VAT update

May 2018

In this month's update we report on HMRC's cooperation agreement, intended to tackle online VAT fraud; HMRC's recently published Guidance on online marketplace seller checks; and the government's pilot for Making Tax Digital for VAT. We also comment on three recent cases involving consideration of the *Halifax* principle; VAT recovery and hire purchase transactions; and what constitutes a "payment" for the purposes of a claim under section 80(1B), Value Added Tax Act 1994, for overpaid output tax.

News

Tackling online VAT fraud – HMRC publishes its cooperation agreement

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HMRC guidance on online marketplace seller checks – joint liability risk for online marketplaces

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Making Tax Digital

HMRC has confirmed that a live pilot for Making Tax Digital (MTD) for VAT began on 10 April 2018 before becoming mandatory for all businesses and landlords in April 2019. more›

Cases

Newey – consideration of the *Halifax* principle

In the long running case of *HMRC v P Newey (t/a Ocean Finance)* [2018] EWCA Civ 791, the Court of Appeal has decided to remit the case back to the First-tier Tribunal (FTT) for further consideration. The Court considered that the Court of Justice of the European Union (CJEU), on referral of the case after the FTT's original decision, had adopted a new approach to the application of the *Halifax* principle (C-255/02). more›

Any comments or queries?

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Volkswagen Financial Services – AG's opinion on VAT and hire purchase transactions

On 3 May 2018, Advocate General Spuznar released his opinion in *Volkswagen Financial Services UK Ltd* (C153/17), in which he expressed the opinion that the current UK VAT treatment of vehicle purchase agreements is incorrect. **more›**

Rank Group – validity of section 80 claims

In *Rank Group plc v HMRC* [2018] UKFTT 0251 (TC), the FTT has decided that there was no valid claim under section 80(1B) Value Added Tax Act 1994 (VATA) and that the "set off" provisions of sections 81(3) and 81(3A) VATA, did not result in the taxpayer making a "payment" to HMRC. **more›**

About this update

The 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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News

Tackling online VAT fraud – HMRC publishes its cooperation agreement

On 25 April 2018, HMRC announced that it had published an agreement between itself and online marketplaces to help tackle online VAT fraud on their platforms.

Under this agreement, a marketplace agrees to provide HMRC with data relating to online traders in bulk rather than on a case by case basis. The marketplace will also help online traders better understand their UK registration obligations and respond swiftly when notified by HMRC of potential non-compliant traders.

HMRC intends to publish a list of signatories to the agreement, which will be updated regularly.

The scheme is voluntary and the agreement is not legally binding, however, non-accession could have reputational ramifications. Online marketplaces wishing to sign up or anyone who would like more information should contact HMRC at: indirecttax.vatsncfteam@hmrc.gsi.gov.uk.

This cooperation agreement is part of HMRC's ongoing efforts to combat VAT fraud and promote VAT compliance relating to transactions carried out in online marketplaces.

A copy of the agreement is available to view here.

Back to contents>

HMRC guidance on online marketplace seller checks – joint liability risk for online marketplaces

On 15 March 2018, section 38, Finance Act 2018, came into force. This provision amends the Value Added Tax Act 1994, in the case of goods sold through online platforms such as eBay, Amazon and Gumtree.

The effect of the amendments is that if operators of a platform knew or "ought to have known" that a non-UK seller was not accounting for VAT, and does not act, HMRC will have the power to treat both the seller and the operator as jointly and severally liable for any under declaration of VAT.

The new rules place additional requirements on operators of online platforms to undertake due diligence checks on their sellers. If HMRC identify any seller on an online marketplace that has not met their VAT requirements, they will issue the operator with a "joint and several liability" notice. The operator will then usually have 30 days to stop the seller from offering goods for sale in the UK on the marketplace.

A copy of HMRC's Guidance on the checks an online marketplace operator must carry out is available to view here.

For further details of the new rules, readers are referred to our article published on 30 April 2018, which is available to view here.

Back to contents>

Making Tax Digital

HMRC has confirmed that a live pilot for Making Tax Digital (MTD) for VAT began on 10 April 2018 before becoming mandatory for all businesses and landlords in April 2019.

Taxpayers participating in the pilot are self-employed sole traders or businesses that have been invited to join the pilot by HMRC.

