VAT update

September 2015

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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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News

Supreme Court to consider VAT "restitution" claims

The Supreme Court has granted each party leave to appeal against the decision of the Court of Appeal in the case of *Investment Trust Companies (in liquidation) v HMRC*[1] which considers rights and remedies for unlawfully charged VAT.

In February 2015, the Court of Appeal concluded that the investment trusts had a direct remedy against HMRC and that the capping provisions contained within section 80, Value Added Tax Act 1994, did not apply to the trusts' restitutionary claims. However, the court decided that those claims did not include netted-off input VAT, which must be claimed from the supplier.

The Supreme Court will now decide whether any sums payable to the trusts should take account of input VAT claimed by the managers at the time they accounted for VAT on fees charged to the trusts, and what time limit applies to the claims.

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

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European Commission publishes VAT gap report

The European Commission has published the VAT gap report for 2013 for 26 member states (Cyprus and Croatia are not included). The VAT gap is an estimate of VAT lost due to fraud and evasion, avoidance, bankruptcies/insolvencies and miscalculations. According to the report, VAT revenue collection in 2013 failed to show significant improvement across member states compared with 2012.

A copy of the report is available to read here.

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Minimum 5p compulsory charge on carrier bags to be introduced

On 17 August 2015, HMRC published Revenue & Customs Brief 14/15, which confirms the introduction of a compulsory charge on single-use carrier bags provided with goods supplied in or to England, with effect from 5 October 2015.

Suppliers using a retail scheme should ensure that VAT is properly accounted through their scheme. There are also direct tax implications. For corporation tax and income tax, receipts from the compulsory charge on single-use carrier bags should be brought into account in calculating trading profits.

A copy of Revenue & Customs Brief 14/15 is available to read here.

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1. [2015] EWCA Civ 82.

Cases

Minimum alcohol pricing may be contrary to EU law

In the case of *The Scotch Whisky Association* C-333/14, Advocate General Bot has considered the legality of Scotland's minimum alcohol pricing and concluded that it may be contrary to EU law.

Background

The Alcohol (Minimum Pricing) (Scotland) Act 2012 (AMPSA), sought to create minimum unit pricing in the retail sale of alcoholic drinks in Scotland. By way of Ministerial Order, the price for a unit of alcohol was set at 50p.

However, before AMPSA came into force, the legality was challenged by the drinks industry. Judicial review proceedings were brought in Scotland by The Scotch Whisky Association and others (SWA).

SWA argued that the Scottish legislature did not have sufficient competence to introduce AMPSA and, even if it did, AMPSA was contrary to the EU principle of free movement of goods. They claimed that the legislation would have an equivalent effect to a quantitative restriction on imports and was contrary to Articles 34 and 35 of the EC Treaty.

By its decision of 3 July 2014, the Court of Session decided to stay the proceedings and referred questions to the Court of Justice of the European Union (CJEU) for preliminary ruling to determine whether the establishment of a minimum price was compatible with EU law.

The Advocate General's opinion

The Advocate General examined the rules at issue and considered that the proposed "minimum price per unit" was a measure having equivalent effect to a quantitative restriction on imports and contrary to the free movement of goods (Article 34 EC Treaty). The prohibition of retail sale below a minimum price deprived traders from other Member States of the possibility of marketing their products at a selling price reflecting their lower cost price and impeded their access to the market.

He went on to consider whether the restriction could be justified by assessing the suitability of the measure for the objective sought (Article 36 EC Treaty). In particular, he considered whether the objective of protecting public health could be attained by alternative means i.e. a higher tax on alcoholic beverages, while being less restrictive of trade.

The Advocate General commented that whilst it was ultimately for the national court to identify the objective of the measure in question and examine the merits of the alternative measure of "increased taxation", he felt it was difficult to justify the rules at issue. He considered that the minimum pricing was less consistent and effective than an "increased taxation" measure, and could be perceived as discriminatory.

