VAT update

March 2019

In this month's update we report on (1) HMRC's updated guidance on claiming exemption from Making Tax Digital for VAT; (2) the latest edition of HMRC's impact assessment for the movement of goods if the UK leaves the EU without a deal; and (3) HMRC's policy change on VAT treatment of personal contract purchases. We also comment on three recent cases relating to (1) the recovery of input tax on legal fees incurred by a company in defending proceedings brought against its director; (2) when a new point can be argued on appeal; and (3) whether goods were ordinarily incorporated into eco-build homes and qualified for a refund of VAT under the DIY house-builders scheme.

News items

Updated guidance on claiming exemption from Making Tax Digital for VAT

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HMRC impact assessment for the movement of goods if the UK leaves the EU without a deal

On 25 February 2019, HMRC published the second edition of its impact assessment for the movement of goods if the UK leaves the UK without a deal. The paper provides an overview and more detailed considerations of the impact of the UK leaving the EU without a deal. more›

HMRC policy change on VAT treatment of personal contract purchases

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Cases

Praesto Consulting – VAT input tax recoverable on legal fees incurred by company in defending proceedings brought against its director

In *Praesto Consulting UK Ltd v HMRC* [2019] EWCA Civ 353, the Court of Appeal has held that a company was entitled to recover input tax on legal fees it incurred in defending civil proceedings brought against its director. more›

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Eynsham Cricket Club – arguing a new point on appeal

In *Eynsham Cricket Club v HMRC* [2019] UKUT 47, the UT decided to remake the FTT's decision so that the parties could argue a point before it which had not been argued before the FTT. **more›**

Cosham – eco-build homes are a distinct category of building when determining VAT

In *David Cosham v HMRC* [2019] UKFTT 0119 (TC), the FTT has held that, for the purposes of determining if VAT was refundable under the DIY housebuilders scheme, eco-build houses were a separate category of building. **more›**

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.

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 items

Updated guidance on claiming exemption from Making Tax Digital for VAT

On 5 March 2019, HMRC updated VAT Notice 700/22, which sets out the rules for Making Tax Digital (MTD) for VAT, to include a new section concerning exemptions.

From 1 April 2019, businesses (other than certain complex businesses and those benefiting from an exemption) with taxable turnover above the VAT registration threshold must use HMRC's MTD service to maintain records digitally and use software to submit their VAT returns.

The updated guidance confirms that a business will only be exempt from using the MTD service if HMRC is satisfied that either:

- it is not reasonably practicable for a business to use digital tools to keep business records or submit returns
- the individual or their business is subject to an insolvency procedure, or
- the business is run wholly by members of a religious society whose beliefs are incompatible with the use of electronic communications and records.

To determine whether one of the above exemptions applies, HMRC will consider factors including, the impact of a person's age or disability, the extent to which a person uses electronic software for other purposes. HMRC will not grant an exemption solely on the basis that complying with MTD will involve reasonable effort, time and cost.

To claim an exemption, a business must call or write to HMRC and provide the information specified in the updated guidance. Until HMRC's written decision is received, businesses should continue to file VAT returns in the usual manner. Businesses that are already exempt from making online VAT returns, or whose turnover is below the registration threshold are not required to apply for an exemption.

A copy of VAT Notice 700/22 can be viewed here.

Back to contents>

HMRC impact assessment for the movement of goods if the UK leaves the EU without a deal

On 25 February 2019, HMRC published the second edition of its impact assessment for the movement of goods if the UK leaves the UK without a deal. The paper provides an overview and more detailed considerations of the impact of the UK leaving the EU without a deal.

This is the second edition of the impact assessment which was first published on 4 December 2018. It has been updated to include the impacts of the customs, VAT and excise regulations laid before Parliament in January 2019, alongside those laid in November 2018 under The Taxation (Cross-border Trade) Act 2018 and the EU Withdrawal Act 2018.

A copy of the impact assessment can be viewed here.

