VAT update

August 2015

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Holding companies can recover input tax: CJEU follows Advocate General's opinion in *Larentia and Minerva*

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FTT provides guidance on the application of zero-rating in a chain of supplies

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Any comments or queries?

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About this Update

The VAT Update is published on the final Thursday of every month, and is written by members of RPC's Tax Disputes team.

We also publish a general Tax Update on the first Thursday of every month, and a weekly blog, RPC Tax Take.

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Court of Appeal rejects HMRC's appeal and application for a stay in judicial review proceedings

The Court of Appeal (Lord Justice Arden, Lord Justice Black and Lord Justice Floyd) recently confirmed the circumstances in which the court will exercise its case management powers and grant a stay where a taxpayer is pursuing both an appeal before the FTT and judicial review (JR) proceedings in the Administrative Court. more›

News

HMRC Brief 10/2015 clarifies VAT treatment of direct marketing supplies using printed matter

On 15 July 2015, HMRC published Revenue & Customs Brief 10/2015 which confirms that supplies of direct marketing services using printed matter are standard rated for VAT.

HMRC accepts that its guidance in Notice 700/24 was not clear and that has led some businesses to misunderstand which supplies should be zero or standard rated. It has now updated the guidance to provide greater clarity.

Where there has been a misunderstanding, HMRC has confirmed it will not take any retrospective action for supplies made prior to 1 August 2015. This transitional period was agreed with trade representatives and is available for certain cases. The Brief sets out in detail the circumstances, for addressed and unaddressed mail, where HMRC will take no action for past errors.

Suppliers wishing to adopt the transitional arrangements must notify HMRC by 30 November 2015.

Where businesses are not entitled to adopt the transitional arrangements, the Brief sets out the terms on which HMRC will settle outstanding VAT liabilities.

A copy of Revenue & Customs Brief 10/2015 is available to read here.

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Government reconsiders application of reduced VAT rate for energy-saving materials

Following the Court of Justice of the European Union (CJEU) decision on 4 June 2015[1] (as reported in our June newsletter), that the UK's application of the reduced rate breaches EU law HMRC has published Revenue & Customs Brief 13/2015.

The Brief explains that the Government is currently considering the implications of the CJEU's decision and that no legislative changes will be made before the Finance Act 2016. Until then, suppliers of relevant energy-saving materials should continue to apply the reduced rate. Any changes will not have retrospective effect.

A copy of Revenue & Customs Brief 13/2015 is available to read here.

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Ministry of Justice consults on fees for appeals to the First-tier Tribunal (Tax Chamber) and Upper Tribunal (Tax Chamber)

The Ministry of Justice is consulting on the introduction of fees for certain court proceedings, including appeals to the First-tier Tribunal (Tax Chamber) (FTT) and Upper Tribunal (Tax and Chancery Chamber) (UT). The purpose of the fee increase is to allow the Government to recover 25% of the annual operational costs of the tribunals.

Under the proposals, there would be two different issue fees in the FTT, depending on the case category. A tiered fee structure may also be introduced where cases go to a full hearing, which would be based on the complexity and length of the case.

1. *Commission v United Kingdom* (Case C-161/14). Click here

For the UT, the consultation proposes fees for seeking permission to appeal from the FTT to the UT and for a substantive hearing before the UT. It is not clear whether the fees would be recoverable in the event of a successful appeal.

These proposals form part of a wider consultation on further increases to courts and tribunal fees which runs until 15 September 2015.

Details of the consultation can be read here.

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On 16 July 2015, the CJEU released its decision in the joined cases of *Larentia + Minerva mbH & Co. KG* and *Marenave Schiffahrts AG*. The CJEU followed Advocate General (AG) Mengozzi's earlier opinion and held that active holding companies should have the right to fully reclaim input tax incurred in relation to the acquisition of shares in subsidiaries.

Background

Larentia + Minerva owned 98% of the shares in two limited partnerships each one operating a vessel. It acted as a management holding company for those subsidiaries provided taxable supplies for remuneration. Larentia + Minerva sought to recover input VAT incurred in procuring capital from a third party which was used to fund the acquisition of its shareholdings in the subsidiaries and its services.

Following a similar factual pattern, Marenave incurred input VAT on costs relating to raising capital through the issue of new shares. The capital raised was used to fund the acquisition of shares in four limited shipping partnerships to which Marenave provided management services for remuneration.

The issue was the extent to which deductions were allowed, in relation to input tax incurred on acquisition and issue costs. The German tax authorities only permitted Larentia + Minerva partial deductions and denied Marenave the right to deduct in full.

Questions were referred to the CJEU. Clarification was sought as to the method of calculating the input VAT deduction and, the scope of "VAT group", within Article 4(4) of the Sixth Directive, and whether this included a partnership.

On 26 March 2015, AG Mengozzi delivered his opinion and considered that fully-taxable holding companies should enjoy complete input tax recovery. He also suggested that VAT grouping rules excluding entities due to legal form, or requiring control and subordination, contravene EU law.

