court for judicial review of the Decision.

High Court judgment

Mr Justice Phillips quashed the Decision and ordered HMRC to pay the Claim.

Although none of the officers who dealt with the Claim following its receipt in 2007 recollected considering the question of whether the Claim was made by the correct claimant, on review of the available evidence, the Court concluded that HMRC had considered entitlement on a fully informed basis in or about 2008, and determined that the claimants had standing to make the Claim.

On this basis, and in a strongly-worded judgment, the High Court held that the Decision was a "total reversal of HMRC's fully-informed determination" in 2008 not to object to the Claim. Such reversal was made at a time when the taxpayer could "no longer take the simple steps to reformulate and resubmit the claim (with the authority of HAL)" before the March 2009 deadline. The Court concluded that the belated reversal after the claim deadline had passed, without a change in circumstances or good reason, was unlawful and irrational given the "highest public standards" expected of HMRC. Further, the claimants had a legitimate expectation that if HMRC had appreciated such a readily solvable problem before the claim deadline, they would be notified promptly or the point would remain untaken. In the view of the Court, the Decision was "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it".

Comment

In arriving at its decision, the Court appears to have been heavily influenced by the fact that HMRC was aware, prior to the end of the limitation period in March 2009, that the Claim was not made by the representative member but nevertheless determined that no issue of entitlement would be raised and the Claim could be pursued, and only reversed its decision after the deadline had passed, and without any change in circumstances. In the circumstances, it is not surprising that the Court took such a dim view of HMRC's conduct.

The judgment can be viewed here.

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Smart & Son – Supreme Court confirms VAT incurred on funds raised for business purpose was recoverable

In *HMRC v Frank A Smart & Son Ltd* [2019] UKSC 39, the Supreme Court has held that a farming company was entitled to repayment of input VAT charged on its acquisition of single farm payment entitlement units which were related to its overall economic activities and future taxable supplies.

Background

Frank A Smart & Son Ltd (FASL) is a Scottish company which runs a farming business in Aberdeenshire. It produced beef cattle and crops, which were taxable. FASL received single farm payments (SFP) from the Scottish government. SFPs were agricultural subsidies which between 2005 and 2014, were paid to farmers who had eligible land at their disposal on 15 May of each year and who met certain other requirements. When the scheme was initiated in 2005, farmers in the UK were allocated initial units of entitlement to single farm payments (SFPEs) for no consideration. The SFPEs were tradeable and a market in them developed.

FASL took advantage of the market in units of SFPEs to accumulate a fund for the development of its business. With the assistance of bank funding, it spent some £7.7m on purchasing units (in addition to its initial allocation).

FASL claimed repayment of VAT, amounting to £1,054,852, which was paid on its purchase of 34,477 units of SFPEs. HMRC refused the claim and FASL appealed.

The issue before the First-tier Tribunal (FTT) was whether FASL was entitled to deduct the input tax incurred on purchasing the units. The FTT concluded that the purchase of the units was a funding exercise for the purpose of the farming business and was not a separate business activity. The FTT held that there was a direct and immediate link between the expenditure and FASL's future taxable supplies and allowed the appeal.

HMRC appealed to the Upper Tribunal, who dismissed its appeal. HMRC then appealed to the Inner House of the Court of Session. The Inner House also dismissed HMRC's appeal. HMRC then appealed to the Supreme Court.

The central question in the appeal was whether the receipt of the SFPs, which were transactions outside the scope of VAT, prevented FASL from deducting VAT which it had paid on the purchase of the SFPE units.

Supreme Court judgment

The appeal was dismissed.

The Supreme Court reviewed relevant EU case law on input tax recovery, and in particular *Abbey National* (C-408/98), *Kretztechnik* (C-465/03) and *Securenta* (C-437/06). The Court confirmed that these cases are authority for the proposition that a taxable person who acquires professional services, for an initial fund-raising transaction which is outside the scope of VAT, is not prevented from deducting the corresponding input tax, provided "its purpose in fund-raising, objectively ascertained, was to fund its economic activity and it later uses the funds raised to develop its business of providing taxable supplies".

