VAT update

February 2020

In this month's update we report on (1) publication by the EU of the Implementing Regulation (EU) 2020/21; (2) publication by HMRC of letters to businesses regarding preparations for customs and border arrangements after the Brexit transition period; and (3) the new Value Added Tax (Miscellaneous Amendments, Revocation and Transitional Provisions) (EU Exit) Regulations 2019 (Appointed Day No. 1) (EU Exit) Regulations 2020. We also comment on three recent cases which consider (1) the application of the *Halifax* principle to what HMRC considered to be VAT avoidance arrangements involving supplies of winter sports training; (2) whether there is a private right of action to enforce the statutory duty to provide a VAT invoice; and (3) whether the general partner of a property fund was entitled to recover VAT incurred on set-up and operating costs.

News items

Publication of European Commission Implementing Regulation (EU) 2020/21

On 15 January 2020, the EU published, in the Official Journal, the Commission Implementing Regulation (EU) 2020/21, amending Implementing Regulation (EU) 79/2012, laying down detailed rules for implementing certain provisions of Council Regulation (EU) 904/2010 concerning administrative co-operation and combating fraud in the field of VAT. more›

HMRC has published letters to VAT-registered businesses regarding preparations for customs and border arrangements after the Brexit transition period

On 27 January 2020, HMRC published letters to VAT-registered businesses in Great Britain and Northern Ireland which trade with the EU, or with the EU and the rest of the world. more›

Value Added Tax (Miscellaneous Amendments, Revocation and Transitional Provisions) (EU Exit) Regulations 2019 (Appointed Day No. 1) (EU Exit) Regulations 2020

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Cases

Snow Factor – Tribunal applies the *Halifax* principle to redefine supplies of winter sports training

In *Snow Factor Ltd and Snow Factor Training Ltd v HMRC* [2019] UKFTT 0664 (TC), the First-tier Tribunal (FTT) found that certain VAT arrangements were abusive within the scope of the Halifax principle, and redefined supplies of winter sports training by a non-profit making company as a supply by its profit making parent and therefore as falling outside the education exemption in Item 1, Group 6, Schedule 9, Value Added Tax Act 1994 (VATA). 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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Royal Mail – There is no private right of action to enforce the statutory duty to provide a VAT invoice

In *Claimants in the Royal Mail Group Litigation v Royal Mail Group Ltd* [2020] EWHC 97 (Ch), the High Court found that a customer cannot enforce the statutory duty for a supplier to provide a VAT invoice. more›

Melford Capital – General partner of a property fund was entitled to fully recover VAT incurred on set-up and operating costs

In *Melford Capital General Partner Ltd v HMRC* [2020] UKFTT 0006 (TC), the First-tier Tribunal (FTT) held that VAT costs incurred on the set-up and operation of a fund were deductible in full by its general partner because, as representative member of a VAT group, the general partner was treated as undertaking the economic activities of another member of the VAT group. more›

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Implementing Regulation (EU) 2020/21 will apply from 1 January 2021.

The new regulation can be viewed here.

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HMRC has published letters to VAT-registered businesses regarding preparations for customs and border arrangements after the Brexit transition period

On 27 January 2020, HMRC published letters to VAT-registered businesses in Great Britain and Northern Ireland which trade with the EU, or with the EU and the rest of the world.

The letters explain the actions such businesses need to take to prepare for changes to customs and border arrangements after the transition period. In particular, the letters explain that businesses should:

- make sure that they have an Economic Operator Registration and Identification (EORI) number, as this will be required to submit customs declarations to move goods between Great Britain and the EU after the transition period; and
- start to prepare now to make customs declarations, by deciding if they want to use a third party such as a customs agent, or make declarations themselves. If businesses decide to use a customs agent, they are advised to start contacting agents now, to find out about the services they provide.

The letters can be viewed here.

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Value Added Tax (Miscellaneous Amendments, Revocation and Transitional Provisions) (EU Exit) Regulations 2019 (Appointed Day No. 1) (EU Exit) Regulations 2020

On 30 January 2020, the Treasury made the Value Added Tax (Miscellaneous Amendments, Revocation and Transitional Provisions) (EU Exit) Regulations 2019 (Appointed Day No. 1) (EU Exit) Regulations 2020.