The CJEU's decision

The CJEU followed AG Mengozzi's opinion and confirmed that companies whose "economic activity" consisted in the active management of subsidiary companies were entitled to deduct input VAT on fees incurred with the acquisition of subsidiaries, as part of the general "overhead" costs of this activity.

In reaching its conclusion, the CJEU considered whether the holding of shares was an economic activity and drew a distinction based on whether a holding company was involved in the management of all (ie active holding), or only some of its subsidiaries through the provision of taxable services to them. They held that only an active holding constitutes an economic activity.

In this case, it was apparent from the information provided by the referring court that, in the main proceedings, the holding companies were subject to VAT in respect of their economic activity which consisted of supplies they provided for remuneration to their subsidiaries. The VAT incurred on that expenditure was therefore fully deductible.

The CJEU considered that deduction of VAT will only be limited to the extent that costs were attributable to other subsidiaries in whose management the holding company played no part. In those circumstances it would be necessary to apportion the input VAT between the economic and non-economic activities of the holding company.

Finally, in response to the second question, the CJEU confirmed that Article 4(4) of the Sixth Directive, precludes Member States from restricting entities which do not have a legal personality from the formation of a "VAT group" unless such restrictions are necessary and appropriate to prevent abusive practices or combat tax evasion or tax avoidance.

Comment

The CJEU's decision confirms the VAT deduction right of holding companies and we expect that HMRC will in due course provide its response to the judgment. It is likely that other EU Member States will also revise their current practice.

The CJEU affirmed the AG's opinion regarding the formation of a VAT group. This is an interesting development, particularly given that membership of a UK VAT group is restricted to corporate bodies. It remains to be seen how HMRC will respond to this aspect of the judgment.

In the light of this decision, businesses with holding companies within the EU should review their corporate structure and, in particular, consider whether they have been prevented from recovering input VAT in the past.

The CJEU's decision can be read here.

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FTT provides guidance on the application of zero-rating in a chain of supplies

In *City Fresh Services Ltd v HMRC*[2], the FTT has held that each supply in a chain of medical supplies was exempt for VAT purposes, and it was not a condition of the exemption for the supply to be made to the final patient.

Background

In March 2009, two partners of an existing dental practice (CDP) set up City Fresh Services Limited (City Fresh) as an alternative entity through which to provide their dental services to an NHS trust.

Due to issues relating to an existing contract between CDP and the NHS for dental services, the services from City Fresh were provided via CDP, which retained the contract with the NHS trust and sub contracted its dental services to City Fresh.

From March 2010, City Fresh invoiced CDP for the supply of dental services for a fixed monthly fee.

HMRC queried the VAT status of City Fresh during the course of a direct tax enquiry. Later, by decision letter dated 1 October 2013, HMRC confirmed that City Fresh was required to register for VAT from 1 August 2010, on the basis that it made standard rated supplies of staff and accordingly the business's turnover exceeded the VAT registration threshold.

City Fresh appealed the decision. It submitted that the supplies were exempt as the provision of medical care provided in Item 2, Group 7 of Schedule 9 of the Value Added Tax Act 1994. It argued that the nature of the recipient of the supplies was not a component of the exemption and the provision of medical care was therefore not restricted to care provided directly to patients.

2. [2015] UKFTT 364.

The FTT's decision

The FTT concluded that all entities were making exempt supplies of medical care and the taxpayer's appeal was allowed.

In reaching its decision the FTT considered the following two issues:

- whether the supplies of medical care must be made to the final patient
- whether the supplies were a supply of medical care or a supply of staff.

Whether the supplies of medical care must be made to the final patient

- The FTT considered whether the addition of a third party in a supply chain altered the nature of the supply being made. It acknowledged that whilst there are some circumstances where the insertion of a third party will break the link between the supply of the services and the recipient, that was not the case in the present appeal. In this case, it was clear from the evidence that what the patient received was exactly the same whether provided directly from CDP or as a service sub-contracted via City Fresh. The essential nature of the supply was a supply of dental services.
- The FTT confirmed that unless a chain of entities has been set up for abusive purposes, or there was complete coincidence between the services provided by each entity to the end user, then the nature of the services should not be treated any differently. There was no suggestion of either scenario in the present case and therefore the introduction of the third party had no impact on the substance of the supplies made.

Supply of medical care or supply of staff?

- HMRC argued that as the dentists were under CDP's control and it was CDP which was legally obliged to provide the dental services to the NHS trust, the supply made by City Fresh was a supply of staff.
- The FTT disagreed. It confirmed that a supply would be a supply of staff if the recipient, by controlling the persons supplied, can control their activities and in so doing change the nature of the supply made. Although CDP was an intervening entity, there was no evidence that CDP changed the nature of the supply or that there was a change of control from City Fresh to CDP over the dentists' activities. The evidence indicated that this was a back to back arrangement and on this basis the FTT concluded that it was a supply of medical care.

