VAT update

August 2016

Summary

In this month's edition of our VAT update we report on (1) the Law Society's response to HMRC's consultation on VADRA, (2) HMRC's new brief on TOGCs, and (3) HMRC's new policy paper on "Use and Enjoyment" of insurance repair. We also comment on three recent cases concerning Article 9 of the VAT Directive, repayment of VAT by an individual member of a VAT group, and a "hardship" application.

News

Law Society responds to HMRC's consultation on the reform and extension of the disclosure of VAT avoidance schemes (VADRA) and proposed changes to inheritance tax hallmark regulations

In April 2016, HMRC published a consultation on the reform and extension of the disclosure of VADR and proposed changes to the inheritance tax hallmark regulations. more›

HMRC Brief 11 (2016) – VAT and the transfer of a going concern

Following the decision in *Intelligent Managed Services Limited v HMRC*[1], HMRC has revised its guidance on the VAT treatment of businesses transferred into a VAT group. more›

HMRC publish policy paper on use and enjoyment

HMRC has published its policy paper on new rules relating to use and enjoyment of insurance repair. more›

Cases

Lajvér Meliorációs Nonprofit Kft – CJEU provides guidance on "economic activity"

The Court of Justice of the European Union (CJEU) in *Lajvér Meliorációs Nonprofit Kft*.[2] has concluded that a non-profit company that only engaged in commercial activities on an ancillary basis and whose investments had been financed by state aid, could be carrying on an economic activity for the purposes of Article 9 of the VAT Directive. more›

Any comments or queries?

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

Robert Waterson
Senior Associate
+44 20 3060 6245
robert.waterson@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 Dispute 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.

1. [2015] UKUT 0341 (TCC).
2. CaseC-263/15.

Taylor Clark – individual members entitled to advance claims on behalf of VAT group

In *Taylor Clark Leisure Plc v HMRC*[3], the Scottish Court of Session (SCS) overturned the decisions of the First-tier Tribunal (FTT) and the Upper Tribunal (UT) in finding that a claim for repayment of VAT by an individual member of a VAT group must normally be construed as a claim made on behalf of the group as embodied in the representative member. more›

Javed And Azra Mughal – FTT considers the rules relevant to "hardship" applications

In *Javed and Azra Mughal (Partnership) Trading as Dallas Chicken and Ribs v HMRC*[4], the FTT considered the information necessary for a "hardship" application. more›

3. [2016] CSIH 54.
4. [2016] UKFTT 56 (TC).

News

Law Society responds to HMRC's consultation on the reform and extension of the disclosure of VAT avoidance schemes (VADRA) and proposed changes to inheritance tax hallmark regulations

In April 2016, HMRC published a consultation on the reform and extension of the disclosure of VADR and proposed changes to the inheritance tax hallmark regulations.

With regard to VAT, there are three aims: reform of VADR so that it more closely resembles the disclosure of tax avoidance schemes (DOTAS) regime; move the primary obligation to disclose VAT avoidance schemes from users to promoters; and consider the extent to which the other requirements of DOTAS should be carried across to a revised VADRA.

The Law Society has published its comments on these proposals. It raises concerns regarding the compatibility of the proposed rules with EU law; whether the proposals are too broad; and, whether those who may be subject to the rules will be able to comply with them.

The Law Society's response can be found here.

Back to contents>

HMRC Brief 11 (2016) – VAT and the transfer of a going concern

Following the decision in *Intelligent Managed Services Limited v HMRC*[5], HMRC has revised its guidance on the VAT treatment of businesses transferred into a VAT group. In the past, where companies only made supplies within a VAT group, HMRC did not consider the transfer to be a TOGC. HMRC now accepts that there is a TOGC where:

- the business plans to run the same business offering services to other group members
- those group members use the supplied services to make their own supplies outside the group.

Brief 11 (2016) can be found here.

Back to contents>

HMRC publish policy paper on use and enjoyment

HMRC has published its policy paper on new rules relating to use and enjoyment of insurance repair.

The new measures seek to counter perceived VAT avoidance by UK insurers who arrange for insurance to UK customers to be provided by a company based off-shore and outside the scope of VAT. Where insurance repairs are charged to the offshore company, no VAT was applicable.