Participants in the pilot are being given the opportunity to submit their returns using the new system. HMRC intends to monitor progress to ensure the system works as intended.

Under the new MTD requirements, from April 2019, businesses and landlords with a VAT turnover above the threshold of £85,000, will be required to set up a digital tax account and record their tax affairs using online accounting software or an app. This will be a significant change from the current online filing system.

A list of MTD compatible software products is yet to be published, but such a list is expected to be released shortly. Progress is also being made on guidance relating to MTD. HMRC is expected to share revised draft guidance for comment next month.

An overview of the government's MTD proposals is available to view here.

Back to contents>

Cases

Newey – consideration of the *Halifax* principle

In the long running case of *HMRC v P Newey (t/a Ocean Finance)* [2018] EWCA Civ 791, the Court of Appeal has decided to remit the case back to the First-tier Tribunal (FTT) for further consideration. The Court considered that the Court of Justice of the European Union (CJEU), on referral of the case after the FTT's original decision, had adopted a new approach to the application of the *Halifax* principle (C-255/02).

Background

The case concerns Mr Newey's restructuring of Ocean Finance, which sought to minimise irrecoverable VAT incurred on advertising services. Ocean Finance transferred a UK loan broking business to an entity in Jersey, which outsourced the processing operations back to the UK. The effect of this was that the supplies made by Ocean Finance were in the UK (where the recipients belonged) and therefore remained exempt. However, the advertising services were not subject to UK VAT, as the supplier of the services was in Jersey.

The issue was whether the restructuring constituted an abuse of law under the *Halifax* principle.

The FTT found in favour of the taxpayer. It held that the establishment of the Jersey entity was not itself abusive, because, if the scheme was genuine and not a sham, it was not contrary to the purpose of the VAT Directive. The FTT found that there were no exempt supplies in the UK.

HMRC appealed to the Upper Tribunal (UT).

Before the matter came before the UT for determination, a number of questions were referred to the CJEU on the interpretation of a "supply" for the purposes of the Directive. The CJEU provided further guidance suggesting that the contractual relationships could be redefined to reflect the economic reality of the situation. Taking into account a number of factors, in particular, Mr Newey's financial interest and his business relationships with the other parties, the CJEU suggested 'it is conceivable that' the effective use and enjoyment of the advertising services was in the UK. This was for the national court to decide, following an analysis of all the relevant circumstances of the case.

The UT, taking account of the CJEU's guidance, dismissed HMRC's appeal. The UT reviewed the FTT's findings and held that its conclusion that there were no exempt supplies was a conclusion that had been open to it and did not result from any error of law. The scheme, which had commercial features, was not 'wholly artificial' and therefore was not abusive.

HMRC appealed to the Court of Appeal on the basis that the UT did not identify an error of law and it was therefore not open to the UT to consider whether the FTT had been entitled to reach the conclusion it did (section 12, Tribunals, Courts and Enforcement Act 2007).

Court of Appeal judgment

The Court decided to remit the case to the FTT.

The Court concluded that the decisions of both the FTT and the UT were based on material errors of law. In particular, the FTT had lost sight of the fact that the Jersey entity was providing

loan broking services in the UK. This was incorrect because the place of supply of the loan-broking services supplied to the lenders was the UK, by virtue of article 16 of the VAT (Place of Supply of Services) Order SI 1992/3121. It was noted that the UT had not considered this error material to the FTT's conclusion, but the Court disagreed. In the Court's view, it infected the FTT's whole consideration of the abuse issue.

In addition, and in light of the CJEU's guidance, the Court considered that the critical question of whether the insertion of the Jersey company was "artificial" had not been assessed following receipt of the CJEU's guidance.

In the Court's view, the CJEU's judgment means that arrangements do not necessarily need to be "wholly artificial". The question is whether the arrangements are "artificial" having taken into account the business relationships actually entered into between the parties and the continued role of Mr Newey in those arrangements, and whether they reflect the underlying commercial reality.

The Court referred to the CJEU's comments that it was "conceivable" that the advertising services were received in the UK. Whilst the Court thought this indicated a low likelihood, it acknowledged that the actual relationships had to be assessed in light of relevant factors such as whether the supplier is under another's overall control; has the necessary knowledge and expertise; bears commercial risk; and performs the decisive elements of the service, or sub-contracts them. The Court concluded that no such evaluation had been carried out and did not feel able to undertake such an evaluation itself and remake the decision. As the FTT had already heard the witnesses, the FTT was the correct body to perform that task and it therefore remitted the case to the FTT for determination.

