VAT update

January 2016

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In *Isle of Wight Council & Ors v HMRC* [2015] EWCA Civ 1303, the Court of Appeal has dismissed an appeal by four local authorities (the Appellants) against a decision of the Upper Tribunal (UT), and confirmed that a local authority which charges members of the public for off-street car parking (OSCP) is not a non-taxable person for VAT purposes. more›

WebMindLicenses – ECJ provides guidance on whether a licensing agreement is "abusive" for VAT purposes

On 17 December 2015, the European Court of Justice of the European Communities (ECJ) released its judgment in *WebMindLicenses* [2015] EUECJ C-419/14. This case concerned whether licensing agreements were abusive for VAT purposes. 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 general Tax Update on the first Thursday of every month, and a weekly blog, RPC Tax Take.

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R v Harvey – Supreme Court confirms that when making a confiscation order and assessing the amount of benefit obtained by an offender any VAT accounted to HMRC should be ignored

In *R v Harvey* [2015] UKSC 73, the Supreme Court allowed the appeal of Mr Jack Harvey (the Appellant) against the decision of the Court of Appeal (Criminal Division) and confirmed that when making a confiscation order, and assessing the amount of benefit obtained by an offender within the meaning of section 76(4) of the Proceeds of Crime Act 2002 (POCA), any VAT paid or accounted for to HMRC, should be ignored. more›

News

Brief 22/15 – VAT partial exemption changes concerning foreign branches

HMRC has announced changes to The VAT Regulations 1995, to ensure that UK VAT law complies with EU law following the ECJ's decision in *Le Credit Lyonnais* (Case C-388/110).

Regulations 101, 102 and 103, have been amended and exclude supplies made by overseas branches from partial exemption methods. The operative changes are effective in relation to any method or VAT prescribed accounting periods on, or after, 1 January 2016.

HMRC is expected to update its guidance shortly to reflect these changes. However, it is expected that only a minority of businesses will be affected, since most businesses that make supplies from overseas establishments use a special method that is already compliant with the new legislation.

Brief 22/115 is available to view here.

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Brief 1/16 – VAT reverse charge to apply to telecommunication services from 1 February 2016

On 7 January 2016, an order was made to provide that, with effect from 1 February 2016, and subject to some exceptions, the VAT reverse charge will apply to wholesale buying and selling of telecommunications services in the UK.

This measure is intended to prevent missing trader fraud.

Given the short timetable for the introduction of the charge, some businesses may find it challenging to comply. HMRC has confirmed it will be adopting a "light touch" approach regarding penalties in circumstances where taxpayers have made reasonable efforts to comply.

Brief 1/16 is available to view here.

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Brief 3/16 – HMRC launches consultation on VAT grouping provisions

On 14 January 2016, HMRC published Brief 3/16, in which it confirmed the launch of a consultation on VAT grouping provisions following the ECJ judgments in *Larentia +Minerva and Marenave* (C-108/14 and C-109/14) and *Skandia* (C-713).

In *Larentia +Minerva and Marenave*, the ECJ concluded that member states may only restrict VAT grouping to legal persons where those restrictions are appropriate and necessary in order to prevent abuse, avoidance or evasion. As a result of this decision, it is anticipated that there will be changes to UK law and VAT grouping provisions.

The government has launched a consultation to gather views on policy design, the impact of change and alternative approaches to develop the new legislation. They intend to use the

consultation process to find out what businesses think about other grouping related matters, particularly those where the provisions differ across EU member states, as identified in *Skandia* [2015] EUECJ C-126/14.

The formal consultation period will last for 12 weeks. A summary of consultation responses is expected to be published during summer/autumn 2016.

Brief 3/16 is available to view here.

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Cases

Isle of Wight Council & Ors v HMRC – Court of Appeal confirms that a local authority which charges members of the public for off-street car parking is not a non-taxable person for VAT purposes

In *Isle of Wight Council & Ors v HMRC* [2015] EWCA Civ 1303, the Court of Appeal has dismissed an appeal by four local authorities (the Appellants) against a decision of the Upper Tribunal (UT), and confirmed that a local authority which charges members of the public for off-street car parking (OSCP) is not a non-taxable person for VAT purposes.

Background

The issue of principle raised in the appeal (the proceedings are in the nature of test cases as there are many local authorities which have the same issue) was whether a local authority which charges members of the public for OSCP is a non-taxable person for VAT purposes. The answer to this question turned on whether treating the authority as a non-taxable person "would lead to significant distortions of competition" within the meaning of Article 4.5(2) of the Sixth Council Directive (77/388EEC), replaced in substantially similar form by Article 13 of the Principal VAT Directive (2006/112/EC) (the Directive).

