VAT update

October 2017

In this month's update we report on the processing of personal data to combat tax fraud, the new proposals for taxing intra-EU supplies and the change in VAT treatment of pension fund management services supplied by regulated insurers. We also comment on three recent cases involving taxpayer access to a tax authority's documents, the VAT treatment of leases and a cost order against HMRC for unreasonable conduct.

News

CJEU decides tax authorities can process personal data to combat tax fraud

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Business Brief 3 (2017) – VAT treatment of pension fund management services

On 5 October 2017, HMRC announced that, with effect from 1 January 2018, it will withdraw its policy of allowing all pension fund management services supplied by regulated insurers to pension funds without "special investment fund" (SIF) status to be exempt from VAT. This means insurers will need to determine whether a pension fund qualifies as a SIF in order to determine the correct VAT treatment. more›

Cases

Ispas – access to tax authority's documents and information

In *Ispas and another* (C-298/16), Advocate General Bobek (AG) has opined that a taxpayer assessed to VAT is entitled, upon request, to access the key documents and information forming the basis of the Romanian tax authority's assessment. more›

Any comments or queries?

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About this update

The VAT update is published on the final Thursday of every month, and is written by members of RPC's Tax Disputes team.

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

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Mercedes Benz – guidance on the VAT treatment of leases

In *HMRC v Mercedes-Benz Financial Services UK Ltd* (C-164/16), the CJEU held that leasing arrangements, with an option to purchase, constitute a supply of goods for VAT purposes if transfer of ownership will follow "in the normal course of events". more›

Sussex Cars Association – Tribunal orders HMRC to pay taxpayer's costs of appeal

In *Sussex Cars Association v HMRC* [2017] UKFTT 0691 (TC), the FTT has exercised its discretion, under Rule 10(1)(b) of the Tribunal Rules, to make an order for costs against HMRC on the basis that it had "acted unreasonably in bringing, defending or conducting the proceedings". more›

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CJEU decides tax authorities can process personal data to combat tax fraud

In *Puksar v Finance Directorate of the Slovak Republic* C-73/16, the Court of Justice of the European Union (CJEU) has confirmed that tax authorities may use taxpayers' personal data for the purposes of collecting taxes and combatting fraud, provided that a number of conditions are satisfied.

The tax authority in question had used a taxpayer's personal data in drawing up a confidential list of individuals considered to be "front-men" in company director roles, without their consent. The CJEU confirmed that this use was acceptable.

The CJEU considered the phrase "tasks carried out in the public interest", as set out in Article 7(e) of Data Protection Directive (95/46/EC), did not preclude the processing of personal data. However, tasks must be legally assigned to tax authorities within the meaning of Article 7(e), the drawing up of such a list and the inclusion of individual names must be adequate and necessary and there must be sufficient indications to assume that the individuals' names are rightly included. All of the conditions set out in the Directive for the lawfulness of processing must be satisfied.

A copy of the CJEU decision is available to view here.

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Proposals for taxing intra-EU supplies

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Other measures included proposals concerning the one-stop shop, introducing the concept of "certified taxable person", the simplification of VAT administration for certified taxable persons and the modification of requirements for zero-rating (where applicable).

Under the proposals, certified taxable persons will be able to continue applying the current rules (ie to apply a zero rate of VAT to intra-EU transactions, with the reverse charge applying) although this is only intended to be a transitional arrangement pending extension of the proposal to supplies of services.

A copy of the proposal is available to view here.

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Business Brief 3 (2017) – VAT treatment of pension fund management services

On 5 October 2017, HMRC announced that, with effect from 1 January 2018, it will withdraw its policy of allowing all pension fund management services supplied by regulated insurers to pension funds without "special investment fund" (SIF) status to be exempt from VAT. This means insurers will need to determine whether a pension fund qualifies as a SIF in order to determine the correct VAT treatment.

Historically, HMRC's policy has been to allow all pension fund management services provided by regulated insurance companies to be exempt from VAT. However, following the recent CJEU's decisions in *Wheels Common Investment Fund Trustees Ltd v HMRC* (Case C-424/11) and *ATP Pension Services A/S v Skatteministeriet* (C 464/12), HMRC now accepts that pension funds that have all the required characteristics are SIFs and the services of managing and administering those funds are, and always have been, exempt from VAT. Pension funds that do not have all those characteristics will not qualify as SIFs and will not be within the scope of the exemption.

HMRC understands that the majority of pension fund management services provided by insurers are supplied by defined contribution pension funds and therefore qualify (and have always qualified) for exemption as SIFs, following the judgment in *ATP Pension Services*.

A copy of Business Brief 3 (2017) is available to view here.

