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De Voil Indirect Tax Intelligence

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NEWS IN BRIEF

Finance Bill

The Government has announced that the Finance Bill 2013 will be published on Thursday 28 March.

(http://www.parliament.uk/documents/commons-vote-office/February_2013/7-Feb-2013/1.Treasury-FinanceBill2013.pdf)

Legislation

Finance Act 2009, Sections 101 and 102 (Machine Games Duty) (Appointed Day) Order 2013, SI2013/67

This Order appoints 1 February 2013 as the day on which provisions concerning late payment and repayment interest in FA 2009, ss101–103 come into force in relation to machine games duty.

The Single Use Carrier Bags Charge Regulations (Northern Ireland) 2013, SR 2013/4

These regulations will require sellers in Northern Ireland to charge customers at least 5 pence for single-use carrier bags with effect from 8 April 2013 (increasing to 10 pence after 5 April 2014). Sellers will then be required to pay the net proceeds, after deduction of any VAT included, to the Department of the Environment at quarterly intervals.

The Climate Change Levy (Combined Heat and Power Stations) (Amendment) Regulations 2013, SI 2013/232

These amending regulations re-introduce from 1 April 2013 the provisions that previously applied before the introduction of the combined heat and power (CHP) levy exemption certificate (LEC) system in respect of partly-exempt CHP stations, by amending the calculation of the limit on the quantity of electricity such stations may produce and supply directly for the purposes of the exemption from climate change levy. Budget 2011 announced the ending of the CHP "indirect supplies exemption" and "CHP LECs" with effect from 1 April 2013.

Finance Act 2009, Section 101 (Tax Agents: Dishonest Conduct) (Appointed Day) Order 2013, SI 2013/280

FA 2009 s 101 applies late payment interest to any overdue sums owed to HM Revenue & Customs. Section 104 provides that the Treasury may, by order, provide for the coming into force of s 101 on different days for different provisions. This order specifies 1 April 2013 as the day on which FA 2009 s 101 comes into force for the purposes of penalties assessed under Parts 3 to 5 of Schedule 38 to the Finance Act 2012 (penalties for dishonest conduct or for failure to comply with a file access notice by tax agents).

The Air Passenger Duty (Amendment) Regulations 2013, SI 2013/Draft

These draft regulations create two new accounting schemes, an "annual accounting scheme" and an "occasional operator's scheme", designed to ease the administrative burden on small or occasional aircraft operators coming within the scope of air passenger duty on business jets and smaller aircraft from 1 April 2013. Comments on the draft regulations are invited by 28 February 2013.

The Finance Act 2012, Schedule 38 (Tax Agents: Dishonest Conduct) (Appointed Day and Savings) Order 2013, SI 2013/279

This order appoints 1 April 2013 as the date on which legislation in FA 2012 comes into effect to enable HMRC to issue civil penalties of up to £50,000 on tax agents found to have engaged in dishonest conduct and publish details of those agents in certain circumstances. The

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legislation applies to all taxes and duties administered by HMRC except customs duty and tax credits.

Value Added Tax (Refund of Tax to the Natural Resources Body for Wales) Order 2013, SI 2013/412

This Order, which comes into effect on19 March 2013, specifies the Natural Resources Body for Wales (also known as Corff Adnoddau Naturiol Cymru) for the purposes of section 33 of the Value Added Tax Act 1994. A body that is so specified is entitled to claim refunds of value added tax on supplies to, or acquisitions or importations by, it; provided that the supplies, acquisitions or importations are not to be used for the purpose of any business activity which the body may carry on.

Government publications

Revenue & Customs Brief 1/2013: Assurance visits to customers of Controlled Oils and Tied Oils traders

HMRC have published RCB 1/13 dated 18 January 2013. It announces the start of a programme of assurance visits in 2013 to businesses purchasing rebated fuel from Registered Dealers in Controlled Oils and customers of distributors trading under the Tied Oils Class Approval scheme who purchase closed containers of 210 litres or less.

The text of the Brief is set out in full below.

"**Excise duty: Programme of Assurance – Registered Dealers in Controlled Oils and Tied Oils Class Approval scheme**

Purpose of this Brief

This Brief gives information about our intention to start a programme of assurance visits to business customers of Registered Dealers in Controlled Oils (RDCO), and business customers of distributors trading under the Tied Oils Class Approval scheme who purchase closed containers of 210 litres or less.

Who needs to read this?

RDCOs and their commercial customers who purchase controlled oils (red diesel, rebated bio blend, kerosene, avtur) for business use, users and distributors trading under the Class Approval scheme for tied oils.

Background

The RDCO scheme was introduced to support the UK Oils Strategy with the aim of identifying and tackling commercial oils fraud. Under the scheme all dealers in controlled oils register with HM Revenue & Customs (HMRC). Controlled oils are liable to a rebated rate of excise duty which is much lower than the full rate of road fuel duty, and it is not allowed to be used in vehicles using public roads other than in a limited number of excepted vehicles, where the use is incidental to the main use.

Under the Tied Oils scheme, oils intended for use in an industrial process may be delivered relieved of duty to traders who are approved by HMRC to receive them. Products may also be released with no payment of duty to customers of distributors under the Tied Oils Class Approval scheme who purchase closed containers of 210 litres or less.

RDCOs and Tied Oils traders are obliged to keep records of their sales, including details of who they are selling to. HMRC carries out regular assurance visits to RDCOs and to Tied Oils traders to ensure that the oils are put to an eligible end use and not diverted for misuse as road fuel. Failure to comply with the requirement of the scheme is subject to penalties.

HMRC is now planning a programme of assurance to ensure that the oils are used for their intended purpose.

What are the changes?

HMRC intends to start a programme of assurance visits to:

- businesses purchasing rebated fuel from RDCOs

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- customers of distributors trading under the Tied Oils Class Approval scheme who purchase closed containers of 210 litres or less

What is an assurance visit?

An assurance visit may include:

- visiting your business premises to inspect goods, or documents relating to your business
- visiting your business premises to check that you are complying with the terms of any excise approval, registration, authorisation or licence that you may hold
- the visit being notified in advance but officers can visit unannounced

Why are these changes being made?

The changes are being made to improve HMRC's control of the controlled oil supply chain, and oils supplied relieved of duty under the Tied Oils scheme, to ensure that the oils are put to a legitimate use. The illegal use of cheaper rebated or duty relieved oils places legitimate businesses at a disadvantage.

Who will be affected?

All commercial purchasers of rebated fuels for the purposes of their business; commercial customers of oils from Tied Oils traders in particular those purchasing oils in closed containers of less than 210 litres.

Customers purchasing rebated fuel for domestic purposes, for example heating fuel, are not affected by this change.

What records must I keep?

You will need to keep your normal business records and produce them to HMRC if asked to do so. These must include evidence of all your purchases, such as invoices, of oils purchased for your business.

You will be required to provide evidence that you have used the oils for your business purposes.

If HMRC establishes that the oils have not been used for a legitimate purpose penalties may be applied.

What legislation is being changed or introduced?

No changes to legislation are being made.

Timing

HMRC will start an assurance programme of business customers of RDCOs, and business customers of Class Approved traders in 2013.

Further guidance

Further information relating to:

- records required to be kept by those involved in any way with goods or services liable to excise duty can be found in Notice 206 Revenue traders records
- the RDCO scheme can be found in Notice 192 Registered dealers in controlled oils
- the Tied Oils scheme can be found in notice 184A Mineral (Hydrocarbon) oil put to certain uses: Excise Duty relief
- the legitimate uses of controlled oil can be found in Notice 75 Fuel for road vehicles
- general information and accounting of motor and heating fuels for Excise Duty and VAT can be found in Notice 179 Motor and heating fuels: General information and accounting for Excise Duty & VAT"

Revenue & Customs Brief 2/2013 VAT: rooms provided in hotels or similar establishments with catering

HMRC have issued RCB 2/136 dated 22 January 2013. It confirms HMRC's view that the provision of accommodation in an hotel or similar establishment for the purpose of catering is standard rated, regardless of whether the catering is provided by the operator of the hotel or by another person. This view is contained in the most recent version of Notice 709/3 (October 2011). Previously, HMRC treated the supply of the room only as exempt, where catering was supplied by a third party. HMRC will take

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no action to alter the treatment of relevant supplies made before 22 January 2013.

The text of the Brief is set out in full below.

"This brief confirms HM Revenue & Customs' (HMRC's) view of the VAT treatment of rooms provided in hotels and similar establishments for the purpose of supplies of catering. It is issued following the review and publication of Notice 709/3 Hotels and holiday accommodation.

Readership

Anyone who provides rooms in hotels or similar establishments for the purpose of supplies of catering.

Action

Information only to ensure that all those affected are aware of HMRC's change of interpretation.

Background

Supplies of land are normally exempt from VAT. However, this exemption does not apply to the provision of accommodation in hotels, inns, boarding houses and similar establishments, including accommodation in rooms provided for the purpose of supplies of catering, such as rooms provided by hotels for wedding receptions.

Normally, hotels (and similar establishments) supply both the venue and the catering. However, in some instances the catering may be supplied by third parties. When the previous version of the guidance was written, HMRC's view was that, where both the room and the catering were supplied by the hotel or similar establishment, the whole supply (including the provision of the room) would be standard rated. However, where the catering was supplied by a different person, the supply of the room only by the hotel would be exempt (unless the supplier had opted to tax). HMRC subsequently changed its view on this point, but did not update its guidance to reflect this.

HMRC's interpretation of the law

HMRC published an updated version of Notice 709/3 Hotels and holiday accommodation in October 2011. Paragraph 4.1 of the updated Notice confirms that the provision of accommodation in an hotel, inn, boarding house or similar establishment for the purpose of catering is standard rated regardless of whether the catering is provided by the operator of the hotel, etc, or by another person.

What this change means

Where businesses have treated supplies as exempt from VAT in the past no assessments will be issued or action taken to correct the treatment of such supplies. All supplies should, however, be treated consistently with HMRC's revised interpretation from the date of this Revenue and Customs Brief.

Further guidance

Notice 709/3 Hotels and holiday accommodation is available from HMRC's website.

Issued 22 January 2013"

Notice 162 Cider Production

HMRC have issued a revised (January 2013) edition of Notice 162. The notice has been updated to inform of the addition of dimethyl dicarbonate ("Velcorin") as a permitted ingredient in cider and perry – see section 25.

Notice 192 – Registered Dealers in Controlled Oil

HMRC have published a revised (February 2013) edition of Notice 192. This notice has been amended to update the instructions in paragraph 6.3 on the completion of the RDCO return. According to HMRC, "there is also a slight addition to paragraph 8.4 about how to avoid an unnecessary penalty when we receive a return after the due date", although paragraph 8.4 does not appear to contain any such advice.

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Notice 452 – Machine Games Duty

HMRC have published a revised (February 2013) edition of Notice 452. Changes include clarification of the examples and comments in paragraph 26 relating to completion of duty returns.

Notice 552 Air Passenger Duty (APD) annual accounting

HMRC have issued Notice 552 (March 2013). This is a new notice, concerning the proposed annual accounting scheme for businesses with an annual APD liability not exceeding £500,000, due to be introduced from 1 April 2013.

Notice 554 – Fuel used in private pleasure craft and for private pleasure-flying

HMRC have issued a revised (February 2013) edition of Notice 554. It covers the changes made from 1 April 2012 regarding the use of red diesel with full duty paid for propelling private pleasure craft

Notice 700/18 – Relief from VAT on bad debts

HMRC have published a revised (February 2013) edition of Notice 700/18. The notice has been re-written to explain the rules and time-limits which currently apply to bad debt relief claims, and to remove details of historical changes which are no longer relevant. Worked examples have also been amended to reflect the 20% standard rate of VAT which was introduced on 4 January 2011.

Notice 701/21 – Gold

HMRC have published a revised (January 2013) edition of Notice 701/21. The notice has been updated to reflect changes in section 8 "Imports and exports of investment gold" and section 9 "Penalties".

Notice 701/29 Betting, gaming and lotteries

HMRC have issued a revised (February 2013) edition of Notice 701/29. The technical content of this notice has been updated to take account of developments in the law. From 1 February 2013 exemption will apply to machine games on which Machine Games Duty ("MGD") is accountable (paragraph 9).

Notice 701/36 – Insurance

HMRC have issued a revised (February 2013) edition of Notice 701/36.

Paragraph 10.2 (Services of Protection and Indemnity (P&I) Club managers and agents) has been updated so that it more accurately represents the services that P&I managers and agents perform.

Paragraphs 10.3 (Pension review services) and 10.4 (Phone helplines) have been amended to reflect changes in tax treatment announced in Revenue & Customs Brief 33/12.

Notice 701/49 – Finance

HMRC have published a revised (January 2013) edition of Notice 701/49. The notice has been updated to reflect changes in Section 5 " Debts and related services".

Notice 727/5 – Retail schemes: How to work the Direct Calculation Schemes

HMRC have published a revised (January 2013) edition of Notice 727/5. Para 2.6 has been updated to reflect the current capping regulations, and para 8.2 provides an address for comments or suggestions.