Comment

This case is an important case on the scope of the abuse of rights principle in VAT cases. In the Court's view, the CJEU's judgment has changed the way the *Halifax* principle should be applied and it will be interesting to see how the FTT applies this new approach.

A copy of the judgment is available to view here.

Back to contents>

Volkswagen Financial Services – AG's opinion on VAT and hire purchase transactions

On 3 May 2018, Advocate General Spuznar released his opinion in *Volkswagen Financial Services UK Ltd* (C153/17), in which he expressed the opinion that the current UK VAT treatment of vehicle purchase agreements is incorrect.

Background

The case was referred to the CJEU by the UK Supreme Court. The issue in the case is whether Volkswagen Financial Services (VWFS) is able to recover VAT paid on overhead costs incurred in its provision of hire purchase agreements.

Regular readers of our Updates will recall that we reported on the Supreme Court's decision in our April 2017 Update, a copy of which is available to view here.

Briefly, VWFS is an ultimately owned 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. When a customer purchased a vehicle on hire purchase, VWFS 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, VWFS 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, VWFS 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 VWFS for valuing the proportion of the residual input tax attributable to the exempt transactions. VWFS 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. 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 VWFS, concluding that the overheads could be treated as cost components of both the taxable and exempt supplies. The UT agreed with HMRC's approach that as the taxable supply was at cost, the overheads could only be attributable to the exempt supply.

On appeal, the Supreme Court decided that guidance was required from the CJEU in respect of HMRC's approach to the apportionment of residual input tax.

AG's opinion

Following a review of the relevant authorities, the AG agreed with HMRC that a cost must be a cost component of a taxable supply to be deductible. However, the AG also agreed with VWFS that factually some of the goods and services contributing to the overheads must be used for its taxable transactions.

The AG then went on to consider the UK's treatment of hire purchase contracts. Although this was not part of the questions that had been referred, in his opinion, it was not possible to give a correct response to the matter without addressing this issue.

In the view of the AG, the current UK treatment of splitting a supply of a vehicle on hire purchase terms into an exempt supply and taxable supply is flawed and inconsistent with EU legislation. In his view the hire purchase agreements constitute a single transaction that should not be split into several transactions, each of which is treated differently for VAT purposes. He considered splitting a transaction in this way is artificial and contrary to the principle of fiscal neutrality, reduced tax revenue and distorted competition.

In light of this, the AG suggested that in addition to carrying out an analysis of the questions which had been referred for a ruling, the CJEU should also address the issue of the tax treatment of hire purchase agreements. In the opinion of the AG, such transactions should be treated as a single taxable supply, with the right to deduct all the VAT on associated costs.

Comment

Having opined that hire purchase agreements are taxed incorrectly in the UK, the AG essentially reformulated the questions that the referring court should consider. It will be interesting to see if the CJEU follows the AG's approach. If it also considers that the transactions should be treated as a single taxable supply, this will result in a significant change in the VAT treatment for hire purchase businesses across a range of sectors.

The CJEU's judgment is expected shortly, following which the matter will be referred to the Supreme Court to determine what proportion of residual input tax (if any) is recoverable by finance houses.

A copy of the AG's opinion is available to view here.

Back to contents>

Rank Group – validity of section 80 claims

In *Rank Group plc v HMRC* [2018] UKFTT 0251 (TC), the FTT has decided that there was no valid claim under section 80(1B) Value Added Tax Act 1994 (VATA) and that the "set off" provisions of sections 81(3) and 81(3A) VATA, did not result in the taxpayer making a "payment" to HMRC.

Background

Rank operates a number of bingo clubs, making supplies of mechanised and cash bingo to members of the public. Until 2009, in accordance with HMRC's then practice, Rank treated its supplies of bingo as taxable. However, following the decision of the CJEU in the joined cases of *Linneweber* (C-453/02) and *Savva Akriditis* (C-462/02), it was established that Rank's supplies should have been treated as exempt for VAT purposes.

