VAT update

November 2016

In this month's update we report on new regulations which allow HMRC to refuse registration of VAT representatives, HMRC's new policy on the correct treatment of VAT incurred by a business prior to its VAT registration and the EU's extension of the UK's VAT derogation permitting the UK to restrict input tax recovery on car leasing costs to 50% where the car is available for private use. We also comment on three recent cases involving VAT bad debt relief provisions, issues surrounding ownership of VAT repayment claims where members have left a VAT group and admissibility of evidence where fraud is not alleged.

News

New regulations allow HMRC to refuse registration of VAT representatives

On 21 October 2016, the government published regulations, amending regulation 10 of the Value Added Tax Regulations 1995 (SI 1995/2518), to allow HMRC to refuse or cancel a VAT representative's registration if HMRC is satisfied that the representative is not (or is no longer) "a fit and proper person to act in that capacity". more›

Brief 16/16 – HMRC clarifies policy on treatment of VAT incurred prior to registration

HMRC has clarified its policy on the correct treatment of VAT incurred by a business prior to its VAT registration. more›

EU extends UK's 50% input VAT recovery restriction on certain car leasing costs to 2019

On 14 March 2016, the UK requested authorisation to continue to apply a derogation measure concerning the right of deduction of VAT borne on the hire or lease of motor cars also used for private purposes. more›

Cases

GMAC (UK) Plc – VAT bad debt relief provisions incompatible with EU law

In *HMRC v GMAC (UK) Plc*, the Court of Appeal has held that the UK's legislation, which barred bad debt relief claims unless the debtor was insolvent and the property in the goods had passed, was incompatible with EU law. more›

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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 Dispute team.

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

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(1)BMW (UK) Holdings and MG Rover Ltd (2) Standard Chartered plc – Upper Tribunal confirms that right to make VAT repayment claims belongs to representative member of VAT Group

In *HMRC v MG Rover Group Limited; Standard Chartered PLC v HMRC* , the UT has confirmed that section 43, Value Added Tax Act 1994 (VATA) required repayment rights under section 80, VATA, to be held only by the representative member both before and after they have left the group or the group has been dissolved. **more›**

Infinity Distribution Limited – admissibility of evidence where fraud not alleged

In *HMRC v Infinity Distribution*, the Court of Appeal has held that evidence purporting to establish that alleged supplies had not actually taken place was admissible, even in the absence of an allegation of fraud by HMRC. **more›**

News

New regulations allow HMRC to refuse registration of VAT representatives

On 21 October 2016, the government published regulations, amending regulation 10 of the Value Added Tax Regulations 1995 (SI 1995/2518), to allow HMRC to refuse or cancel a VAT representative's registration if HMRC is satisfied that the representative is not (or is no longer) "a fit and proper person to act in that capacity".

On 7 November 2016, HMRC published guidance setting out criteria for determining whether an individual is a fit and proper person to act as a VAT representative of a non-established taxable person. In summary, the guidance provides that a person is not a fit and proper person if:

- the person has been disqualified as a director or has had previous requests for a similar role in VAT or other regime revoked or refused
- the person is, or has been, involved in crime, has criminal convictions or has incurred penalties for deliberate wrongdoing
- the person is connected with the relevant business or key persons involved in that business, or with any non-compliant or fraudulent business.

This measure follows the government's announcement in the Budget of an intention to tackle VAT evasion on online sales by overseas businesses. The amendment, however, is not expressly limited to VAT evasion through online sales.

The new regulations came into force on 7 November 2016.

A copy of the Regulations is available to view here.

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Brief 16/16 – HMRC clarifies policy on treatment of VAT incurred prior to registration

HMRC has clarified its policy on the correct treatment of VAT incurred by a business prior to its VAT registration.

Businesses registering for VAT are allowed to recover the tax they have incurred on goods and services before their effective date of registration (EDR) provided the goods or services are used or "consumed" within certain time limits.