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Cases

Ispas – access to tax authority's documents and information

In *Ispas and another* (C-298/16), Advocate General Bobek (AG) has opined that a taxpayer assessed to VAT is entitled, upon request, to access the key documents and information forming the basis of the Romanian tax authority's assessment.

Background

Mr and Mrs Ispas (the taxpayers) were subject to a tax inspection. On the basis of that inspection, it was found that they had failed to declare their VAT obligations correctly. Two tax assessment notices setting out the VAT amounts due were issued. The taxpayers challenged those notices claiming they were null and void on the ground that their rights of defence had not been respected. In particular, they claimed that during the procedure leading to the issue of the notices, the tax authority should have given them access to the entire content of their file, including all the documents collected before the beginning of the tax inspection.

The national court referred questions to the CJEU concerning the right of access to the file (guaranteed by Article 41(2)(b) of the Charter of Fundamental Rights of the European Union (the Charter)) and the general principle of EU law of respect for the rights of the defence.

AG's opinion

In the view of the AG, a taxpayer should, upon request, have access to information forming the basis of the administrative decision.

The AG rejected the Romanian government's submissions that the request for a preliminary ruling was inadmissible on the basis that the national court had not described the factual situation in enough detail. In the AG's opinion, although the factual information could be said to be "economical" as to details, it contained the basic factual elements that allowed the parties to present observations to the court and was admissible.

The AG also rejected the proposition put forward by the Romanian government that while the VAT Directive was within the jurisdiction of the CJEU, national compliance measures were not and therefore the CJEU had no jurisdiction in this case. In the AG's view, although the procedural guarantees contained in the Code of Fiscal Procedure are not specifically provided for in EU law, those rules form part of the overall process of "proper VAT collection" (the obligation contained in Article 273 of Council Directive 2006/112/EC).

The AG then turned to the substantive question concerning whether the general principle of respect for rights of the defence required that a taxpayer should have access to all of the information and documents considered by the public authority when it made its decision. The AG opined that a taxpayer assessed to VAT is entitled, upon request, to access the key documents and information forming the basis of the tax authority's decision. This does not, however, amount to access to the "complete file", which the AG interpreted to mean the entire file, including all the elements not directly related to the decision, such as internal notes, drafts, auxiliary calculations, and all the information obtained from third parties.

Comment

The AG commented that taxpayers do not have a right to automatic access to their entire file, but should, upon request, be given access to information forming the basis of the administrative decision.

Of course, the AG's opinion is not binding on the CJEU and it will therefore be interesting to see how this case develops.

A copy of the decision is available to view here.

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Mercedes Benz – guidance on the VAT treatment of leases

In *HMRC v Mercedes-Benz Financial Services UK Ltd* (C-164/16), the CJEU held that leasing arrangements, with an option to purchase, constitute a supply of goods for VAT purposes if transfer of ownership will follow "in the normal course of events".

Background

Motor companies commonly have several types of agreement by which a customer can acquire a vehicle. This case concerned a particular type of car hire finance package offered by Mercedes Benz (MB), which was part way between a typical hire purchase (HP) agreement and lease, known as an agility agreement. Under an agility agreement the customer paid monthly instalments in exchange for use of the vehicle for a specified period. At the end of the period, the customer had an option to purchase the vehicle in consideration for a "balloon" payment (varying between 42% and 48% of the initial purchase price).

In the view of HMRC, the agility agreement was a supply of goods within the meaning of Article 14(2)(b) of the Principal VAT Directive 2006/112/EC. HMRC therefore claimed full payment of VAT from MB in circumstances where the customer exercised the option to purchase.

MB challenged the classification before the First-tier Tribunal (FTT), arguing that the agility agreement, which did not necessarily provide for the transfer of ownership, had to be regarded as a supply of services and therefore VAT was chargeable only on each monthly instalment.

The FTT dismissed the application and MB appealed to the Upper Tribunal which allowed its appeal. HMRC appeal that decision to the Court of Appeal, which referred questions to the CJEU on the correct interpretation of Article 14(2)(b) of the VAT Directive.

The main issue for determination was whether such an agreement constitutes a supply of goods or services under the VAT Directive.

In May 2017, Advocate General Szpunar opined that the agility agreement constituted a supply of services. Article 14(2) of the Directive provides that "in the normal course of events" ownership is to pass at the latest upon payment of the final instalment. The AG stated that this only covers agreements where the right to purchase, although formally an option, is the only economically rational course of action. Where, as in this case, the lessee has a genuine choice whether to purchase, the agreement will be a supply of services for VAT purposes.

CJEU decision
On 4 October 2017, the CJEU held, agreeing with the opinion of the AG, that the agreements were a supply of services for VAT purposes.