He concluded that a Member State could choose rules imposing a minimum price per unit of alcohol, which restricts trade and distorts competition, but only if that has additional advantages or fewer disadvantages than the alternative. In his view, the alternative measure of increased taxation, was capable of providing additional advantages by contributing to the general objective of combating alcohol abuse. Accordingly, he considered that the proposed

minimum price per unit of alcohol measure was not a proportionate way of ensuring public health and contrary to EU law.

Comment

The request in this case was unusual as AMPSA had not entered into force, however, that did not affect the admissibility of the request. The CJEU has, on previous occasions, recognised the admissibility of questions referred to it for preliminary ruling in preventative actions. Advocate General Bot commented that it is open to individuals to challenge the validity of legislation even where it has not been the subject of implementing measures.

The CJEU's decision is expected shortly. However, it remains to be seen whether it will follow the approach taken by Advocate General Bot. If the CJEU agrees, then the matter will be referred back to the national court and the Scottish Ministers will need to reconsider the appropriate measure to promote public health and reduce the consumption of alcohol.

A copy of the Advocate General's opinion is available to read here.

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VAT default surcharges disproportionate only in wholly exceptional circumstances

In *HMRC v Trinity Mirror Plc*[2] the Upper Tribunal (UT) allowed HMRC's appeal and concluded that a VAT default surcharge imposed for a payment made one day late was proportionate.

Background

Trinity Mirror Plc (Trinity) had been directed by HMRC (under section 28(2A), Value Added Tax Act 1994) to make payments on account of VAT. It was required to make two monthly payments on account and a third balancing payment on a specified date (which had been notified to Trinity in advance) approximately one month after the end of the VAT period.

Trinity failed to make the balancing payment for the 06/07 VAT period by the due date (the first default). It paid in full one day late. As a result of this late payment, it was served with a surcharge liability notice and was notified of the surcharge period that had commenced. It was advised that if it defaulted again in this period it might be liable to a surcharge.

Trinity failed to make the balancing payment for its 12/07 VAT period by the due date (the second default). Again, it paid in full one day late. HMRC raised a surcharge for the second default at the rate of 2% on the amount of the late balancing payment. This amounted to a penalty of £95,900, but this was later reduced to £70,906.44, following a declaration of overpayment.

Trinity appealed the surcharge on the grounds that it was contrary to the EU principle of proportionality. The First-tier Tribunal (FTT) agreed with Trinity and held that the surcharge went beyond what was strictly necessary and was excessive in view of the gravity of the infringement. Accordingly, the surcharge was to be discharged.

HMRC appealed to the UT.

2. [2015] UKUT 421.

The UT's decision

The UT agreed with the FTT that the surcharge imposed on the taxpayer under the surcharge regime must be proportionate. However, it concluded that the FTT's approach to determining whether the surcharge was proportionate was wrong in law.

The UT noted that the FTT had undertaken a comparative exercise to determine whether the surcharge was appropriate, involving a calculation based on the number of defaults and the amount of the surcharge imposed in previous cases. They held that a tribunal in a different case should not extrapolate from a previous decision, a conclusion based on an arithmetical calculation. To do so failed to have regard to the individual circumstances of the trader (Trinity), the gravity of the default, and was contrary to authority. Accordingly, it concluded that the FTT had made an error of law.

Having determined that the FTT was wrong and that its decision should be set aside, the UT considered whether the surcharge was proportionate. It agreed with the tribunal's comments in *Total Technology*[3] that the default surcharge regime, viewed as a whole, is a rational scheme and accepted that the absence of any financial limit on the level of surcharge may result in an individual case in a penalty that might be considered disproportionate, but concluded that that would only occur in a wholly exceptional case.

With these observations in mind, the UT analysed the particular facts of the present case. Although payment was delayed by only one day, the purpose of the default surcharge regime is to impose a penalty for failing to pay VAT on time. In its view, the fact that payment was only one day late did not render an otherwise proportionate penalty disproportionate.

