VAT Update

January 2018

In this month's update we report on the VAT treatment of pension fund management services for insurers; the establishment of the EU cross-border prosecution service; and guidance published by HMRC following the Supreme Court's decision in *Littlewoods*. We also comment on three recent cases involving refunds for overpaid VAT on investment management services for pensions; the lawfulness of the UK's derogation for direct selling; and the application of section 80, VATA, to repayment claims for pre-1990 price adjustments.

News

Business Brief 3 (2017) – VAT treatment of pension fund management services

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EU member states agree to establish cross-border fraud prosecutor

Following a European Commission report on the reform of the European Anti-Fraud Office, 20 EU countries have agreed to set up an EU-wide prosecution service to investigate and bring to court cases involving the misuse of EU funds or large-scale VAT fraud. more›

HMRC issues VAT refund interest guidance following the *Littlewoods* judgment

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Cases

United Biscuits – High Court rejects claims for refunds of overpaid VAT

In *United Biscuits (Pension Trustees) Ltd and another v HMRC* [2017] EWHC 2895 (Ch), the High Court has held that pension fund management services by non-insurers are standard rated and dismissed the claimants' claims to recover VAT on investment management services for pensions. more›

Any comments or queries?

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

David Gubbay
Partner
+44 20 3060 6050
david.gubbay@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

Avon Cosmetics – no deviation from derogation

In *Avon Cosmetics Ltd* C-306/16, the Court of Justice of the European Union (CJEU) has rejected a claim that a derogation from EU law which authorised the UK to charge VAT on sales by direct selling companies based on their open market value, was unlawful. **more›**

Iveco – time limit for repayment claims for pre-1990 price adjustments

In *Iveco Ltd v HMRC* [2017] EWCA Civ 1982, the Court of Appeal has held that the time limit in section 80 VATA applied to a taxpayer's claim for repayment of VAT. **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

Business Brief 3 (2017) – VAT treatment of pension fund management services

In our October 2017 VAT Update (which can be viewed here) we reported on HMRC's announcement that, with effect from 1 January 2018, it would withdraw the VAT exemption for pension fund management services for insurers.

On 20 November 2017, HMRC announced an amendment to the proposed withdrawal date. The withdrawal will now take effect from 1 April 2019, rather than 1 January 2018, as previously announced.

A copy of Business Brief 3 (2017) is available to view here.

Back to contents›

EU member states agree to establish cross-border fraud prosecutor

Following a European Commission report on the reform of the European Anti-Fraud Office, 20 EU countries have agreed to set up an EU-wide prosecution service to investigate and bring to court cases involving the misuse of EU funds or large-scale VAT fraud.

The European Public Prosecutor's Office (EPPO) will be based in Luxembourg and take on cross-border cases that national prosecutors alone often find difficult to track. It is envisaged that the service will not be operational for another three years.

The EPPO's reach will initially be limited to the 20 EU member states that signed the agreement. The countries which have not signed up are Malta, Netherlands, Ireland, Poland, Hungary, Sweden, Denmark and the UK.

A copy of the EU press release is available to view here.

Back to contents›

HMRC issues VAT refund interest guidance following the *Littlewoods* judgment

On 8 December 2017, HMRC published Revenue & Customs Brief 5 (2017) in which it confirms its position following the Supreme Court's judgment in *Littlewoods Limited and Others v HMRC* [2017] UKSC 70.

Following the Supreme Court's decision that statutory interest in the case of refunds for overpaid VAT is all that is required, HMRC has confirmed that claims for compound interest will not be paid. HMRC has also confirmed that it will invite claimants to withdraw their claims and any related appeals to the First-tier Tribunal.

Taxpayers with compound interest claims relating to overpaid VAT should liaise with their professional advisors and, if appropriate, arrange for the timely withdrawal of their claims.

A copy of Business Brief 5 (2017) is available to view here.

Back to contents›

Cases

United Biscuits – High Court rejects claims for refunds of overpaid VAT

In *United Biscuits (Pension Trustees) Ltd and another v HMRC* [2017] EWHC 2895 (Ch), the High Court has held that pension fund management services by non-insurers are standard rated and dismissed the claimants' claims to recover VAT on investment management services for pensions.

Background

The claimants were United Biscuits (Pension Trustees) Ltd, the trustee of a defined benefits occupational pension scheme, and the former trustee of the undefined benefits Pension Investment Fund (a collective investment fund in which the assets of the scheme were invested between 1989 and 2006) (the Trustees). The Trustees submitted claims to HMRC to recover VAT which they had paid on supplies of pension fund management services to various investment managers that were not authorised insurance companies (Non-Insurers).

Under UK law, pension fund management services have always been treated by HMRC as exempt supplies when provided by insurers but as standard rated supplies when provided by Non-Insurers.

The Trustees argued that the supplies made by Non-Insurers were insurance transactions and therefore attracted a mandatory exemption from VAT. They claimed that they had a directly effective right to exemption with a consequential right to recover from HMRC the VAT which they should not have been obliged to pay.

