# VAT update

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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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# News

## HMRC publishes guidance on pension fund management costs

Since the decision of the Court of Justice of the European Union (CJEU) in *PPG Holding BV cs te Hoogezand*[1], HMRC has issued a number of Business Briefs (see Brief 43/14 and Brief 08/15) setting out its position regarding an employer's ability to deduct VAT incurred on pension fund management costs.

On 26 October 2015, HMRC published Brief 17/15, which announced a 12 month extension to the transitional period, which was due to end on 31 December 2015, for pension schemes to restructure existing arrangements so as to maximise input tax recovery on fund management and administration services.

This latest Brief also provides an update on HMRC's position regarding possible arrangements for employers to achieve VAT deduction for the costs of administering occupational pension schemes and managing their assets going forward.

Brief 17/15 is available to view here.

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## PAC reports on HMRC's performance in 2014-2015

The Public Accounts Committee (PAC) has published its report on HMRC's performance in 2014-15. The report commends HMRC for increasing tax revenues whilst reducing its running costs. However, it also highlights areas where there has been little or no improvement.

The PAC criticised HMRC's performance, in particular customer service was considered unacceptable, and the PAC also described the number of criminal prosecutions for tax evasion as "wholly inadequate". The PAC chair, Meg Hiller MP said "*HMRC must do more to ensure all due tax is paid. The public purse is missing out and taxpayers expect and deserve better*". A number of recommendations were made to improve HMRC's performance.

The PAC report is available to view here.

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## VAT groups and Skandia: HMRC publishes guidance

On 30 October 2015, HMRC published guidance (Business Brief 18/15) confirming the UK VAT changes resulting from the *Skandia*[2] judgment and providing details of how it expects other member states to operate VAT grouping (if they have it).

From 1 January 2016, an overseas establishment of a UK-established entity will be treated as part of a separate taxable person if the overseas establishment is VAT grouped in a Member State that operates similar "establishment only" grouping provisions to those in Sweden, which were considered in Skandia. This will be the case whether or not the entity in the UK is part of a VAT group. Therefore, businesses must treat intra-entity services provided to or by such overseas establishments as supplies made to or by another taxable person and account for VAT accordingly.

1. (C-26/12).
2. (C-7/13).

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HMRC currently expects the changes to apply to Belgium, the Czech Republic, Denmark, Estonia, Hungary, Latvia, Slovakia, Spain and Sweden. The position in Cyprus, Finland, Germany and the Netherlands remains unclear. The remaining Member States are either not expected to apply the "establishment only" VAT grouping or do not have VAT grouping at all.

HMRC's Brief is of course only a guide and businesses should check with the relevant Member State tax authority to confirm the situation in that Member State.

Brief 18/15 is available to view here.

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# Cases

## CJEU considers the position on the recoverability of input tax deduction

In *"Sveda" UAB v Valstybinė mokesčių inspekcija Lietuvos Respublikos finansų ministerijos*[3], a case referred from Lithuania, the CJEU has clarified the application of the "direct and immediate link" test for the deductibility of input tax in circumstances where the construction of a recreational path was provided to visitors free of charge.

### Background

Sveda UAB (Sveda) is a commercial company which provides accommodation, food and beverages, organises trade fairs, conferences and leisure activities, as well as the engineering and consultation associated with those activities.

In 2012, Sveda was working on the creation of a "Baltic recreational path". The path was intended to entice visitors and improve access to one of Sveda's retail outlets. However, Sveda could not afford the construction costs of the new path and so on 2 March 2012 it entered an agreement with the National Paying Agency under the Ministry of Agriculture (the Agency) to supply funding. Under this agreement, Sveda was required to provide the public with access to the recreational path free of charge. In return, the Agency agreed to reimburse up to 90% of the cost of the construction work, in the form of a "grant". Sveda only had to suffer 10% of the cost, but reclaimed all of the input tax.

The Lithuanian tax authorities refused Sveda's application to deduct all of the input tax as they considered there was no direct and immediate link between the costs and the retail activity of the outlet, as visitors could use the path free of charge. They also argued that as the company had only borne 10% of the cost, it could not reclaim all of the VAT.

Questions were referred by the national court to the CJEU, to determine whether, in the circumstances, there was a direct and immediate link between the expenses of the construction work and the planned economic activity of Sveda's retail outlet.

### The CJEU's decision

The CJEU found in favour of Sveda and determined that all the VAT was recoverable.