The Appellants appealed to the First-tier Tribunal (FTT) a decision of HMRC that they were not taxable persons for the purposes of recovering VAT on the OSCP charges. HMRC had refused the Appellants' claims to recover VAT under section 80, Value Added Tax Act 1994, in respect of the OSCP supplies.

The FTT's decision

The issue before the FTT was whether local authorities were entitled to be treated as non-taxable persons, which depended upon whether treating them as non-taxable persons would lead to significant distortions of competition within the meaning of the Directive.

The FTT concluded that the non-taxation of local authorities would distort competition in the OSCP market in the areas of pricing and outsourcing, so that fewer commercial car parks would remain open and more local authority car parks would open in pursuance of the local authorities' duty to ensure adequate parking provision under section 122, Road Traffic Regulation Act 1984 (RTRA). The Appellants appealed to the UT.

The UT's decision

Before the UT, the Appellants contended that the FTT had misunderstood the legal framework governing the setting of local authority OSCP charges. They argued that there was no causal connection between increased revenue through non-taxation and lower OSCP charges and that the FTT had wrongly inferred that they could set OSCP charges at a level which would raise income for other traffic management purposes.

The UT found that if local authority OSCP was not taxed, local authorities would not need to consider raising their charges in the event of a VAT increase, whereas commercial providers would be compelled to do so, which supported the FTT's finding, as a fact, that the absence of taxation would reduce upward pressures on local authority charging. As to the provision of outsourcing, the UT said that there would be a significant difference of approach if commercial provision was taxed but local authority provision was not. It concluded that the FTT's finding that local authorities did not disregard the incidence of taxation when deciding whether

and how to outsource a car park, or its management, was a finding of fact not based on any misunderstanding of the relevant law. It therefore dismissed the Appellants' appeal. The Appellants appealed to the Court of Appeal.

The Court of Appeal's decision

Before the Court of Appeal, the Appellants contended that the FTT and UT had failed to take into account two overriding considerations. First, that the OSCP charges were paid into, and expenditure for OSCP was taken from, a local authority's general fund established under section 91, Local Government Finance Act 1988 and secondly, that the pricing of OSCP was informed by numerous policy considerations related to the policy objections in section 122.

They submitted that had those matters been properly considered, the FTT and UT would have been bound to conclude that HMRC could not discharge the burden on it of showing that in the hypothetical, notional market for OSCP, in which there was no VAT payable on local authority provision of OSCP, the absence of VAT would have a causal connection with a significant distortion of competition.

The Court rejected the Appellants' arguments that the cost to them of providing OSCP could only be taken into account in fixing OSCP charges for the purpose of ensuring that they do not trade with a view to raising finance for their general activities. The Court did not accept that, as a matter of law, the cost of providing OSCP can only be taken into account, if at all, only after all other matters relevant to setting OSCP charges had been factored in. The Court found nothing in the legal framework precluding local authorities from relating the OSCP charge to the cost of providing OSCP and nothing wrong with the FTT's conclusion to that effect.

The Court considered that if authorities had no liability to pay VAT on OSCP charges, they would be able to provide OSCP while charging less to those using that facility. The Court noted the FTT's finding that authorities would do precisely that by not increasing charges in line with inflation, reducing them in real terms over time. It further noted the FTT's finding that, in the hypothetical "non-taxation world", the downward pressure on OSCP charges resulting from authorities' wish to contribute to the economic vitality of their areas through favourable pricing would have brought charges to a level lower than in the "taxation world" by a margin approaching the VAT fraction. The Court commented that if one OSCP supplier could have lower prices over time because of its special tax status, that was likely to distort competition.

The Court therefore dismissed the appeal.

Comment

The critical issue in this appeal was whether the FTT had made an error of law in the light of its factual findings. The FTT's conclusion that, in a hypothetical world in which VAT had never been imposed on OSCP charges, those charges would have been lower, was based on two principal matters: (a) in fixing the level of charges, local authorities were bound to have regard to the need to meet costs; (b) if VAT had never been payable on OSCP charges, local authorities would have been able to, and would have wished to, keep charges lower in order to boost the local economy by attracting shoppers with cars while maintaining the same spending priorities and the same allocation of the general fund as between the different activities financed out of the general fund. Local authorities had to be permitted to set OSCP charges with a view at least to covering the cost of operating loss-making or free car parks. In the view of the Court of Appeal, it could not be said that the FTT's conclusions were plainly wrong or outside the bounds within

which reasonable disagreement was possible and accordingly it is not surprising that given this view the appeal was unsuccessful.

This decision is not all bad news for local authorities. The need to establish a distortion of competition has been recognised. It is not sufficient to simply show that the services provided by the local authority are similar to services provided by the private sector. However, once competition has been shown, the bar for distortion as a result of non-taxation is very low.

The Court of Appeal's judgment is available to view here.

