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Indirect tax update

Week ending 08 November 2019

Summary

Welcome to this week's Indirect Tax Update.

After a few quiet weeks in the world of indirect tax with little to report, this week we look at the Advocate General's opinion in the case of Golfclub Schloss Igling – (a German referral to the Court of Justice).

The VAT Directive provides an exemption from VAT for the supply of certain sporting services by not-for-profit organisations. However, Germany denied this particular golf club the exemption and the question for the Court of Justice was whether the club could rely on the doctrine of direct effect.

The Advocate General has confirmed that, in his view, the provisions of Article 132(1)(m) of the Directive do not have direct effect and cannot be relied upon by the golf club in preference to German domestic VAT law.

Here in the UK, the First-tier Tax Tribunal has issued a number of decisions. The first concerns the imposition by HMRC of a demand for security against a taxpayer company. The Director of the company had been involved with several previous businesses that had failed leaving substantial unpaid tax debts and HMRC sought to 'protect the revenue' by requiring the latest company to deposit a security payment as a condition of trading. The company appealed against that requirement.

The second decision relates to the construction of an annexe to a building and whether the construction qualified for zero-rating.

The taxpayer is a college for Muslim students which claimed that the new annexe qualified for zero-rating as it was a 'charitable annexe'. In other words, the college contended that the new building was intended to be used for a 'relevant charitable purpose'.

The issue to be resolved by the First-tier Tax Tribunal was whether that contended use was correct. To be regarded as a relevant charitable use building, the college needed to satisfy the Tribunal that it was to be used otherwise than in the course or furtherance of a business activity or as a village hall or similar.

In the circumstances, the Tribunal dismissed the college's appeal.

Court of Justice – Advocate General's Opinion – Golfclub Schloss Igling

VAT – Whether Article 132(1)(m) has direct effect

The way that European law works is complex but, in essence, the EU passes laws by way of Directives that are addressed to the Member States. Member States are then required to implement the provisions of a Directive into domestic legislation through their own legislative procedures. In the majority of cases, this 'transposition' into domestic law goes without a hitch but, occasionally, a Member State may fail to transpose the law at all or may transpose it incorrectly. European law has established that, in such cases, provided certain conditions are met, a taxpayer in a Member State can rely on the Directive rather than on the domestic law provision. This is known as the doctrine of direct effect.

In this referral to the Court of Justice by the German courts, the question was whether the provisions of the VAT Directive relating to the VAT exemption for services relating to sport had direct effect. The Golf Club in question argued that German domestic VAT law did not implement the VAT exemption set out in Article 132(1)(m) correctly. Accordingly, it contended that it could rely on the direct effect of the VAT Directive in preference to German VAT law. The dispute proceeded through the German courts to the Bundesfinanzhof (the German Federal Finance Court) which decided to refer the matter to the Court of Justice.

Advocate General Hogan has given his opinion and has dismissed the Golf Club's contention. The doctrine of direct effect has two conditions that must be met for it to be invoked by a taxpayer. The provision of EU law in question (here Article 132(1)(m) of the VAT Directive) must be unconditional – ie it must not be qualified by any condition - and must be sufficiently precise in its wording. If either of those two conditions are not met then the provision of EU law is not directly effective.

In the Advocate General's opinion, he considers that the wording of Article 132(1)(m) does not meet these conditions. The Article is worded in such a way that it confers power on Member States to exempt from VAT only 'certain services' related to sport and, by using the term 'certain services' the Advocate General recognises that Member States are, therefore, afforded some discretion as to which services may (or may not) benefit from the VAT exemption. According to the Advocate General, such use of discretion means that, the wording of Article 132(1)(m) is not, therefore, unconditional.

In reaching that conclusion, the Advocate General considered the previous case-law of the Court of Justice. In particular, he examined the UK case concerning the British Film Institute which was concerned with the exemption for supplies of cultural services under Article 132(1)(n). In that case, the Court found that, by using the term 'certain services' in relation to cultural services, Member States were entitled to use their discretion and this meant that the provision did not have direct effect.

Comment – In due course, (approximately three months) the full Court of Justice will deliver its judgment in this case. The Court does not always follow the opinion of the Advocate General. However, given the Court's earlier judgment in the case of the British Film Institute, it is difficult to believe that the outcome in this case will be any different to the outcome in that case.