In the view of the Court, there was objective evidence that FASL, when carrying out its fund-raising activity, was carrying out a taxable business and contemplating using the funds raised on three principal developments, namely, a windfarm, the construction of further farm buildings and the acquisition of neighbouring farmland. There was no basis for distinguishing expenditure incurred in a fund-raising exercise which takes the form of a sale of shares from a fund-raising exercise that involves the receipt of a subsidiary over several years. In the view of the Court, the FTT was entitled to conclude that FASL had acted as a taxable person when it had purchased the units.

Comment

The FTT made some important findings of fact which, ultimately, had a bearing on the outcome of this appeal. The FTT's findings of fact led the Supreme Court to conclude that VAT incurred by FASL, a fully taxable business, on the cost of finance was recoverable.

The Court commented that: "The recognition that fund-raising costs may, where evidence permits, be treated as general overheads of a taxable person's business means that the taxable person must be able to provide objective evidence to support the connection between the fund-raising transaction and its proposed economic activities". If such objective evidence cannot be provided, HMRC has power to charge VAT under the VAT (Supply of Services) Order, SI 1993/1507, reg 3. This is consistent with what the CJEU recorded in *Sveda* (C-126/14) – the taxpayer has to repay input VAT if it does not use the goods or services for the purposes of its economic activity.

As a result of this decision, it is likely that HMRC will carefully scrutinise the subsequent use of raised funds and closely examine the available evidence of the connection between the fund-raising and the proposed business activities.

The judgment can be viewed here.

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Pachangas Mexican Restaurant – Tribunal allows appeal against notice of security as no reasons for the notice given

In *Pachangas Mexican Restaurant Ltd v HMRC* [2019] UKFTT 436 (TC), the FTT allowed the taxpayer's appeal against a demand for security as HMRC had failed to communicate the reasons behind its decision to demand security.

Background

HMRC had concerns about the ability of Pachangas Mexican Restaurant Ltd (the taxpayer) to submit returns and pay VAT on time. These concerns were based on links between the taxpayer and other non-compliant businesses that had failed owing VAT. On 27 September 2017, HMRC served a written notification on the taxpayer which required it to provide security in the sum of £29,450, against future VAT sums due. There were no reasons given in the notification as to why HMRC required security. HMRC informed the taxpayer, by letter on 19 October 2017, that if it made taxable supplies without providing security, it would be committing a criminal offence under section 72(11), Value Added Taxes Act 1994.

The taxpayer asked HMRC for the reasons for the requirement to provide security. HMRC responded by letter on 3 November 2017, stating that security was required due to "concerns that the company would be non-compliant. These concerns arose due to the links between this company and other non-compliant businesses which failed owing VAT.

The taxpayer appealed to the FTT.

FTT decision
The appeal was allowed.

The FTT was very critical of HMRC.

The officer who made the decision failed to attend the FTT hearing. The FTT commented this was a serious omission as it is the reasoning of the officer who took the decision, on the basis of the facts and matters taken into account by her, that is important. By failing to attend, the taxpayer was denied the opportunity to cross-examine her.

The FTT confirmed that for almost all public law decisions, particularly those where the exercise of discretion is involved, valid reasons must exist and be communicated to the citizen at the time the requirement or decision is notified.

Because the taxpayer had been given no reasons for the demand, its right of appeal was "of little or no practical value". The lack of information meant it was unable to make an informed decision on whether to exercise this right. The FTT commented that: "It is extremely important that a person should be aware of the facts and reasons relied upon by a public authority which imposes a requirement or decision". In its view, this was a situation where a 'minded to' letter from HMRC would have been appropriate. Such a letter would have given the taxpayer the opportunity to respond to, comment on, or make representations on, the facts presented in the letter.

The FTT concluded that the absence of reasons behind the decision to demand security was unlawful and therefore unreasonable. Accordingly, the appeal was allowed.

Comment
It is unusual for HMRC to lose an appeal based on a demand for security. In this case, the reasons HMRC considered it had for demanding the security may well have been justified but because the reasoning behind the decision was not communicated to the taxpayer, the FTT concluded that the demand was unlawful and unreasonable.

Although the FTT allowed the appeal, it made clear in its decision that it was making no finding as to whether HMRC could or should have issued the notification requiring security to be provided. Its decision was based on the fact that HMRC had failed to provide the taxpayer with its reasons for issuing the notification.

The decision can be viewed here.

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