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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

It has been a fairly quiet week from a UK perspective, but the Court of Justice has issued both an Advocate General's opinion and a judgment.

Firstly, in the case of Sonaecom SGPS SA – a Portuguese referral to the Court of Justice – the Advocate General has, once again, considered the issue of input VAT recovery by a holding company.

Given the number of cases that have been considered previously on this issue, one could be forgiven for thinking that there was nothing left to discuss! In this case however, the company incurred input VAT in relation to the costs of a proposed corporate acquisition. It paid consultancy fees and also paid a commission in relation to the raising of capital by way of a bond issue. The proceeds of the issue were intended to fund the acquisition but, unfortunately, the acquisition fell through. The company then used the capital to provide a loan to its group parent company.

The Portuguese tax authority argued that, as a result, the VAT claimed on the consultancy fees could not be reclaimed. Advocate General Kokott agrees with the tax authority.

The Court has also delivered its judgment in the case of Agrobet CZ – a Czech Republic referral to the Court. In this case, the tax authority undertook a VAT investigation into the taxpayer company's VAT returns. It considered that some of the company's input VAT claim required further investigation. The tax authority accepted that some of the input VAT was not in dispute but it refused to repay this undisputed VAT until it had concluded its investigation.

In an opinion released in 2019, the Advocate General concluded that the tax authority was not entitled to withhold payment of the undisputed sums. The full Court has now released its judgment (although not released in English) but it seems that the Court has agreed with the Advocate General.

Finally this week, HMRC has announced that the time limit for notifying an option to tax is to be extended on a temporary basis from 30 days from the date of the decision to 90 days. This applies to any option to tax decisions made between 15 February 2020 and 31 May 2020.

Court of Justice of the European Union – Advocate General's opinion – Sonaecom SGPS SA (Sonaecom)

Whether input VAT incurred by a holding company can be reclaimed

Advocate General Kokott has issued an opinion in this case which is a referral to the Court of Justice by the Portuguese Supreme Administration Court. The issue, a familiar one, is whether, in the particular circumstances, the taxpayer company is entitled to deduct input VAT incurred on various costs associated with a planned corporate acquisition.

Sonaecom is a 'mixed' holding company. That is, it merely holds shares in some subsidiary companies (passive investment) but it also actively manages other subsidiaries (active investment). Case law of the Court of Justice has determined that the mere holding of shares is not an 'economic' activity for VAT purposes and provides no right of deduction whereas active management of a subsidiary (in addition to the holding of shares) is an economic activity which, in principle, gives rise to a right of deduction. In this case, Sonaecom wished to acquire the shares in a target corporation and it incurred input VAT in relation to certain costs associated with that proposed acquisition. In particular, it incurred input tax on consultancy fees and it paid a commission in relation to the raising of capital by way of a bond issue. Unfortunately, the acquisition did not take place but, based on its clear stated intention to provide the target company with management services (a taxable economic activity), Sonaecom deducted the whole of the input VAT through its VAT return.

Following the failed acquisition, the company still had the capital it had raised through the bond issue. It decided to lend that money to its group parent company. This loan constitutes an exempt supply for VAT purposes and, as a consequence, the Portuguese tax authority considered that Sonaecom was not entitled to make the deduction. Sonaecom appealed to the Portuguese courts and the Supreme Administration Court decided to refer the case to the Court of Justice as it required assistance with the interpretation of the VAT directive.

Advocate General Kokott has issued her opinion and has confirmed that, in her view, the input VAT incurred in relation to the consultancy services is deductible but that the VAT incurred in relation to the bond issue is not. She rehearsed the history of the Court's case law on this topic and confirmed that, in relation to the consultancy fees, if there was a clear intention of the company to use the inputs for the purposes of its taxable economic activity (the supply of management services) in principle, the input VAT is deductible. This is so, even though the stated intention did not materialise. However, as far as the VAT paid on the bond issue commission is concerned, the intervening exempt supply (the loan of the capital to the group parent) meant that the actual use of the inputs was for the exempt activity. Accordingly, in the circumstances, the actual use of the inputs for an exempt supply means that the company has no right of deduction in relation to the input tax incurred.

Sonaecom argued that it had merely 'parked' the capital with the group parent as a temporary measure and, on return of the capital, it used the capital to acquire other companies to which it provided taxable management services. Advocate General Kokott dismissed this argument concluding that there was a direct and immediate link between the input services and the exempt loan of the capital raised as a result of those services. Actual use of the inputs takes precedence over the original intention to supply taxable services to the subsidiary.

