VAT update

October 2015

News

HMRC publishes responses to consultation on new penalties model

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Alcohol wholesaler registration scheme deferred until 2016

The 'alcohol wholesaler registration scheme' (AWRS) was due to begin on 1 October 2015, but this has been deferred to 1 January 2016. Under the Finance Act 2015, all alcohol wholesalers, including those who hold other excise regulations, will have to register for AWRS, or be at risk of trading illegally. more›

Guidance on the categorisation of tax appeals provided by the Tribunal: *JSM Construction Limited*

In the recent case of *JSM Construction Limited*, the taxpayer sought a direction for its appeal to be re-allocated as complex. Whilst the First-tier Tribunal (FTT) ultimately dismissed the application, in reaching its conclusion, it provided helpful guidance on the criteria and relevant principles to be taken into consideration when deciding whether a case should be allocated as 'complex' under Rule 23(4) of the Tribunal Rules. more›

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The importance of evidence in VAT appeals: *Why Pay More for Cars v HMRC*

The Upper Tribunal (UT) has upheld the FTT's decision to dismiss the taxpayer's appeal in this case on the basis that the taxpayer had not established, on the balance of probabilities, that it had overpaid VAT. more›

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Any comments or queries?

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Retrospective inclusion of companies into a VAT group: *Copthorn Holdings v HMRC*

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It is expected that HMRC will publish two further consultation documents seeking views on the reform of penalties for late filing and payment, and the reform of penalties for inaccuracies in returns.

The summary of responses HMRC received is available to view here.

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Details of the scheme and revised dates are available to view here.

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Guidance on the categorisation of tax appeals provided by the Tribunal: *JSM Construction Limited*

In the recent case of *JSM Construction Limited*, the taxpayer sought a direction for its appeal to be re-allocated as complex. Whilst the First-tier Tribunal (FTT) ultimately dismissed the application, in reaching its conclusion, it provided helpful guidance on the criteria and relevant principles to be taken into consideration when deciding whether a case should be allocated as 'complex' under Rule 23(4) of the Tribunal Rules.

It is clear that what is a "complex" case is a matter of judgment and to be determined on the facts of the case. However, if the issue is not one which is considered by the FTT on a regular basis or, if the amounts involved are generally large (when compared to the general value of appeals to the FTT), then the FTT has indicated that it is likely to satisfy one or more of the criteria in rule 23(4) of the Tribunal Rules. The FTT confirmed it is not enough for the issue to be important to the taxpayer alone; it must also be important in the context of VAT and tax appeals generally.

A copy of the decision can be viewed here.

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Cases

The importance of evidence in VAT appeals: *Why Pay More for Cars v HMRC*

The Upper Tribunal (UT) has upheld the FTT's decision to dismiss the taxpayer's appeal in this case on the basis that the taxpayer had not established, on the balance of probabilities, that it had overpaid VAT.

Background

The appeal concerned a claim made by Why Pay More for Cars Limited (WPMC) under section 80 of the Value Added Tax Act 1994, for repayment of VAT that WPMC contended was overpaid in various VAT periods between June 1973 and March 1997, on bonus payments received from car manufacturers.

The background to the claim was not disputed. Following *Elida Gibbs,* HMRC had accepted that the bonus payments should have been treated as a discount on the original price of the cars. However, HMRC refused WPMC's claim because it considered that WPMC had not established, on the balance of probabilities, that it had overpaid VAT.

Before the FTT, WPMC relied upon three arguments in support of its contention that it had overpaid VAT:

- it was the practice of HMRC to treat all bonus payments as consideration for a supply of services and require dealers to account for VAT on them irrespective of whether the bonus payments followed the line of supply of the car
- it could be inferred from HMRC's table, which set out the periods and manufacturers in respect of which evidence was available to show VAT had been paid (the "Elida table"), that WPMC accounted for the VAT in periods for which there was no entry (the "silent periods" issue) and
- irrespective of the guidance contained in the Elida table, it could be inferred that WPMC accounted for VAT on the disputed bonus payment (the "VAT accounting" issue).

The FTT rejected all three arguments, and declined to draw any inferences in the absence of any direct evidence, and inconsistent approaches of manufacturers during the relevant period. The FTT held that WPMC had failed to show, on a balance of probabilities, that it had overpaid VAT.

WPMC appealed against the FTT's decision in relation to arguments 2 and 3 to the UT. WPMC argued that the FTT's analysis and conclusions (that were factual in nature) were flawed and the only true and reasonable conclusion, on the evidence before it, was to make the necessary inferences.

The UT's decision

The UT considered that WPMC's challenges to the FTT's decision could only succeed on the basis set out in *Edwards v Bairstow* [1956] AC 14. In that case, Justice Viscount Simonds said that a finding of fact should be set aside if it appeared that the finding had been made "without any evidence or upon a view of the facts which could not reasonably be entertained". If, on the application of this principle, an error of law is established, then the UT could exercise its power, under section 12 of the Tribunals, Courts and Enforcement Act 2007, to re-make the decision of the FTT.

