VAT update

October 2019

In this month's update we report on (1) how businesses who have paid too much VAT, as a result of an error in the TOMS, can correct it; (2) delays to the introduction of the domestic VAT reverse charge on construction services; and (3) the OTS's update on its VAT review.

We also comment on three recent cases relating to (1) whether a charity's supply of educational services was for "remuneration"; (2) salary sacrifice arrangements and their effectiveness; and (3) whether an assessment was made to "best judgement".

News items

HMRC publishes guidance to businesses making TOMS supplies who have paid too much VAT

On 6 September 2019, HMRC published Revenue and Customs Brief 9, in which it explains how businesses that have paid too much VAT from 1 March 2019, as a result of an error in the Tour Operators Margin Scheme (TOMS), can correct it. more›

HMRC delays VAT reverse charge on construction services

On 5 September 2019, an order was made to defer the commencement date of the VAT reverse charge on construction services to 1 October 2020. more›

OTS publishes update on its VAT report

On 1 October 2019, the Office of Tax Simplification (OTS) published an update on its VAT review. The update outlines and evaluates responses by the government, HM Treasury and HMRC to the report it published in November 2017. more›

Cases

Yeshivas Lubavitch Manchester – charity's fees for nursery education not remuneration

In *Yeshivas Lubavitch Manchester v HMRC* [2019] UKFTT 0427 (TC), the First-tier Tribunal (FTT) has held that fees charged by a charity for the supply of nursery education were not remuneration and the charity was therefore entitled to VAT zero rating on construction services and building materials for an annexe because it did not use the annexe for business purposes. more›

Any comments or queries?

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

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

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.

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

Pertemps – salary sacrifice scheme was not a business for VAT purposes

In *HMRC v Pertemps Ltd* [2019] UKUT 234 (TCC), the Upper Tribunal (UT) has provided guidance on salary sacrifice arrangements and their effectiveness. more›

Homsub – VAT assessment not made to "best judgement" due to flawed methodology

In *Homsub Limited v HMRC* [2019] UKFTT 536 (TC), the FTT has clarified the relevant principles to be applied in determining whether an assessment has been made to "best judgement", for the purposes of section 73(1), VATA. more›

News items

HMRC publishes guidance to businesses making TOMS supplies who have paid too much VAT

On 6 September 2019, HMRC published Revenue and Customs Brief 9, in which it explains how businesses that have paid too much VAT from 1 March 2019, as a result of an error in the Tour Operators Margin Scheme (TOMS), can correct it.

When HMRC updated its guidance on the policy on retained payment and deposits, it made an error in the TOMS (VAT Notice 709/5). It was stated, in error, that taxpayers should include all forfeited deposits and cancellation fees in TOMS calculations when in fact they should only include them in the circumstances described in Brief 9.

Any business that has accounted for too much VAT from the 1 March 2019 as a result of following HMRC's incorrect advice in VAT Notice 709/05, may correct this by following the normal error correction procedure.

The Brief can be viewed here.

Back to contents>

HMRC delays VAT reverse charge on construction services

On 5 September 2019, an order was made to defer the commencement date of the VAT reverse charge on construction services to 1 October 2020.

The Value Added Tax (Section 55A)(Specified Services and Excepted Supplies) Order 2019 (SI 2019/892), provides that the reverse charge will apply to business-to-business supplies of construction services if the recipient is not the final consumer. The reverse charge was announced in the Autumn 2017 Budget, following a consultation by HMRC on VAT fraud in the construction industry.

The deferral will no doubt be welcomed by the construction sector as a number of trade bodies had written to the Chancellor of the Exchequer highlighting the cash flow impact of the changes.

On 6 September 2019, HMRC published Revenue and Customs Brief 10, in which it explains the reasons for the delay in implementation.

The Brief can be viewed here.

Back to contents>

OTS publishes update on its VAT report

On 1 October 2019, the Office of Tax Simplification (OTS) published an update on its VAT review. The update outlines and evaluates responses by the government, HM Treasury and HMRC to the report it published in November 2017.