Comment – the previous case law of the Court confirms a right of deduction where there is a direct and immediate link between the inputs and taxable outputs or where the inputs form part of the undertaking's general overheads. Here, the company used the proceeds of the bond issue – albeit on a temporary basis – to provide a loan to its parent undertaking. That loan created a direct and immediate link with an exempt activity which confers no right of deduction. The fact that the capital was used subsequently for the stated purpose – ie the acquisition of subsidiaries to which Sonaecom provided taxable management services did not displace the direct and immediate link with the exempt loan.

Court of Justice of the European Union - Judgment

Agrobet CZ

This is a referral from the Czech Republic and concerns the question of whether a tax authority (here the Czech tax authority) is entitled to withhold the repayment of a claim pending the outcome of a VAT investigation. The investigation only concerns part of the claim and the taxpayer argued that, in relation to the undisputed claim (ie. the part of the claim not under investigation), the tax authority had no right to withhold payment.

Agrobet is an undertaking engaged in the import and export of agricultural products and feed. In February 2016 it submitted a VAT return for December 2015 and January 2016 showing a refund of VAT due. The repayment also included amounts to be deducted in respect of the purchase of rapeseed oil which Agrobet had sold on to a Polish undertaking free of tax. The tax authorities initiated a tax inspection for the two tax periods because it had doubts as to the correct taxation of the rapeseed oil transactions. The doubts related both to the tax rate applied and to the existence of fictitious transactions in the light of the fact that the rapeseed oil originated from Poland, was traded on without further processing in the Czech Republic and was then sold on again by Agrobet to a consignee in Poland.

Pending the outcome of that investigation, the tax authority refused to repay any of the repayment. In December 2019, the Advocate General confirmed that it is not consistent with the VAT Directive, in the light of the principle of neutrality, to defer the assessment and payment of the undisputed part of the claimed VAT for an indefinite period of time until the disputed part of the VAT claimed has been adequately inspected.

In its judgment issued on 14 May 2020, the full court appears to agree with that conclusion. Unfortunately, the judgment has not been published in English but a translation from the French text suggests that a tax authority may withhold the repayment of part of a claim but only if the undisputed part is clear, precise and unequivocal. This should be determined by the national court and be based on the facts of the case.

Comment

This seems like a sensible outcome. It would be wholly unreasonable for a tax authority to accept that part of a claim was not in dispute but yet to withhold repayment of that part until it had concluded its investigation into the disputed part.

According to the Advocate General, to do so would offend the principle of neutrality of the tax which is supposed to relieve the taxpayer of the entirety of the burden of the tax in a situation where the taxpayer only makes taxable supplies.

The full Court suggests that in a case where the undisputed claim is clear, precise and unequivocal, then the tax authority cannot and should not withhold the repayment. It is for the national court to determine this on the facts of each case.

This case sets a useful precedent and may be cited in situations where a tax authority takes a similar stance during an investigation.

HMRC Announcement

Extension to the deadline for notifying an 'option to tax'

Where a person elects to waive exemption (or exercises an option to tax as it is known colloquially), that election must be notified to HMRC with 30 days from the date that the decision to elect was made.

HMRC has announced that, where such a decision has been made between 15 February 2020 and 31 May 2020, the period for notifying it to HMRC is to be extended to a period of 90 days. This is due to administrative difficulties being encountered by UK businesses as a result of the coronavirus pandemic.

For businesses notifying an option to tax, HMRC's guidance stipulates that:

The form can be submitted with an electronic signature but evidence will be required to show that the signature is from a person authorised to make the option on behalf of the business. Examples of supplementary evidence include emailing the form with an email from the authorised signatory to the sender (of the email notification within the business), giving authority to use the electronic signature; from the authorised signatory with their sign off in the email and the form or with an email chain or a scan of correspondence showing the authority given by an authorised signatory.

Where agents such as accountants or solicitors are notifying an option to tax on behalf of a business, the guidance stipulates that:

Proof will be needed to show that the signature is from a person authorised to make the option on behalf of the business and that authority has been granted to the agent by the business to use the electronic signature. Examples include emailing the form with a current email or email chain from an authorised signatory of the client's business, giving the agent authority to use this signature and send it to HMRC on their behalf or with a scan of correspondence showing authority is granted by an authorised signatory to use their electronic signature on the form and to also send this form to HMRC on their behalf.

Comment

The procedures for making a valid election to waive exemption require the election to be 'notified' to HMRC within 30 days of the decision being taken.

During the coronavirus lockdown, businesses have experienced difficulties in meeting that deadline.

In recognition of these difficulties, HMRC has agreed, on a temporary basis to allow decisions made between 15 February 2020 and 31 May 2020 to be notified within 90 days of the decision date.

HMRC's guidance published on 14 May 2020 should mean that these difficulties in relation to notifications should be alleviated.

Unless the temporary arrangements are extended beyond 31 May 2020, businesses will be required to notify elections within 30 days.

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