The silent periods issue

WMPC argued that the FTT should not have taken the inconsistency of approaches between

manufacturers into account. This lead to the FTT reaching the wrong conclusion.

The UT rejected this criticism. It held that it was clear from the FTT's decision that it had considered the manufacturers individually as well as taking into account practices as a whole. In addition, the UT considered that the FTT was entitled to conclude that changes in practices by individual manufacturers made it unsafe to infer that VAT had been accounted for in a silent period from the fact it had been accounted for in another period. In the view of the UT, WPMC had not shown that the FTT's evaluation was flawed in the *Edwards v Bairstow* sense.

The VAT accounting issue
WPMC relied on the well-known dicta of Justice Walton in *Jonas v Bamford* [1973] 51 TCI (at page 25), and the presumption of continuity to show that, in the absence of direct evidence in relation to an issue, the courts are willing to draw appropriate inferences.

WPMC's submissions focussed on what was described as the Renault claim between 1989 and 1999. It relied on a letter from HMRC, dated 22 December 2010, which it submitted showed that HMRC had accepted that WPMC had accounted for VAT on the bonuses received from Renault between 1992 and 2000. It argued that, based on this evidence, the FTT had erred in misconstruing or failing to take account of the letter dated 22 December 2010.

The UT considered that the FTT was entitled to place little or no weight on the 2010 letter and rejected WPMC's Renault claim. The fact that HMRC accepted that WPMC had probably accounted for VAT on the bonuses it had received from Renault between 1992 and 1997, did not mean that WPMC had shown that it had accounted for VAT on bonuses received between 1989 and December 1991. The FTT was entitled to conclude that it was not satisfied that WPMC had shown that it had accounted for VAT on bonuses received during this earlier period. There were good reasons for the FTT's doubts, namely, the absence of any documentary evidence in relation to any period other than between 1997 and 2000 and the length of time between that period and the one which was the subject of the appeal.

WPMC also sought to rely on other instances where HMRC had accepted that WPMC had accounted for VAT on bonuses in other periods eg Honda bonus payments received between 1981 and 1997. The UT accepted this was relevant, but did not agree that this meant the FTT had erred in reaching its conclusion. In the absence of evidence regarding the basis of the claims in dispute, the mere acceptance of a claim by HMRC in relation to a different period was not sufficient to establish that the disputed claim should also have been accepted.

WPMC's appeal was therefore dismissed.

Comment
As is so often the case in tax appeals from decisions of the FTT, the longstanding *Edwards v Bairstow* principle looms large. The UT was clearly conscious of the constraints imposed on it by this principle in relation to findings of fact by the FTT.

This case serves as a reminder of the importance of gathering appropriate evidence to support claims for overpaid VAT. In the absence of any direct evidence, the FTT is unlikely to infer that the taxpayer has shown, on the balance of probabilities, that it has overpaid VAT.

A copy of the UT's decision is available to read here.

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Abuse of rights: *WebMindLicenses*

Background

A Hungarian software company, WebMindLicenses Kft (WML), licensed software to an independent Portuguese company (Lalib) which exploited the software to run an adult website. Under the terms of the license agreement, WML remained responsible for ongoing maintenance and development of the software.

Following an audit, WML was assessed to Hungarian VAT in respect of Lalib's supplies. The Hungarian fiscal authorities were of the view that the license agreement had not effectively transferred the rights in the software to Lalib. This meant that the operation of the website was in fact in Hungary. The authorities considered WML had committed an abuse of rights by giving the impression of being based in Portugal, in order to circumvent Hungarian tax law and qualify for lower tax in Portugal.

The Hungarian tax authorities based their decision on evidence which had been obtained covertly by other state authorities. In particular, parallel to the tax proceedings, a criminal investigation had commenced and the investigating authority had recorded telephone conversations of senior personnel at WML and Lalib.

WML appealed against the decision and challenged both the allegation of abuse and the use of the covertly obtained evidence. The Hungarian national court referred a number of questions to the Court of Justice of the European Union (CJEU), the majority of which related to the abuse of rights doctrine as elucidated by the House of Lords in *Halifax plc v C&E Commissioners* [2006] STC 919.

Advocate General Wathelet's Opinion

The Advocate General (AG) considered that under the *Halifax* abuse test, choosing a foreign place of business could constitute an abuse of rights where the essential aim was to obtain a tax advantage contrary to the purpose of the VAT Directive, and where there was no other justification for having an establishment abroad.

In the present case, the AG's view was that in order to satisfy the *Halifax* principle, the national court would have to find that the licensing agreement was fictitious and created for the sole purpose of giving the impression that the benefits in question were provided by Lalib in Portugal, when they were in fact provided by WML, or that the establishment in Portugal had no substance.