In reaching this conclusion, the CJEU relied on the national court's finding that the expenses were incurred ultimately with the intention of carrying out Sveda's economic activities. The recreational path was a means of attracting visitors with a view to providing them with goods and services.

The CJEU held that the fact the path was provided free of charge did not affect the existence of a direct and immediate link between the input and output transactions. They agreed with the earlier Advocate General opinion that the expenditure formed part of Sveda's general costs and had a direct and immediate link with the economic activity as a whole. The path created better access to the retail outlet and there was therefore a direct and immediate link to the sale of goods and services which Sveda intended to provide. The source of the funding was irrelevant.

The CJEU considered that all of the VAT incurred on the costs was deductible provided that Sveda continued to use the path in connection with the shop.

3. [2015] EUECJ C-126/14.

### Comment

HMRC have consistently maintained that input tax is only recoverable in circumstances where it is directly referable to the output transactions and so this decision will be welcomed by taxpayers. The CJEU has confirmed that the mere fact that costs have been financed by a grant has no bearing on whether input tax can be covered. The most important determinant for the deductibility of input tax is the overarching use of the expenditure and how this use is associated with supplies the taxpayer makes.

The CJEU's decision is available to view here.

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## VAT repayment and interest is subject to corporation tax

In *Coin-a-drink Limited v HMRC*[4], the First-tier Tribunal (FTT) considered the ability of HMRC to impose corporation tax on repayments of overpaid VAT and associated interest in the light of EU law.

### Background

Coin-a-drink Limited (CAD) operates a wide range of full service automatic food beverage and snack vending machines which it supplies to its customers.

The background to the claim was not disputed. For many years all sales made through vending machines were treated as liable to VAT at the standard rate. However, following *Compass Contract Services UK Limited*[5], HMRC had accepted that the sale of cold food from vending machines, in addition to tea and coffee sales up to 1 May 1984, should have been zero-rated rather than standard rated. Accordingly, CAD submitted a claim to recover overpaid VAT on supplies of hot drinks up to 1 May 1984.

HMRC accepted CAD's claim and repaid the overpaid VAT together with statutory interest[6], in the total sum of £1,360,682.

CAD recognised the repayments and interest in accordance with relevant GAAP, however the amounts were excluded from CAD's profit and loss account for the period 1973 to 1984. HMRC subsequently opened an enquiry into CAD's return and requested payment of corporation tax on the repaid VAT and interest.

The main dispute concerned whether the imposition of corporation tax on the repayment and interest was in breach of EU law.

The parties were in agreement that if considered solely in the light of UK law, the appeal must fail, following the decision in *Shop Direct Group and others v HMRC*[7]. However, CAD relied on EU law in support of its case, such arguments having not been considered in *Shop Direct Group*.

CAD sought to rely on a "mistake-based" restitution claim, in relation to the repayment and the associated interest. It submitted that by virtue of the operation of EU law, section 80(7) of the Value Added Tax Act 1994 (VATA) should be disapplied to allow CAD to pursue its mistake-based claim. It was argued that a central principle of restitution is that the party

4. TC/2013/03851.
5. [2006] STC 1999.
6. Arising under section 78 Value Added Tax Act 1994.
7. [2014] EWCA Civ 255.

unjustly enriched should disgorge all the benefits he has received. HMRC could not therefore impose a corporation tax liability, as to do so would not disgorge all the benefit it had obtained as a consequence of the overpaid VAT.

HMRC's primary argument was that the VAT repayment and interest arose from simple statutory claims and EU law did not require section 80 VATA to be disapplied. In the alternative, HMRC submitted that even if the claims were restitutionary in nature, the position would still be the same. The imposition of corporation tax simply represented a delayed working through of the normal statutory rules.

### The FTT's decision

The FTT dismissed the taxpayer's appeal.

In reaching its conclusion, the FTT considered the true legal character of the payments and whether they were statutory or restitutionary in nature.

The FTT concluded that the VAT repayment was made exclusively pursuant to section 80 VATA and could not be characterised as a payment made in respect of a mistake-based restitution claim.  It considered that section 80 provided a complete and EU law compliant remedy to enable the recovery of overpaid VAT and satisfied the taxpayer's EU law "*San Giorgio*" right to repayment. No disapplication was required and accordingly, the claim could not be characterised as a mistake-based restitution claim. The decision in *Shop Direct* therefore applied and a corporation tax liability on the repayment was due.

