Indirect tax update

[05/2018]

20 April 2018

Summary

It has been a quiet few weeks since our last update due to the Easter holidays. The Court of Justice is back in full swing and HMRC has issued a new Revenue & Customs Brief dealing with its change of policy in relation to cost sharing groups. This change follows a number of judgments of the Court of Justice most notably in relation to DNB Banka and Aviva.

The Court of Justice ruled that cost sharing groups were not available to businesses in the financial or insurance sectors. HMRC's Brief confirms this position and gives affected businesses in those sectors a short period to regularise their positions.

The Court of Appeal has also confirmed that it is to refer the University of Cambridge endowment fund case to the Court of Justice. The issue to be resolved is one of attribution and, in particular, whether input VAT incurred on fund management services provided to the fund are attributable to the overall activities of the University. HMRC's contention is that the fund 'consumes' the management services and that, as a result, the University cannot treat the input VAT as 'residual' input tax.

Finally this week, The Court of Appeal has issued its judgment in the long-running case of Paul Newey t/a Ocean Finance. The issue – whether a VAT planning arrangement involving the establishment of an offshore loop for the purposes of gaining a VAT advantage was contrary to EU law – is to be referred back to the First-tier Tax Tribunal as both it and the Upper Tribunal made errors of law. The Court of Appeal is not a fact finding court and so the case must go back to the FTT to be reheard. This may take several years yet to resolve definitively.

HMRC revises its policy in relation to cost sharing groups

Following the Court of Justice judgments in the separate cases of DNB Banka and Aviva, and the same Court's judgments in the cases of Commission v Germany and Commission v Luxembourg, HMRC has issued Revenue & Customs Brief 03/2018 and Information Sheet 02/2018 revising its policy in relation to the VAT treatment in the UK of cost sharing groups

Readers will recall that both the Advocate General and the full court of the CJEU concluded in the DNB Banka and Aviva cases that the exemption provided by Article 132(1)(f) of the VAT Directive is not available to suppliers unless their supplies of goods or services fall under the 'public interest' exemptions contained in Article 132. As DNB Banka supplied financial services and Aviva supplied insurance services, both of which are exempt under Article 135 of the Directive (and not Article 132), the CJEU confirmed that the cost sharing exemption was simply not available to them.

Readers will also be aware that the UK introduced the cost sharing exemption in 2012 when Schedule 9 of the VAT Act was amended. The law as written states that the supply of services by an independent group of persons is exempt from VAT if a number of conditions are met. These conditions include that each of the persons (ie members of the group) must carry on an activity that is exempt from VAT or they should be non-taxable persons as defined by the VAT Directive. The law does not state that the supplies in question must be 'in the public interest' or must be services falling within Article 132 of the VAT Directive.

Nevertheless, armed with the DNB Banka / Aviva CJEU judgment, HMRC has announced that it is to change its policy on cost sharing groups. With immediate effect, (except in relation to Housing Associations), the cost sharing exemption contained in UK law is removed for supplies that do not fall within Article 132 (which includes both financial services provided by banks and insurance services provided by insurance businesses). However, there will be a transitional period of two months (until 31 May 2018) for those businesses that have already established cost sharing groups and who are no longer eligible to do so to regularise their VAT position.

Businesses that are involved in the delivery of postal services, the supply of qualifying education (by Universities and Colleges etc), the supply of health and welfare services, trade unions and professional bodies, sports services, fund raising by charities and supplies of cultural services will all continue to be eligible to form cost sharing groups and to benefit from the VAT exemption for cost sharing groups. As far as Housing Associations are concerned, HMRC has stated that it is considering the implications of the CJEU judgments on that sector and will make further announcements at a later date. In the meantime, however, Housing Associations may continue to benefit from the cost sharing exemption.

Comment – We consider that HMRC's change of policy creates a number of issues. Firstly, EU law has established in previous case law that if a Member State wishes to remove an EU law right, it cannot do so with immediate effect. Case law dictates that a reasonable transitional period should be introduced. The question here is whether the two month transitional period to 31 May is reasonable in the circumstances to allow those businesses affected by the change of policy to regularise their affairs.

Secondly, we consider that HMRC's policy change actually requires a change of UK law. The law, as it stands, merely imposes a condition that the members of the cost sharing group make exempt supplies and does not impose any additional condition that those exempt supplies should be those deemed to be 'in the public interest' contained in Article 132 of the VAT Directive. When the cost sharing group legislation was introduced into the UK in 2012, Parliament made no such distinction and simply passed the law on the basis that it would be available (subject to meeting all relevant conditions) to any person making exempt supplies.

