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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

The Court of Justice has issued an Advocate General's opinion in the case of Blackrock Investment Management (UK) Ltd (Blackrock). This is a referral to the Court of Justice by the UK's Upper Tribunal. The case concerns whether the supply of investment management services to Blackrock should be apportioned. Blackrock uses the services in relation to its own supply of fund management to both Special Investment Funds (SIFs) and other funds (Non-SIFs).

The First-tier Tax Tribunal dismissed Blackrock's appeal and Blackrock appealed to the Upper Tribunal which, in turn referred the issue to the Court of Justice as it required guidance on the correct interpretation of EU VAT law. The Advocate General has issued his opinion to the Court. In essence, the Advocate General considers that apportionment is not possible unless the tax authority in question is provided with sufficient data which enable the tax authority to identify precisely and objectively the services provided specifically for SIFs.

In the Upper Tribunal, judgment has been released in the case of David Moulsdale t/a Moulsdale Properties. In this case, the appellant had opted to tax a property (ie the appellant had elected to charge VAT in relation to the property). However, as the tenant was a "connected" party who used the property for both taxable and exempt purposes, the appellant's option to tax had to be disapplied. The appellant then sold the property some years later and did not charge VAT. HMRC considered that a valid option to tax was in existence and that, in the circumstances, even though the option to tax had been disapplied in relation to the lease to the connected party, it was still a valid election in relation to the freehold sale. The case highlights the complexity of dealing with VAT and property. The Tribunal was very critical of the way that the VAT law is drafted.

Finally, in the Budget, HMRC announced that it is to legislate in the Finance Bill for the 'call-off stock' provisions that should have been implemented in the UK from 1 January 2020. Businesses that move goods around the EU on a 'call-off' basis will need to understand and implement these new rules.

Court of Justice – Advocate General's Opinion – Blackrock Investment Management (UK) Ltd

Whether fund management services provided by a third party should be apportioned

A supply of fund management services to a Special Investment Fund (SIF) is exempt from VAT under Article 135(1)(g) of the VAT Directive. A supply of fund management services to any other type of fund (non-SIF) is liable to VAT at the standard rate. In this case, Blackrock purchased fund management services from a US based third party. The service in question was the use of the third party's investment management platform (called Aladdin). Blackrock used this platform for its own provision of fund management services to various investment funds some of which were SIFs but most of which were non-SIFs. When paying the third party platform provider, Blackrock was required to apply the reverse charge mechanism whereby it is the recipient of a supply who must account for any VAT due. Here, adopting the reverse charge, Blackrock accounted for UK VAT on the full value of the charge that was made by the third party platform provider. However, Blackrock argued that, in relation to the SIFs, the supply of the platform should be regarded as fund management services and should, therefore be exempt from VAT (and thus not subject to the reverse charge). HMRC disagreed and, ultimately, the issue was heard at the First-tier Tax Tribunal (FTT).

The FTT agreed that the service provided by the platform provider was a supply of fund management services. However, as the platform provider provided exactly the same service to Blackrock in relation to both SIFs and non-SIFs and did not differentiate between the two, the FTT concluded that, for VAT purposes, there was a single supply and there was no basis in law for the consideration to be apportioned. Moreover, the predominant use of the services provided to Blackrock were for the management of non-SIFs.

Blackrock appealed to the Upper Tribunal which, as the issue concerned the interpretation of the VAT Directive, decided to refer the matter to the Court of Justice. The Advocate General has now provided his opinion and has concluded that, in the specific circumstances, the provision of a single supply of fund management services cannot be apportioned between services relating to SIFs and those relating to non-SIFs. Accordingly, the Advocate General will recommend to the full court that the exemption for the management of special investment funds cannot apply in Blackrock's case.

However, notwithstanding the outcome of this case, the Advocate General was of the view that, in a different case, it may be possible to apply the exemption if sufficient data is provided by the supplier to allow a tax authority to identify precisely and objectively the services that have been provided specifically for SIFs. In that event, the services provided solely for SIFs may be exempt under Article 135(1) provided that the supplier of the fund management services (or the recipient of those services in the case of a reverse charge) is able to provide the tax authority with those data. Since such data was lacking in Blackrock's case, the exemption provided for in Article 135(1)(g) of the VAT Directive cannot be granted.

Comment – this opinion will come as a blow to Blackrock. However, it is possible that the full court will disagree with the Advocate General and will rule differently when it delivers final judgment in a few months time.

The Advocate General does, however, provide a chink of light going forward. If the parties can provide sufficient data to show HMRC the extent to which the Aladdin platform is used by Blackrock for the provision of fund management services to SIFs and HMRC can objectively verify that data, it ought to be possible to exempt the platform charges going forward. Alternatively, where possible, the platform services provided in relation to SIFs and non-SIFs should be the subject of entirely separate supplies and invoiced separately.