Notice 760 – Customs Freight Simplified Procedures (CFSP)

HMRC have issued a revised (February 2013) edition of Notice 760. It explains the purpose of the Customs Freight Simplified Procedures, the procedures available and guidance on the authorisation conditions.

HMRC publish Fraud Civil Investigation Manual

HMRC have published the full online version of their Fraud Civil Investigation

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Manual, containing guidance applicable from 1 January 2012 on the new Contractual Disclosure Facility offered under Code of Practice 9 for investigations where tax fraud is suspected.

The manual may be viewed in full at www.hmrc.gov.uk/manuals/fcimanual/index.htm.

Customs Information Paper (13) 04: Mode of Transport completion guidance

HMRC have issued CIP (13) 04 **dated** 24 January 2013. It provides guidance on the relevant codes for completion of the Mode of Transport field on customs declarations.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip13-04.pdf

Customs Information Paper (13) 05: EU-US AEO Mutual Recognition & HMRC IT systems

HMRC have issued CIP (13)05 dated 25 January 2013. It explains the current implementation status of the EU-US AEO mutual recognition agreement and the impact on HMRC's IT systems.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip13-05.pdf

Customs Information Paper (13) 06 – Exports: Best practice for arrival and departure messages

HMRC have issued CIP (13) 06 dated 29 January 2013. It contains practice guidance for inputting arrival and departure messages onto HMRC's declaration processing system for exports of goods from the UK. HMRC has identified a number of common errors being made.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip-13-06.pdf.

Customs Information Paper (13) 07 – EU Council Regulation amending restrictive measures against Iran

HMRC have issued CIP (13)07 dated 1 February 2013. It concerns EU Council Regulation 1245/2012, amending measures prohibiting the supply of equipment to Iran which could be used for internal repression. The amendment permits the provision of such equipment intended solely for the protective use of EU personnel in Iran.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip-13-07.pdf.

Customs Information Paper (13) 08 – EU Council Regulation on further restrictive measures against Iran

HMRC have issued CIP (13)08 dated 11 February 2013. It concerns a new EU Council Regulation specifying further prohibitions on equipment and technology exports to Iran.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip-13-08.pdf.

Customs Information Paper (13) 09 – EU Council Regulation on further restrictive financial measures against Iran

HMRC have issued CIP (13)09 dated 1 February 2013. It concerns a new EU Council Regulation adding to the list of natural and legal persons in Iran to whom it is prohibited to provide funds or economic resources.

The paper may be viewed in full athttp://www.hmrc.gov.uk/jccc/cips/2013/cip-13-09.pdf.

Customs Information Paper (13) 11 – Customs and excise law modernisation project update

HMRC have issued CIP (13)10 dated 11 February 2013. It provides an update on progress with HMRC's customs and

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excise law modernisation project since April 2012, including measures in Finance Bill 2013.

HMRC relax penalty policy on Machine Games Duty registration by 1 April 2013

HMRC have announced a relaxation of their penalty policy on failure to register for machine games duty (MGD). Where a person liable for MGD has not registered by 1 February 2013, but registration takes place before 1 April 2013, HMRC will not charge a penalty provided the amount of duty owed for the period is less than £50,000 and this amount is entered in the section of the return for "MGD previously under-declared". This new policy will be included in an Annex to Notice 452 in due course.

For further details,see http://www.hmrc.gov.uk/machinegamesduty/late-registration-news.pdf

Discussion document and draft guidance on Tax and Procurement

HMRC have outlined a proposal requiring potential suppliers to confirm their tax compliance as part of the procurement process.

Under the new policy, from 1 April 2013 potential suppliers to central government will have to self-certify, as part of the selection stage of above-threshold procurements, their recent tax compliance history.

In addition, Contracting Authorities will ensure contractual documentation contains a standard clause enabling them to terminate a contract, at their discretion, if a supplier has had an "*occasion of non-compliance*". It also places a contractual obligation on the supplier to keep the Contracting Authority notified of changes in relation to tax compliance. Failure to do this will also trigger remedies including, potentially, termination of the contract.

Responses to the document are required by 28 February 2013.

For further details, see http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&id=HMCE_PROD1_032594

Authorised Economic Operator (AEO)

The agreement between the EU and US was fully implemented with effect from 31 January 2013. This means that an AEO business with S or F status can receive benefits at the US frontier and a US C-TPAT business with exports to the EU will receive benefits at the EU frontier.

For further details, seehttp://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&id=HMCE_PROD1_026308&propertyType=document

Notifying HM Revenue & Customs about vehicles brought into the UK – new online system replaces paper forms

From 15 April 2013, new or used vehicles brought into the UK from abroad for permanent use on UK roads have to be notified to HM Revenue & Customs (HMRC) within 14 days.

A new online system called Notification of Vehicle Arrivals (NOVA) supports this change and is available from this date. This will ensure any VAT due is accounted for before the vehicle can be registered through the Driver and Vehicle Licensing Agency (DVLA) or the Driver and Vehicle Agency (DVA) for vehicles registered in Northern Ireland.

For further details, seehttp://www.hmrc.gov.uk/nova/#2

Briefing note for new Air Passenger Duty operators from 1 April 2013

This note contains guidance for aircraft operators on the extension of air passenger duty to smaller aircraft, down to a

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take-off weight of 5.7 tonnes, with effect from 1 April 2013, including the new accounting schemes for smaller operators. The guidance will be incorporated into HMRC's Public Notice 550 in due course. For full details, see http://www.hmrc.gov.uk/air-passenger-duty/briefing-note-feb2013.pdf

Other Publications

OECD publishes two reports on energy taxes in 34 member countries

Two new reports provide, in respect of all OECD member countries: (1) analysis of the structure and level of energy taxes, showing effective tax rates on energy use in terms of both energy content and carbon emissions; and (2) details of more than 550 fossil fuel support measures in these countries.

The reports may be viewed athttp://www.keepeek.com/oecd/media/taxation/taxing-energy-use_9789264183933-en , andhttp://www.keepeek.com/Digital-Asset-Management/oecd/environment/inventory-of-estimated-budgetary-support-and-tax-expenditures-for-fossil-fuels-2013_9789264187610-en.

European Commission

Commission takes the UK to Court over reduced VAT rate

The European Commission has decided to refer the UK to the Court of Justice of the European Union for its reduced VAT rate on the supply and installation of energy-saving materials on the grounds that the measure goes beyond what is allowed under Directive 2006/112/EC.

Under EU VAT rules, Member States may apply reduced VAT rates to the supply of goods and services used in the housing sector, so long this is part of a social policy. Energy saving materials could be covered by this provision if the conditions are met i.e. if they are used for social policy purposes in the construction, renovation and alteration of housing.

However, there is no provision in the VAT Directive to allow a reduced VAT rate on "energy saving materials" specifically, and the universal application of a reduced rate for energy saving materials is therefore not allowed. By allowing a reduced VAT rate to all energy saving materials, the UK is therefore going beyond the scope of what is permitted under EU law.

Member States themselves unanimously decided on the list of goods and services that could benefit from a reduced VAT rate, and they also insisted that this list be strictly applied, with no room for manoeuvre or interpretation. This is important to prevent competitive distortions in the Single Market and to ensure a fair and level playing field between all Member States.

The Commission is aware that the reduced VAT rate for energy saving materials has been linked to the UK's "Green Deal" to improve the energy efficiency of buildings. While it supports the objectives of the UK Green Deal (seeIP/13/89), the Commission does not believe that breaking EU VAT rules will help in achieving these objectives.

Economic studies have shown that reduced VAT rates are often not the best way to achieve policy objectives or change consumer choices. In the case of promoting energy efficiency, there are a number of reasons why a reduced VAT rate is not the most efficient way deliver on this goal. For a start, it is difficult to define precisely these products, which can evolve and develop quite quickly, thereby creating uncertainty around the level of tax due. Moreover, a reduced rate does not target the population that needs it most, but instead is universally applied. In the case of energy efficient products, businesses are likely to represent a large proportion of those wishing to invest in them, in which case the VAT is deductible anyway. It is has been shown that frequently reduced

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rates are not fully passed on to consumers in the form of lower prices.

There are other, more efficient, ways of promoting energy efficient materials while remaining in line with EU law e.g. through direct subsidies.

The referral to the EU Court of Justice is the last step in the infringement procedure.

The Commission's case reference number is 2007/2449.

See Press Release IP/13/139 dated 21/2/13 (http://europa.eu/rapid/press-release_IP-13–139_en.htm)

Fighting evasion: Commission launches consultations on EU Taxpayer's Code and EU Tax Identification Number

The European Commission has launched two public consultations on specific measures which could improve tax collection and ensure better tax compliance across the EU.

The first consultation is on the development of a European Taxpayer's Code, which would clarify the rights and obligations of both taxpayers and tax authorities. The second consultation is on a European Tax Identification Number (EU TIN), which would facilitate the proper identification of taxpayers in the EU. Both the Taxpayer's Code and the EU TIN were among the measures proposed by the Commission last December in its Action Plan to tackle tax fraud and evasion (seeIP/12/1325). The consultations will run until 17 May 2013.

Algirdas Šemeta, Commissioner for Taxation, Customs, Statistics, Anti-Fraud and Audit, said: *"As we intensify our battle against tax evaders, we must also make it easier for the willing to comply. This would be the point of an EU Taxpayers' Code, and today we are asking taxpayers themselves to help shape it. We must also help authorities to identify those that owe taxes, so that they can collect the revenues they are due. This would be the purpose of an EU Tax Identification Number, and we want the public's view on how it can best be developed."*

Most Member States have established taxpayer's codes to define the rights and obligations of taxpayers and tax authorities. However, these codes vary considerably from one Member State to another. This can make it extremely difficult for citizens and companies to understand their rights in different Member States and comply with their tax obligations in cross-border situations.

Member States also find it increasingly difficult to properly identify taxpayers, given the increased mobility of people and more cross-border nature of economic activity. This can undermine national efforts to properly collect taxes, lead to situations of double non-taxation, and even facilitate tax fraud and evasion.

The aim of the public consultations is to gather examples of best practices in the Member States on collecting data on taxpayers' identities as well as taxpayer compliance and transparency. The results of both consultations will be used to identify and develop the appropriate policy responses by the end of 2013.

The consultation papers are available in English, French and German. All contributions will be taken into account.

Contributions must be submitted online no later than 17 May 2013 using the available electronic questionnaires:

- http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=TPCODE
- http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=EUTIN

For the consultation paper see:

- http://ec.europa.eu/taxation_customs/common/consultations/tax/2013_tpcode_en.htm
- http://ec.europa.eu/taxation_customs/common/consultations/tax/2013_eutin_en.htm

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Press release IP/13/154 dated 25.2.13 (http://europa.eu/rapid/press-release_IP-13-154_en.htm)

Court of Justice of the European Union

Société le Credit Lyonnais v Ministre du Budget, des Comptes Publics et de la Réforme de l'État

In *Société le Credit Lyonnais v Ministre du Budget, des Comptes Publics et de la Réforme de l'État, ECJ Case C-388/11; 28 February 2013* (*Advocate-General's Opinion*) the Conseil d'État referred a case to the ECJ for a ruling on whether, in calculating the deductible proportion of input tax for a company with branches in other Member States, the income of those branches had to be taken into account. Advocate-General Cruz Villalón expressed the Opinion that *Article 19* did not oblige Member States to stipulate this.

(*Note*. At the time of writing, the Advocate-General's Opinion is not available in English.)

Woningstichting Maasdriel v Staatssecretaris van Financiën

In *Woningstichting Maasdriel v Staatssecretaris van Financiën* (*Case C-543/11*) on 13 November 2006, the Woningstichting entered into an agreement for the sale of a plot of land with the municipality of Maasdriel (the vendor). At that time there was a building on the land which had been used as a library (the building). Next to the building there was a public, surfaced car park. The contract of sale stipulated that "the property sold shall be supplied in an improved condition" in view of the Woningstichting's intention to have homes built on the land, possibly combined with offices with parking facilities. It was agreed that the vendor would be responsible for the demolition of the building as well as for the removal of the surface of the car park. In the months of January and February 2007 the vendor had the building demolished and the resulting building rubble removed. The land was supplied to the Woningstichting at the time of the transfer of ownership by notarial act of 2 March 2007. On that date, the car park was still in use, as the surface had yet to be removed and the Woningstichting had not yet obtained the necessary planning permission for its construction plans for the land, which was still at the planning and design stage. Under Netherlands law, in order to avoid double taxation, if a purchase of real estate was subject to VAT, it was exempted from the transfer duty calculated on the sale price. The supply of building land was subject to VAT. By contrast, the supply of land which "has not been built on" was exempt from VAT and remained subject to transfer duty. The Woningstichting paid VAT to the vendor for the supply of the land at issue, as it considered that it was building land and was, accordingly, subject to VAT, meaning that transfer duties were not due. The tax inspector, however, considered that the supply at issue concerned land which had not been built on, exempting it as such from VAT and thus subjecting it to the payment of transfer duty. The Woningstichting received an assessment of the outstanding transfer duty. When the objection lodged against that assessment was rejected by decision of the tax inspector, the Woningstichting brought an action against that decision before the District Court, Arnhem. That court dismissed the action. The Court of Appeal, Arnhem, rejected the Woningstichting's appeal.

