VAT update

February 2016

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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

Nicole Kostic
Associate
+44 20 3060 6340
nicole.kostic@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 Disputes team.

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Social Care 4U Ltd: Tribunal considers reasonable excuse for late payments of VAT

In *Social Care 4U Ltd v HMRC*[8], the FTT considered the principles set down by the Court of Appeal in *Customs and Excise Commissioners v Steptoe*[9] and whether insufficiency of funds constitutes a reasonable excuse for late payment of VAT. more›

News

Commission publishes an Action Plan on VAT

In January 2016, the European Commission published a Roadmap for an Action Plan, to set out a direction for future work towards a simple, efficient and fraud-proof definitive system of VAT tailored to the single market.

The Action Plan will take stock of the achievements made since the 2011 Communication on the future of VAT and will set out the direction for future work. In particular, it will set out the main features of the definitive VAT regime for intra-EU trade that the Commission wants to propose and the methodology it intends to use. In particular, the initiative is intended to address:

- the difficulties arising from the VAT treatment of intra-EU trade under the current system and its exposure to fraud
- the VAT rates structure and levels and
- simplification of the VAT system to reduce compliance costs to businesses and reduce mistakes, tax avoidance and fraud.

The Commission intends to gather further information through public consultations and communications with the Group on the Future of VAT, representatives of business, tax practitioners and academics.

Details of the Roadmap are available to view here.

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Reminder of withdrawal of the VAT Misdirection Extra Statutory Concession 3.5 in cases of VAT liability change

On 1 February 2016, HMRC published Revenue & Customs Brief 7/16, reminding taxpayers that the misdirection class concession (MCC) no longer exists.

From 1 August 2016, HMRC will no longer routinely consider requests not to pursue the tax due.

Any request not to pursue net VAT due, where VAT has not been charged on to customers, must be received by HMRC's VAT registration service on or before 31 July 2016. HMRC will only consider requests that include complete and accurate calculations of both output tax not charged on and the associated input tax and where the VAT return (covering all supplies whether or not VAT has been charged on) has been submitted.

This applies to all taxpayers regardless of whether they are, have been, or intend to apply to be registered for VAT.

Brief 7/16 is available to view here.

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Draft Legislation: VAT use and enjoyment provisions for insurance repair services

In the Summer Budget 2015, the government announced that it would introduce a use and enjoyment provision to counter tax avoidance involving the provision of repair services, carried out under a contract of insurance, to insurers located outside the EU.

This "use and enjoyment" provision is intended as an anti-avoidance measure to counter tax avoidance involved in the provision of repair services carried out under a contract of insurance, to insurers located outside the EU.

On 27 January 2016, HMRC published the draft secondary legislation, accompanied by a draft explanatory memorandum, for the implementation of the provision.

A technical consultation is open on the draft legislation. All comments must be submitted by 29 February 2016.

The draft legislation is available to view here.

The explanatory memorandum accompanying the draft legislation is available to view here.

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Cases

Tower Bridge GP Ltd: Tribunal grants "disclosure" application against HMRC

The recent case of *Tower Bridge GP Ltd v HMRC*[1] concerned applications by Tower Bridge GP Limited (Tower Bridge) and HMRC to the First-tier Tribunal (FTT) for disclosure of information and documents from each other, pursuant to Rule 5 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Tribunal Rules). Tower Bridge sought disclosure of material principally concerned with policy advice provided to HMRC officers. Notwithstanding that it had failed to utilise its information powers contained in Schedule 36, Finance Act 2008, to obtain the relevant documents during the course of its lengthy enquiries, HMRC sought disclosure of material it considered relevant to the underlying dispute. The FTT ordered that both Tower Bridge and HMRC should provide some disclosure to each other in line with its decision.

Background

Tower Bridge is the representative member of a VAT group that includes CantorCO2e Ltd (CO2e). The underlying substantive appeal relates to decisions made by HMRC on 6 December 2012 to refuse Tower Bridge the right to recover input tax incurred on certain purchases of emissions allowances under the European Union Emissions Trading Scheme (carbon credits) and to issue VAT assessments accordingly. One of the grounds relied upon by HMRC was that CO2e knew, or ought to have known, that the transactions in question were connected with fraudulent evasion of VAT (applying the decision of the ECJ in *Axel Kittel v Belgium*[2] (the Kittel issue).