Back to contents>

HMRC policy change on VAT treatment of personal contract purchases

On 27 February 2019, HMRC published Brief 1 (2019) which explains when it will treat personal contract purchases and similar contracts (PCP) as single supplies of taxable leasing services for VAT purposes following the Court of Justice of the European Union's (CJEU) decision in *Mercedes Benz Financial Services* (C-164/16) (*MBFS*). In *MBFS* the CJEU confirmed that leasing arrangements with an option to purchase cannot be treated as a supply of goods unless transfer of ownership had to follow "in the normal course of events", including it being the only economically rational course for the lessee.

Previously, HMRC regarded supplies made under PCP contracts as supplies of goods and a separate supply of credit. Following the *MBFS* decision, it now considers that some of these contracts are a single supply of taxable leasing services.

The Brief explains the circumstances in which these contracts must be treated as a supply of leasing services, the date from when the change in treatment must be applied, and how to correct past periods where necessary.

A copy of Brief 1 (2019) can be viewed here.

Back to contents>

Cases

Praesto Consulting – VAT input tax recoverable on legal fees incurred by company in defending proceedings brought against its director

In *Praesto Consulting UK Ltd v HMRC* [2019] EWCA Civ 353, the Court of Appeal has held that a company was entitled to recover input tax on legal fees it incurred in defending civil proceedings brought against its director.

Background

Mr Ranson was formerly an employee of Customer Systems plc (CSP), an information technology consultancy and claimant in civil proceedings brought against Mr Ranson. In 2009, Mr Ranson resigned from CSP to set up Praesto Consulting UK Ltd (Praesto), which carried on a consultancy business competing with CSP.

Praesto paid legal fees in relation to the civil proceedings brought against Mr Ranson by CSP. The issue was whether Praesto was entitled to credit for input tax on VAT charged by the law firm conducting the litigation.

The First-tier Tribunal (FTT) allowed Praesto's appeal. It found that both Mr Ranson and Praesto had been clients of the law firm and the input tax had been incurred in relation to legal services supplied to Praesto. The fact that Praesto was not a party in the trial on liability did not affect that conclusion. Praesto had made the profits from any breach of duty by Mr Ranson and Praesto's profits would have to be accounted for, either by Mr Ranson or by Praesto itself, if CSP's claim was successful.

Praesto therefore had a direct interest in CSP's claim being dismissed, so that the link between the supplies and Praesto's taxable activities was sufficiently direct and immediate to entitle it to the input tax credit. The supplies had been made for the purpose of its business.

HMRC successfully appealed to the Upper Tribunal (UT). In the view of the UT the legal services were not used by Praesto for the purposes of its business.

Praesto appealed to the Court of Appeal.

Court of Appeal judgment

The appeal was allowed.

Although the FTT made no express finding of a contractual relationship between the law firm and Praesto, the findings of fact the FTT made clearly established a relationship. Mr Ranson and Praesto were jointly and severally liable for the law firm's fees and there was nothing significant in the fact it had addressed its invoices to only one of the parties so liable. In the view of the Court, there was no error of law in the FTT's conclusion that the invoices related to services supplied by the law firm to Praesto.

The Court considered whether *Becker* (C-104/12) applied to the circumstances of this case. The FTT and UT had reached opposing conclusions on this point. In *Becker*, the CJEU held that legal fees invoices to a company were not deductible because the lawyers were defending two directors of the company who had been charged in their personal capacity with making illegal payments to secure a contract for the company. The Court agreed with the FTT, that Becker was distinguishable on its facts and the UT was wrong to conclude otherwise.

The consequences of a finding of liability on the part of Mr Ranson would result in a real risk of proceedings being successfully brought against Praesto with disastrous consequences for its business activities. Praesto had a direct interest in CSP's claim being dismissed and the benefit was therefore not merely "incidental" as the UT had found.