The Woningstichting brought an appeal on a point of law against that judgment before the Supreme Court of the Netherlands (the referring court). The referring court wondered, inter alia, whether the freedom of the member states to define the concept of "building land" allows a member State to exempt from VAT the supply of land which "has not been built on" obtained by demolition of the previously existing building, even if the demolition took place for the purposes of constructing new buildings on the land.

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In those circumstances, the referring court decided to stay the proceedings and to refer a question to the Court of Justice of the European Union (the Court) for a preliminary ruling.

By its question the referring court asked, in essence, whether art 135(1)(k) of Council Directive (EC) 2006/112 (on the common system of value added tax) (the VAT Directive), read in conjunction with art 12(1) and (3) therein, should be interpreted as meaning that the exemption from VAT provided for in art 135(1)(k) covered a supply, such as that at issue in the main proceedings, of land which "has not been built on", following the demolition of the building situated on it, even where, at the time of that supply, improvement works on the land, apart from that demolition, had not been carried out, but the land at issue had been intended to be built on.

The Court ruled:

It was well established that the terms used to specify exemptions such as that set out in art 135 of the VAT Directive were to be interpreted strictly, since they constituted exceptions to the general principle that VAT was to be levied on all goods and services supplied for consideration by a taxable person. Nevertheless, the interpretation of those terms should be consistent with the objectives pursued by those exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT. Accordingly, the requirement of strict interpretation did not mean that the terms used to define the exemptions referred to in art 135 should be construed in such a way as to deprive the exemptions of their intended effect. Under art 135(1)(k) of the VAT Directive, the supply of land which had not been built on other than the supply of building land as referred to in art 12(1)(b) of that directive was exempted from VAT. According to art 12(3) of that directive, for the purposes of that paragraph 1(b), "building land" meant any unimproved or improved land defined as such by the member states. It followed that supplies of building land were subject to VAT and did not fall within the category of exemptions referred to in art 135 of the VAT Directive, which were to be interpreted strictly.

In the instant case, it was not disputed that, at the time of supply, the demolition work of the building had been carried out or, as regards the car park, would be carried out, for the purposes of reconstruction. It was, in any event, for the referring court to carry out an overall assessment of the factual circumstances surrounding the transaction at issue in the main proceedings and prevailing at the time of supply, including the intention of the parties, provided that it was supported by objective evidence, in order to determine whether or not the transaction at issue in the main proceedings concerned building land. It followed that art 135(1)(k) of the VAT Directive, read in conjunction with art 12(1) and (3) therein, should be interpreted as meaning that the exemption from VAT provided for in art 135(1)(k) did not cover the supply, such as that at issue in the main proceedings, of land which had not been built on following the demolition of the building situated on it, even where, at the time of that supply, improvement works on the land, apart from that demolition, had not been carried out, where it was apparent from an overall assessment of the factual circumstances surrounding that transaction and prevailing at the time of supply, including the intention of the parties when it was supported by objective evidence, that, at that time, the land at issue had in fact been intended to be built on, a matter which was for the referring court to determine.

Stroy Trans EOOD v Direktor na Direktsia Obzhalvane i upravlenie na izpalnenieto – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite

In *Stroy Trans EOOD v Direktor na Direktsia Obzhalvane i upravlenie na izpalnenieto – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite, ECJ Case*

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C-642/11; 31 January 2013 unreported a Bulgarian case, the tax authority formed the opinion that a company (S) had reclaimed input tax on the basis of false invoices which did not represent any actual supply. S appealed, and the case was referred to the ECJ, which held that *Article 203* of *Directive 2006/112/EC* "must be interpreted as meaning that the value added tax entered by a person on an invoice is payable by him regardless of whether a taxable transaction actually exists". Furthermore, "it cannot be inferred from the mere fact that the tax authorities did not correct, in a tax adjustment notice addressed to the issuer of that invoice, the value added tax declared by the latter that those authorities have acknowledged that the invoice corresponded to an actual taxable transaction. The principles of fiscal neutrality, proportionality and the protection of legitimate expectations must be interpreted as not precluding the recipient of an invoice from being refused the right to deduct input value added tax because there is no actual taxable transaction even though, in the tax adjustment notice addressed to the issuer of that invoice, the value added tax declared by the latter was not adjusted. However, if, in the light of fraud or irregularities, committed by the issuer of the invoice or upstream of the transaction relied upon as the basis for the right of deduction, that transaction is considered not to have been actually carried out, it must be established, on the basis of objective factors and without requiring of the recipient of the invoice checks which are not his responsibility, that he knew or should have known that that transaction was connected with value added tax fraud, a matter which it is for the referring court to determine."

(The Court reached a similar decision in *LVK-56 EOOD v Direktor na Direktsia Obzhalvane i upravlenie na izpalnenieto – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite, Case C-643/11; 31 January 2013 unreported*).

Město Žamberk v Finanční ředitelství Hradci Králové (Case C-18/12) 21 February 2013 unreported.

In *Město Žamberk v Finanční ředitelství Hradci Králové* (*Case C-18/12*) *21 February 2013 unreported* a Czech case, a town council operated an aquatic park including a swimming pool and a paddling pool. The tax authority issued a ruling that it should account for VAT on its admission charges. The council appealed, and the case was referred to the ECJ for a ruling on the interpretation of Article 132(1)(m) of Directive 2006/112/EC. The ECJ held that Article 132(1)(m) "must be interpreted as meaning that non-organised and unsystematic sporting activities which are not aimed at participation in sports competitions may be categorised as taking part in sport within the meaning of that provision". Furthermore, "access to an aquatic park offering visitors not only facilities for engaging in sporting activities but also other types of amusement or rest may constitute a supply of services closely linked to sport". This was a matter for the national court to determine.

Finanzamt Köln-Nord v W Becker

In *Finanzamt Köln-Nord v W Becker* (*Case C-104/12*) *21 February 2013 unreported* a German case, a sole trader (B), who was also the managing director of a limited company, was charged with bribery. He claimed a deduction for input tax on the fees charged by the lawyers who defended him. The tax authority rejected the claim and he appealed. The case was referred to the ECJ, which rejected B's contentions, holding that "the supplies of lawyers" services, whose purpose is to avoid criminal penalties' did not give rise to a right to deduct input tax.

Minister Finansów v RR Donnelley Global Turnkey Solutions Poland Sp Zoo

In *Minister Finansów v RR Donnelley Global Turnkey Solutions Poland Sp Zoo* (*Case-155/12,31 January 2012 unreported*)(*Advocate-General's opinion*) a

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Polish company (P) provided services for the storage of goods to undertakings established in other Member States of the European Union and in non-member States. Those services included admitting the goods to a warehouse, placing the goods on storage shelves, storing the goods, packaging the goods for the customer, issuing the goods, unloading and loading. The Polish tax authority issued a ruling that, where the warehouse was in Poland, the place of supply was in Poland and VAT was chargeable accordingly. P appealed, contending that its supplies should be treated as taking place where its customer was established. The case was referred to the ECJ for a ruling on the interpretation of *Article 47* of *Directive 2006/112/EC*. Advocate-General Kokott expressed the Opinion that *Article 47* "requires that the subject-matter of the service be the use of, work on or assessment of specific immovable property or that the service be explicitly listed in that provision. Complex services relating to the storage of goods fulfil these requirements only if the storage of the goods is the principal supply of a single service and it is connected with a right to use specific immovable property or a specific part of such property."

Supreme Court

R (on the application of Prudential plc) v Special Commissioner of Income Tax

In *R* (*on the application of Prudential plc*) *v Special Commissioner of Income Tax [2013] UKSC 1, [2013] All ER* (*D*) *146* (*Jan*) in 2004, an international firm of chartered accountants (the firm) devised a marketed tax avoidance scheme (the scheme), which they disclosed to the Commissioners for Inland Revenue (HMRC). At about that time, a group of companies of which the claimant companies formed part (the group) instructed the firm to advise them in connection with overseas holdings and the firm identified that the scheme could be adapted for their benefit. Thereafter, the group implemented the scheme, which involved a series of transactions (the transactions). The inspector of taxes (the inspector) considered it necessary to look into the details of the transactions and served notices, pursuant to s 20(B)(1) of the Taxes Management Act 1970, on the claimant companies, giving them the opportunity to make available specified classes of documents in relation to the transactions. The claimants disclosed many of the documents requested, but refused to disclose certain documents (the disputed documents) on the ground that they were entitled to claim legal advice privilege (LAP) in respect of them. The inspector obtained authorisation from the first respondent to require the claimants to disclose the disputed documents and accordingly served notices pursuant to ss 20(1) and (3) of the Act on the second and first claimant companies respectively, requiring disclosure of the disputed documents. The claimants applied for judicial review, challenging the validity of the notices on the ground that they sought disclosure of documents which related to the seeking and giving of legal advice in connection with the transactions, which were therefore said to be excluded from the disclosure requirements of s 20 of the Act by virtue of LAP. That application was rejected on the ground that, although the disputed documents would have attracted LAP if the advice in question had been sought from, and provided by, a member of the legal profession, no such privilege extended to advice, even if identical in nature, provided by a professional person who was not a qualified lawyer (see [2009] All ER (D) 142 (Oct)). That decision was subsequently upheld by the Court of Appeal (see [2010] All ER (D) 132 (Oct)). The claimants appealed to the Supreme Court.The issue for determination was whether legal advice privilege (LAP) extended, or ought to be extended, so as to apply to legal advice given by someone other than a member of the legal profession and, if so, how far LAP thereby extended, or ought to be extended, and more specifically, whether LAP ought to

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attach to communications passing between chartered accountants and their client in connection with expert tax advice given by the accountants to their client, in circumstances where there was no doubt that LAP would attach to those communications if the same advice was being given to the same client by a member of the legal profession. The claimants submitted, amongst other things, that, based on the proposition that LAP was a common law right created by judges which should be applied and, if necessary, extended so as to accord with the principles which underlay and justified the right, LAP did attach to such communications. Given that LAP was justified by the rule of law, and that it existed for the benefit of a client who sought and received legal advice, there was no principled basis upon which it could be restricted to cases where the adviser happened to be a member of the legal professions, as opposed to a qualified accountant. Consideration was given, amongst other things, to ss 20, 20A 20B and 20BA of and para 5 of Sch 1AA to the Act.

The appeal would be dismissed (Lord Sumption and Lord Clarke dissenting).It was universally believed that LAP only applied to communications in connection with advice given by members of the legal profession. It ought not to be extended to communications in connection with advice given by professional people other than lawyers, even where that advice was legal advice which that professional person was qualified to give.

What the court was being asked to do was a matter for Parliament rather than for the judiciary. First, the consequences of allowing the appeal were hard to assess and would be likely to lead to what was a clear and well understood principle becoming an unclear principle, involving uncertainty. It might be necessary for a court to delve into the qualifications or standing and maybe into the rules and disciplinary procedures of a particular group of people to decide whether the group constituted a profession for the purpose of LAP. There would accordingly be room for uncertainty, expenditure and inconsistency if the court had to decide such an issue. Secondly, the question whether LAP should be extended to cases where legal advice was given from professional people who were not qualified lawyers raised questions of policy which ought to be left to Parliament. The general implications of extending the generally understood limits of LAP could have significant implications which would be very difficult to identify, let alone to assess and should be considered through the legislative process, with its wide powers of inquiry and consultation and its democratic accountability. Further, despite thinking it appropriate to extend LAP to certain other professions such as patent attorneys, trade mark agents and licensed conveyancers, Parliament had apparently chosen not to extend LAP to accountants giving tax advice. Thirdly, Parliament had enacted legislation relating to LAP, which, at the very least, suggested that it would be inappropriate for the court to extend the law on LAP as proposed. Parliament had, on three occasions, thought it appropriate to extend LAP and had done so on the basis that LAP was limited to advice given by members of the legal profession.

On the facts, there was a strong case in terms of logic for allowing the appeal. LAP was conferred for the benefit of the client and could only be waived by the client; it did not serve to protect the legal profession. In the light of that, it was hard to see why, as a matter of pure logic, that privilege should be restricted to communications with legal advisers who happened to be qualified lawyers, as opposed to communications with other professional people with a qualification or experience which enabled them to give expert advice in a particular field. However, where a common law rule was valid in the modern world, but it had an aspect or limitation which appeared to be outmoded, it was by no means always right for the courts to modify the aspect or remove the limitation. In any such case,

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the court had to consider whether the implications of the proposed modification or removal were such that it would be more appropriate to leave the matter to Parliament. The court also had to consider whether the aspect or limitation in question had led to problems, and whether it had been assumed, approved or disapproved impliedly or expressly by Parliament. If Parliament had unequivocally endorsed the aspect or limitation then the courts should not alter it. If the appeal were to have been allowed, the court would have been extending LAP beyond what had, for a long time, been understood to have been its limits. It would have been extending it considerably, as the issue could not simply have been treated as limited to the question as to whether tax advice given by expert accountants was covered by LAP. Whilst that was the specific question between the parties, it was just a subset of a much larger set. To have concentrated on tax advice given by accountants would have been wrong, because it would ineluctably have followed from accepting the claimants' argument that legal advice given by some other professional people would also have been covered.