In relation to the interest payment, the FTT held that this was made exclusively pursuant to section 78 VATA and could not be characterised as payment in respect of a mistake-based restitution claim. Whether the interest payment represented an "adequate indemnity" remained  to be determined[8] and it was not within the FTT's jurisdiction to decide that point.

### Comment

For any taxpayers claiming repayments and interest (including those with pending compound interest claims) this is an important decision. In the view of the FTT, HMRC is able to impose a corporation tax liability in respect of amounts of repaid VAT and associated interest.

The decision has added significance given that the government has included in the Finance Bill 2015 provisions which introduce a new special rate of corporation tax for restitution interest paid by HMRC to companies. Where certain conditions are satisfied, interest payable by HMRC will be treated as restitution interest and subject to a 45% corporation tax charge.

The FTTs decision is available to view here.

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## The Upper Tribunal confirms payment plan arrangements are not abusive

In *HMRC v DPAS Limited*[9], the Upper Tribunal (UT) has partly allowed HMRC's appeal against the FTTs decision that a dental plan provider supplied VAT-exempt payment services to patients. A decision on whether supplies were exempt has been reserved pending upcoming CJEU decisions.

8. See *Littlewoods Retail Limited v HMRC* [2015] EWCA Civ 515.
9. [2015] UKUT 585 (TCC).

## Background

DPAS Limited (DPAS) managed the administration, finance and insurance aspects of dental plans.

DPAS entered into contracts for the provision of its services with dentists. The dental plans were "practice branded" and offered in the name of, and under the "brand" of the dentists' practices. The agreements to provide dental services under the plan were made between the dentists and their patients. DPAS did not have any contract with the patients.

Patients paid DPAS a fixed sum each month to cover the costs of their dental maintenance and insurance for emergency treatment. After deducting its fee and the insurance premium, DPAS paid the balance of the money it collected to the dentists. A one off £10 registration fee was also payable by each patient.

Following the CJEU decision in *AXA UK plc v HMRC*[10], with effect from 1 January 2012, DPAS implemented changes to its existing contractual arrangements to avoid the supplies being treated as standard rated. The new arrangements provided a taxable contract with the dentist and an exempt payment handling contract with the patient. The issue in the present appeal was whether DPAS made an exempt supply of services to the patients.

The FTT concluded that the £10 registration fee was an exempt supply, being ancillary to the main exempt supply and that the arrangements were not abusive. HMRC challenged this decision on a number of grounds and appealed to the UT.

## The UT's decision

The UT partly allowed HMRC's appeal. In reaching its conclusion it considered each of HMRC's grounds of appeal in turn.

First, the UT examined the contractual position and economic reality of the arrangements between DPAS and the patients. With the exception of existing patients who did not sign the acceptance form, the UT found that there was a contractual agreement between DPAS and the patients under which DPAS provided services for a consideration. HMRC's appeal on this ground was therefore dismissed.

HMRC's second and third grounds concerned whether the services were exempt under the relevant provisions of the Principal VAT Directive. However, the UT acknowledged that since the FTT's decision there had been two references to the CJEU in *Bookit*[11] and *NEC*[12] and accordingly directed that the determination of the liability of the supplies be stayed pending the CJEU judgements in those cases.

HMRC also challenged the FTT's decision regarding the treatment of the £10 registration fee as an ancillary part of the exempt supply. It argued that the FTT gave insufficient reasons for its conclusion and was not entitled, on the evidence before it, to come to the conclusion it did. The UT allowed HMRC's appeal on this ground. In light of the facts, it was of the view that the patients paid the fee to join the dental plan primarily in order to obtain dental care and not to obtain payment services from DPAS. The UT therefore concluded that the £10 registration fee was chargeable to VAT at the standard rate.

10. [2010] STC 2825.
11. [2014] UKFTT 856 (TC).
12. [2015] UKUT 23 (TCC).

Finally, the UT considered HMRC's argument that the transactions constituted an abusive practice, contrary to the principle identified by the CJEU in *Halifax*[13]. The relevance of this ground rested on the outcome of the CJEU judgments in *Bookit* and *NEC*. If the CJEU decisions in those cases are such that DPAS's supplies are standard rated, then the issue of abuse will not arise. However, if the CJEU decides the services are exempt, the UT commented that this would strongly suggest that the structure of the contracts would not be abusive.

## Comment

Whilst the VAT treatment of the supplies in this case is yet to be determined, taxpayers will be reassured that the UT agreed with the FTT that the arrangements were not abusive and did not contravene fiscal neutrality.

The UT's decision is available to view here.

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13. C-255/02.

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