HMRC's primary case was that the supplies by the Non-Insurers were not insurance transactions within the meaning of the VAT Directives and did not attract exemption under those Directives. In HMRC's view, the supplies were standard rated and VAT was correctly paid in accordance with UK law. If that was not the case, HMRC argued that the Trustees had no right to recover directly from HMRC the VAT which was paid to the Non-Insurers.

High Court decision

The Trustees' claims were dismissed.

The following two issues fell to be considered by the Court:

- whether supplies by Non-Insurers were to be treated as exempt supplies of "insurance", and
- if the Non-Insurers supplies should have been exempt, whether EU law required the Trustees to be given a direct claim against HMRC to recover the VAT they had overpaid to the Non-Insurers.

On the first issue, the Court was of the view that pension fund management services were not "insurance transactions" within the meaning of Article 135(1)(a), Principal VAT Directive (2006/112/EC). Such services were not regarded by the insurance Directives as insurance when carried out by a Non-Insurer. In addition, the principle of fiscal neutrality did not require the services to be treated as if they were "insurance transactions". The supplies were therefore properly standard rated.

With regard to the second issue (which only arose if the Court was wrong on the first issue), relying on EU and English case law, the Court said that the Trustees' remedy would have been against the supplier, not HMRC. In reaching this conclusion, the Court applied the Supreme Court's decision in *Investment Trust Companies v HMRC* [2017] UKSC 29. There were two separate payments that could not be conflated and it could not be said that HMRC had been unjustly enriched at the expense of the Trustees. Under section 80, VATA, the customer could not seek direct recovery from HMRC unless recovery from the Non-Insurer was impossible, or excessively difficult and, in the view of the Court, it was not "impossible or excessively difficult" for the Trustees to claim against the Non-Insurers.

The Court went on to consider what remedy the Trustees would have if it was wrong in the conclusions it had reached on the first and second issue. In such circumstances, the Court said that the Trustees would have a remedy against HMRC. However, the time limit for such a claim would be four years (rather than six years under the Limitation Act 1980) in accordance with the time limits for reimbursement set out in section 80, VATA. In the Court's view, such an approach was entirely consistent with EU law.

Comment

The debate between HMRC and pension funds over whether management services provided to pension funds are taxable or exempt for VAT purposes has been running for over 10 years. During that time the CJEU has had cause to consider the issue on two occasions, first in *Wheels* C-424/11 and then again in *ATP* C-464/12. It is not known whether this decision is to be appealed, but subject to any successful appeal the decision represents the law.

Given the large amounts at stake, an appeal to the Court of Appeal would not be surprising. It is, however, worth bearing in mind that this issue is now largely of historic interest as HMRC announced the withdrawal of its long-established policy of allowing exemption for pension fund management services provided by insurers in Revenue & Customs Brief 3 (2017).

A copy of the judgment is available to view here.

Back to contents>

Avon Cosmetics – no deviation from derogation

In *Avon Cosmetics Ltd* C-306/16, the Court of Justice of the European Union (CJEU) has rejected a claim that a derogation from EU law which authorised the UK to charge VAT on sales by direct selling companies based on their open market value, was unlawful.

Background

Avon Cosmetics Limited (Avon), sells beauty products in the UK to representatives, known as "Avon ladies", who in turn make the retail sale to their customers. Avon sells its goods to the Avon ladies at a discount from the "brochure prices" of either 20% or 25%, so that unless they pass on some of that discount to their customers, the 20% or 25% represents gross profit. The majority of the Avon ladies have modest turnover and are not therefore registered for VAT. The consequence of this ordinarily would be that VAT would be charged on Avon only on the consideration received by it on the sales to the representatives and no VAT would be charged in respect of the retail sales. However, by a derogation approved by the EU Council, HMRC is permitted to charge VAT on the supplies made by Avon by reference to the full market value.

Avon argued that HMRC's treatment on valuation was incorrect because it failed to take into account the seller's costs which would have been deductible had the representatives been VAT registered, in particular, the costs of demonstration products by which the representatives present their products to their customers. The result was that the disregarded notional input tax in relation to such costs "sticks" in the supply chain and increases the overall VAT charged on the direct selling model over that charged on sales through ordinary retail outlets.

Avon challenged the UK's method of calculating its VAT liability and the lawfulness of the derogation for direct selling. It argued that the derogation should be applied with modifications so as to enable the Avon ladies to recover input tax.

The First-tier Tribunal (FTT) agreed with Avon but said that it did not have jurisdiction to amend the derogation or declare it invalid. The FTT therefore decided to refer the matter to the CJEU to consider the validity of the derogation and whether its implementation infringed the principles of fiscal neutrality.

Advocate General Bobek released his opinion on 7 September 2017, in which he considered that the derogation for direct selling could not be applied with modifications so as to enable the Avon ladies to recover input tax.