The Court also considered whether the services supplied by the law firm had a direct and immediate link to Praesto's taxable activities. In its view, the FTT applied the right legal test. It had regard to all the circumstances surrounding the transactions at issue, looked for an objective link and found that 'objectively' the reason Praesto obtained the law firm's services was to limit any liability arising from its taxable activities. In particular:

- the services were supplied to both Mr Ranson and Praesto under a joint retainer
- the supply acquired reflected the economic reality. The proceedings were effectively being brought against Mr Ranson and Praesto, targeting the profits made by Praesto with the aim of putting it out of business
- there was a real risk of a claim against Praesto being brought by CSP and it succeeding if breach of fiduciary duty by Mr Ranson was first established
- objectively the reason Praesto retained the law firm's services was to avoid the real risk of it being liable to CSP which, if established, would have meant accounting for the profits of its taxable activities with the consequence that it would have been unable to continue to trade.

Commentary

The circumstances in which a company will or will not be able to claim VAT in relation to legal fees incurred in defending a director against a legal claim will very much depend upon the circumstances. The facts in Praesto were ultimately distinguishable from those in *Becker*. In order to successfully claim input tax it would appear that the consequences of a finding of liability against the director must be such that it would result in a real risk of proceedings being successfully brought against the company with disastrous consequences for its business activities. The benefit to the company of a claim against a director being dismissed must not be merely "incidental".

A copy of the judgment can be viewed here.

Back to contents>

Eynsham Cricket Club – arguing a new point on appeal

In *Eynsham Cricket Club v HMRC* [2019] UKUT 47, the UT decided to remake the FTT's decision so that the parties could argue a point before it which had not been argued before the FTT.

Background

The appeal concerned whether the construction of a cricket pavilion by Eynsham Cricket Club (Eynsham), was zero rated for VAT purposes. Eynsham argued that it was a charity and could therefore receive zero-rated building services from its contractor. HMRC decided the conditions for zero rating were not met and refused its claim. Eynsham appealed to the FTT.

The FTT found that the club was established for 'charitable purposes', which was the main point of contention between the parties, but it also found that the club was established for the subsidiary purpose of providing social facilities to the residents of Eynsham (the subsidiary purpose point) and dismissed the appeal.

Enysham appealed to the UT on the ground that the subsidiary purpose point had not been relied on by either party and the FTT had not heard any submissions on it. It also argued that, in any event, the subsidiary purpose was a charitable purpose.

HMRC accepted that the basis on which the FTT had decided the relevant issue was wrong in law, and both parties agreed that the FTT had decided the point on a basis which was 'entirely unprompted and of its own volition'.

However, in its response to Enysham's grounds of appeal to the UT, HMRC sought to introduce a new argument on the basis of which it contended that the FTT's conclusion on the issue could stand so that the appeal could be dismissed. HMRC's argument was essentially that Enysham's constitution was drafted too broadly for it to be established for charitable purposes only (the establishment point). Before the FTT, HMRC had solely argued that Enysham did not meet the public benefit test.

HMRC applied to the UT for permission to rely on a new argument. Eynsham opposed HMRC's application and argued that had this new argument been raised before the FTT, then it would have made efforts to identify and adduce factual evidence relevant to this argument.

The matter came before the UT in a case management hearing. The issue was whether either or both parties should be permitted to argue a point on appeal which had not been taken before the FTT.

UT decision

In the view of the UT, the FTT had not been given all the help it might have been to determine the establishment point by reference to Enysham's constitution. It was therefore no surprise that the FTT had proceeded on the basis that Enysham had been established for a charitable purpose.

The UT commented that Enysham had clearly stated in its own grounds of appeal that it wished to raise the establishment point. In the view of the UT, it would not be in the interests of justice to enable it to do so in circumstances where HMRC was precluded from raising it because Enysham says it could not be argued properly without it being given an opportunity to adduce new evidence. That issue must apply equally to both parties. Accordingly, the UT decided not to grant permission to either party to argue the establishment point before the UT.