The UT concluded that there were no exceptional circumstances in Trinity's case which could render the surcharge disproportionate. The penalty was based on a modest percentage of the amount of VAT unpaid. Trinity had been notified following the first default that further default was within the surcharge period. In addition, the penalty of 2% was arrived at by the application of a rational scheme; it might be considered harsh, but in the UT's view it could not be regarded as unfair.

HMRC's appeal was allowed and the surcharge was upheld.

Comment

This decision will make it increasingly difficult for taxpayers to successfully appeal against surcharges on the basis that they are disproportionate, or result from only a minor infringement. It is only in "wholly exceptional" circumstances that a surcharge will be considered disproportionate.

Unfortunately, the UT declined to provide further guidance on what characteristic would identify a case as wholly exceptional. In its view, such cases by reason of their exceptional nature, are likely to defy such characterisation.

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

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3. [2012] UKUT 418 (TCC).

Think long and hard before withdrawing an appeal

In *Rolls Group & Others v HMRC*[4], the FTT has refused to reinstate VAT appeals, pursuant to an application made under Rule 17(3) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Rules), many months after withdrawal of the appeals.

Background

The Rolls Group and a number of other joined appellants (the Appellants), withdrew their appeals in early 2013. The Appellants are motor traders and their appeals related to VAT issues and what the FTT described as "Italian Uplift Claims". The Appellants withdrew their appeals on the advice of their previous advisers. Some considerable time later, (in some cases more than 18 months later) the Appellants applied to the FTT to have their appeals reinstated. There were two issues for determination before the FTT, namely, should an extension of time for applying to reinstate the appeals be granted, and if so, should the appeals be reinstated?

Rule 17 of the Rules

Rule 17 provides as follows:

> *"17(1) Subject to any [particular] provision ... a party may give notice to the Tribunal of the withdrawal of the case made by it in the Tribunal proceedings, or any part of that case –*
> *(a) by sending or delivering to the Tribunal a written notice of withdrawal; or*
> *(b) orally at a hearing.*
> ...
> *(3) A party who has withdrawn their case may apply to the Tribunal for the case to be reinstated.*
> *(4) An application under paragraph (3) must be made in writing and be received by the Tribunal within 28 days after -*
> *(a) the date that the Tribunal received the notice under paragraph (1)(a) ... ".*

The facts

Automotive Management Services (AMS) was an adviser to various motor traders. In or about 2008, AMS and Deloitte agreed to work together in relation to VAT repayment claims by motor trader clients of AMS. Deloitte had particular experience of pursuing claims for repayment of VAT in relation to the margin on sales of demonstrator vehicles (so called "Italian Republic Claims") and in relation to VAT on payments made by manufacturers (so called "Elida Gibbs claims").

Deloitte agreed to provide VAT advice to AMS clients in relation to such claims. Italian Uplift claims were summarised as based on an argument that payments by HMRC in relation to Italian Republic Claims had been based on average margins which were too low. In 2009, HMRC did not accept that argument. A lead case, known as Bristol Street Motors, who was represented by Deloitte, proceeded before the FTT.

The judge referred to the facts in one particular matter as illustrative of events in the other cases.

Tyn Lon Garage Limited (Tyn Lon) was originally a client of AMS in relation to motor trader VAT claims. Tyn Lon retained a small high street firm of accountants for general accountancy and tax matters. That firm knew very little about specialist matters relevant to motor traders. On 10 March 2008, Tyn Lon appointed Deloitte to handle its Italian Uplift claim. Tyn Lon duly lodged an appeal with the FTT on 16 October 2009. The appeal was stayed behind Bristol Street Motors.

4. [2015] UKFTT 0404 (TC).