Court of Appeal

BAA Ltd v HMRC

In *BAA Ltd v HMRC, CA [2013] EWCA Civ 112* in 2006 a large Spanish company (F) arranged for the incorporation of a new company (AD) with the aim of making a "takeover bid" for another company (B), which operated several British airports. The bid was successful, and AD incurred significant costs in relation to the acquisition. After the takeover, AD joined B's VAT group. The representative member of the group (BL) claimed a deduction for input tax of more than £6,000,000 which AD had incurred in relation to the takeover. HMRC issued an assessment to recover the tax on the grounds that there was no direct and immediate link between the supplies on which this VAT was incurred and any taxable supplies made, or intended to be made, by BL's group. The Upper Tribunal upheld the assessment and the CA unanimously dismissed BL's appeal. Mummery LJ held that, at the relevant time, there was no evidence that AD had made taxable supplies or had an intention to make taxable supplies. There was no "direct and immediate link between the input tax on the supplies of services to (AD) and the output tax on the supplies of taxable services made by (B)". B's supplies were "not connected at the relevant date with the supplies to (AD) on which input tax was incurred".

Tribunal Decisions

Upper Tribunal

HMRC v Purple Telecom Ltd

In *HMRC v Purple Telecom Ltd, UT [2013] UKUT 49 (TCC)* in 2006 a company (P) reclaimed substantial amounts of input tax. HMRC rejected the claim on the grounds that the transactions appeared to be connected to MTIC fraud. P appealed, and the appeal was listed for hearing in February 2013. In December 2012 P applied for the hearing of its appeal to be adjourned on the grounds that its controlling director (W) was undergoing psychiatric treatment. The First-tier Tribunal granted the application but HMRC appealed to the Upper Tribunal, which reversed this decision and directed that the substantive appeal should be set down for hearing. Proudman J observed that a report from an independent psychiatrist had contradicted some of the claims made by W's own psychiatrist, and had indicated that "although (W) does suffer from a moderate depressive disorder, it is not a severe one". There had already been substantial delay, and "this appeal cannot go on for ever".

Birmingham Hippodrome Theatre Trust Ltd v HMRC

In *Birmingham Hippodrome Theatre Trust Ltd v HMRC, UT [2013] UKUT 57 (TCC)* a

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company (B) which was a registered charity, and operated a theatre, had accounted for VAT on supplies which qualified for exemption as "cultural services". In 2007 it submitted a claim for repayment covering the period from 1990 to 1996. HMRC rejected the claim on the grounds that for 2000 and 2001 B had reclaimed substantial input tax on the refurbishment of its theatre, which should have been attributed to exempt supplies, and that the effect of *VATA 1994, s 81(3A)* was that the previous underclaim of input tax should be set against the subsequent overclaim. The First-tier Tribunal accepted this contention and dismissed the appeal, and the Upper Tribunal upheld this decision. Proudman J held that "the operation of *s 81(3A)* is not precluded by the principles of legal certainty, equality, equivalence, or the supremacy of Community law".

HMRC v A Noor

In *HMRC v A Noor, UT [2013] UKUT 71 (TCC)* a trader (N) registered for VAT in 2009. In his first return, he reclaimed input tax on services which he had received more than six months before the date of registration. HMRC rejected the claim by virtue of *VAT Regulations, reg 111*. N appealed, contending that he had previously telephoned HMRC's National Advice Service and had been told that that there was a three-year period for reclaiming input tax. The Upper Tribunal upheld HMRC's rejection of N's claim. Warren J held that "Parliament did not intend to confer a judicial review on the VAT Tribunal or the First-tier Tribunal", and that the First-tier Tribunal "does not have jurisdiction to give effect to any legitimate expectation which (N) may be able to establish in relation to any credit for input tax". Furthermore, "no reasonable tribunal properly directing itself in law could have concluded that (N) had a legitimate expectation such that it would be so unfair as to amount to an abuse of power for HMRC to refuse his claim in respect of the VAT on the invoices".

First-tier Tribunal

Brims Construction Ltd v HMRC

In *Brims Construction Ltd v HMRC, [2013] UKFTT 35 (TC), TC02455* a company had purchased a school, which was a Grade 2 listed building, from a council with the intention of developing it. The school site included a separate building. The company arranged for a contractor (B) to convert this building into residential accommodation. B treated its supplies as zero-rated. HMRC issued an assessment charging tax on the basis that the work did not qualify for zero-rating, since the relevant planning permission prohibited the separate use of the building, and the work therefore failed to meet the conditions of Sch 8, Group 6, Note 2(c). The First-tier Tribunal dismissed B's appeal, applying the Upper Tribunal decision in *Lunn , [2010] STC 493; [2009] UKUT 244 (TCC)*. Judge King specifically disapproved the earlier decisions in *Phillips [2011] UKFTT 372 (TC), TC01227* and *Wendels , [2010] UKFTT 476 (TC), TC00737*.

R Drummond v HMRC

In *R Drummond v HMRC (2012) TC02456* an individual (D) lived in a bungalow in the grounds of a caravan park. He built a house adjacent to the park. The relevant planning permission stipulated that the house should only be occupied by "a person solely or mainly employed, or last employed prior to retirement, at the adjacent caravan park", and explained that new housing should only be allowed in this location "where it is essential in the interests of a site manager or other essential worker", D reclaimed VAT on the cost of constructing the house, under VATA 1994, s 35. HMRC rejected the claim on the basis that, since the planning permission prohibited the separate use of the house, the effect of VATA 1994, Sch 8, Group 5, Note 2(c) was that it did not qualify as a "building designed as a dwelling". The First-tier Tribunal dismissed D's appeal against this decision.

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M & SN Saheid v HMRC

In *M & SN Saheid v HMRC* (*2013*) *TC02458* a family partnership dismissed an employee (B). B sued the partnership for wrongful dismissal. The County Court ordered the partners to pay B's legal costs. The partnership reclaimed input tax on this. HMRC rejected the claim on the basis that the supplies had been made to B rather than to the partnership. The First-tier Tribunal dismissed the partners' appeal against this decision.

Hewlett Packard Ltd v HMRC

In *Hewlett Packard Ltd v HMRC* (*2012*) *TC02459* a case where the facts were similar to those in *Harrier Llc v HMRC* (*2012 SFTD 348*), the successful appellant company applied for a direction that the VAT Tribunal Rules 1986 (SI 1986/590), rule 29 should apply to the proceedings rather than the Tribunal Procedure (First-Tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273), rule 10. The First-tier Tribunal dismissed the application, applying the principles laid down by Warren J in *HMRC v Atlantic Electronics Ltd* (*No 3*)*, [2012] UKUT 45* (*TCC*).

Nettexmedia.com Ltd v HMRC

In *Nettexmedia.com Ltd v HMRC* (*2013*) *TC02470* a company (N) sold retail goods by the internet. Customers who paid it a monthly fee of £19.95 were entitled to purchase certain goods at below their normal retail price. Where customers purchased goods, N treated the monthly fees as taxable consideration for their purchases and accounted for VAT accordingly. However, where customers paid the monthly fee but did not purchase any goods, N did not account for VAT on the fees. HMRC issued an assessment charging tax on the fees, and N appealed, contending that they were exempt from VAT under *VATA 1994, Sch 9, Group 5*, as being consideration for the management of their accounts. The First-tier Tribunal rejected this contention and dismissed the appeal. Judge Bishopp held that the monthly fees were "consideration for the taxable supply of the right to purchase goods at a preferential rate. Whether or not the customer chooses to exercise the right is immaterial; he has paid for it."

British Film Institute v HMRC

In *British Film Institute v HMRC* (*2012*) *TC02490* the British Film Institute was formed as a non-profit-making body. From 1990 to 1996 it accounted for output tax on its admission charges to films which it showed at the National Film Theatre and at various festivals. In 2009 it submitted a repayment claim on the basis that it should have treated these supplies as exempt under Article 13A(1)(n) of the EC Sixth Directive. HMRC rejected the claim on the basis that Article 13A(1)(n) did not have direct effect. BFI appealed. At a preliminary hearing, the First-tier Tribunal accepted BFI's contention that Article 13A1(n) had direct effect, applying the ECJ decision in *EC Commission v Spain, [1998] STC 1237*. The tribunal also held that BFI's films were "cultural services", specifically declining to follow the VAT tribunal decision in *Chichester Cinema at New Park Ltd* (*VTD 19344*). (Both sides were given leave to seek a further hearing to consider the application of the partial exemption provisions, and the question of "unjust enrichment".)

Tui Travel plc v HMRC (and related appeals)

In *Tui Travel plc v HMRC* (*and related appeals*) (*2012*) *TC02493* in 2009 a large group of holiday companies submitted claims for substantial repayments of VAT, contending that they had overpaid output tax because they had not deducted the value of discounts given to customers from commission which they had earned for acting as an agent. HMRC rejected the claims and the First-tier Tribunal dismissed the companies' appeals. Judge Connell observed that the claims related to cases where the companies were acting

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as agents or brokers, and did not "enter into contractual relations with the customer with regard to the supply of the holiday". He held that the amounts which the companies had contributed towards the total cost of the holidays were "mischaracterised when referred to as a discount. In reality there was no discount on the contractual cost of the holiday supplies by the tour operator." The companies had received the commission payments which they had earned, although they had not retained them. The companies should be treated as having "contributed third-party consideration towards the price of the holiday", since "the consideration in contractual terms was funded by the customer, utilising the contribution paid by the appellants. Privity of contract only existed between the customer and the tour operator with regard to the supply of the holiday. The consideration for the holiday was at law paid in full by the customer." Accordingly, "the consideration towards the cost of the holiday paid by the appellants does not therefore lead to a reduction in the value of its (sic) supply of introductory services to the tour operator. The very reason the appellants are able to fund the contribution is because they have been paid the full amount of the commission." The companies were "not entitled to reduce the amount of their output tax on account of the contributions made to the customer's holiday."

BA Hubbard v HMRC

In *BA Hubbard v HMRC* (*2012*) *TC02496* a self-employed lorry driver (H) introduced other drivers to the contractors for whom he worked. In such cases, he invoiced the contractors for the amounts payable to the other drivers. HMRC issued assessments on the basis that the effect of the invoicing arrangements was that H had been acting as an independent principal and was required to account for output tax on the full amount shown on the invoices. H appealed, contending that the invoices had been issued in error, that he had been acting as an agent, and that he should only be required to account for tax on the commission which he retained. The First-tier Tribunal accepted H's contentions and allowed his appeal. Judge Walters observed that "it was convenient to all parties for (H) to invoice the haulage company customer for the full amount due from that customer and for the driver to invoice (H) for the balance of what the haulage company customer paid which was due to them".

L Wallis v HMRC

In *L Wallis v HMRC* (*2013*) *TC02499* the owner of a listed building obtained planning consent to replace the windows with new triple-glazed windows. HMRC issued a ruling that the supply was standard-rated repair or maintenance. The owner appealed, contending that it should be treated as a zero-rated approved alteration. Judge Hellier accepted this contention and allowed the appeal.

(**Note**. Judge Hellier's decision fails to refer to the earlier decision in *B Moore* (*VTD 18653*), where the replacement of windows in a protected building was held to be "repair or maintenance".)

Antiques Within Ltd v HMRC

In *Antiques Within Ltd v HMRC* (*2013*) *TC02507* a company operated an "antique centre", and rented out about 70% of its floor space to stallholders. It did not account for tax on the payments it received from the stallholders. HMRC issued an assessment charging tax on them, and the company appealed, contending that it was supplying a right to occupy land, which was exempt from VAT. The First-tier Tribunal allowed the appeal in part. Judge Mitting held that the company was making two separate supplies, i e an exempt supply of land and a taxable supply of a sales service, so that the consideration should be apportioned.

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First Class Communications Ltd v HMRC (No 2)

In *First Class Communications Ltd v HMRC* (*No 2*) (*2013*) *TC02508* a company (F) submitted returns claiming substantial repayments of input tax. HMRC rejected the claims on the grounds that it appeared that the transactions were connected to MTIC fraud. F appealed. The hearing of the appeals were delayed for several years because criminal proceedings were being taken against two people allegedly involved in the transactions, both of whom were convicted and one of whom (R) was sentenced to 17 years' imprisonment. R appealed to the CA, which upheld his conviction. Following the dismissal of R's appeal, F applied to the tribunal for HMRC to be barred from the proceedings, under SI 2009/273, rule 8, for failing to comply with a tribunal direction. The tribunal rejected this application. Judge Mosedale observed that "a four-month delay, in a case which has already taken five years to get to this point, is not particularly large".

