VAT update

August 2017

In this month's update we report on updated guidance from HMRC on distance selling, the EU (Withdrawal Bill) and the revised place of supply rules for B2C telecommunications. We also comment on three recent cases involving the awarding of costs for unreasonable behaviour, whether temporary classroom units are "immovable property" and the debarring of HMRC from appeal proceedings for failure to comply with a case management direction.

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Updated guidance on distance selling

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Withdrawal Bill

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BPP Holdings: HMRC debarred from further participation in proceedings

In *BPP Holdings Ltd v HMRC* [2017] UKSC 55, the Supreme Court has held that the FTT was justified in directing that HMRC should take no further part in the proceedings due to its failure to adhere to directions issued by the FTT. 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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News

Updated guidance on distance selling

HMRC has published new sections in its VAT Place of Supply (Goods) Manual on distance selling. The new sections relate to artificial structures which HMRC considers are designed to achieve a more favourable VAT outcome.

The distance selling rules apply to businesses selling goods cross-border to private individuals. The rules shift the normal place of supply from the member state of dispatch to the member state of delivery, where the business must then register and account for VAT. In the UK this is dealt with by section 7(4), Value Added Tax Act 1994 (VATA).

HMRC is of the view that some businesses may have sought to avoid the rules by, for example, arranging for a third party to enter into a separate delivery contract with the individual customer (known as "artificial splitting").

A copy of the updated guidance is available to view here.

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Withdrawal Bill

On 13 July 2017, the Government published the European Union (Withdrawal) Bill. The proposed legislation seeks to prevent future EU law becoming part of domestic law and convert existing EU law, applicable in the EU the day before the UK exits the EU, into domestic law.

At present, UK domestic legislation providing for VAT is derived from EU law and legislative bodies must apply VAT according to European directives, principles and rulings from the European Court of Justice (ECJ). After the UK leaves the EU, the Government will be responsible for the UK's VAT policies.

Clauses 4 to 6 and Schedule 1 of the Bill provide a helpful indication of how general principles and ECJ case law will be applied in the UK post Brexit.

A copy of the European Union (Withdrawal) Bill is available to view here.

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Revised place of supply rules for B2C telecommunications

On 20 July 2017, the Government published regulations abolishing the "use and enjoyment" rule that currently applies to supplies of telecommunication services from business to individual (non-business) consumers. The new rules will come into effect on 1 November 2017.

The regulations will amend Schedule 4A, VATA, to provide that when UK customers use their mobile phones abroad they will be charged UK VAT regardless of where they are. Under current rules, UK VAT is chargeable when UK consumers use their mobile phones in the EU, but not when they are used in a non-EU country.

The "use and enjoyment" rule continues to apply to business to business consumers.

A copy of the regulations is available to view here.

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Cases

Gekko: HMRC's unreasonable conduct

In *Gekko & Company Ltd* [2017] UKFTT 586 (TC), the First-tier Tribunal (FTT), in allowing an appeal against assessments to VAT and penalties, awarded the taxpayer its costs as HMRC's conduct had been unreasonable.

Background

In February 2015, Miss Pearce, an HMRC Officer, carried out a Compliance Check of the taxpayer's VAT returns for the preceding four years. Following this review, Miss Pearce wrote to the taxpayer setting out her conclusions. In this letter, she identified three issues. The first related to a declaration of output tax on a sale of land at Ferry Lane, Bath, in June 2011. The sale was not included in the VAT return for 06/11 and not corrected until 06/14, some three years late. The second concerned an input tax claim for motoring expenses. The last issue concerned an input tax claim on purchases in relation to a property at Fellands Gate.

Miss Pearce proposed to issue assessments and penalties for the three inaccuracies identified. There was further correspondence between the parties in the months that followed. The taxpayer responded on each matter, providing further information.

On 13 November 2015, Miss Pearce wrote to the taxpayer summarising details of her "VAT Review". She concluded that she had supporting evidence to verify a number of purchases of fuel, but not all, allowing her to reduce the amount of the proposed input tax assessment. She proposed to issue an input tax assessment in relation to Fellands Gate. With regard to Ferry Lane, she maintained that the taxpayer's behaviour for late disclosure was "deliberate" because the error was identified in 2012 but not corrected until 2014.

On 11 December 2015, a Notice of Penalty Assessment was issued in the amount of £1,062.05. The Notice referred to tax for the period for which penalties were assessed. It did not break down the penalties into three separate amounts and did not refer to the tax period in respect of which each penalty had been issued.

The taxpayer requested a review which was carried out by Mr Matthews. The outcome of Mr Matthews' review was that the fuel costs assessment was upheld. With regard to the penalties, he acknowledged that the taxpayer should have been notified of three separate penalties each with its own tax period, but was not. This was incorrect and the Notice of Penalty would be cancelled and reissued accordingly. Mr Matthews added that Miss Pearce would be asked to reconsider the characterisation of the taxpayer's behaviour in relation to sale of land at Ferry Lane and whether any conditions could be identified that would enable the penalty to be suspended.

