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UK Indirect Tax Conference 2015

Case law update

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Input tax deduction

Input tax deduction – business/ non-business

Sveda UAB Case C-126/14

Background

- Sveda incurred input VAT on the construction of a recreational tourist trail mostly funded by the Lithuanian Ministry of Agriculture.
- Funding was provided on condition that the public could access the trail free of charge.
- Sveda's aim was to make taxable supplies of souvenirs and catering to users to the trail so as to recover the balance of its costs and also, presumably, to make a profit.
- A dispute arose concerning the deductibility of the input VAT incurred to build the trail.

Input tax deduction – business/ non-business

Sveda UAB Case C-126/14

CJEU decision

- CJEU finds for Sveda.
- The costs were incurred on capital goods ‘directly intended for use’ by the public free of charge but were still part of Sveda’s objective of carrying out taxable transactions.
- Objective evidence is required to evidence this intention.
- The fact that the trail was free was irrelevant as the costs in creating the trail were linked to Sveda’s planned economic activity.
- There was no break in the direct and immediate link to Sveda’s taxable activities.

Input tax deduction – business/ non-business

Sveda UAB Case C-126/14

Implications

- The right to deduct input VAT may not be restricted provided that the free products facilitate and/or are related to taxable supplies and/or the economic activities of the taxpayer as a whole.
- Paperwork and evidence will be needed.
- In some EU member states, specific restrictions apply to the right to deduct input VAT, so called ‘stand still’ clauses/derogations which may deviate from the EU VAT Directive and therefore the impact of CJEU decisions.
- The provision of goods for free, or the use of goods for free, therefore remains an activity which could in principle trigger an additional VAT cost.
- Suppliers should, however, assess any supplies that are for free and consider the potential VAT consequences of this decision.

Input tax deduction – VAT recovery for holding companies

Larentia + Minerva Cases C-108/9/11

Background

- Both German cases involved share acquisitions through holding vehicles/companies.
- In each case, full VAT recovery on acquisition costs had been claimed by the companies on the basis of economic activities being carried out, in the form of management services provided to the subsidiaries.
- The German Tax Authorities objected to the full VAT recovery, and allowed only a portion of VAT incurred on share acquisition costs as recoverable, suggesting that there must be some non-economic activity arising from the resulting shareholdings.
- The CJEU was asked to determine the apportionment of VAT incurred in connection with the acquisition of shares and whether a partnership could be included in a VAT group.

Input tax deduction – VAT recovery for holding companies

Larentia + Minerva Cases C-108/9/11

CJEU decision

- Where the holding company involves itself in the active management of all of the subsidiaries it acquires, it is entitled to recover input VAT incurred on transaction costs in full, unless it makes exempt supplies.
- Where the holding company is involved in passive management of all of the subsidiaries it acquires, only part of the input VAT incurred on transaction costs may be recovered (i.e. an apportionment must be made to reflect economic vs non-economic activity).
- The VAT grouping conditions implemented in Germany, limiting the participation to a VAT group to corporate entities and requiring a relationship of control and subordination between the members of the group, were too restrictive and go beyond the requirements set by the EU VAT directive.
- However, the EU VAT Directive on VAT grouping cannot have direct effect allowing taxable persons to claim a benefit thereof.

Input tax deduction – VAT recovery for holding companies

Larentia + Minerva Cases C-108/9/11

Implications

- The decision confirms that active holding companies should have the right to fully reclaim input VAT on costs incurred in relation to the acquisition of shares in subsidiaries.
- An apportionment of the input VAT is only required if the holding company renders VAT exempt supplies to its subsidiaries.
- Mixed holding companies should review the calculation method for the deduction of their input VAT costs as the apportionment between economic and non-economic activities will be required.
- In light of this decision, various Member States are likely to revise their current practice on the VAT recovery of holding companies and the VAT grouping requirements imposed in their national legislation.
- Active holding companies having been prevented by tax authorities in the EU to deduct in full their input VAT costs in the past should assess the possibility to reclaim this input VAT.

Restitution

Restitution

Investment Trust Companies (ITC) [2015] EWCA Civ 82

Background

Case concerns the right to recover amounts of overpaid VAT directly against HMRC on the basis of the English law of restitution and/or by enforcing rights under EU law.