Insurance companies are usually wholly exempt businesses for VAT purposes and any VAT charge is not recoverable. The new rules, which will come into force on 1 October 2016, widen the "use and enjoyment" provisions to include repair services so that the place of supply for such services will be need to be the UK.

The policy paper can be found here.

5. [2015] UKUT 0341 (TCC).

Back to contents>

Cases

Lajvér Meliorációs Nonprofit Kft – CJEU provides guidance on "economic activity"

The Court of Justice of the European Union (CJEU) in *Lajvér Meliorációs Nonprofit Kft*.[6] has concluded that a non-profit company that only engaged in commercial activities on an ancillary basis and whose investments had been financed by state aid, could be carrying on an economic activity for the purposes of Article 9 of the VAT Directive.

Background

The applicants in the main proceedings were two "non-profit" companies (the Applicants) which had been established to construct and operate a water disposal system, a reservoir and a rainwater collection system (the Works), on land belonging to members of the Applicants. The Works were financed through state and EU funding and the Applicants subcontracted the construction and maintenance of the Works to another company, Recontír BPM (the Sub-contractor).

In order to maintain the Works, the Applicants agreed to charge their members a modest operating fee for a period of eight years (the Operating Fee). Subsequently, the Sub-contractor issued invoices to the Applicants including VAT for the work carried out and the Applicants sought to deduct this VAT from the amount charged to their members on the Operating Fee. The Hungarian tax authority denied the Applicants the right to deduct the VAT on the basis that they were not carrying out an economic activity and they did not carry out an activity that could be considered as a supply of services for consideration.

The Applicants brought an action disputing the refusal that was dismissed at first instance on the same grounds as those set out by the Hungarian tax authority. The Applicants appealed to the Supreme Court of Hungary. The Supreme Court stayed the main proceedings and referred the following questions to the CJEU for preliminary ruling (summarised for present purposes):

- are the Applicants able to carry out an economic activity where they only engage in commercial activities on an ancillary basis? (Issue 1)
- is the fact that the Applicants receive a significant share of their funding from State aid and that, in the context of the management of their operation, they only obtain income from charging modest fees, relevant for the purposes of carrying out an economic activity? (Issue 2)
- if the answer to Issue 2 is in the negative, must it be considered that the Operating Fee represents consideration for a service and that there is a direct link between the supply of the service and the payment of the consideration? (Issue 3)
- does the fact the management of the Works by the Applicants is performance of a legal obligation prevent it from being regarded as a supply of services for consideration? (Issue 4).

CJEU's decision

Issue 1

The CJEU confirmed that the Applicants were carrying out an economic activity. It made clear that economic activity is defined as including "all activities of a person supplying services for the purpose of obtaining income from it on a continuing basis". This definition was satisfied as the Applicants provided the service of operating the Works and this gave rise to remuneration in the form of the Operating Fee. The Operating Fee was obtained on a continuing basis as it was charged over a number of years.

6. Case C-263/15.

Issue 2
The CJEU concluded that the fact that the Works were largely financed by aids granted by the Member State and the EU could not have a bearing on whether or not the activity pursued by the Applicants is an economic activity. This is because the concept of an economic activity is objective in nature and applies without regard to the purpose of the transaction or the method of financing chosen.

Issue 3
In the CJEU's view, the Works could only be regarded as a supply of services for consideration if there was a direct link between the services supplied by the Applicants and the Operating Fee received in return. The CJEU said that it was for the referring court to assess, on the facts, whether there was a direct link between the services supplied by the Applicants and the Operating Fee.

Issue 4
In the CJEU's view, the fact that part of the services provided by the Applicants constituted a legal obligation to maintain public highways has no bearing on the assessment as to whether the services were effected "for consideration".

The CJEU concluded that:

- the operation of agricultural engineering works, such as those in issue, by a non-profit company which engages in such commercial activities only on an ancillary basis, constitutes an economic activity. This is notwithstanding the fact that those works have in large part been financed by State aid and that their operation gives rise only to revenue from modest fees, provided that that fee can be regarded as having a "continuing basis"
- the operation of agricultural engineering works, such as those in issue, constitutes a supply of services for consideration, on the ground that the services rendered are directly linked to the fee received.

