Indirect tax update

Week ending 19 October 2018

Summary

There have been two major judgments delivered by the Court of Justice of the European Union this week. The first, delivered on Wednesday concerned an Irish referral to the Court in the case of Ryanair Ltd. The second judgment, delivered on Thursday concerned a UK referral from the Supreme Court in the case of Volkswagen Financial Services (UK) Ltd (VWFS).

HMRC has also announced this week that it is to defer the introduction of Making Tax Digital (MTD) for certain taxpayers from 1 April 2019 to 1 October 2019

In Ryanair, the issue was whether the company was entitled top reclaim input tax on costs incurred on the aborted takeover of airline rival Aer Lingus. Ryanair argued that as it intended to provide management services to Aer Lingus after the takeover, it was to be directly 'involved in the management' of the target. The CJEU has ruled in previous cases that such 'involvement' is a prerequisite to recovery. The Irish Revenue considered that as the takeover did not happen (the EU blocked it on competition grounds), there was no 'involvement'.

In VWFS, the issue was also about the recovery of input VAT on overheads. VWFS supply vehicles and finance and argued that it was entitled to reclaim a proportion of the VAT on overheads to reflect the fact that it did make a taxable supply of the vehicle (albeit the vehicle was sold at cost). HMRC argued that the company made its profit from the supply of finance and that, as a result, the overheads of the business were cost components of the exempt supply of finance. According to HMRC this precluded the recovery of any input VAT.

The deferral of MTD for certain complex businesses gives those businesses more time to prepare for this major change in VAT reporting.

VWFS – CJEU restores some sanity

Back in May this year, the Advocate General (AG) of the Court of Justice issued his opinion in this case. To say the least, that opinion caused some consternation in the asset finance sector. However, the full court has now issued its judgment and, thankfully, both order and sanity have been restored.

The issue – whether a business which sells motor vehicles on finance is entitled to reclaim any of the VAT it incurs on its overheads – is relatively straightforward. The dispute between VWFS and HMRC however is complex and was made even more difficult by the AG when he went off on something of a detour. As with many similar finance businesses, VWFS purchase the underlying asset (a car) from a motor dealer and then sell it on to the customer along with finance. The car is sold on to the customer at the same price for which it was purchased from the dealer and this supply of the vehicle to the customer is a taxable supply. VWFS then also provide the customer with finance (an HP agreement). The supply of finance is an exempt supply for VAT purposes. HMRC took the view that as VWFS made all of its profit on the two transactions from the VAT exempt supply of finance, the overheads of the business could only be regarded as constituting cost components of that exempt supply. On that basis, HMRC's view was that VWFS was not entitled to credit for any input VAT incurred on its overheads.

The issue has been litigated through the UK's courts and Tribunals and has ended up at the UK's Supreme Court which, in turn, decided to refer the case to the Court of Justice. That process began with the AG's opinion in May this year. The AG's unhelpful detour brought into question the UK's treatment of HP agreements for VAT purposes. The AG was of the view that in HP cases, the UK's VAT treatment (ie recognising a taxable supply of the asset and a separate exempt supply of the finance) was questionable. In his view, there was actually only a single, taxable supply of a vehicle on finance. In other words, as the supply of credit to the customer was ancillary to the main supply of the car, the two transactions should be treated as one supply for VAT purposes and VAT should be accounted for on the full price received including the interest paid on the finance. In such circumstances, the AG accepted that, as the single supply of the vehicle was a taxable supply, there was no doubt that the supplier was entitled to reclaim the VAT incurred on overheads. In an instant, the AG had turned a question about the recoverability (or otherwise) of input tax into an entirely different matter concerning whether, in HP transactions, there is a single supply of the underlying goods.

The full court has now issued its judgment and has paid no heed to the AG's detour other than to confirm that the question of whether there is a single supply or more than one supply is a matter to be determined by the national courts. However, it was clear from the papers before it that, in this case, the national court had accepted that the sale of the vehicle on HP terms constituted two separate supplies. With that in mind, the CJEU turned its focus to the question of input VAT recovery. The judgment makes it very clear that HMRC's notion that no input tax could be reclaimed by VWFS is wrong. In essence, the VAT Directive provides a taxpayer with a right to reclaim input VAT provided that his output supplies are taxable. This right cannot be limited. Where a taxpayer also makes supplies that are exempt from VAT, the Directive stipulates that the taxpayer must apportion his input tax between his taxable outputs and his non-taxable outputs by using a method of apportionment. The method to be used is based on the respective values of the taxpayer's taxable and non taxable turnover. However, the tax authority may allow or direct the use of a different method but only if the use of that different method guaruntees a more accurate result.