Where, through the wording of the Directive, a Member State is afforded some latitude to determine who is entitled to benefit from a VAT exemption and who is not, it seems fairly clear that the Court of Justice will consider that the doctrine of direct effect cannot be invoked by a taxpayer in preference to domestic law.

First-tier Tax Tribunal – Tower Hire and Sales Ltd

Demand for Security to 'Protect the Revenue'

In this case, the taxpayer company had been asked by HMRC to provide security (a cash deposit) as a condition of being allowed to continue trading. This power is provided to HMRC under the provisions of Schedule 11 of the VAT Act and is generally invoked where HMRC considers it necessary to protect the revenue.

In this case, the company was asked to provide security because its shareholder / Director had been involved with previous businesses that had had 'failed' leaving a string of unpaid VAT, PAYE and NIC debts and a history of poor VAT compliance. Nevertheless, the company appealed to the Tribunal against HMRC's demand for it to provide security. The Tribunal's role in such proceedings is supervisory rather than appellate. In other words, the Tribunal is required to examine whether HMRC's decision to require security is reasonable in the circumstances. The test of reasonableness is whether HMRC failed to take account of relevant information in reaching its decision or whether it took account of irrelevant information (or both). In either case, a Tribunal is likely to find that a demand for security – a draconian power – was unreasonable.

In the case, the Tribunal found that although there was a history of failures and poor compliance where the shareholder / Director was clearly involved and influential, HMRC had taken into account three earlier business failures where the individual was not involved at the relevant time. Accordingly, HMRC took into account information that was not relevant and, as such, the Tribunal found that its decision to require security from the latest business was unreasonable. – Appeal allowed.

Comment

One would have thought that the recent failures and poor compliance where the individual was definitely involved was sufficient for HMRC to base its decision to require security.

By including the failure of three other businesses – which the Tribunal found could not be attributed to the same individual, HMRC had taken into account information that was irrelevant.

As difficult as it is to reconcile the Tribunal's decision here, the onus is always on HMRC to act in a reasonable way. Clearly, in this case, the Tribunal considered that, based as it was on irrelevant information, HMRC's decision was unreasonable and allowed the taxpayer company's appeal.

First-tier Tax Tribunal – Madinatul Uloom Al Islamiya

Zero rating for the construction of a charitable annexe

UK VAT law allows for the construction of a charitable annexe to be zero-rated. A charitable annexe is an annexe to a building that is intended to be used by a charity for a relevant charitable purpose. This means that the new annexe must be used by a charity otherwise than in the course or furtherance of a business or as a village hall or similarly in providing social or recreational facilities for a local community.

In this case, the taxpayer is a college for Muslim students. It charges fees to students although these fees do not cover the costs of providing the education. Any shortfall in income is covered from donations made to the college. In some cases, where a student cannot afford to pay the fees, the fees will be forgiven or waived.

The college argued that, in light of this, it was acting otherwise than in the course or furtherance of a business and that, as a result, the construction of the annexe qualified for zero-rating. HMRC took the view that, despite the student fees not covering the cost of the provision of education, nevertheless, the college made supplies of education for consideration and it was, thus, carrying on a business. As such, HMRC contended that construction of the annex did not qualify for zero-rating.

The Tribunal was bound by the findings of the UK's Court of Appeal in a similar case involving Wakefield College. In that case, the Court found that there were supplies of education in return for the payment of fees. That was a supply of services for consideration. In addition, the Court found that the activity (of providing education) was done 'for remuneration' and, as a result, the College was acting as a taxable person when it made those supplies. The College's appeal was, therefore, dismissed.

Comment

This case highlights that the UK Courts and Tribunals now recognise that it is not sufficient for an entity simply to make supplies of goods or services for consideration for such supplies to be regarded as a business activity.

The case of Wakefield College established that it is also necessary to be acting as a taxable person. The test for this is whether or not the entity is supplying such goods or services for the purposes of deriving income therefrom on a continuing basis (which the Court of Justice refers to as 'for remuneration').

In this case, the Tribunal found that the College was making supplies of education for consideration and for remuneration. Accordingly it was intending to use the annexe for business purposes.

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