These Regulations appointed "Exit day" (11pm on 31 January 2020) as the date that Regulations 4(1) and (2) of the Value Added Tax (Miscellaneous Amendments, Revocation and Transitional Provisions) (EU Exit) Regulations 2019 came into force.

Regulations 4(1) and (2) insert a new paragraph 2A into Regulation 102 in Part 14 (input tax and partial exemption) of the Value Added Tax Regulations 1995/2518.

The new paragraph 2A provides that any partial exemption special method which attributes input tax to exempt supplies specified by the Treasury in an order made under section 26(2)(c) of the Value Added Tax Act 1994 may, if such supplies are made in the UK, only do so if:

- the supply is directly linked to the export of goods and the recipient of the goods is located outside both the UK and the EU, or
- the supply is between a UK based intermediary and a UK based service provider and the recipient of any supply being arranged by the intermediary is located outside both the UK and the EU.

The new regulations can be viewed here.

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Cases

Snow Factor – Tribunal applies the *Halifax* principle to redefine supplies of winter sports training

In *Snow Factor Ltd and Snow Factor Training Ltd v HMRC* [2019] UKFTT 0664 (TC), the First-tier Tribunal (FTT) found that certain VAT arrangements were abusive within the scope of the Halifax principle, and redefined supplies of winter sports training by a non-profit making company as a supply by its profit making parent and therefore as falling outside the education exemption in Item 1, Group 6, Schedule 9, Value Added Tax Act 1994 (VATA).

Background

Snow Factor Ltd (SF) operates an indoor snow sport resort at a site in Glasgow (the Snow Dome).

On 18 May 2012, Snow Factor Training Ltd (SFT) was incorporated as a company limited by guarantee. Mr Smith, the managing director of SF, was a director of SFT, and SF's finance director was SFT's company secretary.

On 1 June 2012, SF entered into a Business Transfer Agreement (the BTA) with SFT, pursuant to which SFT purchased, for consideration of £1, the business of ice and snow sports training and tuition carried on by SF at the Snow Dome, and the assets of SF (subject to an exclusion for items which did not specifically relate to training).

On the same day, SF entered into a Training Services Agreement (the TSA) with SFT, whereby SFT would provide training services, as defined, at the Snow Dome.

The TSA provided that the entire income of SFT would be paid to SF plus the costs incurred, but this provision was not implemented. Instead, SF collected all the income from the tuition services and remitted it to SFT, with monies being extracted from SFT via costs and management charges. The net result of this arrangement was the same, with SFT having a profit of nil, and all monies going to SF in the first instance and ultimately to SF's shareholder.

SF and SFT treated the supplies of winter sports training (the tuition services) as exempt from VAT, on the basis that they were provided by SFT and fell within the exemption from VAT contained in Item 1, Group 6, Schedule 9, VATA (the provision by an eligible body of education or vocational training).

HMRC challenged the arrangements on the basis that:

- the tax advantage sought under the arrangements fell to be disallowed under the general principle of EU law preventing "abuse of rights" (the Preferred Decision), and
- if the Preferred Decision was incorrect, SFT was not an "eligible body" for the purposes of Item 1, Group 6, Schedule 9, VATA, in accordance with Note 1(e) to the Items.

Both of the above arguments were based on SF being regarded by HMRC as the supplier for VAT purposes.

HMRC assessed SF and SFT for VAT in the sum of £382,074, in respect of the tuition services.

SF and SFT appealed to the FTT.

FTT decision
The appeals were dismissed.

In finding against SF and SFT, the FTT applied the ECJ's decision in *Halifax plc v HMRC* (Case C-255/02), which sets out the general principles to be applied when considering VAT avoidance arrangements.

In the view of the FTT, although the BTA purported to transfer the tuition services to SFT, the reality was that, with effect from 1 June 2012, apart from book keeping entries between the companies and the creation of a bank account for SFT (which was part of a group banking facility) "nothing very much really changed".

In reaching this conclusion, the FTT noted that SF's website and publicity made no mention that SFT provided the tuition services; customers paid SF and, although the receipt showed the exempt supplies, there was no mention of SFT; the instructors had every reason to consider SF to be their employer; and SF provided all of the administrative support.

The FTT found that the primary driver for the restructuring was to achieve exemption from VAT on tuition services, and that none of the other purported non-tax drivers had any substance.