J & Mrs S Kear v HMRC

In *J & Mrs S Kear v HMRC,* (*2013*) *TC02513* a married couple owned a large house, which included five adjacent commercial buildings in its grounds. They obtained planning permission to convert three of these buildings to provide residential accommodation in a "live-work unit". The planning permission stipulated that "the residential floorspace of the live-work unit shall not be occupied other than by a person solely or mainly employed or last employed in the business occupying the business floorspace of the unit". The couple claimed a refund of VAT under *VATA 1994, s 35*. HMRC rejected the claim on the basis that the effect of *VATA 1994, Sch 8, Group 5, Note 2*(*c*) was that the building did not qualify as a building "designed as a dwelling". The tribunal dismissed the couple's appeal against this decision, finding that there was "an express condition preventing the separate use of the business and residential elements of the property".

Chi Drinks Ltd v HMRC

In *Chi Drinks Ltd v HMRC* (*2013*) *TC02512* a company (C) sold coconut water. HMRC issued a ruling that this was a beverage, and was excluded from zero-rating by *VATA 1994, Sch 8, Group 1, Excepted Item 4*. The First-tier Tribunal dismissed C's appeal against this decision.

W Cadbury v HMRC

In *W Cadbury v HMRC* (*2013*) *TC02515* an individual (C), who had a severely disabled son, imported a motor cruiser from Jersey. HMRC issued a ruling that VAT was chargeable on the import and C appealed, contending that it should be treated as zero-rated under *VATA 1994, Sch 8, Group 12, Item 2*(*i*). The First-tier Tribunal rejected this contention and dismissed his appeal. Judge Herrington held that "the test as to whether the boat qualified for relief under *Item 2*(*i*) must be tested at the time of importation". At the time that C had imported the cruiser, "no adaptations had been made to the boat to make it suitable for use by disabled persons".

Mrs B Massey (t/a the Basement Restaurant) v HMRC

In *Mrs B Massey* (*t/a the Basement Restaurant*) *v HMRC* (*2013*) *TC02520* a woman (M) opened a restaurant in the basement of a property which she owned. In 2006 she leased the restaurant to a tenant (P), who registered for VAT. In 2009 P surrendered the lease. The restaurant closed for about 10 days before M reopened it, employing her son as a chef. HMRC issued a ruling that M had acquired the restaurant as a going concern and was required to register for VAT. The First-tier Tribunal dismissed M's appeal against this decision.

Westinsure Group Ltd v HMRC

In *Westinsure Group Ltd v HMRC* (*2013*) *TC02532* a company (W) supplied services to insurance brokers, designed to help them obtain better terms and related

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benefits from insurance companies. It charged its clients an annual fee which was normally between £1500 and £3500. HMRC issued a ruling that it was required to register for VAT. W appealed, contending that its supplies should be treated as exempt under VATA 1994, Sch 9, Group 2, Item 4. The First-tier Tribunal rejected this contention and dismissed the appeal. Judge Herrington held that the services which W provided "prepare the ground in order to enable other market participants to intermediate and are too remote from the effecting of particular insurance transactions to amount to the services of an insurance broker or insurance agent".

Colaingrove Ltd v HMRC (No 3)

In *Colaingrove Ltd v HMRC* (*No 3*) (*2013*) *TC02534* a group of companies provided serviced holiday accommodation in caravan parks and chalets. Initially the group accounted for VAT on the full amount charged to clients, but it subsequently submitted a repayment claim on the basis that it should have treated its supplies of electricity as a separate supply which qualified for the reduced rate under *VATA 1994, Sch 7A, Group 1*. HMRC rejected the claim on the basis that the group was making a single composite supply of holiday accommodation, which was standard-rated. The representative member of the group appealed. The First-tier Tribunal allowed the appeal. Judge Walters held that the specific provisions of *Sch 7A* overrode the general principle that composite supplies should not be split.

Safeguard Europe Ltd v HMRC

In *Safeguard Europe Ltd v HMRC* (*2013*) *TC02543* a company (S) manufactured a gel product which it called "Stormdry". HMRC issued a ruling that the supplies of the product were standard-rated. S appealed, contending that the product qualified for the reduced rate of VAT under VATA 1994, Sch 7A, Group 2. The First-tier Tribunal allowed the appeal in principle, finding that the product functioned as insulation and qualified as "energy-saving materials" within Group 2, Note 1. (However the tribunal noted that S would still have to account for VAT on its sales, as the reduced rate only applied to the installation of such materials.)

Mrs G Candy v HMRC

In *Mrs G Candy v HMRC* (*2013*) *TC02544* a company (S) began operating a cleaning business in 2006, and registered for VAT in 2008. HMRC subsequently formed the opinion that it should have registered from an earlier date, and imposed a penalty under VATA 1994, s 60. S subsequently went into liquidation, and HMRC issued a notice under s 61 imposing the penalty on its controlling director (C). She appealed, accepting that S should have registered from an earlier date but contending that she had not acted dishonestly. The First-tier Tribunal accepted her evidence and allowed her appeal. Judge Khan held that there was "no clear evidence that the appellant intended to evade tax either by the standards of a reasonable person or a subjective intention on the part of (C) herself. Her registration when advised to do so by her accountant does not support the inference of dishonesty."

GB Housley Ltd v HMRC

In *GB Housley Ltd v HMRC* (*2013*) *TC02548* a company (G), which traded as a scrap metal dealer, had operated a "self-billing" system for many years. Between 2006 and 2008 four of its suppliers deregistered for VAT. When HMRC discovered this, they issued an assessment to recover the tax shown on the invoices from the deregistered suppliers. G appealed, contending that HMRC should have exercised their discretion under VAT Regulations 1995 (SI 1995/2518), reg 29(2) to allow the invoices in question. The First-tier Tribunal accepted this contention and allowed G's appeal. Judge Porter observed that in *Dankowski v Dyrektor Izby Skarbowej w Łodzi, ECJ Case C-438/09*, the ECJ had held that the

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Sixth Directive precluded national legislation which automatically excluded "the right to deduct VAT paid by a taxable person to another taxable person, who has provided services, where the latter has not registered for the purpose of VAT". He held that HMRC had acted unreasonably in not exercising their discretion to allow their invoices, and that the assessment was therefore invalid.

David Rudling and Alan Dolton LexisNexis

EDITORIAL

The only constant in VAT ·········

··········· is change. Whilst Benjamin Franklin may have said that the only certainties in life are taxes and death, constant VAT changes demonstrate that there is no certainty in VAT. HMRC have announced changes in two areas in recent weeks and an Advocate General's opinion on 31 January has provided support for a change announced by HMRC in August last year. It may be thought that these changes impact vastly different areas of VAT – it is, after all a broadly based tax – but no, these are all land or construction based matters. Exemption and mixed supply is a constant thorn in the side of a business trying to manage its VAT affairs.

Storage

In *C-155/12 Minister Finansów v RR Donnelley Global Turnkey Solutions Poland Sp zoo* the Advocate General has given his opinion, in a Polish case, that the storage of goods is a supply connected with immoveable property (land) and consequently it is an exempt supply with (in the UK) the option to tax where there is a grant of a right to occupy a specific area. This opinion not only clarifies what service has been supplied but it also determines the place of that supply (being the location of the land rather than being determined using the "general" rule and, therefore, outside the scope of VAT where the customers were established outside the EU). The taxpayer had contended that the services (including the security of the goods, loading and unloading the goods and placing them in the warehouse) were distinct supplies and the supply should be treated as a supply under the general rule and not connected with land. The Polish authorities contended that the supply was a supply connected to immoveable property and wholly supplied in Poland.

The Advocate General's opinion was that a single supply was made and that the storage of goods has a sufficiently direct connection with immovable property when a right to use specific property or a specific area of a property has been granted to the customer. It can, therefore, be implied that, where there is an agreement to store goodsbut no grant of a right over specific property or a specific area, the supply does not have a direct connection with immovable property. It was also held that it was for the national court to determine the position based upon the particular facts of the case. The ECJ may, of course, form a different view, but it coincides with HMRC's view of storage as announced in *Revenue & Customs Brief 22/12*.

Hotel catering

HMRC have altered their view of the VAT liability of rooms supplied with catering supplies provided by hotels or similar establishments (*Revenue & Customs Brief 02/13*). The VAT liability for a supply of a right over land (including a room) is exempt (with the option to tax). An exception to this general rule is that the provision of accommodation in hotels, inns, boarding houses and similar establishments, including accommodation in rooms provided for the purpose of catering (such as wedding receptions) is taxable at the standard-rate.

HMRC had previously taken the view that where a hotel provided just a room and the catering was supplied by a third party then the provision of the room was

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just a right over land and exempt (with the option to tax). The third party's catering supply would be standard-rated (although there also remained the intriguing possibility that the caterers may only supply food rather than catering, and the food would then fall to be zero-rated or standard rated depending on what was supplied). Perversely, where the catering was provided by the hotel HMRC believed that there was a single supply of accommodation for catering and the whole supply was standard rated.

HMRC's interpretation of the law has now changed. HMRC regard the supply of the room to be standard rated even where a third party makes the catering supply. HMRC actually altered their view some time ago, but did not publicise this change in interpretation. HMRC published an updated version of *Notice 709/3 Hotels and holiday accommodation* in October 2011 and this contained this change in interpretation. As HMRC does not believe this change has been sufficiently publicised, they will not issue any assessments where a supplier has not accounted for VAT in accordance with this changed view. HMRC, however, expect VAT to be accounted for in accordance with their new interpretation of the law with effect from 22 January 2013.

Connecting your waterworks

HMRC have also announced a change in their view of the liability of charges for the first time connection of water in *Revenue & Customs Brief 40/12*. This follows HMRC's announcement in *Revenue & Customs Brief 43/11* that from 1 January 2012 that one-off charges for the connection to gas and electric supplies by the supplier of the gas or electricity (or by a person in the same VAT group) would follow the treatment of the utility. The supply would, therefore, be made at the reduced-rate. It seems that after a gap of a year HMRC also realised that residential properties also had water supplies made to them and reviewed the first time connection charges for water. The VAT liability of the connection of water supplies is complicated and determined by what exactly is being supplied, by whom and to whom. I am glad it is a simple tax. The following list may help determine the correct VAT liability:

- Connection to a water supply by the person who is the supplier of the water for the first time is zero-rated unless:
  - The customer is involved in a relevant industrial activity when it is standard rated; or
  - At the time of connection the supplier of the water has not been identified, in which case it will be taxable work and not regarded as ancillary to the supply of water for the first time – but see the bullet points below regarding civil engineering works for a further exception to this exception!
- Repairs, alterations or replacements to the exiting pipes are standard rated;
- Replacement water supplies (for example to replace lead piping or damaged pipes, relocation of piping, or to cope with increased water usage) are standard rated unless:
  - An existing building is demolished and replaced by a new property or properties that are not to be used for a relevant industrial activity; or
  - A property is divided into multiple properties; except

  –Where the divided properties are used for a relevant industrial purpose; or

  –There is still one water connection shared by the individual properties.
- Civil engineering works for the first time connection to the water supply of a new dwelling, a relevant residential property or relevant charitable building are zero-rated if the connection is made as part of the construction of a new building;
- Civil engineering works for connecting a property converted from commercial use to residential use for a housing association to a water supply are zero-rated; and

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- Civil engineering works for the first time connection to a water supply during the construction of a permanent residential caravan park are zero-rated.

HMRC recognise that errors may have been made regarding the VAT liability for what is essentially the same supply (water connection). They have stated that customers can make reclaims from suppliers where they have been incorrectly charged VAT. The supplier can, subject to the four year cap, unjust enrichment provisions and any further restrictions under *S80 VAT 1994*, make claims for any overpaid VAT.

Tinkers

The constant tinkering around the edges of the tax does suggest that there is a need for some fundamental design changes to the European VAT system. Also, why would it be thought sensible to have such a labyrinthine system for VAT lability for water connection charges? It is clear that there are deep-seated problems with VAT. Whilst the uncertainly may provide a good income for consultants, lawyers, accountants and writers, it is a drag on business and should be addressed. It does not take a great deal of imagination or perception to envisage what changes could be made.

Examining the systems of other countries provide potentially simple solutions to the problems of the European VAT system. New Zealand, for example, has the simplest VAT system; pretty much everything is taxed. The only exceptions are exports, residential rents and financial services. Relief for the poor is provided by increased social security payments. Australia has a more complex system but provides a solution as an alternative to exempting services provided for public need. Services such as health and education are GST-free (zero-rated). Thus, the problems for exemption are avoided, although there does remain the problem of definition and mixed supplies. In practice, few issues have not arisen regarding these areas. The problems of the Australian VAT/GST system that do exist could and can be avoided.

The constant changes of the VAT system, its continuing anomalies and complexities do cause problems for all concerned. The whole system is overdue for a review. It was after all designed in the late 1960s when many areas were though too hard to tax. Subsequently solutions have been found to many of the problems, and insurance and betting and gaming are taxed in several jurisdictions rather than remaining exempt. Whilst change requires all member states to agree (although the UK can make certain unilateral changes to the zero-rating provisions), it must be in the interests of all member states to improve the system in one step rather than the necessary tinkering undertaken by member states to correct their systems and frequent Court cases required to clarify the law.

John Davison
Independent Indirect Tax Consultant

CASES & COMMENT

BGZ Leasing [2013] C-224/11Court of Justice of the European Union (CJEU)

The Decision

This case concerned the VAT treatment of insurance provided alongside a supply of leased vehicles by BGZ Leasing ("BGZ").