The OTS notes in its update that there has been substantial progress on guidance and communication, partial exemption and the capital goods scheme, and penalties, alongside wide ongoing consideration of the approach to the VAT threshold. The OTS will continue to monitor future developments and may provide a further review on progress at a later date.

The update can be viewed here.

Back to contents>

Cases

Yeshivas Lubavitch Manchester – charity's fees for nursery education not remuneration

In *Yeshivas Lubavitch Manchester v HMRC* [2019] UKFTT 0427 (TC), the First-tier Tribunal (FTT) has held that fees charged by a charity for the supply of nursery education were not remuneration and the charity was therefore entitled to VAT zero rating on construction services and building materials for an annexe because it did not use the annexe for business purposes.

Background

Yeshivas Lubavtich Manchester (YLM) is a charity providing education for children between the ages of 3 and 16 in return for a fee (set at a level to cover costs). The charity also received donations without which it would have run at a loss.

In 2013, YLM decided to relocate the nursery and school to a newly acquired site. The new site had an existing building and a new single storey extension was to be constructed at the rear. YLM accepted that the work on the existing building was appropriately standard rated. It was the VAT treatment of the new structure that was in dispute. YLM contended it should be zero-rated whereas HMRC was of the view that it should be standard rated.

YLM argued that the new structure qualified for zero rating under Items 2 and 4 in Group 5 of Schedule 8, Value Added Tax Act 1994 (VATA). YLM contended that the works were not excluded by Note 16 because the new structure was not an "enlargement of, or extension to" the existing building, but rather, an "annexe" that is capable of functioning independently from the existing building, with the new structure and the existing building each having their own means of access (Note 16(c) and Note 17).

Even if the requirements of Note 17 were satisfied, the new structure could only qualify for zero-rating if it was intended for use solely for a relevant charitable purpose.

YLM appealed to the FTT.

FTT decision
YLM's appeal was allowed.

In the view of the FTT, the new structure was not sufficiently integrated to be considered an extension to the existing building, although it did have a sufficient degree of integration to prevent it from being considered an entirely separate building. The FTT concluded that it was an "annexe" for the purpose of Note 16 and Note 17.

The FTT could see no reason why the annexe would not be capable of functioning independently. It had its own toilets, kitchen, storage and office spaces. It was connected to water and electricity. It had its own separate boiler, which could be controlled from within the annexe itself. In addition, the building and annexe had their own separate main points of access.

The FTT found that, while the nursery was funded in part from fees paid by families of children attending the nursery, the ability of the nursery to exist and to carry out its charitable purposes depended on the receipt of donations and grants from other sources. It could not be said the supply of nursery services was made for the purposes of obtaining income on a continuing basis. The FTT therefore concluded that the fees charged were not "remuneration" within the meaning of the *Wakefield College* test (*Wakefield College v HMRC* [2018] EWCA Civ 952).

The FTT relied on *Customs & Excise Commissioners v Yarburgh Children's Trust* [2001] BTC 5651 and *Customs & Excise Commissioners v St Paul's Community Project Ltd* [2004] EWHC 2490 (Ch), in finding that the provision of a nursery by a charity was not a "business" within the meaning of Note 6.

Comment
This decision provides a useful summary of recent case law in this area and clarifies the ambit of the test for determining what constitutes economic activity as set out in the *Wakefield College* case.

The decision can be viewed here.

Back to contents>

Pertemps – salary sacrifice scheme was not a business for VAT purposes

This case summary is based on an article which was first published in Tax Journal on 11 October 2019, which can be viewed here.

In *HMRC v Pertemps Ltd* [2019] UKUT 234 (TCC), the Upper Tribunal (UT) has provided guidance on salary sacrifice arrangements and their effectiveness.

Background
Pertemps Ltd (Pertemps), is a recruitment agency which introduced a "Mobile Advantage Plan" (MAP). This was an optional scheme that provided eligible employees with travel and subsistence expenses by way of salary sacrifice. The employees were flexible employees engaged by Pertemps on indefinite contracts of employment. Employees were offered the opportunity to participate in the MAP. Any employees who took part agreed to a wage reduction, in return for Pertemps making a payment for expenses which was equal to the wage deduction.