So far as relevant to the applications, there were three underlying issues, namely:

- the validity of certain invoices
- a time limit issue relating to whether HMRC was in time to make an assessment and
- the Kittel issue.

Tower Bridge applied for disclosure of eight categories of documents and information from HMRC. The basis of the application was that the documents requested would enable it to determine whether HMRC had exercised reasonable discretion, in time, and within the statutory framework.

HMRC requested disclosure of internal documents from Tower Bridge.

Rule 5 of the Tribunal Rules sets out the FTT's case management powers. Specifically, Rule 5(3)(d) provides that the FTT may direct:

"... a party or another person to provide documents, information or submissions to the Tribunal or another party."

When exercising any power under the Tribunal Rules (including the power under Rule 5(3)(d)) the FTT must take into account the "overriding objective" set out in Rule 5(1) of the Tribunal Rules to deal with cases "fairly and justly".

The FTT's decision

Whilst acknowledging that the FTT operates a more flexible approach than the courts, Tower Bridge referred the FTT to Rule 31 of the Civil Procedure Rules (CPR) which governs disclosure in the courts. It was submitted that Tower Bridge's application should be treated as analogous to

1. [2016] UKFTT 054 (TC).
2. Case C-430/04.

an application for 'specific disclosure', under which the court makes an order for the disclosure of specific documents or classes of documents, which are relevant to an issue in the appeal. Although the FTT considered the analysis of CPR 31 as useful, the FTT said that it preferred to follow the default position set out in Rule 27(2) of the Tribunal Rules, namely, that each party will disclose to the other only those documents on which it proposes to rely.

However, given the complexity of the issues in the underlying appeal and the serious allegation that a major financial institution either knew, or should have known, that transactions with which it was involved were connected with fraud, the FTT was of the view that there should in this case be a presumption that both parties will disclose relevant material to each other. The FTT said that the test of relevance should not set an unduly high bar. Documents and information that might advance or hinder a party's case, or which might lead to a "train of inquiry" that might advance or hinder a party's case are in principle relevant.

The FTT considered the specific documents requested by each party and whether they should be disclosed. It concluded that HMRC should disclose to Tower Bridge policy advice that the relevant HMRC officer admitted considering when making his decision. The FTT held that the test for "self-certification" for the relevance of documents was appropriate in the circumstances. Should any issues arise in relation to relevance, Tower Bridge would be able to make a further application to the FTT.

In relation to HMRC's application for disclosure, Tower Bridge argued that HMRC had ample opportunity to utilise its Schedule 36 information powers during its enquiries to gather all relevant documentation and information and that it was now seeking to carry out an exercise which should have been performed during the enquiry stage of the process.

The FTT concluded that in the circumstances the documents requested satisfied the relevance test and the fact that HMRC had not utilised its Schedule 36 powers during the course of its enquiries to obtain the documents was not a bar to it requesting disclosure under Rule 5 of the Tribunal Rules (*HMRC v Ingenious Games LLP and others*[3] applied).

Comment

This decision provides helpful guidance on the approach to be taken when applying to the FTT for a disclosure direction under Rule 5 of the Tribunal Rules. Given HMRC's traditional reticence about disclosing documentation and information to taxpayers during the course of litigation, taxpayers should not hesitate in applying to the FTT for an appropriate disclosure direction should they form the view that HMRC is in possession of relevant material which it is refusing to disclose.

The decision also confirms that once HMRC's enquiries are concluded and an appeal has been made to the FTT, HMRC cannot utilise its Schedule 36 information powers. If it requires further documents or information from the taxpayer, it must make an appropriate application to the FTT for a disclosure direction.

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

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3. [2014] UKUT 0062 (TCC).

Air France-KLM v Ministère des Finances et des Comptes publics: Non-refundable unused airline tickets are supplies for VAT purposes

On a reference from France, the Court of Justice of the European Communities (ECJ) has confirmed in *Air France-KLM v Ministère des Finances et des Comptes publics*[4], that the sum paid to an airline on the issue of a non-refundable airline ticket was consideration for a supply even if the passenger did not use the ticket.