It was clear to the CJEU that HMRC's method of apportionment failed to produce a more accurate result and could not be imposed on VWFS. The fact that VWFS chose to make its profits from the interest element of the two transactions was irrelevant to the analysis.

Comment – the CJEU has, in effect, ignored the AG's detour which will be a huge relief to businesses in the sector. The judgment also debunks HMRC's theory that it is where a business makes its profits that determines whether the costs are cost components of a supply. The judgment makes it clear that such an analysis is wholly incorrect. What matters is whether the costs have a direct and immediate link with the activities of VWFS as a whole and not just with the exempt supply of finance. The very fact that the overheads support the making of both taxable supplies (albeit in VWFS's case for no profit) and exempt supplies is sufficient to provide the taxpayer with a right of recovery of a proportion of the input VAT incurred with which the tax authority cannot interfere.

Ryanair Ltd

Court of Justice judgment

The issue in this case was whether Ryanair Ltd was entitled to reclaim input VAT incurred on costs relating to its failed takeover bid for Aer Lingus its rival Irish airline.

The Irish Revenue Commissioners considered that as the takeover ultimately failed, Ryanair's intention to provide management services to Aer Lingus after the takeover did not materialise. As such, it could not be said that Ryanair was directly or indirectly 'involved in the management' of Aer Lingus. The case law of the CJEU over the last few decades has resolved that such 'involvement in management' is necessary to confer a right of recovery of input tax on holding companies.

The evidence before the court was that there was a clear intention stated by Ryanair to provide management services to Aer Lingus after the takeover. However, the European Commission blocked the takeover on competition grounds such that Ryanair abandoned the bid and, as a consequence, its stated intention could not be fulfilled.

The CJEU has confirmed that the Irish Revenue's stance in this case is incorrect. The case law of the court has determined that, where there is objective and clear evidence to support a taxable persons intention to provide taxable services but, for whatever reason that intention is thwarted, the VAT Directive provides a right to recover input VAT on the related costs. The Revenue Commissioners' position would deny Ryanair's rights enshrined in the Directive.

Comment

Given the direction of travel over the last few decades with regards to the recovery of input tax by holding companies, it is difficult to understand the Irish Revenue's stance in this case.

There is a string of earlier cases which make it clear that, in order to respect the neutrality of the VAT system, the VAT Directive provides taxpayers with the right of recovery provided that their own outputs are taxable.

The case law and the Directive also make it clear that it is the intention of the taxable person that matters (subject only to objective verification). Where there is clear evidence that the taxable person intended to make taxable supplies, the fact that, for whatever reason, that intention does not materialise does not impinge on his right to recover attributable input tax.

Making Tax Digital

HMRC announces the deferral of MTD for certain taxpayers

HMRC has made a surprising announcement this week. It produced an update to its policy paper on MTD introducing the MTD pilot scheme to more business. However, it also announced that for more complex businesses, the mandation date of 1 April 2019 would be deferred until 1 October 2019.

The 6-month deferral applies to entities that fall into one of the following categories: trusts, 'not for profit' organisations that are not set up as a company, VAT divisions, VAT groups, those public sector entities required to provide additional information on their VAT return (Government departments, NHS Trusts), local authorities, public corporations, traders based overseas, those required to make payments on account and annual accounting scheme users.

Affected entities now have an additional six months to prepare but HMRC has stated that they will invite these entities to take part in the pilot scheme from 1 April 2019. It is not clear whether the 'soft landing' period (to enable entities to implement the requisite 'digital links' into their accounting systems) will also be extended for a further six months.

We are communicating with HMRC in relation to this point and we will provide a further update in due course. Many businesses may find that they will have to meet the original deadline for some of their VAT registrations but that the extension will apply to others. In these circumstances, it is debateable whether a dual roll-out would be efficient but the flexibility will be there if required.

Comment

All VAT registered businesses in the UK (with very few exceptions) are required to adapt their VAT accounting systems to comply with the new MTD regulations coming into force on 1 April 2019.

HMRC states that it has recognised that, for some more complex businesses, more time will be needed for them to be fully prepared.

The announcement of a deferment of the mandation date to 1 October 2019 will be welcomed by the affected businesses but there is still a great deal of work required.

Grant Thornton has developed an MTD filing solution and is listed as a software supplier supporting HMRC's MTD project.

Any business requiring a demonstration of the software should get in touch with their usual Grant Thornton contact.

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