To benefit from the MAP, expenses had to be "incurred wholly, exclusively and necessarily" in the performance of the employee's duties of employment. Travel expenses were included so long as they were not "ordinary commuting" expenses to a "permanent" workplace. A workplace became permanent if the employee attended for a period of work lasting more than 24 months. Only employees who operated outside of a permanent workplace were eligible for the MAP.

Employees who participated in the MAP, benefited from the cash flow advantage of an immediate deduction as opposed to receiving taxed employment income and then having to reclaim tax in their end of year return in relation to their expenses (which was the position for those who did not participate in the salary sacrifice scheme). Pertemps also benefitted as it did not have to pay primary Class 1 NICs in relation to those employees using MAP.

HMRC formed the view that the MAP involved a taxable supply of services by Pertemps to its participating employees. It considered that the services were supplied in return for the MAP adjustment and that Pertemps was liable to account for VAT on that amount.

Pertemps appealed to the FTT.

The FTT allowed Pertemps' appeal. In the view of the FTT, whilst the operation of the MAP was a supply of services for VAT purposes, it did not constitute an economic activity and therefore was not within the scope of VAT.

HMRC appealed to the UT.

UT decision
HMRC's appeal was dismissed.

The UT considered the following two questions.

(i) Supply of services for consideration

In order for there to be a supply of goods or services for consideration there must be a legal relationship between the supplier and the recipient, pursuant to which there is reciprocal performance whereby the goods or services are supplied in return for consideration provided by the recipient (*Wakefield College v HMRC* [2018] EWCA Civ 952). In the view of the UT, there was clearly a legal relationship between Pertemps and the flexible employee. The real issue was whether there was a supply to the employee and, if so, whether that supply was made for consideration.

In order to answer this question, it was necessary to characterise the supply; there must be a transaction. In earlier cases (*Commission v Finland* (Case C-246/08), *Longridge on the Thames v HMRC* [2016] EWHC Civ 930, *Astra Zeneca UK Ltd v HMRC* (Case C-40/09)) there was no question that there were services being supplied as, in each case, an identifiable service was provided (legal services in *Finland*, the use of an outdoor activity centre in *Longridge* and vouchers in *Astra Zeneca*).

The facts in the instant case were different. What was provided by Pertemps was the payment of expenses ie just money in one (tax efficient) way rather than another. Faced with these facts, the UT struggled to characterise the service, commenting that: "*a cash flow advantage in itself is not a service, but merely the consequence of the application of the section 65 ITEPA dispensation*".

It was clear that Pertemps was not providing its employees with anything or changing anything on their behalf. The MAP was not a service in itself, nor was Pertemps supplying anything which might be regarded as an administrative service. HMRC sought to argue that the position was analogous to accountancy or book-keeping services, but this analysis was rejected by the UT. In the UT's view, all Pertemps did was comply with the requirements imposed by HMRC on employers operating PAYE and remunerated employees in accordance with their employment contracts.

Whilst the UT accepted that the MAP adjustment was capable of representing consideration, it ultimately disagreed with the FTT on the existence of a supply. A supply of services requires something to be provided and it was clear there was no supply in this case. The UT commented that where an employer "*offers two methods of being remunerated, each of which had slightly different tax consequences ... we do not regard that arrangement as showing there is any service supplied by the employer*". It follows that not all salary sacrifice schemes will result in a supply taking place for VAT purposes. Whether there is a supply of services or not will turn on distinguishing between the situation where a true supply exists and simple reciprocal rights and obligations under a contract.

(2) Economic activity

In light of its conclusion that there was no supply of services, it was not necessary for the UT to consider whether operation of the MAP was an economic activity. However, for completeness, the UT did consider this issue.

The UT agreed with the FTT that determining whether a person is carrying on an economic activity requires a broad enquiry which has to take into account all of the circumstances in which the goods or services are supplied. Whether the operation of the MAP was an economic activity was a question of mixed fact and law. There were, however, several factors which ultimately supported the conclusion that the taxpayer was not carrying on an economic activity.

First, the supply was not made for the purposes of obtaining income on a continuing basis. In this case, based on the witness evidence given on behalf of Pertemps, it was clear that the MAP was not operated for the purpose of obtaining income.