Finally, the R&C Brief also makes a distinction between supplies made by Housing Associations and financial and insurance services made by financial and insurance institutions even though the supplies made by Housing Associations (the granting of rights over land) do not fall within Article 132. The proposed new policy highlighted in the R&C Brief therefore treats Housing Associations differently for VAT purposes and, as a consequence, it seems that this distinction may contravene the EU principle of fiscal neutrality.

Court of Appeal

HMRC v University of Cambridge

The University of Cambridge has an endowment fund which is worth in excess of £900 million. The University engages a third party fund manager to manage the endowment fund. The fund generates in excess of £40 million of investment returns each year which are used to fund the various activities of the University. From a VAT perspective, these activities include the making of exempt supplies of education and research and some taxable supplies. There are also some non-business activities.

The question in this case is whether input VAT incurred by the University on the fund manager's fees (for managing the fund), are to be directly attributed to the investment activity of the fund itself or whether the University is entitled to treat the VAT as 'residual' input tax. The University contends that, in essence, it is on all fours with earlier Court of Justice decisions in cases such as Kretszechnik and Securenta which established that one is entitled to 'look through' the immediate supplies to the underlying activities of the entity. HMRC considers that the services of the fund manager are wholly 'consumed' by the fund and, as the funds activities are investment activities that are outside the scope of VAT, there is no entitlement to treat the input VAT as residual. Both the First-tier Tax Tribunal and the Upper Tribunal agreed with the University and this is HMRC's appeal to the Court of Appeal.

As the issue to be resolved concerns the interpretation of EU law, the Court of Appeal has decided that it needs to refer the matter to the Court of Justice. The case will not, therefore, be resolved for some while yet.

Comment

This is an important case because, eventually, it will establish whether or not it is permissible to 'look through' the supply (here fund management services) to the underlying purpose of the supply (here the general activities of the University).

The University cites the Kretztechnik case as authority for that premise (ie one can ignore the sale of shares and look at the purpose behind the sale which was to raise working capital for the taxable business activities).

HMRC on the other hand cite the case of Wellcome Trust which established that the sale of investments was an end in itself and, as such, the input VAT on costs associated with the sale of the investments could not be reclaimed. In due course, the Court of Justice will decide the issue once and for all.

Paul Newey t/a Ocean Finance

Court of Appeal

This case concerns the EU principle of 'abuse of rights'. In essence, the question is whether a scheme of arrangement entered into by the taxpayer with a view to obtaining a VAT advantage contravenes the principle of abuse and should, thus, be redefined by the tax authority to defeat the advantage sought.

This long-running litigation relates to VAT periods ending in 2004. HMRC contends that the scheme of arrangement put in place by Mr Newey is wholly artificial and thus infringes the abuse of rights principle. The case was heard at the First-tier Tax Tribunal (FTT) in 2010 which found that, although the sole purpose of the arrangement was to obtain the VAT advantage, establishing the scheme through a corporation in Jersey was not abusive. HMRC appealed to the Upper Tribunal which referred the matter to the Court of Justice. That Court concluded that an arrangement might be abusive if the economic reality of the arrangement is different to the contractual terms and the arrangement was conceived with the sole aim of obtaining a tax advantage. This was a matter for Upper Tribunal to decide.

With the Court of Justice judgment in mind, the Upper Tribunal considered that, although the FTT had made a number of errors, they were not sufficient for it to interfere with the FTT's decision and dismissed HMRC's appeal.

HMRC appealed to the Court of Appeal. In its judgment, the Court has determined that the Upper Tribunal's judgment also contains errors of law. As a consequence, it could have remade the decision of the Upper Tribunal but it considers that it has insufficient facts before it to do so. Accordingly, the matter must be returned to the FTT for a rehearing.

Comment

After so many years of litigation, one would have expected that this case might have been resolved by now. However the issue is not a simple one.

Mr Newey admitted at the original FTT hearing that the sole reason for implementing the scheme of arrangement was to avoid the incidence of VAT on advertising costs that he could not reclaim due to the exempt nature of his loan brokerage activities.

The FTT found that despite that admission, the establishment of the scheme of arrangement was not, of itself, abusive. However, the FTT also made errors of law relating to whether the Jersey company that was established as part of the scheme made exempt supplies in the UK at the material time. It is in respect of that error that Court of Appeal considers the case must be reheard by the FTT.

Contacts

Stuart Brodie

Scotland

T +44 (0)14 1223 0683
E stuart.brodie@uk.gt.com

Karen Robb

London & South East

T +44 (0)20 772 82556
E karen.robb@uk.gt.com

Vinny McCullagh

London & South East

T +44 (0)20 7383 5100
E vinny.mccullagh@uk.gt.com