Over recent years there has been a misinterpretation of the word "consumed", particularly in relation to business assets. HMRC Business Brief 16/6 has been prepared to clarify HMRC's position and ensure VAT on assets held prior to EDR is treated consistently.

Subject to the normal rules on VAT deduction, VAT incurred prior to registration may be recovered:

- in the case of services, where the services are received within 6 months of registration and used in the business at the date of registration
- in the case of stock, where the goods are still on hand at registration (apportionment may be required)
- in the case of fixed assets, where the assets remain in use by the business at registration.

HMRC will amend its guidance to make this clear. In the meantime, taxpayers that have been adversely affected should consider whether an error correction may be made.

A copy of Revenue and Customs Brief 16/6 is available to view here.

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EU extends UK's 50% input VAT recovery restriction on certain car leasing costs to 2019

On 14 March 2016, the UK requested authorisation to continue to apply a derogation measure concerning the right of deduction of VAT borne on the hire or lease of motor cars also used for private purposes. The derogation is set out in Council Decision 2013/681/EU and was due to expire on 31 December 2016.

By a Council Implementing Decision adopted on 27 October 2016, the Council of the European Union agreed to the continuation of the UK's VAT derogation permitting the UK to restrict input tax recovery on car leasing costs to 50% where the car is available for private use. The derogation also relieves the business of the obligation to account for VAT on the supply of the car for private use. The derogation will now continue until 31 December 2019.

A copy of the Council Implementing Decision is available to view here.

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Cases

GMAC (UK) Plc – VAT bad debt relief provisions incompatible with EU law

In *HMRC v GMAC (UK) Plc*[1], the Court of Appeal has held that the UK's legislation, which barred bad debt relief claims unless the debtor was insolvent and the property in the goods had passed, was incompatible with EU law.

Background

This case related to an appeal brought by HMRC against an Upper Tribunal (UT) decision relating to the VAT bad debt relief provisions.

GMAC (UK) PLC (GMAC) bought cars from independent dealers (who had agreed sales with customers) and sold them under hire purchase agreements. In February 2006, GMAC made a claim to HMRC for bad debt relief in respect of supplies made under the hire purchase agreements entered into before 20 March 1997.

Article 11C(1) of the Sixth Council Directive 77/388/ECC (now Article 90 of Council Directive 2006/112/EC), provided that, in the case of cancellation, refusal or total or partial non-payment of consideration, or where the price is reduced after the supply takes place, the taxable amount is reduced under conditions that are determined by the member state. In the case of total or partial non-payment, member states may derogate from this rule.

The UK implemented Article 11C(1) by a bad debt relief scheme which enabled a person who had accounted for output tax on a supply to claim a refund of VAT to the extent the consideration for the supply was not paid (the Old Scheme). There were conditions attached which stated that the property in the goods supplied must have passed from the claimant (the Property Condition) and the debtor must be insolvent (the Insolvency Condition).

The UK legislation governing bad debt relief was amended in 1997 to remove the Property Condition and the Insolvency Condition (the New Scheme). Bad debt relief is now available if consideration for the supply has been written off in the claimant's accounts. Under the New Scheme, pursuant to section 39(5), Finance Act 1997, no claim under the Old Scheme can be made after 19 March 1997. Further, no claim for a refund may be made under the New Scheme in relation to any supply that took place before 1 April 1989.

GMAC was ineligible for bad debt relief because title did not pass under its hire purchase agreements and it normally did not pursue insolvency proceedings against defaulting customers. Its claim for bad debt relief rested on the direct effect of Article 11C(1) and the incompatibility of the Insolvency and Property Conditions.

GMAC succeeded in the First-tier Tax Tribunal (FTT) and the UT. It was held that the Insolvency and Property Conditions were incompatible with Article 11C(1). The UT also found that the introduction of section 39(5) interfered with GMAC's vested right to claim bad debt relief which was taken away retrospectively without any transitional measures.