Rank made claims under section 80, VATA, for the repayment of overpaid VAT. HMRC paid three of those claims (Claims (i) to (iii)) and in doing so, required Rank to take into account both the VAT that it wrongly paid and also input tax for which it was wrongly given credit. HMRC rejected the fourth claim as being out of time.

Rank complained to HMRC on the grounds that HMRC had deducted too much by way of over-credited input tax when dealing with Claims (i) to (iii). HMRC rejected that claim (The "Birmingham Hippodrome claim"). Rank appealed against that decision but was unsuccessful in that litigation.

The current appeal proceeded on the basis that HMRC was correct to reject the fourth claim on the grounds that it was out of time.

In the current appeal, Rank argued that it had made a valid claim under section 80(1B) and that it was entitled to the amount claimed applying the relevant statutory conditions and the principles set out in *Birmingham Hippodrome Theatre Trust v HMRC* [2014] EWCA Civ 648. That case established that where HMRC relies on section 81(3A), it must take into account all of the consequences of the same mistake and, in particular, must take into account all other over and under-declarations.

HMRC argued that there was no valid claim under section 80(1B) and in any event Rank was not entitled to the sum claimed.

FTT decision
The appeal was dismissed.

The FTT confirmed that section 80, as worded at the relevant time, envisaged a gross claim for credit of output tax which is then diminished by operation of sections 81(3) and 81(3A).

With regard to section 81(3), the FTT observed that there are two pre-conditions that must be satisfied in order for this provision to apply, namely, an amount must be due from HMRC and that person must be liable to pay a sum by way of VAT, penalty interest or surcharge. In the instant case, the FTT held that HMRC was out of time to recover over-credited input tax by way of assessment under section 73 in relation to Claims (i) to (iii), and therefore the second condition in section 81(3) was not satisfied.

The FTT did consider that the conditions referred to in section 81(3A), namely, HMRC have a liability to pay an amount to a person, the amount falls to be paid or repaid in consequence of a mistake and, by reason of that mistake a liability to pay was not assessed, had been satisfied when Claims (i) to (iii) were made. Accordingly, any limitation on the time within which HMRC was entitled to take any steps for the recovery of the amount of over-credited input tax should be disregarded in determining whether that sum is required by section 81(3) to be set against the gross output tax.

Applying the guidance provided by the Upper Tribunal in *Birmingham Hippodrome* [2013] UKUT 57 (TCC) (which was not disturbed by the Court of Appeal), for the purposes of section 81(3), the input tax which Rank over claimed in the periods that were relevant to Claims (i) to (iii), was to be treated as if it was "VAT due" to HMRC even though HMRC had not assessed Rank as being liable to repay the over claimed input tax and even though HMRC was, at the time Claims (i) to (iii) were made, out of time to assess Rank.

What was crucial was whether Rank had made a "payment" to HMRC for the purpose of section 80(1B). In the view of the FTT, Rank had not made a payment to HMRC.

In the view of the FTT, as section 80(2A) envisaged that Claims (i)-(iii) would be settled by the making of a single net payment, Parliament could not have intended that single net payment to be disaggregated into multiple payments when determining whether a further claim could be made under section 80(1B).

In arriving at its decision, the FTT was influenced by the potential impact on time limits. If the process of settling over-claimed input tax in relation to Claims (i)-(iii) involved Rank making a "payment" to HMRC, that could introduce further claims under section 80(1B) which could lead to taxpayers re-opening claims long after all relevant deadlines had passed. In the view of the FTT, such a result would not be consistent with the VAT legislation, which provides that claims can be made no later than 4 years after the end of the relevant accounting period.

Although the FTT acknowledged that the decision in the *Birmingham Hippodrome* case was released after Rank's claims and as a result, Rank could not have known of possible arguments linked to that case, the FTT held that in making the Birmingham Hippodrome claim, Rank was either seeking to amend Claims (i)-(iii), or to appeal against HMRC's decisions on those claims. Rank was not in time to take either of those steps and this was another reason why the FTT held the appeal must fail.

Comment

Each case must of course be decided on its own particular facts and although in the circumstances of this case, the FTT concluded that Rank had not made a "payment" for the purposes of the legislation, it will not always be the case that the operation of the set off provisions of sections 81(3) and 81(3A) will result in the taxpayer not making a payment.

A copy of the FTT's decision is available to view here.

Back to contents>

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