In the view of the AG, the license agreement was not fictitious, or for the sole purpose of obtaining a tax advantage. There were commercial reasons for appointing Lalib. Hungarian banks would not offer payment systems to providers of adult websites. No one in the WML group had a sufficient network of relationships or appropriate expertise to enable the website to be operated internationally. Lalib had a permanent structure, was autonomous, and met its tax obligations in Portugal.

The AG noted that at the time the first licensing agreement was signed with Lalib, the VAT rate difference between Hungary and Portugal was only 4%. He considered such a margin was unlikely to be the sole reason for the arrangements.

In reaching his conclusion, the AG re-iterated a point which has been made at various levels

by both the UK and European courts. It is perfectly acceptable for taxpayers to structure their affairs so as to limit their tax liability. However, in order to avoid the *Halifax* principle, there must be commercial reasons for the arrangements and transactions carried out. In this case, the AG considered there were commercial reasons for appointing Lalib and the transactions were not therefore abusive.

The AG also said that the seizure of emails without judicial authorisation and the lack of opportunity for WML to verify the existence of any such authorisation for intercepting telephone calls, did not respect the principle of proportionality, referred to in the Charter of Fundamental Rights of the European Union 2000 (the "Charter").

If the national court finds a violation of WML's fundamental rights as contained in the European Convention on Human Rights and the Charter, any evidence obtained illegally or improperly used should be excluded. It will then be up to the national court to decide whether the admissible evidence is sufficient to support the tax adjustment decision of the Hungarian tax authorities.

Comment
The AG's opinion confirms that carrying on a business from a member state with a lower VAT rate is not abusive, provided there are genuine commercial reasons for doing so.

The CJEU's decision is expected shortly. If the CJEU follows the AG's opinion, it may provide helpful guidance on the relevant factors that tax authorities and national courts should take into account when determining whether an abuse of rights has occurred.

The AG's Opinion is not currently available in English and the above summary is based on a translation of the French text. Copies of the AG's Opinion are available in French and a limited number of other European languages here.

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Retrospective inclusion of companies into a VAT group: *Copthorn Holdings v HMRC*

In the recent case of *Copthorn Holdings* the FTT considered the circumstances when it might be appropriate for HMRC to exercise its discretion to allow retrospective additions to VAT groups.

Background
The dispute resulted from several errors made by various companies in the Copthorn group, which led to the group suffering a forfeiture of a deduction for input tax in excess of £2m. The group mistakenly believed two companies (C26 and C28) were members of the group when they were in fact not, and accounted for VAT on this mistaken basis. The mistaken belief had been caused by a change in staff and HMRC accepted that the mistake was genuine.

This was a second challenge by Copthorn of a decision taken by HMRC not to exercise its discretion to sanction the retrospective inclusion of two companies into the relevant VAT group. In an earlier decision on the same matter, the FTT had asked HMRC to reconsider its decision, expressing concerns regarding HMRC's published policy that prescribed only limited circumstances in which HMRC would exercise its discretion to backdate the inclusion of companies in a VAT group. Approximately a year later, HMRC concluded its reconsideration. It made only minor changes to the published policy and again refused to accept Copthorn's

application. Copthorn therefore appealed to the FTT.

In this second challenge, Copthorn argued that HMRC's policy was still too restrictive of the discretion provided by Parliament to HMRC to backdate the inclusion of companies in a VAT group. It also argued that given the group's mistake had resulted in incoherent tax liabilities, it was unreasonable for HMRC not to exercise its discretion.

The FTT's decision

The FTT agreed with Copthorn and remitted the matter back to HMRC a second time for further consideration.

Whilst HMRC's modified policy had purportedly dealt with the earlier decision, the FTT considered that the policy was substantially unchanged. It held that HMRC's published statement significantly fettered the discretion granted to HMRC in an unacceptable manner.

The FTT acknowledged the limits of its jurisdiction and noted that it was for HMRC to produce policy and general guidelines. However, the FTT proceeded to make a number of suggestions in relation to what it felt should and should not be considered. It explained that the policy should distinguish between cases in which groups simply change their mind and those where companies are assumed to have been in group registrations, when in fact they were not. The policy should also take into account the likely tax and cost consequences of the mistaken assumption for the group.

HMRC placed considerable reliance on the fact that notwithstanding it had provided Copthorn with lists on four separate occasions of the companies believed to be included within the group registration, there had been considerable delay by it in making the application for retrospective inclusion in the group. The FTT was of the view that this was irrelevant. The FTT said it was understandable that anyone receiving the lists may not have detected the errors. In addition, it was not satisfied HMRC's treatment of the application would have been different had the lists lead to an earlier application.

Comment

The FTT did express some hesitation in remitting the matter back to HMRC for a second time as it was not satisfactory for the matter to be simply batted to and fro between the FTT and HMRC. However, the FTT had a duty to consider Copthorn's further appeal in a fair and just manner and a second remittance was necessary.

If HMRC takes heed of the FTT's suggestions, a more flexible solution may be available to companies which have made costly administrative VAT grouping errors.

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

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