The FTT also found that the essential aim, or purpose, of the creation and interposition of SFT into the supply chain was to achieve a VAT advantage by ensuring the tuition services were exempt from VAT. The arrangements therefore represented an abusive practice within the scope of the Halifax principle. The FTT upheld the Preferred Decision and redefined the supplies of the tuition services as supplies made by SF.

The FTT also considered whether, if it had made supplies of tuition services, SFT could have been an "eligible body", which is defined in Note 1(e) to Group 6 as: "a body which (i) is precluded from distributing and does not distribute any profit it makes; and (ii) applies any profit made from supplies of a description within this Group to the continuance or improvement of such supplies".

The FTT concluded that SFT was incorporated with the sole intention of being an eligible body and, for that reason, its Articles of Association prohibited it from paying or transferring its income or property to its members. However, in the view of the FTT, it was not a determining factor that no profits were distributed and that that the aim was to enrich those with a financial interest. Accordingly, SFT was not an eligible body.

Comment
This case illustrates the factors that the FTT are likely to take into account when considering the application of the *Halifax* principle to what HMRC consider to be VAT avoidance arrangements.

In this case there was little evidence of the commercial reality of the arrangements, leading the FTT to comment that SFT was "so far below the radar screen that it was virtually invisible to anyone other than Mr Smith and the companies which he controlled". The FTT was particularly critical that the transactions between SFT and SF were not on arm's length terms and that there were no board minutes evidencing the purpose of the arrangements.

If taxpayers are to successfully resist a challenge from HMRC based on the *Halifax* principle, it is imperative that they maintain full, accurate and contemporaneous documentation when implementing business arrangements. A lack of cogent evidence will reduce the chances of a taxpayer persuading the FTT that the arrangements under challenge were not artificial tax avoidance arrangements subject to the *Halifax* principle.

A copy of the decision can be viewed here.

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Royal Mail – There is no private right of action to enforce the statutory duty to provide a VAT invoice

In *Claimants in the Royal Mail Group Litigation v Royal Mail Group Ltd* [2020] EWHC 97 (Ch), the High Court found that a customer cannot enforce the statutory duty for a supplier to provide a VAT invoice.

Background

Before 2009, there was a general assumption that all postal services were VAT exempt. In 2009, the Court of Justice of the European Union held in *R (on the application of TNT Post UK Ltd) v HMRC* (Case C-357/07) (TNT) that, while the universal postal service is VAT exempt, arrangements that are individually negotiated, such as franking and tracked delivery arrangements, are not.

A group of approximately 340 companies (the claimants) were of the view that the amounts they paid for services before the UK VAT legislation was revised to comply with *TNT* had not been VAT exempt and claimed to be entitled to VAT invoices from Royal Group Ltd (the defendant).

The claimants sought (a) declarations that they were entitled to VAT invoices, (b) orders that the VAT invoices be provided, and (c) damages for not having been provided with VAT invoices in respect of services which *TNT* confirmed were, and always had been, taxable.

HMRC declined to intervene in the case.

High Court decision

The High Court found in favour of the defendant.

The Court concluded that there was neither a statutory duty nor a contractual obligation, enforceable by the claimants, to require a VAT invoice.

It was accepted that there was a statutory duty to provide VAT invoices but, in the view of the Court, Parliament did not intend an individual to have the benefit of a directly enforceable right.

The Court held that, on the facts of the case, the franking schemes were neither intended by the parties to have contractual force nor to require a VAT invoice, and the contracts before the Court contained no express terms capable of being construed as a requirement for a VAT invoice. The Court rejected the argument that a requirement for VAT invoices could be implied into all business-to-business contracts where both parties were registered for VAT, in particular, because such a term could only possibly apply where both parties understood VAT to be applicable, which was not the case on the facts before the Court.

Comment
As 'test litigation', this case was argued on the basis of sample contracts, a schedule of agreed assumptions, and few agreed facts. The Court noted that some very significant lines of argument had to be discontinued during the course of the hearing due to an insufficiency of agreed facts and assumptions on which the arguments could be maintained.

Given that the total potential recovery if the claimants ultimately succeed is in the region of £500 million, the claimants are likely to seek to appeal this decision. There is also likely to be further enquiry into the disputed facts and exploration of the precise wording of the agreements between the parties.

A copy of the judgment can be viewed here.

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Melford Capital – General partner of a property fund was entitled to fully recover VAT incurred on set-up and operating costs

In *Melford Capital General Partner Ltd v HMRC* [2020] UKFTT 0006 (TC), the FTT held that VAT costs incurred on the set-up and operation of a fund were deductible in full by its general partner because, as representative member of a VAT group, the general partner was treated as undertaking the economic activities of another member of the VAT group.