Having reached this conclusion, the UT decided to remake the FTT's decision by allowing Enysham's appeal on the issue of whether it was established for charitable purposes. The effect of the decision on this preliminary issue is that Enysham is regarded as having effectively succeeded in its appeal before the FTT. When the case proceeds to a substantive hearing before the UT, it will be on the basis that Enysham was established for charitable purposes only.

Commentary

The circumstances in which the parties in this case now find themselves are unusual. The UT commented that the outcome was "clearly an imperfect conclusion because all the relevant law was not made available to the FTT, and if it had been, and the establishment point argued, then of course the decision may have been different".

The difficulties caused in this case might have been avoided if the FTT had invited submissions from the parties on the subsidiary purpose point during the course of the hearing, or after the hearing had been concluded.

The decision will be of interest to the many charitable organisations which are not registered with the Charities Commission.

A copy of the decision can be viewed here.

Back to contents>

Cosham – eco-build homes are a distinct category of building when determining VAT

In *David Cosham v HMRC* [2019] UKFTT 0119 (TC), the FTT has held that, for the purposes of determining if VAT was refundable under the DIY housebuilders scheme, eco-build houses were a separate category of building.

Background

Mr Cosham built a property which he describes as an "eco-build" property or a sustainable home. Mr Cosham installed electric blinds which were programmed to regulate the temperature in each of the rooms in which they were installed.

Mr Cosham's accountant wrote to HMRC on 6 March 2017, to claim a total of £14,505.53 in VAT refunds under the DIY housebuilders scheme, pursuant to section 35, Value Added Tax Act 1994 (VATA). Note 22 of Group 5, Schedule 8, VATA defines "Building Materials" as "goods of a description ordinarily incorporated by builders in a building of that description". Whilst electrical appliances are generally excluded, there are exceptions including for appliances which regulate temperature.

HMRC accepted some elements of the claim but rejected the claim relating to the electric blinds, which amounted to £2,303.17. Mr Cosham requested a review of HMRC's decision and the reviewing officer upheld HMRC's decision that the VAT incurred on the electric blinds could not be claimed under the DIY housebuilders scheme because they did not fall within the definition of "building materials" at Note 22.

Mr Cosham appealed to the FTT.

FTT decision

The appeal was dismissed.

Building of that description

The FTT noted that the main point at issue was the question of how, when considering the installation of fixtures into a specific type of building, that building is to be categorised for the purpose of making the comparison required by Note 22.

The FTT agreed with Mr Cosham that at the time of his VAT claim, an eco-home would be generally recognised as a distinct category of building. The FTT referred to *Taylor Wimpey v HMRC* [2017] UKUT 0034 (TCC) and *Taylor Wimpey v HMRC* [2018] UKUT 055 (TCC) and whether the categorisation is one which goes to the quality of the building (which was rejected as a category in *Taylor Wimpey* [2017] UKUT 0034 (TCC)) or the use of the building (which was accepted as a category in *Taylor Wimpey* [2018] UKUT 055 (TCC)). In the view of the FTT, the eco-home fell between these two categories and therefore the eco-build was in its own distinct category.

Would the electric blinds ordinarily be incorporated into buildings of this type?
The FTT considered that in order for Mr Cosham to be successful he needed to demonstrate that the electric blinds would be ordinarily incorporated into buildings of this type. Whilst Mr Cosham was adamant that this was the case, he produced no evidence in support of his claim and as a result the FTT could not accept that electric blinds are ordinarily installed in eco-build houses and his appeal failed on this basis.

Are electric blinds excluded from the definition of electrical appliances?
As the appeal failed at the previous stage, the FTT did not consider whether electric blinds were excluded from the definition of electrical appliances.

Comment
This decision provides useful guidance on the meaning of "ordinarily incorporated" for the purposes of Note 22 of Group 5, Schedule 8, VATA. The decision also highlights the importance of considering the VAT implications of a construction at the outset of building works.

A copy of the decision can be viewed here.

Back to contents>

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