Upper Tribunal – David Moulsdale t/a Moulsdale Properties

Whether an option to tax disapplied

In this case, the taxpayer purchased a property in 2001 and paid VAT on the purchase price. He then opted to tax the property and leased it to a company that was "connected" with him. (Mr Moulsdale also owned Optical Express). The company used the property for both taxable and exempt activities and, as the value of the property was in excess of £250,000, the property was a 'capital item' in the appellant's hands.

Following a VAT inspection in 2007, the appellant became aware that, under the option to tax disapplication rules, as the company was "connected" and was using the capital item for a mixture of taxable and exempt activities, the option to tax should have been disapplied. HMRC agreed to refund the VAT that had been overcharged in relation to the lease. In 2014, the appellant sold the property to a third party with the benefit of the underlying lease and did not charge or account for any VAT on the sale considering that the option to tax exercised in 2001 had been disapplied. HMRC took the view that there was a valid option to tax in place in relation to the property and that the appellant ought to have charged and accounted for output VAT in relation to the sale.

At the First-tier Tribunal (FTT), the appellant argued that the option to tax should continue to be disapplied as it expected that the property would continue to be used by the tenant for both taxable and exempt purposes. However, by the time of the sale of the freehold, the property was no longer a capital item under the Capital Goods Scheme and no adjustments were required in relation to the original input tax claimed on purchase in 2001.

Accordingly, the FTT found that, at the time of the sale, the property was not a capital item and it was not intended or expected that it would become a capital item after the sale. As a consequence, the sale of the property should have been liable to VAT as the option to tax was not disapplied. The taxpayer appealed to the Upper Tribunal but the Upper Tribunal found no fault with the FTT's interpretation or application of the relevant law. Appeal dismissed.

Comment

Dealing with VAT and property transactions is notoriously difficult especially where transaction with connected parties are concerned.

The supply of commercial property is generally exempt from VAT unless an option to tax is exercised by the person granting an interest. However, there are some hideously complicated rules that then disapply the option to tax in relation to certain grants.

In this case, Mr Moulsdale's property was a capital item under the Capital Goods Scheme and the property was to be used by a connected party for both exempt and taxable purposes. In such circumstances, the option to tax would be disapplied. However, when the property was sold, it was not a capital item so any supply of it would be subject to the option to tax and would render the supply as being taxable.

Strangely, being a taxable supply, that then makes the asset a capital item in the purchaser's hands but both the FTT and the Upper Tribunal considered that this fact should be ignored. The test is what the supplier of the property intended or expected at the time of the sale that matters.

Finance Bill 2020

HMRC legislates for the new 'call-off stock' procedures

Clause 78 of the Finance Bill 2020 introduces the new – albeit trailed earlier – rules in relation to the VAT treatment of call-off stock. These new rules will have a major impact on all businesses that move goods around the EU on a call –off basis.

From 1 January 2020 the UK and EU countries were required to implement new VAT rules for call-off stock transactions. For whatever reason, the UK failed to legislate for these changes before that deadline (and have been infracted by the European Commission as a result). HMRC published details of the accounting mechanisms for dealing with call-off stocks earlier in the year. In particular, when transactions and movement should be recorded on the EC Sales List (ESL), what documentation should be completed and maintained and when adjustments/revised declarations will be required at the various stages of dispatch, acquisition, return and re-assignment of call-off stocks. HMRC has now followed up the guidance with actual legislation.

Where the new VAT rules relating to call-off stock arrangements apply businesses will be required to:
Record the transport of call-off stocks to VAT registered businesses (the 'intended customer') in EU countries, on the ESL;
Record any change of intended customer for the call-off stocks on the ESL;
Record the return of any call-off stocks on the ESL; and
Maintain a register with details of call-off stock movements and values. Businesses may provide this information in electronic format. Importantly, failure to submit the relevant information may result in businesses being liable to register for VAT in the EU country to which the call-off stocks were sent.

Comment

The Finance Bill will, in due course become the Finance Act and clause 78 will come into effect retrospectively when the bill receives Royal assent.

However, these changes were supposed to be implemented in the UK from 1 January 2020. Ultimately, HMRC will expect businesses to operate the new rules before Royal assent is received.

Any business that moves goods on a call off basis will need to understand and implement these new rules or risk having to register for VAT in any Member State where call-off stocks are held.

Our team of over 80 VAT specialists are happy to help any businesses that are affected by these new VAT rules.

Contacts

Karen Robb
T +44 (0)20 7728 2556
E karen.robb@uk.gt.com

Nick Warner
T +44 (0)20 7728 3085
E nick.warner@uk.gt.com

Alex Baulf
T +44 (0)20 7728 2863
E alex.baulf@uk.gt.com

Daniel Sherwood
T +44 (0)1223 225616
E daniel.sherwood@uk.gt.com

Nick Garside
T +44 (0)20 7865 2331
E nick.garside@uk.gt.com

Paul Wilson
T +44 (0)161 953 6462
E paul.m.wilson@uk.gt.com

Claire Hamlin
T +44 (0)161 953 6397
E claire.a.hamlin@uk.gt.com

Morgan Montgomery
T +44 (0)121 232 5126
E morgan.montgomery@uk.gt.com

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