Comment
The CJEU, in referring Issue 3 back to the referring court, made clear that if the Operating Fee charged by the Applicants only constitutes partial remuneration for the services supplied, it is likely that it will not be sufficient to establish a direct link between the services supplied and the consideration. This judgment makes clear that the amount of consideration received for a service may be a relevant issue when a court is determining if there is a direct link between the services received and consideration.

A copy of the decision can be found here.

Back to contents>

Taylor Clark – individual members entitled to advance claims on behalf of VAT group

In *Taylor Clark Leisure Plc v HMRC*[7], the Scottish Court of Session (SCS) overturned the decisions of the First-tier Tribunal (FTT) and the Upper Tribunal (UT) in finding that a claim for repayment of VAT by an individual member of a VAT group must normally be construed as a claim made on behalf of the group as embodied in the representative member.

7. [2016] CSIH 54.

Background

Taylor Clark Leisure Plc (the Appellant) was engaged in a range of trading activities in the leisure sector, including bingo and other related businesses. Following the introduction of VAT in 1973, the Appellant charged VAT on its relevant supplies and established a VAT group of which it became the representative member. The VAT group continued in existence until 2009, when it was dissolved.

In 1990, Carlton Clubs Ltd (Carlton) was incorporated as a wholly-owned subsidiary of the Appellant. The Appellant transferred its bingo and related businesses to Carlton, including the operation of gaming machines and mechanised cash bingo. Carlton became a member of the Appellant's VAT group, and remained so until 1998, when it was sold to outside shareholders.

A series of decisions by the CJEU and UK courts later established that income from bingo, gaming machines and other analogous activities was not subject to VAT. On 16 November 2007 and 8 January 2009, Carlton submitted claims to HMRC in respect of VAT that was said to have been overpaid in respect of bingo services in accounting periods from 1973 to 1998. The claims were phrased in the first person plural and signed by Carlton's finance director. The VAT registration number quoted, however, was that of the Appellant's VAT group. No timeous claim was made by the Appellant itself, whether in its capacity as representative member of the VAT group, or as an entity in its own right.

In April 2011, the Appellant asserted that it was entitled to repayment of the claims that had been submitted by Carlton. This was rejected by HMRC. Both the FTT and the UT found for HMRC and the Appellant appealed to the SCS.

SCS's decision

The issue to be determined by the SCS was whether the VAT group, embodied in the Appellant as representative member, could rely on claims for repayment of VAT overpaid by the group which had been made by Carlton rather than by the Appellant.

The SCS considered section 43 of the Value Added Tax Act 1994, which allowed the members of a VAT group to be treated as a single taxable person for the purposes of VAT. All supplies made by and to the individual members were to be treated as made by and to the VAT group. Equally, any liability of HMRC to repay VAT was to be treated as owed to the group. In so far as VAT was concerned, the individual members had no independent existence, they functioned as part of the VAT group as embodied in the representative member.

On this basis, the SCS decided that a claim which related to the activities of an individual member must be treated as having been made by or on behalf of the VAT group. That did not, however, mean that such a claim needed to be advanced by the group itself. There was no reason why an individual member should not be entitled to make a claim on behalf of and as agent for the group.

Further, an individual member leaving the group had no effect on the transactions that took place whilst the individual member was part of the group. Carlton had left the Appellant's group in 1998 and the Appellant had applied for deregistration from VAT in 2009. The SCS concluded that neither of these events was relevant to the status of the Appellant as representative member, and any entitlement to a repayment of VAT in respect of activities during that period remained that of the Appellant.

The SCS concluded that the claims made by Carlton were made on behalf of the Appellant as representative member of the group. Carlton had been a member of the group for a substantial part of the period to which the claim related, and during that period it had no independent existence for VAT purposes. Carlton could not, therefore, make the claim on its own behalf. All it could do was to make the claim on behalf of the Appellant as representative member. This was notwithstanding the fact that the claims were phrased in the first person, they referred directly to the Appellant and quoted the reference number of the Appellant's VAT group.