CJEU's judgment

The CJEU followed Advocate General Bobek's earlier opinion and concluded that the derogation did not infringe the principle of fiscal neutrality and could not be modified for the Avon ladies.

The CJEU said that neither the derogation authorised by Council Decision 89/534/EEC of 24 May 1989 nor national measures implementing that decision, infringed the principles of proportionality and fiscal neutrality. The UK's derogation properly ensures that VAT is not avoided on the final retail sales value.

In the view of the CJEU, adding extra rules to adjust for input tax on demonstration items would introduce unnecessary complexity. Output tax was due on the ultimate retail sale value and there is no credit for any VAT incurred by the Avon ladies.

Finally, the CJEU said that there is nothing wrong with the way that the UK has sought the derogation. It was not necessary for it specifically to point out the potential input tax consequences which reflect the normal operation of the VAT system. HMRC was therefore correct to refuse Avon's claim.

Comment

The CJEU's judgment in this case was keenly awaited by the direct selling sector. In reaching its decision, the CJEU considered that choosing the "direct selling model" meant accepting the derogation without modifications. If businesses want to address the underlying anomaly regarding the recovery of input tax, then individual sellers should exercise their right to register in order to reduce the tax burden.

A copy of the judgment is available to view here.

Back to contents>

Iveco – time limit for repayment claims for pre-1990 price adjustments

In *Iveco Ltd v HMRC* [2017] EWCA Civ 1982, the Court of Appeal has held that the time limit in section 80, VATA, applied to a taxpayer's claim for repayment of VAT.

Background

Iveco Ltd (Iveco) was the representative member of a VAT group selling commercial vehicles. Members of the group had made promotional payments (or rebates) between the beginning of 1978 and the end of 1989. Under Article 11C(1) of the Sixth VAT Directive (77/388/EC) (the VAT Directive), when the price of a supply is reduced, the taxable amount is reduced accordingly. However, UK legislation implementing the Directive only took effect on 1 January 1990. In 2011, Iveco sought a repayment of over £73 million to reflect rebates made between 1 January 1978 and 31 December 1989.

HMRC rejected Iveco's claim on the basis it was time-barred. Iveco appealed.

The issue to be determined on appeal was whether the claim was time-barred.

The FTT found in favour of Iveco, taking the view that its claim was not subject to either a domestic time limit or any requirement under EU law for a claim to be brought within a reasonable period after a price reduction.

HMRC appealed to the Upper Tribunal (UT). The UT disagreed with the FTT and allowed HMRC's appeal on the basis that Iveco's claim was time-barred. Iveco appealed to the Court of Appeal.

Before the Court of Appeal, Iveco contended that it had a directly enforceable right to bring about a reduction in the taxable amount at a time of its choosing. There was therefore no question of any part of the claim being time-barred. HMRC argued that the "taxable amount" was reduced when a rebate was paid. It was open to Iveco to reflect that reduction in its VAT account at the time. As it had failed to do so, it was entitled to seek a repayment, but not a reduction of the taxable amount.

Court of Appeal's judgment

The Court of Appeal dismissed Iveco's appeal.

The Court held that there was nothing in Article 11C(1) of the VAT Directive to suggest that a member state could defer the time at which the taxable amount was reduced. It had therefore been incumbent on the UK to implement Article 11(C) by providing for a reduction in the "taxable amount" at, or soon after, the payment of a rebate.

Whilst the UK had failed to implement Article 11(C) until January 1990, taxpayers had been entitled to rely on this provision as it had direct effect. It was therefore open to a taxpayer to make an appropriate VAT adjustment when a rebate was paid. If a taxpayer failed to do so, its right was to claim that each relevant payment should have been reduced and it was entitled to seek a repayment.

The Court held that a taxpayer's right to rely on Article 11(C)(1), did not permit it to reduce the "taxable amount" itself (and so trigger a repayment claim) years later. A taxpayer could not choose the time at which the reduction in the taxable amount occurred. In the circumstances, Iveco's remedy, as regards pre-1990 rebates, was to claim to recover overpayments, which the

Court held it could do under section 24, Finance Act 1989 and, later, section 80, VATA. However, the four-year time limit in section 80(4) ran from the date of payment of the rebate and on this basis Iveco's claim was time-barred in its entirety.

As the Court had decided that as a consequence of section 80(4), the claim was time-barred, it concluded that it did not need to determine whether Iveco had a claim in restitution that was subject to a six-year limitation period.

Comment
As the Court noted, CJEU case law makes it clear that it is permissible to impose a time limit within which a person may bring proceedings relaying to the failure to implement a directive.

This judgment is largely of historic interest because it relates to supplies and price reductions that occurred before 1 January 1990 and, since that date, regulation 80 of the Value Added Tax Regulations 1995 sets out the procedure for reclaiming VAT on price reductions.

A copy of the judgment is available to view here.

Back to contents>

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17940

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