HMRC appealed to the Court of Appeal.

1. [2016] EWCA Civ 1015.

Court of Appeal's judgment

The Court held that the Old Scheme provisions failed the EU law test of proportionality due to the Property and the Insolvency Conditions. The Property Condition excluded bad debts from relief in any contract for the supply of goods which contained a retention of title clause. The Insolvency Condition required legal proceedings to have been taken to obtain bankruptcy of the debtor.

The Court, in considering whether section 39(5) barred GMAC's claims, allowed HMRC's appeal. The Court held that GMAC had more than adequate time to bring a claim due to the prolonged crossover of the Old and New schemes and it was therefore not excessively difficult or virtually impossible for the company to exercise its EU rights. The Court highlighted that this was not a case where rights were removed without any prior notice. The Court agreed with the UT that, as GMAC had bought a claim under a provision of domestic law (rather than directly enforcing EU law rights) which did not specify a time limit, there was no need to incorporate the EU reasonable time principle to bring a claim.

Comment

The decision is largely of academic interest (except for those with historic bad debt claims) as it relates to a bad debt regime that is no longer in force. However, there were some interesting observations made by the Court regarding the interaction between domestic and EU law. Where a taxpayer enforces its EU law rights pursuant to domestic law that has no time limits, the general EU law obligation to act within a reasonable time does not apply. If GMAC had sought to enforce its EU rights without reference to domestic law, the position may have been different. Given the sums at stake, GMAC may apply for permission to appeal to the Supreme Court.

A copy of the judgment is available to view here.

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(1)BMW (UK) Holdings and MG Rover Ltd (2) Standard Chartered plc – Upper Tribunal confirms that right to make VAT repayment claims belongs to representative member of VAT Group

In *HMRC v MG Rover Group Limited; Standard Chartered PLC v HMRC*[2], the UT has confirmed that section 43, Value Added Tax Act 1994 (VATA) required repayment rights under section 80, VATA, to be held only by the representative member both before and after they have left the group or the group has been dissolved.

Background

The UT considered two joined appeals, both concerned with VAT groups where the supplying entity had left the VAT group before a claim for overpaid VAT was made under section 80, VATA.

At first instance, the FTT came to different conclusions in each case. In the *Standard Chartered* case, the FTT held that where a company, which was a member of a VAT group and made supplies on which VAT was overpaid, left its VAT group, the right to claim the overpaid VAT remained with the representative VAT group. In contrast, in the *MG Rover* case, the FTT held that where a company left its VAT group, it acquired the right to claim the overpaid VAT and that right was withdrawn from the representative member of the VAT group.

2. [2016] UKUT 434.

UT's decision

The UT upheld the conclusion (and reasoning) of the FTT in *Standard Chartered*, dismissing the appeal against that decision, and allowing the appeal against the decision of the FTT in *MG Rover*. The UT considered that the right to repayment rested with the representative member of the relevant VAT group even if the supplying company was no longer a VAT group member. The UT said that section 43, VATA had to be interpreted by reference to Article 4(4) of the Sixth VAT Directive which it considered correctly implemented Article 4(4). The UT considered that the purpose of the VAT grouping arrangements was to simplify the administration of VAT by treating members of the VAT group as a single taxable person rather than taxable persons in their own right.

The UT noted that any potential unfairness caused by its decision could be resolved through specific contractual terms agreed before the member leaves the VAT group.

Comment

This has been an area of contention for some time and the UT's decision provides some welcome clarification in this complex area. It is recommended that parties entering into VAT group arrangements ensure contractually that there are mechanisms in place to address the position of VAT claims in the event a member leaves the VAT group. These mechanisms should be addressed when the VAT group is set up, however, if not, they need to be addressed before a member exits the VAT group.

A copy of the decision is available to view here.