On 16 January 2013, Deloitte wrote to Tyn Lon seeking instructions in relation to its Italian Uplift claim. The letter confirmed that HMRC had refused the Italian Uplift claim. Deloitte indicated that they did not have another client who was intending to progress their own appeal, or become a lead case, and that the chances of anyone doing so were considered to be low. Tyn Lon's options were either to withdraw its appeal, or proceed with the litigation, which was not recommended given the cost of proceedings and the low prospects of success. On 14 March 2013, Tyn Lon confirmed to Deloitte that it did not wish to proceed with its appeal. Shortly afterwards, Tyn Lon's appeal was withdrawn.

The FTT was satisfied that all the appeals were withdrawn in reliance on advice received from Deloitte.

In 2013, and unbeknown to Deloitte, MHA, another adviser, was also in correspondence with HMRC with regard to Italian Uplift claims. MHA acted for a number of motor traders with such claims, including Listerdale Motor Company Ltd (Listerdale). MHA applied to the FTT for Listerdale to be a lead case under Rule 18 of the Rules.

In December 2013, HMRC Solicitor's Office wrote to AMS in relation to Italian Uplift claims and appeals formerly being conducted by AMS. As a result of this correspondence, in early 2014, AMS started to approach clients who had transferred to Deloitte to ascertain the status of their appeals and it was at this stage that they became aware that Deloitte had advised the former AMS clients to withdraw their appeals. In March 2014, AMS contacted MHA and became aware of its proposed lead case. On 13 May 2014, AMS engaged MHA to assist in seeking settlement of all its clients' Italian Uplift claims, including the Appellants.

By this stage, the FTT had made a lead case direction, under Rule 18, specifying Listerdale as a lead case for the purposes of the Italian Uplift claims.

Following the lead case direction, HMRC and MHA reached agreement on the basis for settlement of the Italian Uplift claims. Agreement in principle was reached in or about October 2014. All issues were agreed save for (1) establishing that individual Appellants were the entity entitled to be paid the amounts claimed, and (2) the quantum of the individual claims.

On 14 November 2014, Rolls Group made an application to the FTT to reinstate its appeal.

The FTT's decision

The judge set out a helpful summary of the general principles which apply when the FTT is required to consider whether to extend a time limit. He detailed the factors set out by the UT in *Data Select Ltd v HMRC*[5] and that the FTT should have regard to the overriding objective of dealing with cases "fairly and justly", as required by Rule 2 of the Rules. He commented that in *Leeds City Council v HMRC*[6] the UT had endorsed the approach adopted in *Data Select* and the fact that the UT had in that case commented that the amendments to the CPR introducing a stricter approach to compliance, as explained by the Court of Appeal in *Mitchell v Associated Newspapers Ltd*[7], had not been incorporated into the Rules. The judge noted that the factors relevant to whether an appeal should be reinstated on an application, pursuant to Rule 17(3), were set out by the UT in *Pierhead Purchasing v Commissioners of Revenue and Customs*[8]. It is necessary to consider:

- whether there was good reason for the delay
- whether HMRC would be prejudiced by reinstatement

5. [2012] UKUT 187 (TCC).
6. [2014] UKUT 350 (TCC).
7. [2013] EWCA (Civ) 1537.
8. [2014] UKUT 321 (TCC).

- the loss to the appellant if reinstatement was refused
- whether extending time would be prejudicial to the interests of good administration
- the merits of the proposed appeal.

The judge also said that, when considering whether an appeal should be reinstated, an important consideration would be whether there is good reason for the withdrawal of the appeal and the circumstances in which reinstatement was being sought.

The fact that the Appellants had been professionally advised at the time and what effect this had on the merits of the application, was also considered by the judge. The judge said that, in considering an application under Rule 17(3), if a professional representative was at fault in failing to meet a time limit then that might be a relevant factor in deciding to extend time. The judge was of the view that where a party applied to reinstate an appeal in such circumstances, it would be relevant to consider whether the advice was such that no reasonably competent professional advisor could have given it.