BGZ leased vehicles to its customers and, as a term of the lease, the customer was required to keep the vehicles insured. BGZ offered to arrange insurance from a third party insurer, the cost of which it recharged to the lessee. There was no obligation on the lessee to take this insurance through BGZ; it was free to purchase insurance from a different insurer if it wished to do so.

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BGZ took the view that, where the customer chose to take insurance through it, there were two supplies: a standard-rated supply of a car and an exempt supply of insurance. However, the Polish tax authorities challenged this, claiming that there was only one supply: the lease of an insured vehicle, which was subject in its entirety to VAT.

BGZ appealed the authority's decision. The Polish Supreme Administrative Court referred the following questions to the CJEU:

1 Whether Article (2)(1)(c) of Directive 2006/112/EC (the "Principal VAT Directive") must be interpreted as meaning that the service of providing insurance for a leased item and the leasing service itself are to be treated as separate services or as one single, comprehensive, composite leasing service; and
2 Whether, if the answer to the first question is that they are to be treated as separate services, Article 135(1)(a) of the Principal VAT Directive must, in conjunction with Article 28, mean be interpreted as meaning that the recharge of the cost of the insurance from the lessor to the lessee is to be treated as exempt.

In its judgment, the CJEU observed that every supply must normally be regarded as distinct and independent from each other. However, according to CJEU case law, in certain circumstances, some supplies must be regard as a single transaction where they are not independent, or whether they supplies are so closely linked that they form, objectively, a single indivisible economic supply, which it would be artificial to split.

The CJEU made the following comments:

- Any insurance transaction has, by nature, a link with the item it covers. There is therefore necessarily a connection between the linked item and the insurance, but such a connection is not sufficient in itself to determine whether there is one supply for VAT purposes.
- According to CJEU case law, a service is to be regarded as ancillary to a principal service where it does not constitute an aim in itself, but a means of better enjoying the principal service supplied. In this regard, although it is true that the risks faced by the lessee are normally reduced as compared with those incurred in a situation in which such insurance is lacking, it remains the case that that derives from the very nature of insurance. That, in itself, does not mean that such insurance must be regarded as being ancillary to the leasing service of which it forms part.
- Although such insurance supplied to the lessee through the lessor facilitates the enjoyment of the leasing service, that constitutes essentially an end in itself for the lessee and not only the means to enjoy that service better.
- The fact that the insurance covering the leased item is required by the lessor does not invalidate that finding.
- Invoicing and pricing may be an indication as to whether a supply is a single supply and separate invoicing, without being decisive, supports the view that the services are independent.

The CJEU therefore expressed the view that in the circumstances before it, the leasing service and the insurance service should be regarded as two separate distinct supplies.

In relation to the second question the Court observed that a supply of insurance cannot be subject to VAT simply because the insurance costs have been recharged to the lessee, rather than incurred by the lessee directly. Fiscal neutrality requires that supplies of insurance for a leased item must not be treated differently where the insurance is obtained by BGZ and recharged to the lessee, as opposed to being obtained by lessee itself. However, the CJEU also observed that the same reasoning may not apply if the amount

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invoiced to the lessee is more than the cost of the insurance to the lessor.

Commentary

This case is an interesting practical example of the application of the well-established single/multiple supply rules. Whilst the CJEU gives no affirmative judgment, its findings support the view that, even though there may be certain elements of connection between supplies, this does not mean they are inextricably linked. It seems that this is especially relevant to insurance contracts, which by nature will always have a connection to the supply they are insuring. Also of note is the potential inference that a mark-up on recharged insurance could lead to a different analysis; a point which the CJEU seems to have left open. It will be interesting to see whether this leads to any further litigation on this issue.

Chi Drinks Limited[2013] UKFTT 094 (TC)

First-tier Tribunal

The Decision

This decision related to an appeal by Chi Drinks Limited about the VAT liability of coconut water.

Chi sells coconut water in tetrapak cartons. At Chi's request , HMRC issued a ruling confirming that the supply of the coconut water was zero-rated. However, HMRC later withdrew that ruling and instead ruled that the coconut water was standard-rated. Chi appealed against that conclusion.

The Tribunal was required to consider the following points:

1 Whether the supplies of coconut water fell within the Excepted Items to the zero-rating for "food" contained in item 1 of Group 1 of Schedule 8 to the VAT; in particular, whether it was a "beverage" in accordance with item 4 of those Excepted Items; and

2 If so, whether the supplies fell within Item 6 of the "Items overriding the exceptions" (being "milk and preparations and extracts thereof") such that they would fall back into the zero-rating.

In reaching its decision, the Tribunal noted that it had seen a fairly limited amount of evidence during the course of the hearing. This included printouts from Chi's website and definitions and information from online resources, but the Tribunal did not have the opportunity to taste the product itself, nor examine the packaging in which it was sold.

In deciding whether the supplies were a "beverage", the Tribunal considered whether the product would satisfy the test set out in the Bioconcepts concepts case. The Tribunal pointed to the following factors in deciding that it did: that it was commonly sold as a product to be drunk, that it was described as being a "healthy electrolyte drink", and that the website highlighted its hydration qualities.

Chi attempted to persuade the Tribunal that, despite being a beverage, the product should nevertheless be zero-rated as the common meaning of "coconut milk" included the liquid that was drained from a coconut when cut open (i.e. the coconut water). The Tribunal rejected this argument, as the evidence adduced specifically distinguished coconut milk from coconut water and stressed the importance of not confusing the two.

The Tribunal dismissed the appeal, holding that the supplies of coconut water were standard-rated. However, the Tribunal also commented that Chi had had a legitimate expectation that they could rely on the original ruling (that the product was zero-rated) until the point at which that ruling had been withdrawn.

Commentary

This case seems to be a relatively straightforward application of the *Bioconcepts* test, which the Tribunal acknowledged as a

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"useful starting place" in deciding the liability of the product in question. Perhaps more interesting are the Tribunal's (obiter) comments in relation to coconut milk. They comment that, in light of the fact that soya milk is not "milk" for the purposes of the items overriding the exceptions to the zero-rating, by analogy neither is coconut milk. They therefore draw the assumption that HMRC must have considered this, and must have concluded that coconut milk is a "food" and not a "beverage" in order to have reached their view that coconut milk falls within the zero-rating. It will be interesting to see whether this has any effect on HMRC's approach to the VAT liability of coconut milk.

Amy Bache
Deloitte LLP

MOBILE PHONES AND INPUT TAX RECOVERY

HMRC Enquiries into the VAT Input Tax Repayment Claims of Apple iPhone Traders

Within a three part article in recent editions of De Voil Indirect Tax Intelligence, we have examined various features of Missing Trader Intra-Community VAT fraud ("MTIC" fraud) in some detail, including the possible future mutation of the fraud.

Our analysis in this area may have been apposite. For in enquiries reminiscent of the extended verification exercises conducted by HMRC in cases of suspected MTIC fraud involving mobile telephone and computer component wholesale trading in the early and mid-2000s, HMRC are increasingly investigating the VAT input tax repayment claims of Apple iPhones wholesale traders. HMRC activity in this area may involve extensive enquiries over many months into a trader's business activities. My firm is currently representing several such traders who deal in Apple iPhones and other top of the range mobile telephones, buying in small but regular quantities from retail outlets through employees and selling wholesale to customers either in the UK or overseas. It is the price differential between the cost of product in the UK and the EU which makes it profitable for a business to purchase in small quantities and sell wholesale in this way.

In particular, HMRC's concerns are aroused where the till receipts obtained from the retail outlets by traders' employees do not specifically note the business or employee name upon them. Nevertheless, in these circumstances, as we shall examine below, provided that a bona fide transaction has taken place and there is a clear audit trail evidencing the business' payment for the mobile telephones, HMRC have a discretion to allow a trader's claim to input tax. Indeed, we submit, where alternative evidence for the purposes of input tax deduction can be provided, a trader has the right to deduct.

Significantly, however, unlike in "classic" MTIC fraud, HMRC tend not to allege that a tax loss has arisen within such wholesale traders' supply chains. This is unsurprising, since traders purchase the mobile telephones from major UK retailers such as Apple Stores which account to HMRC directly for the input tax paid by traders on their purchases. Instead, HMRC point to alleged breaches of their Notice 700 "The VAT Guide" with regard to the valid evidence required in support of a claim to input tax, which for purchases where the total exceeds £250, comprises a full VAT invoice including the purchaser's name (or trading name) and address. By contrast, traders are likely to hold simple till receipts alone. When, at HMRC's suggestion, traders approach their retail outlet suppliers with a view to retrospectively obtaining full VAT invoices to cover their purchases, they are merely advised that it is not their suppliers' policy to issue full VAT invoices in such circumstances. The suppliers state that they will not re-issue the till receipts or invoices on the grounds both that the

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existing documentation already has sufficient information upon it and that since the mobile telephones have been purchased in such small and frequent quantities, in practical terms, there is no likelihood of re-issuing the documentation in a different format as now requested.

Furthermore, where it has been established by HMRC that the business has not purchased the Apple iPhones or other product through employees but rather, for example, through friends and family members, then HMRC note the guidance given on supplies made by or through agents within Notice 700: if a person acts as an undisclosed agent making purchases on behalf of a business then for VAT purposes, the supply from the retail outlet will be deemed to have been made to them rather than to the business. When such agents pass the goods on to the business, this is considered by HMRC to be a separate supply in relation to which, the business is not entitled to recover input tax unless the agents are themselves registered for VAT and invoice the business for the supply, charging VAT.

Wholesalers in this trade sector are caught by the policy of their retail outlet suppliers with regard to bulk sales, namely that they will not accommodate bulk orders and will restrict the traders' representatives to the purchase of, for example, two mobile telephones per shop per day. If the retail outlets' policy allowed it, it would surely be in a trader's best interests, both commercially and logistically, to buy mobile telephones in a significantly greater quantity at the same time and from a single outlet rather than having to constantly travel nationwide to source them.

Nevertheless, despite apparently being caught between the Scylla of HMRC regulations and requirements and the Charybdis of their suppliers' policy, wholesale traders are by no means entirely helpless. Under HMRC's "VAT Strategy: Input Tax Deduction without a Valid VAT Invoice Statement of Practice" of March 2007, HMRC have a discretion to allow recovery of input tax where a full VAT invoice cannot be obtained but a taxable supply has taken place. Indeed, provided that a bona fide transaction has occurred, that there is an audit trail to demonstrate payment for the relevant goods and that certain conditions are met as set out in the Statement of Practice, then it is clear from the Statement of Practice that "the Commissioners WILL permit input tax deduction". A "Decision Flowchart" at Appendix 1 of the Statement of Practice combined with the questions at Appendix 2 assist in establishing whether HMRC will allow input tax deduction, should all conditions be satisfied. We submit that, taken together:

- the till receipts obtained from suppliers;
- an audit trail demonstrating payment made for the relevant goods; and
- the fact that all purchases were made by way of business as evidenced by the corresponding sales invoices proving the onward sale;

may provide clear alternative evidence for the purposes of input tax deduction. In such circumstances, under the terms of HMRC's own Statement of Practice, a trader has a right to deduct.

In addition, under HMRC Brief 83/09, the Commissioners have a discretion to allow input tax recovery in the absence of a valid, full VAT invoice where alternative evidence is produced to satisfy HMRC that a taxable supply for a consideration has taken place and that the supply was made to the claimant as the relevant VAT registered entity.

It is also relevant to note HMRC's internal guidance, available upon HMRC's website, relating to "box breaking", "box consolidating" and issues for Officers to consider for example, with regard to whether there has been a supply for VAT purposes, whether the invoice is a valid VAT invoice and who made the purchase (HMRC VAT manuals VATF45210, VATF45220, VATF45231, VATF35100, VATF45232, VATF45233 and

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VATF42500 refer). It may be helpful to provide the following definitions. A "box breaker" is a taxable person who purchases mobile telephones which are locked into a particular network and unlocks them so that they can be used on any network. A "box consolidator" is a taxable person who purchases "sim free" mobile telephones either from retail outlets or from other box consolidators or box breakers and consolidates these purchases into a single onward order. As is clear from HMRC's own internal guidance, neither of these activities is unlawful in itself. Additionally, a trader is entitled to recover the input tax claimed on the basis that:

- under the HMRC guidance within VAT manual VATF35100, there have been supplies for VAT purposes in that there have been supplies of goods which took place in the UK, which were made by a taxable person and which were made in the course or furtherance of a business carried on by that person;
- under the HMRC guidance within VAT manual VATF45232, the persons making the purchases are genuine employees and the purchases have been made in the course or furtherance of its business and were legitimately financed by the business;
- under the HMRC guidance within VAT manual VATF45233, where a taxable person does not hold a proper tax invoice, HMRC have the discretion as to whether to allow input tax recovery on the basis of alternative evidence. Before denying trader's input tax claim, a verifying Officer must first consider whether to allow deduction using HMRC's discretion. Under the guidance, the Officer is required to give the trader a reasonable opportunity to seek to obtain a proper tax invoice from its supplier or to provide alternative evidence of receipt of the taxable supplies;
- under the HMRC guidance within VAT manual VATF42500, HMRC have the discretion as to whether to allow input tax recovery and will consider evidence that the supply as stated on the invoice did take place; that there is other evidence to show that the supply did occur; that the supply is in furtherance of the taxable person's business; that the taxable person has undertaken normal commercial checks to establish the bona fides of the supply and supplier; and that normal commercial arrangements are in place.