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WebMindLicenses – ECJ provides guidance on whether a licensing agreement is "abusive" for VAT purposes

On 17 December 2015, the European Court of Justice of the European Communities (ECJ) released its judgment in *WebMindLicenses* [2015] EUECJ C-419/14. This case concerned whether licensing agreements were abusive for VAT purposes. The ECJ agreed with the earlier Advocate General's Opinion (details of which were reported in our October VAT update) and in doing so have provided helpful guidance on the relevant factors to take into consideration when determining whether an arrangement amounts to "abuse".

Background

A Hungarian software company, WedMindLicences Kft (WML), licensed website and know-how rights to a Portugeuse company (Lalib). Under the terms of the licence agreement, WML remained responsible for ongoing maintenance and development of the software.

Following an audit, WML was assessed to Hungarian VAT in respect of Lalib's supplies on the basis that the licensing agreement was not a genuine economic transaction and that the relevant supplies were actually made by WML in Hungary, rather than Lalib in Portugal.

The authorities considered WML had committed an abuse of rights by giving the impression of being based in Portugal, in order to circumvent Hungarian tax law and qualify for lower relief in Portugal. They based their decision on evidence which had been obtained covertly by other state authorities.

The ECJ was asked to consider a number of questions relating to the application of the abuse of rights doctrine (*Halifax* C-255/02).

The ECJ's judgment

The ECJ confirmed that it was not abusive for a company established in one member state to enter into a licensing agreement with a company established in another member state to exploit the lower VAT rate in force in that second member state. Only if the arrangements were fictitious would they satisfy the *Halifax* principle and be considered abusive.

In the instant case, it was clear from the documents submitted to the Court that Lalib was a separate company from WML and that it paid VAT in Portugal. However, the ECJ concluded that it was for the referring court to analyse all the facts placed before it to determine whether the arrangements were genuine or not. This would include examining whether the establishment of the licensee's place of business, or fixed establishment, was genuine. In particular, whether the licensee (in this case, Lalib) had an appropriate structure, premises, human and technical

resources and equipment to engage in economic activity in its own name, on its own behalf, under its own responsibility and at its own risk.

If an abusive practice is found to exist, the transactions involved must be re-defined so as to re-establish the situation that would have prevailed and VAT adjusted accordingly, even if VAT has been paid in another member state.

Separately, the ECJ also considered the circumstances where it would be compatible with EU law, for a tax authority to use evidence obtained without the taxpayer's knowledge in parallel criminal proceedings, to establish an abusive practice for VAT purposes. In the view of the ECJ, EU law does not preclude tax authorities from using evidence obtained in such circumstances, provided that the rights guaranteed by EU law, especially the Charter of Fundamental Rights of the European Union, are observed. The national court must verify the investigation, the evidence obtained from it and that the use of the evidence was authorised by law, and is necessary.

In the present case, the tax authorities intercepted telecommunications and seized emails without judicial authorisation. It was therefore for the referring court to review whether this was provided for by law and necessary and whether the taxpayer had the opportunity of gaining access to that evidence and to make appropriate representations. If the court is unable to verify the position, the evidence is to be discarded.

Comment
The ECJ has confirmed that carrying on a business from a member state with a lower VAT rate is not abusive, provided there are genuine commercial reasons for doing so. It has also provided some helpful guidance on the relevant factors which national courts should take into account when determining whether a licensing arrangement is genuine or not.

The ECJ's judgment is available to view here.

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R v Harvey – Supreme Court confirms that when making a confiscation order and assessing the amount of benefit obtained by an offender any VAT accounted to HMRC should be ignored

In *R v Harvey* [2015] UKSC 73, the Supreme Court allowed the appeal of Mr Jack Harvey (the Appellant) against the decision of the Court of Appeal (Criminal Division) and confirmed that when making a confiscation order, and assessing the amount of benefit obtained by an offender within the meaning of section 76(4) of the Proceeds of Crime Act 2002 (POCA), any VAT paid or accounted for to HMRC, should be ignored.

Background
JFL Harvey Limited (JFL) was formed in 1972 and was concerned with plant hire and contracting. The Appellant owned 98.9% of the shares in JFL and the remainder was held by his wife. As such, JFL was treated as the Appellant's alter ego.

The Appellant was convicted of nine offences relating to the handling of stolen plant and machinery and arson of a competitor's machinery. He was sentenced to nine years and six months imprisonment.

After trial, the Crown Prosecution Service asked the Crown Court to proceed under section 6 of POCA, setting in motion confiscation proceedings.

The Crown Court assessed the benefit obtained by the Appellant at £2,275,454.40, comprising £1,960,754.40 from general criminal conduct and a further £314,700. Of this, the £1,960,754.40 was calculated on the basis that the proportion of stolen items to the total stock over the relevant period was 38% and JFL's aggregate turnover for the relevant period was £5,159,880 (inclusive of VAT). Accordingly, a confiscation order was made in the sum of £2,275,454.40.