Following the review, Miss Pearce provided a revised penalty calculation summary for each of the three penalties. She had considered the reviewing officer's remarks about the behaviour relating to the Ferry Lane omission and had regraded it to be "careless" and "prompted" disclosure. The taxpayer requested clarification for the change to "prompted", as no explanation had been given. Miss Pearce subsequently advised that the taxpayer's accountant

had explained the circumstances regarding Ferry Lane at the start of their meeting in February 2015. The decision to change the penalty to 'prompted' was based on Public Notice 700/45. In particular, paragraph 4.3, which states that correcting the error on a subsequent return is not a disclosure for the "new" [sic] penalty rules. Because separate notification was not received by HMRC, the disclosure in this case was viewed as prompted.

The taxpayer appealed to the FTT against the penalties.

FTT decision
The FTT allowed the taxpayer's appeal and awarded costs to the taxpayer.

The FTT's primary finding was that no valid penalty assessment had been issued. HMRC accepted that the Notice of Penalty Assessment, issued on 11 December 2015, should be withdrawn (as it did not specify the relevant periods it was invalid). However, no replacement Notice of Penalty Assessment was issued. Accordingly, no penalties had been validly imposed and HMRC was now out of time to issue a new assessment.

Alternatively, the FTT concluded that there was no inaccuracy for the period under dispute in relation to two of the issues (the fuel penalty and the Fellands Gate penalty). However, the FTT was most concerned with the third alleged inaccuracy concerning the sale of land at Ferry Lane. HMRC originally considered this to be a deliberate and unprompted disclosure. However, when subsequently accepting that it was careless, HMRC changed its view and claimed the disclosure had been prompted. The FTT did not consider there was any valid reason for this change of view by HMRC and the penalty should have been reduced to nil.

At the end of the hearing, based on what they had read and heard, the FTT advised they were minded to make an order for costs against HMRC. As the appeal had been classified as Standard, the FTT could only make an order for costs if it considered HMRC had "acted unreasonably in bringing, defending or conducting the proceedings" (Rule 10(1)(b) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rule 2009) (the Tribunal Rules).

The FTT was of the view that HMRC had acted unreasonably in defending the proceedings. Under its Litigation and Settlement Strategy (LSS), HMRC is required to consider the revenue at stake when deciding whether to pursue litigation, which they had not done in this case.

The FTT commented that it was particularly "disturbed" by HMRC's change of position in relation to the error relating to Ferry Lane. The subsequent re-characterisation of the inaccuracy to "careless" and "prompted" was not explained to the taxpayer. Of even greater concern, however, was HMRC's response when the taxpayer raised this change of position with HMRC. The explanation given by HMRC involved a flagrant misreading of a passage from a VAT Notice and ignored the admission made by the officer of the disclosure given by the accountant in 2015.

Comment
It is rare in Standard category cases for the FTT to make an order for costs, but given HMRC's unreasonable behaviour in this case, the FTT considered such an order to be appropriate.

The FTT's comments on the importance of HMRC reviewing whether proceedings should be defended, in particular having regard to its LSS, will be welcomed by taxpayers.

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

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Sibcas: Temporary classroom units subject to VAT

In *HMRC v Sibcas* [2017] UKUT 298, the Upper Tribunal (UT) has held that the supply of temporary accommodation at a school constituted an exempt letting of immovable property.

Background

Part of a secondary school had been condemned and temporary accommodation was needed until more suitable permanent arrangements could be made. A substantial temporary school building, two storeys high and with three interlinked blocks, was supplied by the taxpayer. The supply lasted for 32 months.

The temporary building comprised 66 (seven-tonne) modular prefabricated units that were clipped or clamped together to create a structurally integrated building. The taxpayer created the necessary foundations, including cutting trenches into the ground, laying fresh stone and levelling beams. When the letting came to an end, it took 98 days to dismantle the building and remove it from the site.

The taxpayer charged VAT on its supplies to the school of the temporary accommodation. The school argued that VAT should not have been charged and raised the matter with HMRC. HMRC agreed with the school that the hire was exempt from VAT and issued a decision accordingly. The taxpayer appealed to the FTT.

The issue to be determined was whether the taxpayer's supply of temporary accommodation was exempt as a letting of immovable property (Article 135(l) of the Principal VAT Directive (2006/112/EC) (the Directive). If it was not immovable property, VAT at the standard rate would be chargeable.

The FTT agreed with the taxpayer and held that the modular units, in spite of their scale, could easily be disconnected, dismantled and moved quickly, and could not therefore be treated as a letting of immovable property.

HMRC appealed to the UT.

UT decision

The UT allowed HMRC's appeal.

The UT noted that a building will be immoveable property if it is fixed to or in the ground. However, the ECJ has not provided an exhaustive list of the circumstances in which a building should be treated as fixed to or in the ground.

