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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

The headline this week is the Chancellor of the Exchequer's Summer Statement delivered on Wednesday 8 July 2020.

In a move intended to stimulate the hospitality and tourist sectors as the country comes out of lockdown, the Chancellor has announced the introduction of the reduced rate of VAT (5%) for certain supplies made by the likes of pubs, restaurants, hotels and places of entertainment.

These are temporary measures and will come into force with effect from Wednesday 15th July 2020 until 12th January 2021.

The Chancellor has also introduced a novel discount scheme to get customers back to 'eating out'. The new 'Eat Out to Help Out' scheme will be available to participating outlets and will provide a 50% discount to each customer (including children) for all 'eat-in' meals served during the month of August 2020.

At the time of writing (Thursday 9th July), detailed guidance from HMRC had not been made available. Businesses affected by these changes will need to familiarise themselves with the new rules once the guidance is published.

We also look this week at a judgment from the Court of Justice in the case of 'A' Oy – in connection with whether a supply of 'data centre hosting services' (the location and maintenance of computer servers) is regarded for VAT purposes as a 'land' service (i.e. the leasing or letting of immovable property) or services that are ancillary to such a supply. The reason for the case was that a supply of leasing or letting immovable property takes place where the land is situated. The Member State in this case (Finland) argued that the service was land related and thus took place within its territory and it was entitled to tax the supply. The Court of Justice disagrees in principle but has left it to the referring court to have the final say.

Our final case this week is a judgment from the Upper Tribunal in the case of Nicholas and Charlotte Sandham t/a Premier Metals Leeds. This case concerns VAT fraud conducted by the trader's agent and whether the conduct of the agent could be attributed to the partners.

Chancellor of the Exchequer – Summer Statement

Reduced rate of VAT introduced on a temporary basis to assist hospitality and tourism sectors.

On Wednesday 8 July 2020, the Chancellor of the Exchequer, Rishi Sunak, announced a number of fiscal measures aimed at stimulating the UK's flagging post-pandemic economy. In particular, the Chancellor aimed his aid package at the UK's hospitality and tourism sectors. These sectors have been hit very severely during the enforced lockdown and employ thousands of people. The Chancellor hopes that the measures will encourage consumers to return to their pre-lockdown ways.

The Chancellor has introduced three measures. Firstly, he has introduced a novel 'Eat Out to Help Out' discount scheme whereby the Government will pay 50% of a diner's bill (for food and non-alcoholic drinks consumed at participating restaurants) – capped at £10 per person. Restaurants will need to register to take part in the scheme which will run for the whole of August 2020 and will apply to meals consumed on Mondays, Tuesdays and Wednesdays during August.

Secondly, the Chancellor has announced the introduction of the reduced rate of VAT (5%) for supplies of food and non-alcoholic drinks from restaurants, pubs, bars, cafés and similar premises across the UK. The measure is temporary and will come into force on 15 July 2020 for six months (expiring on 12 January 2021).

Finally, the Chancellor announced a similar measure for UK attractions – again on a temporary basis and covering the same six month period.

By introducing the second and third measures, the Chancellor has taken advantage of EU law. Article 98 and Annexe three to the VAT Directive allow Member States to apply a reduced rate of VAT to supplies of foodstuffs (including drinks but excluding alcoholic drinks) for human consumption. Similarly, Member States are entitled to introduce a reduced rate for admission charges to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities.

Whilst the finer details of these arrangements have yet to be published by HMRC, the sectors affected by the changes will need to give urgent consideration to their VAT accounting. This change comes mid-way through a VAT period so businesses will need to ensure that they are able to differentiate between supplies made prior to the rate change and those made afterwards. The majority of businesses affected are likely to be retail businesses and which could simply require the programming of a new reduced rate button on tills and similar devices. For businesses that issue invoices to customers, however, they will need to familiarise themselves with the tax-point rules to ensure that the correct rate of tax is charged and collected during the temporary period.

Generally, a basic tax point arises when goods are made available to a customer or a service is performed. However, this basic tax-point can be over-ridden by the issue of an invoice within 14 days of the basic tax point. This is an important point for businesses supplying goods or services to other entities that cannot reclaim all of the VAT charged. These businesses will expect only to pay VAT at the reduced rate for supplies that take place during the temporary period. The tax-point rules are complex and there are many hurdles to trip up the unwary. Affected businesses should take appropriate advice.

It is not yet clear how the new measures will affect those business that operate the Tour Operators' Margin Scheme (TOMS) or whether such operators will be required to continue accounting for VAT on their margin at the standard rate of 20%. Hopefully, HMRC's guidance, when published, will bring some clarity on the point.

Comment – a VAT cut had been trailed for a number of weeks so did not come as a particular surprise when it was announced. Rather than apply a blanket cut to the standard rate of VAT for all supplies of goods and services, the Chancellor has directed the fiscal assistance at the two sectors that, arguably, have been hit the hardest during the pandemic and the resulting lockdown. Whether the stimulus will have the desired effect of protecting jobs in the sectors remains to be seen.

We will focus on HMRC's more detailed guidance in next week's Indirect Tax Update. In the meantime, businesses affected by these changes need to get to grips with the new rules without delay.

CJEU – Judgment – A Oy (Case C-215/19)

Whether data hosting services a supply of leasing or letting of immovable property

This is a case referred to the Court of Justice by the Finnish courts and concerns whether the hosting of a data centre (including racks for the servers and other ancillary services) constitutes a supply of the leasing or letting of immovable property.

