VAT Update

February 2019

In this month's update we report on (1) changes to the VAT IT system rules and processes if the UK leaves the EU without a deal; (2) EU exit legislation; and (3) revisions to HMRC's Notice of Making Tax Digital for VAT. We also comment on three recent cases relating to (1) non-compliance with time limits to respond to information requests in VAT refund claims; (2) whether failure to check the accuracy of information in a VAT return is a "careless" or "deliberate" inaccuracy; and (3) the correct VAT treatment for fees paid in connection with a loyalty scheme.

News items

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EU exit legislation

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Making Tax Digital for VAT

On 18 January 2019, HMRC updated VAT Notice 700/22 on Making Tax Digital for VAT (MTDfV). HMRC have extended its MTDfV software pilot to include VAT groups, trusts, unincorporated charities and VAT divisions and all businesses that are required to file their VAT returns under MTDfV with effect from 1 April 2019. more›

Cases

Sea Chefs Cruise – effect of non-compliance with information request in Directive claims

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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 team.

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Sacutia Healthcare Ltd – careless or deliberate inaccuracy

In *Sacutia Healthcare Ltd v HMRC* [2018] UKFTT 699, the First-tier Tribunal (FTT) held that inaccuracies in a return were deliberate due to the taxpayer's total lack of care and failure to check the accuracy of the information the taxpayer provided to its accountants for the purpose of preparing its VAT returns. more›

Tesco – is loyalty deductible?

In *HMRC v Tesco Freetime Ltd and another* [2019] UKUT 18 (TCC), the Upper Tribunal (UT), in dismissing HMRC's appeal, held that VAT incurred on fees paid by a subsidiary of the Tesco Group to third party suppliers, as part of a loyalty scheme, was deductible for VAT purposes. more›

News items

Changes to VAT IT system rules and processes if the UK leaves the EU without a deal

On 4 February 2019, HMRC published guidance on the changes to the way VAT is paid or reclaimed if the UK leaves the EU without a deal.

In the event that the UK leaves the EU without a deal, from 11pm GMT on 29 March 2019, many UK businesses will need to apply the same processes to EU trade that apply when trading with non-EU countries.

The guidance covers topics including claiming EU VAT refunds, checking a VAT number, using the UK's VAT Mini One Stop shop and sales of digital services in the EU and UK after 29 March 2019.

The actions set out in HMRC's guidance do not apply to importing or exporting goods between Northern Ireland and the Republic of Ireland. HMRC intends to provide further information as soon as it is in a position to do so.

A copy of the guidance can be viewed here.

Back to contents>

EU exit legislation

As the date the UK is set to leave the EU looms, the government is publishing legislation to make consequential and transitional amendments to VAT legislation, to cope with the changes that will be needed when the UK leaves the EU.

In particular we note the following:

- The Taxation (Cross-border Trade) Act 2018 (Appointed day No 3) and the Value Added Tax (Postal Packets and Amendment) (EU Exit) Regulations (Appointed Day) (EU Exit) Regulations, SI 2019/104. A copy of the legislation can be viewed here
- The Taxation (Cross-border Trade) Act 2018 (Value Added Tax Transitional Provisions) (EU Exit) Regulations, SI 2019/105. This sets out transitional provisions to deal with certain issues arising from amendments made to VATA 1994 in connection with the UK's withdrawal from the EU. These include: rules to ensure that VAT and import duty amendments in Pt 3 of the Act do not have effect in relation to supplies/acquisitions taking place, or removals commenced, before exit day; and references to inaccuracies or failures in relation to "section 55A statements" about the reverse charge on specified supplies will only include such statements due before exit day. The regulations will come into force on a date appointed by Treasury order in the event that the UK leaves the EU without a negotiated arrangement. A copy of the legislation can be viewed here
- The Value Added Tax (Finance) (EU Exit) Order 2019 (SI 2019/43). The purpose of the order is to remove inconsistencies between UK and EU law in relation to the VAT treatment of the management of pension funds and closed-ended collective investment undertakings. The changes are to come into force on the day on which the UK leaves the EU. A copy of the legislation can be viewed here

- The Value Added Tax (Tour Operators) (Amendment) (EU Exit) Regulations 2019 which sets out amendments to the tour operators' margin scheme. In the event of a no deal, the changes made by the regulations aim to apply the same rules to transactions between the UK and the EU as currently apply to transactions between the UK and non-EU countries. The regulations will come into force on such day of days as the Treasury by regulations appoint. A copy of the legislation can be viewed here.

Back to contents>

Making Tax Digital for VAT

On 18 January 2019, HMRC updated VAT Notice 700/22 on Making Tax Digital for VAT (MTDfV). HMRC have extended its MTDfV software pilot to include VAT groups, trusts, unincorporated charities and VAT divisions and all businesses that are required to file their VAT returns under MTDfV with effect from 1 April 2019.

HMRC also confirmed that organisations for whom MTDfV has been deferred to 1 October 2019, need not comply with "digital links" requirements until 1 October 2020. It is therefore important that you confirm the date on which HMRC expects your business to start using MTDfV.