Background
Melford Capital General Partner Ltd (Melford Capital GP) was the general partner of Melford Special Situations LP (the Fund), an English limited partnership.

Acting through Melford Capital GP, the Fund held the shares in Hyde Park Hayes Ltd (Hyde Park), a company incorporated in the Isle of Man. Hyde Park in turn held the shares in a number of companies or special purpose vehicles (SPVs), each of which held a separate underlying asset, for example, a commercial property. Investors contributed capital to the Fund.

Melford Capital GP was owned by Melford Capital Partners LLP (the LLP). The LLP was contracted to provide advisory, property management and administrative services (the Services) to the Fund. Each SPV entered into a deed of adherence (DOA) in respect of the contract between the LLP and the Fund, under which the LLP provided the Services directly to each SPV in return for a

fee payable directly by the SPV to the LLP. The supplies of the Services to the SPVs were standard rated.

The Fund (through Melford Capital GP) incurred costs relating to the operation of the structure including:

- the costs of setting up and attracting investors to create the investment structure (the Set-up Costs), and
- operating costs of running the business such as audit costs, fund operator costs, accounting and book-keeping costs and costs of due diligence for making new investments (the Operating Costs).

The LLP and Melford Capital GP constituted a VAT group (the Group). Hyde Park and the SPVs constituted a separate VAT group.

HMRC refused a claim by Melford Capital GP to recover VAT incurred on the Set-up Costs and the Operating Costs. Melford Capital GP appealed this decision to the FTT.

FTT decision
The appeal was allowed.

The question for determination by the FTT was whether the VAT on the Set-up Costs and the Operating Costs was input tax which was fully deductible by Melford Capital GP.

Melford Capital GP argued that it/the Group made only taxable supplies, both categories of costs related to those supplies, and it was therefore entitled to full input tax recovery on both categories of costs.

HMRC argued that (1) the Set-up Costs were not recoverable at all because they related solely to investment activities which do not constitute 'economic activity' within the meaning of the VAT rules; and (2) the Operating Costs were recoverable but subject to apportionment to reflect that they related partly to taxable supplies and partly to the non-economic investment activities.

The FTT held that, although the mere holding of shares does not constitute economic activity (applying the decision of the ECJ in *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen* (Case C-60/90)), the provision of management services for consideration to subsidiaries does constitute economic activity (applying the decision of the ECJ in *Cibo Participations SA v Directeur regional des impots du Nord-Pas-de-Calais* (Case C-16/00)).

The LLP provided management services to Hyde Park and the SPVs via an agreement with Melford Capital GP, supplemented by tripartite DOAs between the LLP, Melford Capital GP and each of Hyde Park and the SPVs. Consideration was payable by the SPVs and HPH under the DOAs. Supplies made by the LLP were deemed to be made by Melford Capital GP as the representative member of the Group. The FTT therefore concluded that Melford Capital GP was engaged in an economic activity (the provision of management services to its subsidiaries) and

made taxable supplies in the form of these services. Costs incurred by Melford Capital GP (or deemed to be incurred by Melford Capital GP as representative member of the Group) in the course of the furtherance of this business were therefore recoverable as input tax.

The FTT found that Melford Capital GP did not carry out a separate investment business, distinct from its activities as active holding company for Hyde Park and the SPVs. Its activities (and those of the Fund on behalf of which it acted) were acting as holding company and it provided management services for consideration to all its subsidiaries. The Set-up Costs were incurred for the purpose of subscribing for shares in or providing loans to Hyde Park and the SPVs with the intention of providing the advisory services to them. On this basis, the FTT concluded that there was a direct and immediate link between the Set-up Costs and the economic activity carried out. HMRC accepted that the VAT on the Operating Costs was recoverable as input tax to the extent the Operating Costs related to the economic activity undertaken. The FTT held that the VAT on the Operating Costs was recoverable in full, as Melford Capital GP did not carry out separate economic and non-economic activities.

Comment
Although this decision was fact-specific, it will provide some reassurance to funds operating a similar structure. In light of the decision, funds which are not currently operating a VAT group may wish to consider whether doing so could assist their VAT recovery.

A copy of the decision can be viewed here.

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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:

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- 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

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