EU VAT law provides an exemption from VAT (with an option to tax available) for supplies of leasing and letting immovable property. The question in this case was whether A Oy's (the taxpayer company) supply of data centre hosting services fell within that description. The Finnish tax authority issued a ruling confirming that the services did fall to be treated as the leasing or letting of immovable property and A Oy appealed through the Finnish courts. The company provided a basket of services but the predominant service was that of equipment cabinets to house a customer's servers. These cabinets were screwed to the floor of the building and the individual customer servers were then screwed into the cabinets. The Finnish tax authority considered that the cabinets thus became an integral part of the building and considered that the charges related, effectively, to rent for the space occupied.

In a judgment issued on 2 July 2020 (but not in English), the Court of Justice seems to have confirmed that, on the evidence before the court, the conditions necessary for there to be a leasing and letting of immovable property did not exist. The main conditions – that the supplier must grant a right of occupation to a particular area of the building and the customer must be able to occupy to the exclusion of all others as if it were the owner of the particular area were absent and, as such, the supply by A Oy was not a supply of the leasing or letting of immovable property but was of data-hosting. Ultimately, however, the CJEU considers that it is for the referring Finnish court to determine the facts based on the evidence presented to it. Ultimately, if the above conditions are not met, the Finnish court should arrive at the same conclusion.

Comment

This is an important judgment for IT businesses that are involved in server hosting. The reason that the judgment is important is because of the 'place of supply' rules.

The leasing and letting of immovable property is deemed to take place for VAT purposes where the land in question is geographically located. In this case, the servers were physically located in a building in Finland and had the court concluded that the supply was the leasing or letting of immovable property or land related services covered by EU regulations, then the place of supply would have been Finland.

As the Court has found that the supplies in question were not land related, the place of supply falls to be determined by reference to the general place of supply rule in Article 44 of the VAT Directive (ie the place where the customer belongs). In such circumstances, no VAT would be due in Finland if the customer was established in a different country.

Upper Tribunal – N & C Sandham t/a Premier Metals Leeds

Whether actions of trader's agent could be attributed to trader?

We don't generally cover MTIC fraud cases in the Indirect Tax Update. However, this case – an appeal from the First-tier Tax Tribunal by the partnership of Mr and Mrs Sandham t/a Premier Metals Leeds – serves to remind all businesses that (a) they can be vulnerable to unwitting participation in Missing Trader fraud and, as in this case, (b) the actions of their agent can be attributed to them personally and they can be held liable for any VAT due.

Missing Trader Intra Community (or MTIC) fraud has been around now for well over a decade. There are a number of versions of the fraud and they have become more complex over the years. However, a simple version of the fraud generally involves a business charging VAT in relation to certain supplies of goods (and sometimes services) and then disappearing before paying over the VAT paid by the customer to the tax authority. In this case, the partnership entered into various transactions that were arranged by its agent. Whilst the partners were not, themselves, aware of the fraudulent nature of the transactions their agent (another individual) was so aware.

Under established case law, (known as the Kittel principle) a business that knows that its transactions are connected to VAT fraud (or indeed where they ought to have so known) is not entitled to reclaim the VAT incurred on the purchase of the goods in question. In this case, the agent entered into a number of transactions in primary metals which were immediately sold on. Considering that those transactions were connected to VAT fraud, HMRC denied the partnership's claim for £1.9 million of input VAT. The partnership appealed claiming that they had no knowledge or means of knowledge of the fraud and that it was, in effect, all down to the actions of their agent. As innocent bystanders, they could not be held liable for the actions of their agent. The First-tier Tribunal dismissed their appeal confirming that the actions of their agent were to be attributed to the partnership.

The partnership appealed to the Upper Tribunal which has, similarly, dismissed the partnership's appeal. The Tribunal considers that there is no doubt that, at least in certain circumstances, if an agent has knowledge of particular matters, the agent's principal is also to be treated as having that knowledge.

In this case, the Tribunal was required to use the rules of attribution developed in case law and, in the circumstances, concluded that the fact that Mr France (the partnership's agent) acted contrary to his express instructions does not prevent his knowledge of fraud from being attributed to the Appellants. At the hearing before the Upper Tribunal, the Appellants made a submission that, because the Appellants entered into the transactions as part of a business carried on as a family partnership, the question of knowledge should appropriately be tested by reference to their own state of mind rather than the state of mind of an agent acting on their behalf. The Tribunal rejected that submission since, if correct, it would mean that persons acting in partnership could never be treated as possessing the knowledge of their agents. That would leave partnerships free to delegate all aspects of their business to potentially dishonest actors without being answerable for the consequences so long as they ensured that they were kept uninformed of what was going on. In conclusion, the FTT was correct to conclude that, when applying the Kittel principle, the Appellants were to be attributed with their agent's knowledge that the 56 transactions were connected with fraudulent evasion of VAT. The appeal was dismissed.

Comment

There have been many cases of VAT fraud involving Missing Traders. Tax authorities around the EU (including HMRC in the UK) have struggled to combat the fraud but the Court of Justice came up with a means of denying input VAT claims in case known as Kittel. In that case, a principle was established that a business could not claim a refund of input VAT if it knew or should have known that the transactions it had entered into were connected with VAT fraud.

HMRC has used that defence in many cases since the Court of Justice issued its judgment in Kittel. However, in this case, the taxpayer claimed (and it was accepted) that it had no knowledge or means of knowledge of the fraudulent actions of its agent. The agent had been authorised to deal in various primary metals but not to enter into fraudulent transactions with a view to defrauding the Revenue.

The Partnership considered itself an innocent party which should not be held liable for the deeds of its fraudulent agent. Unfortunately, both the First-tier Tribunal and now the Upper Tribunal disagree.

Established case law states that a principal is to be treated as having the knowledge of his agent. It is not a question of fairness. As the Tribunal suggests, to do otherwise would allow unscrupulous principals to escape liability for the actions of their agents by ensuring that they were always 'kept in the dark'.

It seems unlikely that, in the circumstances, the case will be appealed further.

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