Background

The case concerned the supply of domestic air passenger transport services in France, provided either directly by Air France-KLM or in accordance with a franchise agreement with Brit Air (now Hop!-Brit Air SAS). The flights were subject to VAT, and the tickets were sold at prices inclusive of VAT.

From 1999, Air France ceased paying to the Treasury VAT on the sale of tickets issued to but not used by passengers of its domestic flights in the following circumstances:

- non-refundable tickets which were no longer valid as a result of customers being "no-shows" at boarding and
- invalid exchangeable tickets which were not used during their period of validity.

In addition, where tickets were sold in accordance with the franchise agreement, Air France paid Brit Air an annual flat-rate compensation as a result of passenger "no shows". Brit Air did not subject that sum to VAT.

Following a review of the accounts, the French tax authorities concluded that the amounts relating to tickets "issued and not used" should have been subject to VAT. Accordingly, they assessed Air France for amounts relating to VAT together with default interest. Brit Air were subsequently assessed for VAT for sums corresponding to unused tickets it had received from Air France.

The domestic court had doubts concerning the liability to VAT of an unused travel ticket and referred questions to the ECJ.

The ECJ's judgment

The ECJ was asked to consider first, whether the issue by an airline company of tickets is subject to VAT where those tickets have not been used by passengers and the latter are unable to receive a refund.

The taxpayer argued that the price paid constituted a contractual indemnity to compensate the airline for harm suffered. The ECJ did not agree. In its view such an interpretation would change the nature of the consideration paid.

The ECJ referred to paragraph 40 in *Rehder*[5], which set out guidance on the services provided in performance of the contract to transport passengers by air. It considered that whilst it was only possible to perform those services if the passenger turned up on the agreed date and at the agreed place of boarding, the consideration for the price of the ticket was ultimately a right to benefit from the performance of obligations under the contract, regardless of whether the passenger exercised that right. The price paid by a "no show" passenger was the full price to be paid and the sale was final and definitive. As the airline reserved the right to re-sell unused services, without being required to reimburse the first passenger, the airline did not suffer any harm.

4. (Cases C250/14 and C-289/14).
5. c-204/08.

On this first question, the ECJ was of the view that the ticket price constitutes remuneration for the transport service offered, even where the customer does not use the service.

The second question considered by the ECJ was whether the VAT paid when the air ticket was purchased by a passenger who did not use it became chargeable on receipt of the payment of the price of the ticket by either the airline or a third party acting on its behalf.

As it was evident that the airline company which sells transport tickets fulfils its contractual obligations, even in the event of a "no show", the ECJ said that VAT becomes chargeable on receipt of payment of the ticket price.

Finally, the Court considered whether, in circumstances where a third party sells an airline's tickets and pays a lump sum calculated as a percentage of the annual turnover from corresponding flight routes, that sum is a taxable amount as consideration for tickets.

In the light of the conclusions reached on the other questions, the ECJ was of the view that the sum, which was contractually agreed between the parties, corresponded to the value attributed by the two companies concerned to tickets issued for transport services but not used. Accordingly, the lump sum is remuneration and there is a direct link between the performance of the services provided and the remuneration received. The sum is therefore taxable as consideration for those tickets.

Comment

The ECJ considered the contract for services as one for the provision of a right to travel, in return for which the airline retained the full price regardless of whether or not the customer travelled. This judgment appears to support the distinction that HMRC draws between the decision in *Customs and Excise Commissioners v Bass Plc*[6], which confirmed that a non-refundable deposit paid for a hotel room was consideration for a supply, even if the consumer did not make use of the room and *Société thermale d'Eugénie-les-Bains*[7], which held that such deposits were compensation.

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

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Social Care 4U Ltd: Tribunal considers reasonable excuse for late payments of VAT

In *Social Care 4U Ltd v HMRC*[8], the FTT considered the principles set down by the Court of Appeal in *Customs and Excise Commissioners v Steptoe*[9] and whether insufficiency of funds constitutes a reasonable excuse for late payment of VAT.