A copy of the Notice can be viewed here.

Back to contents>

Cases

Sea Chefs Cruise – effect of non-compliance with information request in Directive claims

In *Sea Chefs Cruise Services GmbH v Ministre de l'Action et des Comptes publics* (C-133/18), Advocate General Hogan has opined that the fact a trader failed to comply with an information request within the time limit provided by Directive 2008/9/EC (the Directive) is not fatal to its claim for a refund.

Background

Sea Chefs Cruise Services GmbH (the taxpayer), applied to the French tax authorities for the refund of a VAT input tax credit. The claim was dismissed as a result of the taxpayer's failure to respond, within the requisite time limit, to a request for further information made by the French tax authorities. The French tax authorities also claimed the taxpayer could not submit the requested information late as part of an appeal.

The matter was appealed to the Administrative Court, Montreuil. The Court observed that in order to guarantee the effectiveness of the VAT system, the Directive established time limits. Article 20(2) of the Directive provided that the information requested must be provided within one month. The French tax authorities had dismissed the taxpayer's claim in its entirety for failure to comply with this time limit. However, the Court noted that neither the Directive, nor any national provision set out consequences for the right to a VAT refund where the time limit to reply is not respected. This was considered critical to resolution of the dispute and in particular, whether the taxpayer should be allowed to regularise its position.

Accordingly, the Court referred the matter to the Court of Justice of the European Union (CJEU) for a preliminary ruling on whether the limitation rule in Article 20(2) of the Directive was compatible with the principles of fiscal neutrality and proportionality.

Advocate General's opinion

Advocate General Hogan (AG) released his opinion on 17 January 2019.

The AG observed that although the right to deduct is a "fundamental principle of the common system of VAT" it is subject to compliance with both substantive and formal requirements. The AG also observed that despite the parallels that have been drawn in the CJEU case law between the right to deduct VAT and the right to a refund of VAT, the rules in the Directive on the information which a refund application must contain and the time limits for the submission of a refund application, are much more detailed than those in respect of the deduction of VAT contained in Directive 2006/112.

The AG noted that it is not clear from the wording itself of Article 20(2) of the Directive, whether the time limit is mandatory, as terms such as "no later than" or "at the latest" are absent from the provision. He did not consider this to be mere happenstance. Given the fundamental nature of the right to a VAT refund in the context of the VAT system, the establishment of mandatory time limits leading to the forfeiture of that right would have to be set out in a "clear and unequivocal manner by explicit language contained in the directive itself". In the view of the AG, this strongly indicated that the interpretation adopted by the French authorities was incorrect.

The AG also considered the following points as further evidence that the time limits laid down were not intended to be mandatory (in the sense that non-compliance automatically extinguishes the right to deduct):

- Article 20(1) applies regardless of the addressee of the request for additional information. This could, for example, render entitlement to a refund vulnerable to the actions of third parties, some of whom may not be able to respond within the designated time. The AG considered it would be unfair if the failure on the part of a third party could result in the forfeiture of a taxpayer's right to a refund
- Article 21 (notification of decision) does not prevent a member state approving a refund despite non-compliance with the information request
- Article 26 provides that a tax authority is not required to pay interest to a taxpayer who fails to comply with an information request on time. This suggests that the legislators had anticipated the possibility of a successful refund claim despite no, or late compliance, with an information request.

For all of these reasons, the AG concluded that the time limit prescribed by Article 20(2) is not mandatory. The taxpayer could therefore submit the additional information (in the context of an appeal pursuant to Article 23) with a view to regularising its refund application.

Having reached this conclusion, the AG did however observe that failure to comply with the time limit is not without consequences for example, a late response may have implications for the taxpayer's entitlement to interest on the late payment of a refund.

Comment

This opinion provides useful guidance on how the CJEU is likely to interpret the wording of the Directive, particularly in circumstances where a fundamental right, such as a VAT refund, may be subject to forfeiture. Any curtailment of such rights should be set out in a clear and unequivocal manner by explicit language contained in the Directive itself.

In this instance, it would appear the French parliament did not seek to lay down a mandatory time limit and envisaged such claims being paid even where the time limit is breached. We anticipate that the CJEU will agree with the AG's opinion. A decision is expected shortly.

A copy of the AG's opinion can be viewed here.

Back to contents>

Sacutia Healthcare Ltd – careless or deliberate inaccuracy

In *Sacutia Healthcare Ltd v HMRC* [2018] UKFTT 699, the First-tier Tribunal (FTT) held that inaccuracies in a return were deliberate due to the taxpayer's total lack of care and failure to check the accuracy of the information the taxpayer provided to its accountants for the purpose of preparing its VAT returns.

Background

Sacutia Healthcare Ltd (the taxpayer), was a supplier of healthcare products. The products were designed by the taxpayer and manufactured and packaged by third parties. Its sole director was Ms Barnes, although Mr Barnes, her father, undertook most of the work in the business on a day to day basis.