Second, the service could not be provided by a third party supplier and the supply (if there was one) was one that could only be made between employer and employee. One of the factors to be considered in determining economic activity is whether the services identified are offered on the general market or likely to be carried on by a private undertaking on a market for the purpose of generating profit (*Wakefield* and *Banque Bruzelles Lambert SA v Belgium* (C-8/03)). The UT concluded in this case that the answer was clearly no. It was significant that Pertemps was acting as an employer in making deductions of tax and NICs in accordance with the law.

The fact that other employers offered similar schemes to MAP did not show a general market, but instead many individual markets. Each employer could only offer the scheme to its own employees. This contrasted with the position in *Astra Zeneca* where the vouchers provided by the employer to its employees could have been provided by a third party independent of the employer/employee relationship.

Comment

The approach adopted in *Wakefield*, sets out the correct test to be applied in the context of establishing what is an economic activity (at least for now). The UT's decision also contributes to our understanding of how that approach will be applied by providing some welcome guidance on how to determine whether there is a supply of services for consideration. There must be an activity which is carried on for a commercial purpose.

The decision is also a reminder that the nature of a supply in VAT terms goes beyond mere discount and adjustment. Not all salary sacrifice schemes will result in a supply taking place for VAT purposes by the employer to the employee, nor will the fact that these may lead to temporary cash flow advantages mark them out as economic activities.

The decision can be viewed here.

Back to contents>

Homsub – VAT assessment not made to "best judgement" due to flawed methodology

In *Homsub Limited v HMRC* [2019] UKFTT 536 (TC), the FTT has clarified the relevant principles to be applied in determining whether an assessment has been made to "best judgement", for the purposes of section 73(1), VATA.

Background

Homsub Ltd (Homsub) is a franchisee in respect of Subway products selling hot and cold food and drinks to be consumed on or off the premises. It operated from five different stores in five towns, with the various outlets being within the business and accounting for VAT within one single company VAT return each quarter. From 1 January 2015, Homsub offered a "meal deal" promotion whereby several products were provided together for one price.

HMRC was concerned that the percentage split between supplies which attracted VAT and those that did not was at an inappropriate level. Additionally, the meal deal promotion of £3 was accounted for by a £2.99 apportionment for the sandwich (hot or cold) and £0.01 for the drink (fizzy or hot beverage attracting VAT, or bottled water attracting no VAT) such that if VAT was payable on the drink, it was 20% of £0.01.

HMRC visited the five stores to carry out an invigilation exercise, recording each sale made and whether it was "eat in" or "take out" and "hot" or "cold" to account for the different VAT treatments of the products sold. The transactions per outlet which did and did not attract VAT were then added up to provide a percentage of the sales which were liable to VAT.

Following the invigilation exercise, HMRC issued a notice of assessment in respect of undeclared VAT caused by the under recording of standard rated sales (the Assessment).

On review, the Assessment was upheld and revised upwards because the assessing officer had used the net figure declared on the VAT returns rather than the gross sales declared.

Homsub appealed to the FTT on the basis that the Assessment was not made to "best judgement", for the purposes of section 73(1), VATA.

FTT decision
Homsub's appeal was allowed.

The FTT referred to *Van Boeckel v Customs & Excise Commissioners* [1981] STC 150 and *Rahman (No2) v HMRC* [2003] STC 150, and the following principles which emerge from those decisions which have to be considered when evaluating best judgement assessments:

1. HMRC had to be in possession of some material upon which a best judgement could be properly based;
2. HMRC is not required to undertake work which the taxpayer would ordinarily undertake to arrive at a conclusion about the exact amount of tax due;
3. HMRC was entitled to exercise its best judgement power by making a value judgement on the material available to it;
4. the FTT should not treat an assessment as invalid simply because it takes a different view as to how the best judgement could or should have been applied to the material available to HMRC; before the FTT interfered, it had to be satisfied that the purported best judgement assessment was wholly unreasonable; and
5. the FTT had to start by assuming HMRC had made an honest and genuine attempt to arrive at a fair assessment.