The CJEU commented that although the agility agreement might be referred to as a "finance lease" or "hire purchase" that was not, in itself, sufficient for it to be categorised as a transaction subject to VAT. In order for such an agreement to be considered a "supply of goods" it is also necessary to determine whether the agreement is a contract for hire which "provides in the normal course of events" that ownership is to pass "at the latest upon payment of the final instalment", within the meaning of Article 14(2)(b).

To be classified as a supply of goods within Article 14(2)(b), the following two conditions must be satisfied:

- the agreement must contain a clause expressly relating to the transfer of ownership of the goods from the lessor to the lessee, and
- it must be clear from the terms of the agreement that ownership of the goods is intended to be acquired automatically by the lessee if performance of the contract proceeds normally over the full term of the contract.

In the present case, the decision to exercise the option to purchase involved a real economic and genuine choice and accordingly the CJEU concluded that the agreement was a supply of services for VAT purposes.

Comment
This is the CJEU's first judgment directly dealing with the interpretation of Article 14(2)(b). The matter has now been referred back to the Court of Appeal for determination.

The judgment may have considerable practical implications for motor vehicle traders. The principle effect of classifying the agreement as a supply of services or supply of goods is the timing of when the taxpayer must pay VAT. If classified as a supply of service this can have significant cash flow advantages for taxpayers as they will not have to account for output VAT upfront, but when instalments are paid.

A copy of the judgment is available to view here.

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Sussex Cars Association – Tribunal orders HMRC to pay taxpayer's costs of appeal

In *Sussex Cars Association v HMRC* [2017] UKFTT 0691 (TC), the FTT has exercised its discretion, under Rule 10(1)(b) of the Tribunal Rules, to make an order for costs against HMRC on the basis that it had "acted unreasonably in bringing, defending or conducting the proceedings".

Background
HMRC raised assessments to VAT of c.£1.4 million on Sussex Cars Association (the taxpayer) as it should have, in HMRC's view, accounted for VAT on its supplies of taxi services. The taxpayer appealed the assessments.

In addition to its appeal to the FTT, the taxpayer made an application to the High Court for judicial review of HMRC's decision to make assessments, based on assurances it claimed HMRC had provided to it in relation to its method of accounting for VAT.

HMRC withdrew its defence to the appeal to the FTT shortly after the judicial review application.

Rule 10(1)(b) of the Tribunal Rules provides that the FTT can make a costs order if:

"the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings ...".

The taxpayer subsequently made an application to the FTT, under Rule 10(1)(b), for an order that HMRC pay its costs due to HMRC's unreasonable behaviour in belatedly withdrawing its defence to the appeal.

FTT decision
The FTT awarded the taxpayer its costs.

HMRC claimed that the reason for withdrawing was the perceived cost of defending both the appeal and the judicial review proceedings. However, the FTT found as a fact that HMRC had withdrawn from the appeal because it had realised that if it won the appeal the taxpayer would charge VAT to its client (a local authority), which would claim the VAT back under section 22, VAT Act 1994. The matter was therefore revenue-neutral and defending the appeal was not a proper use of public funds. Moreover, HMRC considered that it might be unjustly enriched if it successfully defended the appeal.

In determining the application, the FTT applied the three stage test laid down by the Upper Tribunal in *Shahjahan Tarafdar v HMRC* [2014] UKUT 0362 (TCC), namely:

- what was the reason for the withdrawal of that party from the appeal?
- having regard to that reason, could that party have withdrawn at an earlier stage in the proceedings?
- was it unreasonable for that party not to have withdrawn at an earlier stage?

The FTT concluded that HMRC's conduct had been unreasonable. In the view of the FTT, HMRC could have reached its decision at an earlier point had it taken appropriate legal advice.

The FTT acknowledged that HMRC's reasons for withdrawing from the litigation were unusual, as they were not based on the merits of the appeal but on the cost of defending the appeal. However, in the view of the FTT, the fact that its reasons were pragmatic, rather than technical, did not make them reasonable. Given that the quantum of VAT alleged to be outstanding was in the region of £1.4m, HMRC's failure to take legal advice at an earlier point was considered unreasonable. Further, the FTT held that HMRC was not in a special position merely because it was a public body (as confirmed recently by the Supreme Court in *BPP Holdings v HMRC* [2017] UKSC 55).

The FTT also considered that HMRC's conduct in relation to an unsuccessful attempt at alternative dispute resolution (ADR) had been unreasonable and allowed the costs of the ADR process as part of the costs of the proceedings as a whole, since if HMRC had taken appropriate advice at an early stage, ADR would not have been necessary.

Comment

As regular readers of our newsletter will be aware, in *Gekko*, the FTT also awarded the taxpayer its costs on the basis that HMRC had acted unreasonably. It is to be hoped that pressure to increase the tax yield is not influencing the decision making process within HMRC.

A copy of the decision is available to view here.

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