Following a visit by HMRC to the taxpayer's premises, HMRC issued an assessment and imposed penalties relating to (1) the deduction of input tax claimed in the absence of VAT invoices and (2) output tax due to a lack of export evidence.

The taxpayer appealed the penalties on the basis that the errors did not arise from deliberate behaviour either on its own part, or on the part of Mr Barnes. The taxpayer argued that although it did not take every conceivable step to confirm the accuracy or otherwise of documents provided to accountants, or of the returns subsequently submitted by the accountants on its behalf, it did not knowingly provide inaccurate information and therefore the errors were not deliberate.

FTT decision
The appeal was dismissed.

The FTT considered that Mr Barnes did very little other than engaging accountants. For example, he admitted that he would not notice that an invoice sent to the taxpayer was addressed to the wrong business. His approach to VAT compliance was to simply send his records to his accountant. This information was unchecked and incomplete. He also did not check the returns when provided by the accountants and simply paid whatever he was told to pay in relation to VAT. In the light of this, the FTT had to decide whether Mr Barnes had been careless or whether the inaccuracies had been deliberate.

The FTT considered the meaning of "deliberate inaccuracy" as discussed in *Auxilium Project Managements Ltd v HMRC* [2016] TC05024. Whilst the FTT agreed that some measure of knowledge is required for an inaccuracy to be made deliberately, it concluded that the taxpayer had the required knowledge for an inaccuracy to be deliberate because it knew it should take steps to check accuracy before returns were submitted to HMRC, but had failed to do so. The FTT distinguished deliberate behaviour from careless behaviour, where a taxpayer must have reasonable belief that the information was accurate. It added that engaging an accountant does not ensure accuracy. Mr Barnes therefore acted deliberately.

In addition to the penalties relating to the deduction of input tax, the FTT also had to decide whether there had been concealment in relation to exports. Given the seriousness which HMRC accorded to concealed inaccuracy in its guidance, the FTT was of the view that HMRC had not adequately explained to the taxpayer why it had treated the inaccuracy as concealed before imposing the penalty. As a consequence, the FTT held that HMRC had not discharged the burden of proof upon it to show that the penalty was correctly charged and substituted a penalty for deliberate behaviour.

Comment
This decision serves as a timely reminder that taxpayers must take steps to check the accuracy of returns before they are submitted to HMRC.

Engaging an accountant does not, on its own, amount to taking adequate steps to ensure accuracy. Taxpayers should ensure that information provided to their accountants is accurate and check the information that is then produced by their accountant before it is sent to HMRC.

A copy of the decision can be viewed here.

Back to contents>

Tesco – is loyalty deductible?

In *HMRC v Tesco Freetime Ltd and another* [2019] UKUT 18 (TCC), the Upper Tribunal (UT), in dismissing HMRC's appeal, held that VAT incurred on fees paid by a subsidiary of the Tesco Group to third party suppliers, as part of a loyalty scheme, was deductible for VAT purposes.

Background

Tesco ran a loyalty scheme. Participating customers who purchased goods from Tesco Stores Ltd (TSL) (the principal retailer of the Tesco group) were provided with points which were translated into vouchers and could be used to obtain discounts on Tesco goods. In addition, a feature called the "Partner Boost" enabled participating customers to exchange their vouchers for tokens (Reward Tokens) issued by Tesco Freetime Ltd (TFL) (another company of the Tesco group), which could be used to acquire goods or services from third parties (Deal Partners). TFL paid Deal Partners a sum calculated as a percentage of the face value of the Reward Tokens redeemed (the Deal Partner Fee).

UT decision

The issue for the UT to determine was whether TFL was entitled to deduct the VAT paid on the Deal Partner Fee as input tax. This depended on whether the fee constituted "consideration for a supply of services" to FTL.

The UT referred to *Marriott Rewards v HMRC* [2018] STC 1144, and observed that regard should be had to both the terms of the contract between FTL and the Deal Partners and the commercial and economic reality of the arrangement as a whole.

In the view of the UT, the fact that the substantive obligation imposed on the Deal Partners involved the supply of services to participating customers, did not preclude a finding that it also amounted to the supply of services to TFL.

The UT concluded, however, that the contractual arrangements reflected the economic reality. The purpose of the Partner Boost scheme as a whole was to benefit TSL by promoting customer loyalty and TFL operated its own separate business, which consisted in procuring Deal Partners to accept Reward Tokens in exchange for the provision of Rewards. TFL was required to do so in order to fulfil its contractual obligations to TSL. The UT concluded therefore that the only economically rational explanation of TFL's behaviour was the value to TFL itself of the Deal Partner's acceptance of Reward Tokens in exchange for the provision of goods and services to participating customers.

Comment

This case provides useful guidance on how to structure loyalty programmes in a manner which allows for input tax recovery. Due to the amounts at stake and the popularity of similar loyalty programmes, it is anticipated that HMRC will seek to appeal the decision to the Court of Appeal.

A copy of the decision can be viewed here.

Back to contents>

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