In the view of the FTT, the methodology used by HMRC was "significantly flawed" such that it was wholly unreasonable and unfair to issue a best judgement assessment. Simply counting the transactions was not appropriate for Homsub's business. Whilst the FTT accepted that all methodologies attracted an element of imprecision, in Homsub's case, a customer may buy several items, some of which attracted VAT and some which did not.

In respect of the meal deals, Homsub argued that it was entitled to run its business as it saw fit, including selling stock at less than cost price. The FTT noted that the meal deal was not a true loss leader situation, rather, goods were packaged together to be sold at a single price; the apportionment of VAT was to be considered within the reality of the transaction. Whilst it was difficult to ascertain an apportionment, the FTT concluded that the costs of sandwich ingredients and labour was by far the largest cost component of the meal deal package.

The FTT applied the two-stage test formulated in *Rahman v Customs & Excise Commissioners* [1998] STC 826, and confirmed in *Pegasus Birds Ltd v HMRC* [2004] EWCA Civ 1015, to determine a fair overall percentage uplift:

(i) was the Assessment made according to the "best judgement" of HMRC, if not, it fails and stage
(ii) does not arise;
(ii) if the Assessment was made according to "best judgement", should the amount of the assessment be reduced by reference to further evidence or argument available to the FTT.

The FTT concluded that as the methodology was flawed, the Assessment failed the best judgement test, and there was no need for it to consider stage (ii). However, the FTT noted that the calculations should be based on the values of the transactions rather than quantity. The FTT agreed with Homsub that the appropriate percentage uplift to take account of the meal deals was about 2% and that the exercise should look at results over a one month period rather than for a single day.

Whilst there would be variations between outlets, the FTT concluded that its methodology would take a best assessment of the proportion of the cost attributable to the food component of a cold food takeaway compared to the fizzy or hot drink component attracting VAT. It was indeed difficult to arrive at a fair and proper assessment of the cost price, including labour, of the cold food component, but any best judgement assessment in respect of the meal deal promotion would only apply to VAT periods after 1 January 2015.

Comment
This decision confirms the principles to be considered when evaluating a "best judgement" assessment issued pursuant to section 73(1), VATA. It provides helpful guidance on the types of methodology which HMRC should use to issue a best judgement assessment.

The decision also contains some interesting comments in relation to the VAT treatment of "meal deal" packages offered by retailers and how VAT on such packages should be apportioned.

A copy of the decision can be viewed here.

Back to contents>

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol. We put our clients and our people at the heart of what we do.

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

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

- Best Legal Adviser every year since 2009 – Legal Week
- Best Legal Employer every year since 2009 – Legal Week
- Shortlisted – Banking Litigation Team of the Year – Legal Week Awards 2019
- Shortlisted – Commercial Litigation Team of the Year – Legal Business Awards 2019
- Shortlisted – Best Copyright Team – Managing IP Awards 2019
- Shortlisted – Insurance Team of the Year – Legal Business Awards 2018
- Winner – Best Employer – Bristol Pride Gala Awards 2018
- Winner – Client Service Innovation Award – The Lawyer Awards 2017
- Shortlisted – Corporate Team of the Year – The Lawyer Awards 2017
- Winner – Adviser of the Year – Insurance Day (London Market Awards) 2017
- Winner – Best Tax Team in a Law Firm – Taxation Awards 2017
- Winner – Claims Legal Services Provider of the Year – Claims Club Asia Awards 2016

Areas of experience

- Advertising & Marketing
- Alternative Dispute Resolution
- Commercial Contracts
- Commercial Litigation
- Competition
- Corporate Crime & Investigations
- Corporate
- Data & Technology
- Employment & Pensions
- Financial Markets Litigation
- Health, Safety & Environmental
- Insurance & Reinsurance
- Intellectual Property
- International Arbitration
- Private Equity & Finance
- Product Liability & Regulation
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Trusts, Wealth & Private Client

19488

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

38/F One Taikoo Place
979 King's Road
Quarry Bay, Hong Kong
T +852 2216 7000

12 Marina Boulevard
38/F MBFC Tower 3
Singapore 018982
T +65 6422 3000

RPC