The UT also noted that the question of movability/immovability is to be determined by looking objectively at the characteristics of the building and its relationship with its site. Relevant factors include the manner in which the building relates to, or is integrated with, the ground and how easily (or not) it may be moved or dismantled and moved.

In the view of the UT, the FTT had taken an unduly restrictive view of what being fixed to or in the ground involved and focused on the individual components rather than the building as a whole. The FTT should have carried out a holistic examination of the entire building.

The UT concluded that the only reasonable conclusion was that the building was fixed to or in the ground. It had substantial foundations which were sunk into the ground. It was secured firmly in position on those foundations by the large compressive force which it exerted on the foundations. The building was connected to the services which ran through the ground. Importantly, the building could not be moved without being dismantled and it could not be easily dismantled.

Comment

The VAT treatment on supplies relating to land and buildings can often be an area of dispute with HMRC, and between customers and suppliers. It is clear from this decision that it is not always easy to determine what constitutes immoveable property for the purposes of Article 135(l) of the Directive.

In reaching its conclusion in this case, the UT has provided helpful guidance on the approach to be adopted when deciding whether the exemption under Article 135(l) is available.

A copy of the decision is available to view here.

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BPP Holdings: HMRC debarred from further participation in proceedings

In *BPP Holdings Ltd v HMRC* [2017] UKSC 55, the Supreme Court has held that the FTT was justified in directing that HMRC should take no further part in the proceedings due to its failure to adhere to directions issued by the FTT.

Background

The underlying case concerned the VAT treatment of supplies of books to the students of the taxpayer's law school. However, the Supreme Court's decision concerned non-compliance by HMRC of directions issued by the FTT.

In particular, the FTT directed HMRC to provide further and better particulars by 31 January 2014, in respect of its case in response to a request by the taxpayer. HMRC failed to comply with that direction. The FTT issued a direction under Rule 8 of the Tribunal Rules barring HMRC from further participation in the proceedings.

The central question in the case was whether the Tribunal Rules ought to be complied with in a manner similar to the Civil Procedure Rules 1998 (CPR), or whether the Tribunal Rules anticipated a lesser standard of compliance.

The FTT considered the approach to compliance as discussed in *Mitchell v News Group Newspapers Ltd* [2013] EWCA Civ 1537 and *Denton v TH White Ltd* [2014] EWCA Civ 906 and noted that HMRC had failed to explain its non-compliance, and that the delay had caused prejudice to the taxpayer.

HMRC appealed to the UT who allowed its appeal.

The taxpayer appealed to the Court of Appeal. HMRC argued that a CPR-style approach should not be applied in tax appeals before the tax tribunals. The Court of Appeal rejected this argument and noted that HMRC regularly relies on the CPR by analogy in cases where it suits its arguments, remarking "the irony in that circumstance is not lost on this court".

HMRC appealed to the Supreme Court where its appeal was dismissed.

Supreme Court's judgment

It was argued by HMRC that the FTT's reliance on the Court of Appeal's reasoning in *Mitchell* was not appropriate as the position had been modified by the Court of Appeal's later decision in *Denton*.

The Supreme Court noted that the FTT judge had not directly applied the CPR, or the authorities giving guidance thereon, but had applied their principles by analogy. There was no indication that the FTT had misunderstood the *Mitchell* guidance and the fact that the FTT did not consider *Denton* was not a valid reason for upsetting its decision. The Court of Appeal in *Denton* described the *Mitchell* approach as "remaining substantially sound" and the refinements contained in Denton were largely clarifications.

HMRC also argued that the FTT should have accepted the relevance of, and taken into account, the fact that the debarring direction prevented HMRC from discharging its public duty to collect tax and could lead to the public interest being harmed in that VAT which should be paid may not be recovered. The Supreme Court gave short shrift to this argument. It was of the view that it would set a dangerous precedent if the judge had been required to adopt such an approach as such an approach would discourage public bodies from living up to the litigation standards expected of individuals and private bodies. The Court commented that it is arguable that the courts should expect higher standards from public bodies, such as HMRC, when conducting litigation.

The Court was of the view that although, strictly, the approach to compliance with rules and directions made under the CPR (as discussed in *Mitchell* and *Denton*) does not apply to proceedings being conducted before the tax tribunals, it is unrealistic and undesirable for tribunals not to pay close regard to the principles enunciated in those cases.

Comment

This judgment is helpful and confirms that:

- the FTT can rely on the guidance provided in *Mitchell* and *Denton*
- HMRC does not have a special status and must comply with the Tribunal Rules and any directions issued by the FTT, and
- the FTT is within its rights to debar HMRC from further participation in the proceedings when it has not complied with Tribunal Rules and directions.

Taxpayers and their professional advisers need to ensure that the Tribunal Rules and any directions issued by the FTT are adhered to. In the event that there is non-compliance on the part of HMRC, they should adopt a proactive approach and take steps to ensure that non-compliance is dealt with effectively by the FTT.

A copy of the judgment is available to view here.

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