Comment

The decision in this case will be welcomed by taxpayers. Had the FTT found in HMRC's favour, there could have been a significant impact on the economics of outsourcing medical supplies.

The decision is of more wider relevance, and provides guidance on the application of exemptions in supply chains and the circumstances where the introduction of a third party will alter the nature of the supply being made. In this case it was clear that the supplies operated in exactly the same way before and after the incorporation of City Fresh. Each case will however turn on its facts and businesses should carefully consider each supply in a chain to ensure they apply the correct treatment and retain sufficient evidence of the nature of the supplies they make.

The FTT's decision can be read here.

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Court of Appeal rejects HMRC's appeal and application for a stay in judicial review proceedings

The Court of Appeal (Lord Justice Arden, Lord Justice Black and Lord Justice Floyd) recently confirmed the circumstances in which the court will exercise its case management powers and grant a stay where a taxpayer is pursuing both an appeal before the FTT and judicial review (JR) proceedings in the Administrative Court.

Background

In *The Queen on the application of Veolia ES Landfill Limited and others v The Commissioners for Her Majesty's Revenue and Customs*[3], the taxpayers issued JR proceedings and tax appeals concerning overpaid landfill tax. The issue in the tax appeal was whether the taxpayers were liable for overpaid landfill tax. The JR concerned whether the taxpayers had a legitimate expectation of being entitled to a repayment of overpaid landfill tax.

HMRC applied for the JR proceedings to be stayed whilst the tax appeal against the relevant assessments in relation to the same landfill tax were resolved. The key point for the justice system to determine was whether there was a liability to tax in the first place, and the proper place for that issue to be resolved was in the FTT. The JR proceedings may therefore be unnecessary should it transpire that there is in fact no liability to tax.

In addition, HMRC submitted that if both the JR proceedings and tax appeal proceeded at the same time, there might be different findings of fact. They also raised concerns about the division of resources if both proceed, for what might turn out to be a valueless duplication of effort.

On 7 July 2014, Mr Justice Thirlwall granted the taxpayers permission to proceed with their JR application. HMRC's application to stay the JR proceedings was however refused on the basis that the stay would merely cause delay and the JR proceedings could proceed on the assumption that HMRC was right in law in respect of the underlying landfill tax liability.

The judge's decision to refuse a stay was appealed by HMRC and its appeal came before the Court of Appeal for determination.

Shortly before the appeal came on for hearing, HMRC applied for permission to amend its grounds of appeal in the JR proceedings and to rely on a new witness statement. It submitted that the change of case was due to developments in the FTT proceedings since the date of the court order refusing a stay. In the witness statement, HMRC also raised a logistical point noting the difficulties it was experiencing with resourcing due the overwhelming number and variety of claims for repayment being made by landfill site operators.

Court of Appeal's decision

The first question the court had to decide was whether to allow HMRC's application for fresh evidence and permission to amend its grounds. Taking into account all the circumstances, including the fact that this was an interim appeal and that the parties had made reasonably full submissions on the evidence, the court granted HMRC's applications.

The court then went on to consider whether there should be a stay of the JR proceedings. In reaching its decision on this issue, it considered there would have to be strong reasons for restricting the taxpayers' right to pursue both claims. In response to HMRC's contention regarding logistics and resourcing, the court considered that these difficulties could not possibly constitute strong reasons for restricting the taxpayers' right to pursue both claims.

3. [2015] EWCA 747.

Lady Justice Arden commented that significant duplication of fact could be sufficient to justify a stay, as the same issues of fact should not be decided by different tribunals in disputes involving the same parties. Duplication wastes time and costs and is contrary to the interests of justice. She noted that in some cases the risk cannot be avoided, however, she did not consider the present case fell into that category. The question then was whether a decision to allow both proceedings to proceed would result in the Administrative Court making findings of fact which would have to be determined in the tax appeal.

The court dismissed HMRC's appeal for the principal reason that it did not consider HMRC had made it clear precisely what its case would be in the JR proceedings. In the circumstances, it was not clear to the court whether there was any overlap between the JR proceedings and the tax appeal.

Comment

For most taxpayers in dispute with HMRC, pursuing their appeal to the FTT will be sufficient. However, in some cases, as in the present case, a taxpayer will find that they have an issue which also falls into the ambit of the Administrative Court. It will of course depend on the facts and circumstances of the case which issue should be decided first[4]. However, it is clear from this case that where there are two sets of proceedings, HMRC will not be able to secure a stay of the JR proceedings by simply claiming resource issues, or asserting duplication of fact.

The Court of Appeal made it clear that there has to be strong reasons for restricting a taxpayer's right to pursue both claims.

The Court of Appeal's decision can be read here.

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4. *R on the application of Davies & Another) v HMRC* [2011] UKSC 47; *R (on the application of Gaines-Cooper) v HMRC* [2011] STC 2249.

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