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Infinity Distribution Limited – admissibility of evidence where fraud not alleged

In *HMRC v Infinity Distribution*[3], the Court of Appeal has held that evidence purporting to establish that alleged supplies had not actually taken place was admissible, even in the absence of an allegation of fraud by HMRC.

Background

This case related to an appeal of a case management decision by the UT refusing to allow HMRC to deploy evidence in two conjoined appeals in respect of HMRC's refusal to repay input VAT claimed by Infinity or permit Infinity to zero-rate its supplies.

The first appeal group related to HMRC's decision to deny Infinity input VAT paid by it in relation to taxable supplies of mobile telephones on the grounds that the VAT invoices did not comply with regulation 14(1)(g) or (h) of the Value Added Tax Regulations 1995, which require that VAT invoices include a sufficient description to identify the goods and the quantity (the invalid Invoices Appeals).

The second appeal group related to the refusal of HMRC to allow Infinity to zero rate its own supplies of mobile telephones, on the basis the export did not take place (the Zero Rated Appeals). HMRC's case was that the Convention relative au contrat de transport international de Marchandises par route (CMRs) submitted were unreliable because they derived from a notoriously fraudulent freight forwarding company called Magic Transport, who had a track record of falsifying CMRs and export evidence documents.

HMRC had confirmed on numerous occasions that they were not advancing a positive case of fraud, participation or knowledge of fraud, bad faith or failure to take reasonable steps, against Infinity.

3. [2016] EWCA Civ 1010.

In relation to the Invalid Invoices Appeals, HMRC served witness evidence (the Wafer statement) which sought to prove criminal convictions of various named individuals for conspiracy and cheating the public revenue in connection with the supply of mobile telephones, some of whom had connections with Infinity's suppliers.

In relation to both the Invalid Invoices and Zero Rated Appeals, HMRC served a witness statement (the Holden statement) which amongst other things, made allegations of dishonesty against Infinity and others in the supply chain and, in particular, set out a detailed evidential case seeking to prove that the Magic Transport CMR's could not be relied upon (Magic Transport evidence).

Infinity challenged the admission of the whole of the Wafer statement and parts of the Holden statement on the ground that, since HMRC were advancing no positive case of fraud, it was both irrelevant to the issues in the appeal and unfairly prejudicial.

Both the FTT and the UT agreed with Infinity that the whole of the Wafer statement and parts of the Holden statement (including the Magic Transport evidence) should be struck out.

HMRC appealed to the Court of Appeal.

Court of Appeal's judgment

The Court found that the Wafer statement was "manifestly irrelevant" to the issues in the appeal. The statement sought to prove certain convictions of fraud without any connection with the transactions at issue in Infinity's case and did not advance HMRC's case that mobile telephones of the types identified in the relevant invoices could not have been available in the market in sufficient quantities for there to have been genuine supplies to which the invoices related. Accordingly, this part of the appeal was dismissed.

In relation to the Holden statement, at the hearing HMRC accepted that those parts of the statement relating to allegations of fraud against Infinity were no longer relied upon. The Court was heavily critical of HMRC's inclusion of this evidence which was contrary to the case they were advancing. In relation to the Magic Transport evidence, the Court considered it was evidence challenging the reliability of the CMR's. The Court noted that it did not, on its own, contain any allegation of participation in or knowledge of fraud, bad faith or failure to take reasonable steps by Infinity. The Court therefore rejected the argument that HMRC was also trying to prove a case of misconduct by Infinity.

Comment

This case serves as a useful reminder that parties preparing evidence in litigation must ensure that the evidence relates to the pleaded case and is relevant to the issues before the Tribunal. In civil litigation, the same evidence may serve more than one purpose. In this case, the Magic Transport evidence was supportive of a positive case that no real reliance could be placed on the CMRs as evidence of export. The fact that it might also constitute the first plank in a positive case of misconduct against Infinity, which had not been pleaded, was irrelevant.

A copy of the decision can be found here.

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