Matters are complicated further by the general requirements under HMRC's Notice 735 with regard to the application of the reverse charge for sales of mobile telephones and the need to obtain appropriate invoices from suppliers where purchases, or relevant aggregated purchases, equal £5,000 or more. The reverse charge mechanism – introduced to counter MTIC fraud in mobile telephone and computer component wholesale trading – results in no VAT being charged by the supplier to taxable customers who, in turn, become liable for the payment of the VAT. In practice, customers (insofar as they are normal taxable persons with a full right of deduction) declare and deduct at the same time without effective payment to the Treasury. In this way, the theoretical possibility of committing MTIC fraud in these commodities has been removed. In an extended verification of an Apple iPhone wholesale trader's input tax repayment claim, HMRC may therefore require the trader to undertake enquiries with its suppliers not only with regard to potentially obtaining full VAT invoices from them but also in order to address reverse charge issues in relevant purchases, by issuing invoices net of VAT where the reverse charge is said to apply. However, as with a request for a full VAT invoice, the resolution of the reverse charge issue in this way is negated by the suppliers' own view of the applicability of the reverse charge, being that it only applies where a whole order amounts to more than £5,000 on a single invoice.

In responding to HMRC's ongoing, and sometimes apparently endless, requests for

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clarification in an extended verification of its input tax repayment claim, a trader may be required to provide voluminous information and documentation both from its business records and indeed from elsewhere. This may include:

- details relating to the business' commercial operations;
- the till receipts provided by its suppliers;
- its company employee details and records;
- purchase records;
- sales records;
- cash records combined with a reasonable explanation as to why cash may have been used to fund purchases;
- bank statements and transfer records;
- employees' personal bank and credit card statements; and
- gift card receipts to demonstrate payment for the mobile telephones (where applicable).

In a lengthy extended verification of a client's input tax repayment claim in this trade sector, an adviser should consider requesting HMRC to arrange a part payment of the client's VAT repayment claim in relation both to that element of the claim where HMRC's verification has been satisfactorily completed and where the total of purchases evidenced by till receipts, including VAT, falls below the full VAT invoice requirements of £250 under HMRC's Notice 700 "The VAT Guide". It is also HMRC policy to consider making interim payments in the case of hardship.

Phil Rimmer is a Director of M&R Tax Advisers Ltd. and can be contacted on either 07590 047545 or phil@mandrtaxadvisers.com

Website: www.mandrtaxadvisers.com

Phil Rimmer
M&R Tax Advisers Ltd

INPUT TAX RECOVERY

BAA Limited – VAT recovery on corporate acquisition costs

Introduction

On 21 February 2013, the Court of Appeal issued a much-awaited decision in the case of *BAA Limited [2013] EWCA Civ 112*. The case looked at whether it was possible to recover the input tax incurred by an acquiring vehicle in the course of an acquisition of the entire shareholding of a company. The Court of Appeal ruled in favour of HM Revenue and Customs ("**HMRC**") and denied input recovery.

This article traces the history of this litigation and explores the backdrop against which the Court of Appeal ruled in favour of HMRC. This article also addresses a very important question – what does this judgment mean for businesses?

Facts

It is important to appreciate the sequence of events leading up to the acquisition and the recovery of input tax. It is this set of facts that has ultimately contributed to the disappointing result for the taxpayer.

In the Spring of 2006, the Spanish infrastructure giant, Ferrovial, launched a takeover bid for the UK airport operator – BAA plc (now called, BAA Airports Limited) ("**BAA**").

On 27 March 2006, as a part of the bid, Airport Development and Investments Limited ("**ADIL**") was incorporated as a special purpose vehicle to acquire the entire issued share capital of BAA.

On the following day (i.e. 28 March 2006), ADIL appointed an investment bank to act as a co-financial advisor in connection with the acquisition. The bank's advisory services included providing a business plan, financial remodelling, due diligence and valuation.

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Around the same time, ADIL also appointed professional advisors and solicitors for the purposes of facilitating the acquisition.

On 7 April 2006, ADIL entered into an agreement with a syndicate of banks for securing senior and subordinated debt facilities. On the same day, ADIL announced its intention to make an offer for BAA.

On 20 April 2006, ADIL made a formal offer for BAA. In response, BAA issued a defence document. In early June 2006, ADIL made a final recommended offer.

On 26 June 2006, ADIL's final recommended offer was accepted and on the same day, the acquisition was successfully completed.

During the next four months (i.e. between July 2006 and October 2006), ADIL was invoiced for fees by the investment bank, professional advisors and solicitors. ADIL paid the fees and incurred VAT on such fees. It is the recovery of this VAT that is subject to the present litigation.

On 21 September 2006, ADIL applied to become a member of BAA's VAT group. Initially, HMRC rejected this application. However, in early 2007, HMRC agreed that ADIL should be admitted to BAA's VAT group retrospectively from 22 September 2006 (which, in effect, was three months after the successful completion of the acquisition).

On joining BAA's VAT group, BAA claimed the input tax incurred by ADIL in the course of the acquisition. HMRC challenged this recovery and issued an assessment for VAT for an amount of £6.7m (approximately).

BAA appealed against HMRC's assessment at the First-tier Tribunal (Tax Chamber) ("**FTT**").

FTT's decision

At the FTT, BAA was successful in its appeal. The basis of the FTT's decision was that:

(i) ADIL carried out an economic activity; and

(ii) The input tax had a direct and immediate link to BAA's taxable supplies – even though at the time the input tax was incurred, ADIL did not itself make any taxable supplies (and there was no evidence of any intention of doing so).

The FTT found that ADIL had carried out an economic activity since inception-even though ADIL never made an actual taxable supply. The FTT considered that ADIL did not simply invest in BAA's shares (mere investment is a non-economic activity). ADIL provided high-level strategic governance of BAA's group and was involved in the management and operation of the group. Further, the fact that ADIL negotiated and secured debt facilities for BAA's group supported the conclusion that ADIL carried out an economic activity.

In terms of linking the input tax with a taxable supply, the FTT decided that there was no direct and immediate link between the input tax and ADIL's **own** taxable supply. The reason for this was that at the time the input tax was incurred, ADIL did not make any taxable supplies (and there was no evidence of its intention to do so).

The next question before the FTT was whether there was a direct and immediate link between the input tax and the taxable supplies made by BAA's VAT group.

The FTT considered that it was possible to have such a link in the light of the judgment of the Court of Justice of European Union ("**ECJ**") in *Faxworld* (Case C-137/02)[1] ("***Faxworld***"). In the *Faxworld* case, a German partnership incurred input tax on preparatory acts in connection with a business which was to be transferred to a German company (under the German equivalent of the UK's "transfer of a going concern" provisions). The ECJ ruled that the partnership could treat the company's taxable supplies as its own for the purposes of recovering the input tax (the "***Faxworld* principle**").

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The FTT considered that since ADIL was a member of BAA's VAT group, the *Faxworld* analogy should apply in the present situation. Therefore, it was possible to impute BAA's taxable supplies to ADIL in order to recover the input tax. Further, the input tax could be recovered according to the group's method for residual input tax.

HMRC appealed the decision to the Upper Tribunal ("**UT**") and was successful.

UT's decision

The UT acknowledged that ADIL carried out an economic activity; it was a finding made by the FTT and the UT concluded that there was no basis to disturb that finding.

However, the UT considered that at the time the input tax was incurred, there was no direct and immediate link between the input tax and BAA's taxable supplies. The basis of the UT's decision was as follows:

(i) The supplies made to ADIL were mainly concerned with the acquisition and these supplies were not used by ADIL to provide any of its own services to BAA's VAT group;
(ii) While the supplies made to ADIL had a continuing beneficial effect on BAA's VAT group after the acquisition, the benefit was too remote to provide any link between the input tax and BAA's onward supplies;
(iii) Since there was no evidence that ADIL had any intention of making taxable supplies, the input tax could not be attributed to ADIL's own taxable supplies;
(iv) At the time the input tax incurred, ADIL was not a member of BAA's VAT group; and
(v) The *Faxworld* principle did not apply as the supplies made to ADIL were not used by BAA to make taxable supplies (unlike in *Faxworld* where the supplies made to the German partnership were used by the German company in running the transferred business).

BAA appealed this decision to the Court of Appeal but the Court of Appeal unanimously upheld the UT's decision.

Court of Appeal's decision

In order to resolve the issue, the Court of Appeal posed itself two questions:

(i) Did ADIL carry out an economic activity?; and
(ii) Was there a direct and immediate link between the input tax and BAA VAT group's taxable supplies?

Economic activity

In respect of the first question, BAA submitted that ADIL was carrying out an economic activity. The FTT had found that ADIL was not just a vehicle for acquiring shares. Instead, ADIL provided strategic governance to BAA's group which qualified as an economic activity.

On the other hand, HMRC argued that the FTT and the UT had both wrongly concluded that ADIL carried out at an economic activity. Its contention was that at the time the input tax was incurred, ADIL was carrying out and only intending to carry out an investment activity for profit. There was no evidence that, at that relevant time, ADIL carried out or had any intention to make taxable supplies.

The Court of Appeal agreed with HMRC's submissions on this question. The Court considered that, at the relevant time, the only evidence was that ADIL wanted to acquire BAA's shares. Acquiring shares is an act which would have its own economic consequences; however, that act did not in itself qualify as an economic activity.

The Court highlighted that the absence of any intention of carrying out taxable supplies was "fatal" to BAA's case. Therefore, BAA was unable to recover the input tax based on this finding alone.

Direct and immediate link

The Court, however, went on to address the second question concerning direct and immediate link.

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The Court considered BAA's submission that the UT had wrongly concluded that there was no direct and immediate link between the input tax and BAA VAT group's taxable supplies. Among other things, BAA argued that ADIL had carried out one continuous unbroken economic activity and this continuum furnished the direct and immediate link.

The Court admitted that "in a rather loose sense", there was a sort of a link between the input tax and BAA's onward taxable supplies. The link was that the supplies provided to ADIL (on which input tax was incurred) were made in connection with BAA's acquisition and BAA itself was making taxable supplies. However, based on the facts found by the FTT, it was impossible to describe this link as either "direct" or "immediate".

The Court endorsed the UT's reasons for not finding any direct and immediate link. At the time ADIL incurred the VAT, the supplies made to ADIL were only concerned with the act of acquisition. These were unconnected with any supply that ADIL intended to make (let alone actually made). Further, at the relevant time, there was no connection between the supplies made to ADIL and the supplies made by BAA's VAT group.

The Court added that the *Faxworld* principle did not apply to the present situation. *Faxworld* concerned a transfer of a going concern and in this case, there was no such transfer.

Comments

It is not known whether BAA will seek permission to appeal to the Supreme Court. Assuming it does seek, it appears unlikely that it would be granted permission.

While BAA was unsuccessful, this does not mean that other businesses which have incurred similar costs would be unable to recover any VAT. BAA failed largely due to its own facts and as long as businesses can demonstrate that, at the time the input tax was incurred, they made taxable supplies (or had an intention of doing so), they should be able to recover the input tax.

In terms of a way forward, businesses that have been denied input tax recovery should check whether their facts can be distinguished from BAA's and if so, should demand repayment from HMRC. Businesses that are planning to undertake share acquisitions should look at the facts of this case and, where possible, structure their transactions in a manner that is more VAT-efficient.

This case also has a much wider application as it nails down some of the practical aspects of input tax recovery:

(i) Timing is key

It is clear from the decision that the relevant time to test the recovery of input tax is at the time the input tax was incurred. BAA was denied input tax recovery as, at the time the input tax was incurred, ADIL did not make any taxable supplies (and showed no intention of doing so). The courts were not concerned with what ADIL did after the relevant time; what mattered was it did at the time.

(ii) Evidence is crucial

It is extremely important to evidence that, at the relevant time, taxable supplies were made or were intended to be made. The Court of Appeal considered that the lack of such evidence was "fatal" to BAA's case.

(iii) VAT grouping

Being a member of a VAT group is not a solution for recovering input tax incurred prior to joining the group. BAA argued that it should recover the input tax as ADIL was a member of its VAT group. The courts did not endorse this argument as, at the relevant time, the input tax had no connection with the taxable supplies made by the VAT group.

It has been a disappointing result for BAA but perhaps not altogether surprising. However, this case should help bring finality on the issue for many businesses

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that were in a similar position. This case is, arguably, one of the most important decisions concerning the recovery of input tax.

On a final note, there are some businesses that will still have to wait longer for a final resolution. These businesses are mainly those involved in private equity acquisitions and management buy-outs. HMRC has challenged these businesses on not only the question of whether the input tax was linked to a taxable supply (like *BAA*) but also on the issue of whether these businesses incurred the input tax themselves. The latter issue will be heard in due course by the Court of Appeal in the case of *Airtours Holidays Transport Limited*.