- Facts:
  - Following the CJEU judgment of *JP Morgan Claverhouse* (Case C-363/05), fund managers made claims against HMRC to recover overpaid VAT.
  - HMRC only paid the 'net' amount of VAT originally paid to HMRC (output tax of £100 less the input tax of £25).
  - ITCs brought a High Court claim against HMRC claiming the balance (i.e. the input tax offset – the £25) and any other VAT they had not been able to recover from the managers (i.e. VAT accounted for where a s80 claim could not have been made).

Restitution

Investment Trust Companies (ITC) [2015] EWCA Civ 82

Court of Appeal decision

Unjust enrichment:

- HMRC were not unjustly enriched by the £25 credited to the managers as input VAT, the managers were.
- By making s 80 claims the managers had characterised their services to the ITCs as VAT exempt so had no entitlement to input tax credit.

Section 80:

- S80(7) VATA does not apply to restitution claims.
- S32(1)(c) Limitation Act applies to the dead periods.

EU law:

- The consumer who has borne the tax burden must then seek recovery from the taxable person BUT if that is impossible or excessively difficult, the principle of effectiveness confers on the consumer a direct right of recovery from HMRC.

Restitution

Investment Trust Companies (ITC) [2015] EWCA Civ 82

Implications

- On appeal, Supreme Court will be asked to consider:
  - Whether ITCs can claim the £25 from HMRC for all periods?
  - Whether s 80 applies to the dead period?
- Further litigation already progressing.
- Premier Foods useful decision supporting *Reemtsma* claims where a customer has borne VAT burden.
- See also *BrandonBay* (TC04421) party added to proceedings to reduce the risk of inconsistent findings of fact being made in subsequent restitution proceedings, yet to be lodged.
- Expect more litigation on issues such as ‘excessively difficult/impossible’, the passing on defence, use of contract law to defend a restitution claim, 6 years from ‘discovery’ of the error etc.

Abuse of rights

Abuse of rights

Paul Newey t/a Ocean Finance [2015] UKUT 0300 (TCC)

Background

- Case concerns 'Ocean Finance', a loan broking operation established in Jersey (Jerseyco), rather than the UK for VAT purposes.
- The issue was who was receiving the advertising services and providing the loan broking? If the answer is Jerseyco, did the arrangements fall foul of the *Halifax* tests?
- FTT allowed the appeal but UT referred questions to the CJEU.
- Court finds in circumstances where contracts **deviate significantly** (i.e. constitute a wholly artificial arrangement) from the commercial and economic reality of a 'supply of services', and if those contractual terms were put in place with the sole aim of obtaining a tax advantage then they can be disregarded.

Abuse of rights

Paul Newey t/a Ocean Finance [2015] UKUT 0300 (TCC)

Upper Tribunal decision

- UT upholds FTT decision.
- FTT were correct to conclude that the contracts entered into were genuine and that the legal relationships between the parties was governed by the contracts.
- Following CJEU in *Newey* the test is to establish the economic and commercial reality of a transaction. Unless that is found to be wholly abusive, look to the contractual position to identify what supplies are being made and by whom.
- VAT planning is fine, even where a tax advantage is the sole aim.
- CJEU *Newey* decision is nothing new, it just provides further clarification of *Halifax* as applied to the facts of this case.
- Appeal to the Court of Appeal.
- *WebMindLicences* CJEU decision awaited.
- Upper Tribunal – *DPAS* – contractual arrangements not abusive.

Abuse of rights

Pendragon [2015] UKSC 37

Background

- Structure was intended to secure input VAT recovery when demonstrator cars were bought, but limit output VAT when they were sold on as second-hand cars to VAT on any margin achieved at that point.
- Structure had commercial consequences and one of its objectives was said to be to secure financing in a VAT efficient way.

Tribunal and Court of Appeal decisions

- FTT rejected HMRC's 'abuse' challenge and agreed that the structure was technically effective.
- Upper Tribunal decided that FTT had erred in law, and found that the structure was 'abusive'.
- Court of Appeal decided there was no error of law in FTT decision and restored it.

Abuse of rights

Pendragon [2015] UKSC 37

Supreme Court decision

- Supreme Court agreed with the UT (albeit its reasoning is slightly different).
- Supreme Court has confirmed that the planning was 'abusive' and that HMRC was entitled to re-characterise the transactions involved to defeat it.
- Whilst the Supreme Court recognised that *"…Taxpayers faced with a choice between alternative ways of achieving some commercial objective are in principle entitled to select the one with the more tax-efficient statutory outcome …"*, the judgment shows that there are limits to taxpayers' entitlement to order their tax affairs so as to minimise the amount of VAT they pay.
- Taxpayers cannot artificially reclassify transactions which frustrate the objective of VAT legislation without falling foul of its language.