Background

Social Care 4U Ltd's (Social Care) principal activity was the supply of temporary social care workers to managed service companies. Those companies' clients were the social care departments of London Boroughs, such as Hackney, Haringey, Barnet and Redbridge. The terms under which Social Care operated were "pay when paid", in other words, Social Care was paid when the managing service companies were paid.

In early 2010, Social Care began experiencing cash-flow problems under contracts with one of its managed service companies, Ranstad Sourceright Ltd (Ranstad). The essence of the

6. [1993] STC 42.
7. (Case C-277/05).
8. [2015] UKFTT 676 (TC).
9. [1992] STC 757.

problem revolved around the fact that Social Care had to pay the workers on a weekly basis but were only being paid by Ranstad monthly. This was compounded by the administration of timesheets. The workers were only paid on production of a signed timesheet, but the timesheet had to be entered on to the purchase order system before Ranstad would pay Social Care. The administration of this was not in Social Care's hands, but in Ranstad's.

In the light of the cash-flow difficulties, Social Care notified HMRC in advance that they would be unable to pay the liability due on 09/11 in full. However, they did not enter into a "time-to-pay" (TTP) agreement. Accordingly, HMRC issued a default surcharge in respect of the period 09/11.

A TPP agreement was requested for the period 12/11, but this was refused. This was also the case for the period 03/12. As a consequence, Social Care was late in paying the VAT in both periods. HMRC duly issued default surcharges in respect of these periods.

As readers will be aware, the consequences of a default surcharge may be avoided if the person concerned has a reasonable excuse. However, under section 71(1)(a) VATA, an insufficiency of funds to pay any VAT due is not a reasonable excuse. Nevertheless, Social Care appealed the default surcharges levied for the three periods. They relied upon the *Steptoe* case and argued that it was entitled to rely upon the underlying case of insufficiency. It had to surrender control of its cash flow to Ranstad who accounted for nearly half of its business.

The FTT's decision

The FTT began by considering the relevant facts and decision in *Steptoe*. *Steptoe* concerned an electrical contractor who was late in paying VAT in several quarters. His only customer was the London Borough of Redbridge Council, who was an extremely slow payer. In the circumstances, the Court of Appeal concluded that the taxpayer did have a reasonable excuse. The court concluded that: "if the exercise of reasonable foresight and due diligence would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the dates on which such foresight, diligence and regard would have overcome the insufficiency of funds." (the *Steptoe* test).

The FTT acknowledged that the type of issue Social Care faced in the conduct of its business is capable of reasonable excuse. However, on the evidence before it, the FTT concluded that Social Care had not sufficiently demonstrated that it satisfied the *Steptoe* test.

In reaching its decision the FTT noted that the documentary material presented did not provide clarity on the precise position for the periods of default. They did not accept that Social Care was in a comparable position to Mr Steptoe. Social Care was not a business that was without cash altogether; its turnover provided an indication of the extent of its overall cash flow. Social Care decided to use its available cash flow to pay its workers for the services, despite Ranstad continuing to delay, or refusing full payment for those services.

In the FTT's view, there was not enough evidence for the periods in default in question to enable it to conclude that payment of the VAT as soon as Social Care was able to, was all that could be done. The FTT noted that the problems with Ranstad had emerged in 2010, well over 12 months before the periods in dispute. Mr Steptoe was at risk of being offered no further work by the Council if he complained but there was no equivalent evidence in Social Care's case nor any indication as to what steps were open to it vis-à-vis Ranstad to alleviate its VAT default position.

Social Care's appeal was therefore dismissed.

Comment

Unfortunately for Social Care, the evidence presented at the hearing was not sufficient to enable the FTT to conclude that it had a reasonable excuse for non-payment. Whilst VAT returns for the periods in default, together with various schedules of payments and invoices were provided to the FTT, no witness evidence was submitted to provide a detailed explanation of the operation of Social Care's business, its relationship with Ranstad, or its cash flow difficulties.

This decision is a reminder of the crucial role evidence has to play in determining the outcome of appeals before the FTT.

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

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- **Winner – Commercial Team of the Year – The British Legal Awards 2014**
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15827

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

8 Marina View #34-02A
Asia Square Tower 1
Singapore 018960
T +65 6818 5695