[1] *Finanzamt Offenbach am Main-Land v Faxworld Vorgründungsgesellschaft Peter Hünninghausen und Wolfgang Klein GbR* (*Case C-137/02*)

Aditi Joshi
BDO LLP

TAX ADVICE AND LEGAL PRIVILEGE:

The Supreme Court's decision inPrudential

Legal privilege protects documents from disclosure. If communications are cloaked in privilege, they are inviolable and need not be disclosed or produced. Indeed, this principle is of such importance that it has been described as a "fundamental human right": see *Three Rivers* (*No.6*) *[2004] UKHL 48* at [26] *per* Lord Scott and at [87] *per* Lord Hoffmann.

In *R* (*Prudential plc*) *v Special Commissioners of Income Tax [2013] UKSC 1, [2013] 2 WLR 325* (*"Prudential"*) the Supreme Court decided (by a majority of 5 to 2) that legal advice received from accountants on tax law, and communications with the accountants relating to that advice, were not covered by legal advice privilege.

The decision is of obvious significance, because – as Charles J remarked at first instance – "*in modern conditions accountants have the expertise to advise on tax law and it is firms of accountants, rather than firms of solicitors, who do give such advice and represent clients in disputes with the revenue on many aspects of their tax affairs*": *[2009] EWHC 2494* (*Admin*)*, [2011] QB 669 at [64].*

Prudential therefore marks the end of the road of the attempt to wrestle control of legal advice privilege from the hands of lawyers. The Supreme Court has, in effect, provided a competitive advantage to lawyers over accountants. This article considers how this imbalance can be rectified and the practical consequences of *Prudential*.

The facts of Prudential

The *Prudential* case arose from the following facts. The Prudential group instructed Pricewaterhouse Coopers ("PwC") to advise them in connection with certain overseas holdings. PwC identified that a tax avoidance scheme which they had devised could be adapted for Prudential's benefit. Accountants provided legal advice in respect of tax law in relation to the scheme, which was subsequently implemented by two Prudential companies (together referred to as "Prudential") in a series of transactions.

Section 20(1)(a) Taxes Management Act 1970 ("TMA") (which was then in force) provided that an inspector of taxes could require a person to deliver such documents as (in the inspector's reasonable opinion) contain, or may contain, information relevant to (i) any tax liability to which that person is or may be subject, or (ii) the amount of any such liability. (That provision has now been repealed and replaced by Schedule 36 of the Finance Act 2008, paragraph 1, which is in similar terms.)

An inspector of taxes served notices under section 20B TMA on Prudential, giving them an opportunity to provide documents. Prudential disclosed many of

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the requested documents but refused to produce certain ones on the grounds that they were protected by legal advice privilege ("LAP"). The inspector of taxes then served notices under section 20(1) TMA demanding disclosure. Indignant that its "fundamental right" was being infringed, Prudential sought judicial review of these notices.

The decision

It was established by *R (Morgan Grenfell & Co Ltd) v Special Comr of Income Tax [2003] 1 AC 563* that the provisions of section 20 TMA could not be invoked to force anyone to produce documents to which LAP attached. The issue was therefore whether the disputed documents were protected by LAP.

Both the High Court and the Court of Appeal (both decisions are reported at *[2011] QB 669*) held that they were not. A seven justice panel of the Supreme Court dismissed Prudential's further appeal. The leading judgment was given by Lord Neuberger (with whom Lords Hope, Mance, Reed and Walker agreed, some adding judgments of their own). Lords Sumption and Clarke dissented.

The Supreme Court recognised that there was a strong argument in principle for holding that the availability of LAP did not depend upon whether the person providing the advice was a qualified lawyer (see [46]). The justifications for LAP (namely the need to ensure that a person can communicate with an adviser freely and candidly in order to obtain legal advice) apply equally regardless of whether the person providing the advice is a lawyer (see [39]). In Lord Sumption's words at [22], "*the privilege is conferred in support of the client's right to consult a skilled professional legal adviser, and not in support of the client's right to consult members of any particular professional body*." The minority thought this argument of principle determinative. As Lord Clarke put it, if one party instructs Freshfields to provide tax law advice and another instructs PwC, each should be treated in the same way: see [140].

The majority, however, held that, despite this argument of principle, it would be inappropriate for the Court to extend LAP in the way which Prudential sought. It was universally understood that LAP applied only to communications in connection with advice given by members of the legal profession: that was the assumption in various previous cases, textbooks and also of Parliament, which had legislated on that assumption on various occasions: see [29] to [37]. Were the court to make the extension for which Prudential argued, it would be extending the scope of LAP considerably beyond what, for a long time, had been understood to be its limits.

The majority declined to make this extension for three reasons. First, because of a "floodgates" concern: the consequences of such an extension were hard to assess. The principled extension which Prudential sought would not be limited in its effect to tax accountants, but would (on its best formulation) afford LAP to legal advice given by any professional person whose profession ordinarily includes the giving of legal advice. Such an extension had the potential to bring uncertainty to what is currently a workably clear area of law: see [53] to [60].

Secondly, the policy questions involved were such that the matter was best left to Parliament (i.e., the Supreme Court ticked the "too difficult" box!). In particular, if LAP is to be extended to professions other than lawyers, it might be appropriate to do so only upon a conditional basis. That was the basis on which the Keith Report (the *Report of the Committee on Enforcement Powers of the Revenue Departments*, Cmnd 8822) had recommended in 1983 that communications in connection with expert tax advice should be covered by LAP. That was also the approach in other jurisdictions which had extended, or were considering extending, some form of privilege to cover tax advice (see the discussion of the New Zealand and Australian position below). That type

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of limitation could only realistically be imposed by Parliament, not by the courts: see [61] – [67].

Thirdly, it would be inappropriate to extend LAP because Parliament had both legislated on the assumption that LAP only applies to advice provided by lawyers and had declined to legislate to introduce the type of protection for which Prudential were arguing. In addition to the Keith Report in 1983, other proposals for reform had been made and not acted upon. Parliament had, however, thought it appropriate to extend LAP to other professions (such as patent attorneys). It had not done so in respect of tax accountants. In fact, it had legislated on the assumption that advice from tax accountants did not benefit from LAP: see [68] – [72].

Antipodean alternatives: narrow statutory privilege

Lord Mance's judgment contains an interesting analysis of relevant statutory provisions in New Zealand and law reform proposals in Australia. When New Zealand created a statutory privilege in 2005 in relation to any confidential "tax advice document" (by the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005) it provided that disclosure must nonetheless be made of any "tax contextual information". That concept includes facts relating to the transaction which has taken place or is postulated. The New Zealand model was supported by the Australian Law Reform Commission when it considered the matter in 2007. Its approach was that only the tax advice itself should be protected by the privilege. Lord Mance remarked that, when reform of privilege in respect of tax advice has been considered, it has been viewed as significant that the revenue is able to be put in possession of a full understanding of the facts and nature of the relevant transactions, so as to be able then to advise itself of the correct legal conclusions to be drawn as a matter of tax law: see [89].

It remains to be seen whether legislation will be enacted in respect of tax advice in the UK, and whether it will include similar limitations to that found in the New Zealand statute. Certainly, Lord Clarke hoped that the matter will be considered by Parliament as soon as reasonably practicable: see [139]. The Chief Executive of the Institute of Chartered Accountants blogged, following the Supreme Court's judgment, that their campaign to extend the scope of LAP would move from the courts into the political field (*http://www.ion.icaew.com/moorgateplace/26137*), so perhaps there will be legislative intervention. The Institute's view is that the current law denies prospective clients a free choice of adviser. One does wonder whether, if there were to be statutory intervention, the result would not only be that some form of qualified privilege would be extended to tax advice provided by non-lawyers, but that the scope of LAP as it applies to tax advice would itself be restricted. That would be the logical response to the argument of principle that the legal consequences of receiving tax law advice should be the same, regardless of which professional provides the advice. Any such weakening of the scope of LAP would likely be strongly opposed by the legal profession.

Pending any such legislation, are there other arguments which might be advanced to seek to claim privilege in respect of tax advice? The final part of this article considers one potential avenue.

A role for litigation privilege?

LAP is only one form of privilege. The other is litigation privilege which, along with LAP, fall under the umbrella term of "legal professional privilege". Importantly, although LAP is restricted to advice from a lawyer, litigation privilege is not concerned with the source of the communication but its purpose, i.e. litigation. Thus, communications between non-lawyers and, indeed, third parties can be protected from disclosure if litigation privilege applies.

The *Prudential* decision concerned LAP, not litigation privilege. Depending upon

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the circumstances in which the advice on tax law is sought – and, in particular, how contentious the appropriate tax treatment of the matter in respect of which advice is sought is likely to be – there may also be an argument that advice provided by an accountant is protected by litigation privilege.

The leading formulation of the circumstances in which litigation privilege arises remains that of Barwick CJ in the Australian High Court in *Grant v Downs* (*1976*) *135 CLR 674*, adopted by Lord Edmund Davies in *Waugh v British Railways Board [1980] AC 521* at 543 – 544. A document is subject to litigation privilege, provided that

- at the time at which it was created, litigation was "reasonably in prospect" and not a mere possibility;
- the dominant purpose of the author (or of the person or authority under whose direction the document was produced) was that the document or its contents would be used to obtain legal advice about that litigation or to conduct or aid in the conduct of that litigation.

The question whether legal advice provided by an accountant in respect of the conduct of tax litigation would be privileged was canvassed at first instance in *Prudential*. The revenue did not argue that it would not be and Charles J assumed, for the purposes of the litigation, that it would be: *[2011] QB 669* at [54]. That would be consistent with the cases which Charles J cited regarding privilege protecting preparations for litigation by litigants in person and those represented by lay advisers: see [52]. It would also be consistent with the trend of authorities in respect of litigation privilege generally. Modern case law accepts that any documents produced with the dominant purpose of being used in or aiding the conduct of litigation reasonably in prospect are protected by privilege. They need not have been produced at the instigation of a lawyer. (See the discussion in Thanki *The Law of Privilege* (2nd edn, 2011) at §3.19.) By way of example, in *Re Highgrade Traders [1984] BCLC 151* (*CA*) an insurance company, which was suspicious of the circumstances in which a fire had broken out at insured premises, instructed various reports from loss adjusters, specialist fire investigators, and chartered accountants. These were held to protected by litigation privilege. See too, more recently, *AXA Seguros v Allianz Insurance [2011] EWHC 268* (*Comm*)*, [2011]* Lloyd's Rep IR 544.

Might it be argued that the nature of all tax advice is such its purpose is to prepare for a dispute with the revenue? Prudential's argument to the Court of Appeal opened in that way: "legal advice on contentious or unsettled aspects of tax law is inevitably framed on the basis that there may be a dispute or litigation between the taxpayer and revenue": *[2011] QB 669* at 697. However, from the judgments it seems that this line of argument was not pursued. Charles J considered the point briefly at first instance in *Prudential* and stated, at [56] that:

> issues may arise in a given case as to when litigation is contemplated but to my mind it cannot be said that the nature of tax law results in litigation always being contemplated or differentiates it from advice on law in other areas that might lead to litigation.

However, the fact that litigation privilege does not apply generally to protect tax advice obviously does not mean that it will not be available in an appropriate case. In principle, provided that the two substantive requirements of litigation privilege are met, it will protect advice provided by tax accountants. Establishing those substantive requirements may be a significant factual hurdle. In particular, the "dominant purpose" test is a stringent one. It requires that there be "an element of clear paramountcy": *Waugh v British Railways Board [1980] AC 521* at 543. It is not enough that aiding the conduct of contemplated litigation be one of the principal purposes of the document or advice in question: it must, at least, be the

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dominant purpose. If the advice is about the appropriate structuring of a transaction, one suspects that often this will be difficult to make out. Quite apart from the factual difficulties, a claim for litigation privilege in respect of pre-litigation advice provided by tax accountants is likely to be viewed with a degree of scepticism by a court, given the *Prudential* decision. That said, in an appropriate case, the argument is surely worth running. If it is advanced, it will be interesting to see how it fares.

David Scorey
Essex Court Chambers

dscorey@essexcourt.net

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CONTRIBUTORS

David Rudling and Alan Dolton
LexisNexis

John Davison
Independent Indirect Tax Consultant

Amy Bache
Deloitte LLP

Phil Rimmer
M&R Tax Advisers Ltd

Aditi Joshi
BDO LLP

David Scorey
Essex Court Chambers

Subscription enquiries

LexisNexis Customer Services
Tel: +44 (0)84 5370 1234
Email: customer.services@lexisnexis.co.uk

EXECUTIVE EDITOR

Marc Welby
BDO LLP

Assistant Editors

Graham Elliott
Withers Worldwide

John Davison
Independent Indirect Tax
consultant

SPECIALIST EDITOR

Giles Salmond
Deloitte LLP

Editorial enquiries

Halsbury House
35 Chancery Lane
London WC2A 1EL
Commissioning: Tanya Campbell
Technical: David Rudling
Production: Tanya Campbell

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