Vouchers

Vouchers

Associated Newspapers

Background

- UT has heard HMRC's appeals against the FTT decisions in favour of Associated Newspapers (AN) in its two appeals over the VAT treatment of vouchers used in its sales promotion schemes.
- In the first appeal (January 2014), FTT decided that AN was not liable to account for output VAT when it gave away vouchers under its sales promotion schemes.
- In the wake of that decision, HMRC sought to disallow input VAT (or deemed input VAT) on the purchase of the vouchers, which led to the second appeal to the FTT.
- In that case, the FTT confirmed that AN was entitled to reclaim the VAT (or deemed VAT) on the acquisition of the vouchers.

Vouchers

Associated Newspapers

Upper Tribunal

- In the UT, HMRC's primary contention was that AN was, in effect, a 'final consumer' of the vouchers and that it had no right to reclaim input tax on their acquisition.
- Alternatively, HMRC argued that if input tax could be reclaimed, there was a deemed supply when the vouchers were given away and output VAT was due on that.
- AN contended that it bought and used the vouchers for business purposes and that the FTT conclusions that it was entitled to reclaim input tax, and was not liable for output tax, were correct.
- A decision from UT is likely to be delivered later this year or early in 2016 and could have implications for a range of business promotion and staff incentive schemes.

Compound interest update

Littlewoods v HMRC [2015] EWCA Civ 515

Court of Appeal decision

- Littlewoods overpaid £200 million in VAT to HMRC, later repaid with simple interest. Compound interest sought by way of High Court claim.
- The matter has been heard by the High Court (2008-10), CJEU (2012), High Court again (2014) and most recently the Court of Appeal which held:
  - S78 VATA excludes restitutionary claims for interest;
  - This is contrary to EU law as it doesn't afford 'adequate indemnity';
  - 'Adequate indemnity' doesn't mean compound interest will always be awarded, but its more likely to reflect the time value of money where a taxpayer has overpaid VAT to HMRC;
  - An EU compliant construction of S78 VATA is not possible so it must be excluded;
  - Taxpayers can choose between *Woolwich* and restitution claims;
  - Use an 'objective use value' when calculating compound interest quantum.

Littlewoods v HMRC [2015] EWCA Civ 515

Implications

- Appeal to Supreme Court.
- Finance Bill 2015 taxes compound interest received on High Court claims at a rate of 45%.
- Unclear if it would apply to compound interest obtained by a Tribunal appeal.
- The new clause appears to be an attempt to recoup a significant amount of taxpayers' 'adequate indemnity'.
- If Littlewoods succeeds, this change could cost some taxpayers millions of pounds so expect litigation on the validity of this clause.
- Taxpayers who have High Court claims stayed pending Littlewoods should maintain them, and Tribunal appeals should also be maintained.

A look ahead

A look ahead

Expected cases

Upper Tribunal

- *ING Intermediate Holdings* - ‘free’ deposit accounts
- *Iveco* – Regulation 38 adjustments
- *MG Rover/Standard Chartered* – entitlement to s80 claims
- *Norseman Gold* – VAT treatment of management charges
- *Scandico* – right to deduct input tax on iPhones
- *Taylor Wimpey* – Scope of the builders’ block and netting off
- *Vodafone* – the ability to use ‘new reasons’ for a VAT repayment claim
- *Zipvit* – ‘embedded’ input tax

A look ahead

Expected cases

Court of Appeal

- *Ocean Finance* – abuse of rights
- *Whistl/TNT* – damages claim re postal exemption

Supreme Court

- *Airtours* – acquisition costs
- *Volkswagen Financial Services*? – input tax recovery – HP transactions

CJEU

- *ESET* (C-393/15) – recovery of VAT related to an overseas branch
- *BRE Ubezpieczenia* (C-40/15) – claims handling
- *DNB Banka* (C-210/04)/ EC v Luxembourg (C-274/15) – cost sharing exemption
- *National Exhibition Centre* (C-130/15) – payment processing
- *Air France (C-250/14)* – no show fees

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