Comment

The SCS considered the full legislative context and adopted a purposive approach in finding that the claims ought to be treated as having been made on behalf of the Appellant rather than by Carlton as an individual entity. Although this decision is of persuasive authority only, representative members may now be able to rely on claims made by another member where they relate to activities during a period in which that member was part of the VAT group.

A copy of the judgment can be found here.

Back to contents>

Javed and Azra Mughal – FTT considers the rules relevant to "hardship" applications

In *Javed and Azra Mughal (Partnership) Trading as Dallas Chicken and Ribs v HMRC*[8], the FTT considered the information necessary for a "hardship" application.

Background

HMRC originally assessed Javed and Azra Mughal (the Appellants) for unpaid VAT in the sum of £127,951. However, this was reduced following a review to £99,719. The Appellants appealed against the assessment, however, they had not paid or deposited the disputed tax and they made an application for hardship.

Under section 84(3) of the Value Added Tax Act 1994, an appeal shall not be entertained unless the amount notified by the assessment has been paid or deposited with HMRC. However, this obligation is subject to section 84(3B), which permits an appeal to be entertained without payment or deposit of the VAT either:

- if HMRC is satisfied, on application by the appellant, that the requirement to pay or deposit the amount determined would cause the appellant to suffer hardship, or
- the FTT decides that the requirement to pay or deposit the amount determined would cause the appellant to suffer hardship.

In May 2013, HMRC applied for a stay of the Appellants' appeal while it considered the Appellants' application for hardship. On 17 June 2013, HMRC gave notice that it opposed the Appellants' application for leave to appeal without payment or deposit of the tax. HMRC argued that the FTT should not consider the appeal as the appeal was against a notice of assessment for VAT, and the Appellants had not paid to HMRC the amount determined by HMRC to be payable.

HMRC therefore applied to the FTT for the appeal to be struck out on the grounds that the disputed amount remained unpaid.

8. [2016] UKFTT 456 (TC).

On 23 September 2013, the FTT directed that the appeal should be stayed pending the FTT's determination of the hardship application. The parties then entered into ADR discussions, and HMRC agreed to reduce the assessment to £21,048.

In April 2014, the Appellants sent a letter to HMRC indicating that they wished to appeal against the assessment in the sum of £21,048. HMRC responded stating that a decision could only be reviewed once and the case had already been reviewed previously.

As part of their hardship application the Appellants referred to a number of sets of accounts of Dallas Chicken and Ribs in the name of W Mughal. HMRC understood that W Mughal was a relative of the Appellants who had taken on the business. There was nothing in the accounts to show any connection with the Appellants. Further accounts were provided by Mr Javed Mughal as an individual. HMRC's hardship officer's original decision was made on the basis that there was nothing to connect any of these accounts either with Mr Mughal or with the Appellants.

HMRC therefore argued that the Appellants had not provided substantive evidence to support their claim to hardship and requested that its decision to refuse the Appellants' hardship application be upheld.

FTT's decision

The FTT considered *R (ToTel Ltd) v First-tier Tribunal (Tax Chamber)*[9], in deciding whether the issue of hardship should be determined by reference to the position at the time of the hardship application or at some earlier time. In the view of the FTT, the question is whether the Appellants currently have the resources to pay the VAT assessed.

The FTT noted that HMRC had written to the Appellants requesting further information, but that it had not received a reply. Given the absence of relevant information the FTT concluded that there was insufficient information to satisfy it as to the financial position of the Appellants, and it therefore refused the Appellants' application for hardship.

Comment

This case demonstrates that in cases where the issue of hardship is in contention, it is important that the appellant has up-to-date and cogent evidence to place before the FTT. The onus of proof in such cases is on the taxpayer to demonstrate hardship and without persuasive evidence such applications are unlikely to succeed.

A copy of the decision can be found here.

Back to contents>

9. [2012] EWCA Civ 1401.

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 79 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 – 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**
- **Winner – Best Corporate Social Responsibility Initiative – British Insurance Awards 2014**

Areas of expertise

- Banking
- Commercial
- Commercial Litigation
- Competition
- Construction
- Corporate
- Employment
- Insurance
- Intellectual Property
- Media
- Outsourcing
- Pensions
- Private Equity
- Real Estate
- Regulatory
- Reinsurance
- Tax
- Technology

16446

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