The Appellant was given six months (later extended to 12 months) to pay, and was ordered to serve ten years in prison (reduced to eight years by the Court of Appeal) in default of payment.

The Appellant appealed the decision of the judge to include the amount of VAT paid to HMRC, in the £5,159,880 figure.

The Appellant appealed to the Court of Appeal (Criminal Division) where he submitted, amongst other things, that the Crown Court had erred in failing to deduct from the turnover figure the amount of VAT received by the Appellant from customers before proceeding to assess how much of the turnover was attributable to his general criminal conduct.

The Appellant argued that three quarters of the £843,827 of VAT collected was accounted for and expended upon the purchase of goods and services and therefore he should be given credit for the VAT element of these purchases. Applying the principles of *R v Del Basso and Goodwin* [2010] EWCA Crim 1119 and *R v Waya* [2012] UKSC 51, the Court of Appeal concluded that it would be wrong in principle and repugnant to carry out an accounting exercise in respect of those monies. The Appellant had used the proceeds of criminal conduct to purchase goods and services and it was wrong in principle for the Appellant to be given credit in respect of the VAT element of those purchases.

In the alternative, the Appellant submitted that of the VAT collected by JHL, £200,745 had been paid to HMRC. This contention was also rejected by the Court of Appeal, for the same reasons.

The Appellant appealed to the Supreme Court, where he submitted that:

- the benefit of the VAT sum was never obtained by him as it was declared and paid to HMRC
- in the alternative, even if he had obtained the VAT element, his interest was nil, or
- should the information in the above two bullets be wrong, a confiscation order which does not account for VAT already paid to HMRC, is disproportionate.

The Appellant argued that the VAT was a mandatory inclusion in his price which was state imposed and therefore he was collecting on behalf of the state. He argued that the recovery through the VAT regime and the confiscation order would lead to double recovery. This was in breach of his right, under Article 1 of Protocol 1 to the European Convention on Human Rights (A1P1), implemented in the UK through the Human Rights Act 1998, to the peaceful enjoyment of his possessions.

The Supreme Court's judgment

The Supreme Court allowed the Appellant's appeal (Lords Hughes and Toulson dissenting as to the effect of A1P1).

The Supreme Court said that as a matter of ordinary statutory construction, in deciding the benefit obtained within section 76(4) POCA, the VAT paid or accounted for to HMRC was not to be deducted as such deduction would be incompatible with the plain language of the sub-section. It was a core feature of the scheme of post-conviction confiscation that the scheme struck at the gross value of money, or other property obtained as a result of, or in connection with, the relevant criminal conduct. A person obtained money, or property, if he became the owner, or assumed ownership of it. JHL had been the legal owner of the money held in its bank account.

Any statutory provision allowing the executive to effect double recovery from an individual, although not absolutely forbidden by A1P1, was at risk of being found by the courts to be disproportionate. Although sums payable under POCA were intended to be a deterrent, they were not intended to be punitive. Where the proceeds of crime were returned to the loser, it would be disproportionate to treat such proceeds as part of the benefit obtained by the defendant as it would amount to a financial penalty which should not be imposed through POCA. Given that VAT is collected by a taxpayer, the instant position was similar to that of property restored to the victim and the policy behind the principle was in part that a defendant who made good a liability to pay should not be worse off than one who did not. To take the same proceeds twice would not serve the legitimate aim of the legislation and would be disproportionate.

The risk of double recovery through the Value Added Tax Act 1994 and POCA was disproportionate under A1P1. An individual collecting the VAT element of any transaction was doing so on behalf of HMRC, resulting in the notion of fiscal neutrality. It could not be denied that the Appellant had accounted for all of the input tax that he was liable to his suppliers. A double payment of that sum would be penal. As a defendant of criminal proceedings who had discharged his legal obligations to HMRC, he should not be worse off than a criminal who had not. Although their Lordships accepted that this would require the court to engage in an accountancy process in calculating the sums to be deducted, this should not be a reason to breach the Appellant's A1P1 rights.

Lords Hughes and Toulson disagreed with the majority on this issue. In their view, JFL had not been a mere custodian of the VAT for the state and all of the money received by JFL was its money. It was not disproportionate to treat the entirety of JFL's receipts from its criminal conduct as having been obtained by the Appellant.

Comment

The majority view that recovery through the VAT regime and a confiscation order would lead to double recovery and that this would contravene the Appellant's rights under A1P1 to the peaceful enjoyment of his possessions, is to be welcomed. As their Lordships said in their judgment, a confiscation order is intended to be a deterrent and not punitive. HMRC normally seek a confiscation order following a successful prosecution for tax evasion, and this case illustrates how difficult an exercise it can be for the courts to determine the correct sum to be included in any such confiscation order.

The Supreme Court's judgment is available to view here.

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