Having provided some helpful commentary on the general principles applicable when considering whether to extend a time limit, the judge then considered the two issues before him.

Should an extension of time be granted?
On the matter of an extension of time, the judge pointed out that it was clear there was a power under Rule 5(3)(a) of the Rules to extend the time within which an application to reinstate must be made. Rule 17(4) of the Rules provides that such an application must be made within 28 days following receipt of the notice of withdrawal by the FTT. The judge noted that in the case of the Rolls Group, the 28 day time limit expired in or about mid-April 2013. The application for reinstatement however was made on 14 November 2014, some 19 months later. The judge noted that the purpose of the 28 day time limit was clearly intended to promote finality.

The judge was of the view that the Appellants must be taken to have been aware of the 28 day time limit for reinstatement but that "... in the context of an application to extend time based on wrong advice from D, the appellants could not be expected to make such an application until they appreciated that the advice was wrong."

It was however apparent to AMS, by March 2014 at the latest, that the appeals had been withdrawn and why, and there was no application to re-instate until Rolls Group made its application in November 2014 (the other Appellants did so in February 2015). The judge said that the period from March 2014 until that time had to be viewed against the background of the 28 day time limit and accordingly he was not satisfied that there was a good explanation for the delay after March 2014.

The judge then considered a further related issue, namely, the consequences for the parties of a decision to extend or not to extend time. However, it was impossible to do this because other than the amount of the claims, he had no evidence before him as to the impact of the loss of individual claims on the individual Appellants. He did, however, conclude that HMRC had suffered prejudice. HMRC was entitled to consider that the appeals had been finalised and the time for an application for reinstatement had long passed.

Should the appeals be reinstated?
On the second issue, the judge considered Rule 17(3) in the light of the *Pierhead Purchasing* case, and said "The existence of a 28 day time limit to apply for reinstatement does not really give any indication as to what might constitute a good reason to seek reinstatement following a withdrawal. On one view it might be viewed as giving something akin to a cooling off period, recognising that an appellant might change his mind about withdrawal. Alternatively it might be viewed as simply giving time to identify and correct any mistake which led to a withdrawal. It is clear that there is no *entitlement* to reinstate following a withdrawal.".

Reinstatement of an appeal remains a matter of discretion for the FTT and an applicant must show sufficient reason to justify reinstatement. The judge was of the view however that this was not a case like *Pierhead Purchasing* where the Appellant did not receive advice on the consequences of withdrawal. Deloitte had advised the Appellants in terms that withdrawal would mean giving up on the matter. He said "... the Appellants had an opportunity to consider the advice they had received, to take soundings within the industry or to raise the matter with AMS, their previous adviser...".

The judge said that it was a factor to take into account that the Appellants had relied on the advice of a leading firm of professional advisors but it was also relevant to consider whether the advice was such that no reasonably competent professional advisor could have given it. If the advice was reasonable, then reliance on that advice would not support the Appellants' case. The grounds for seeking reinstatement could thus fairly be described, in the judge's view, as subsequently taking a different view as to the prospects of success.

The judge concluded that there was no material before him from which he could find that the appeals had anything more than a reasonable prospect of success and he was not satisfied that the advice received from Deloitte was wrong at the time it was given, or that it was advice that no reasonably competent professional advisor could have given. The most he could say was that a different view of the prospects of success had been reached. Accordingly, carrying out a balancing exercise and taking into account all the surrounding circumstances and the overriding objective, he did not consider that it would be appropriate to re-instate the appeals and the application was therefore dismissed.

Comment
Although hindsight is a wonderful thing, the decision in this case is a salutary reminder to taxpayers and professional advisers that when considering whether to withdraw an appeal, great care should be taken to ensure that withdrawal is the right course of action, as it may be difficult to persuade the FTT to exercise its discretion to reinstate an appeal, particularly when the application is made a long time after the 28 day time limit has expired.

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

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15175

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