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Indirect tax update

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Summary

Welcome to this week's Indirect Tax Update.

The Court of Justice of the European Union is still on an Easter judicial vacation this week so we look to the UK Courts and Tribunals for news of VAT developments.

The Court of Session – the Scottish equivalent of the Court of Appeal has issued its judgment in the case of the NHS Lothian Health Board v HMRC. In this case, the Board submitted a claim for a refund of input VAT that it had incurred on costs relating to its business activities but which it had not claimed previously. The claim was based on 'known' figures taken from published accounts in 2006/2007 which were then, in the absence of any substantive records, extrapolated backwards to 1974. HMRC rejected the claim on the grounds that the Board could not support or evidence the quantities claimed.

Both the First-tier and the Upper Tribunals agreed with HMRC and the Board appealed to the Court of Session. That court has now delivered its judgment and has allowed the Board's appeal. It considered that, on the evidence before it, the FTT should have concluded that the EU law principle of effectiveness had been breached. Once it was established that the level of business supplies made and the level of inputs consumed by the Board had remained reasonably constant over the whole period, the principle of effectiveness should have ensured that the Board's claim was met in part at least.

The Upper Tribunal has also issued a judgment in the long-running case involving Rank Group PLC v HMRC. The Tribunal has dismissed HMRC's appeal from the FTT. HMRC had argued that the FTT had made an error of law in relation to the identification of the relevant characteristics of an 'average' consumer for the purposes of determining whether or not the principle of fiscal neutrality had been breached.

Finally, this week, we understand that HMRC has issued a statement – over the Easter Bank Holiday weekend – that businesses required to pay import VAT on 15 April 2020 could defer such payment if they are suffering 'severe financial difficulty' as a result of the Covid 19 pandemic.

Court of Session – NHS Lothian Health Board v HMRC

Whether rejection of a claim for input VAT breached the EU principle of effectiveness

It is a well established principle of EU law that Member States are to give full effect to EU Directives when enacting domestic legislation and when implementing that legislation in practice. In a VAT context, the principle of effectiveness – an unwritten principle of EU law, confirms that where a taxable person has a right established under the provisions of the VAT Directive, Member States should not make it excessively difficult or virtually impossible for that person to exercise that right.

The case-law of the Court of Justice has confirmed in previous cases that a taxable person is entitled to recover from the State any taxes that have been collected by the State in breach of EU law. The principle of effectiveness therefore ensures that, in such circumstances, a taxable person is not obstructed by the Member State from exercising that right of recovery.

In this case, the NHS Lothian Health Board (the Board) had submitted a claim for VAT that it (and its legal predecessors) had failed previously to claim during the period from 1974 to 1997. The claim was submitted in 2009 following the cases of 'Fleming' and Conde Nast. However, due to the historical nature of the claim, there were very few, if any, records available to the Board for it to quantify the value of the claim with any accuracy. The records that were available related to the years 2006 and 2007. Taking a view that the Board's activities and costs which gave rise to the claim were relatively constant over the full claim period, the Board simply extrapolated the 2006/7 'known' figures as the basis of its claim. HMRC rejected the claim on the basis that it was insufficiently precise and was based on unverifiable accounting data.

The Board appealed to the First-tier Tax Tribunal (FTT) against HMRC's rejection of the claim. Importantly, the FTT heard and accepted evidence from previous employees and accountants that the level of business activities and the level of inputs upon which input VAT had been incurred had remained relatively constant during the full claim period. However, notwithstanding those facts, the FTT agreed with HMRC that the claim should be rejected on the basis that the quantum of the claim was insufficiently precise. The Board's appeal was dismissed. When the Board appealed to the Upper Tribunal, it faced a similar outcome and it then appealed to the Scottish Court of Session which has now delivered its judgment.

The Court of Session has allowed the Board's appeal. In essence, it considers that both HMRC's rejection of the claim and the FTT's decision to dismiss the Board's initial appeal contravened the principle of effectiveness. The crucial point was that the FTT had found as a fact, based on evidence that it had heard and accepted, that the business activities of the Board and the level of inputs had remained fairly constant during the claim period. Once those facts had been established it was not open to the FTT to deny the Board's claim in full. By rejecting the claim in totality, and by insisting that the claim should have been based on verifiable or proven data, both HMRC and the Tribunal had made it excessively difficult or virtually impossible for the Board to exercise its EU law right of refund. The principle of effectiveness does not require such precision or proof especially where, as here, the reasons for the lack of data upon which to base the claim were clearly not the fault of the taxpayer. HMRC and the Tribunal should have accepted that there was a genuine claim and should not have rejected it outright simply because the calculations were based on extrapolated data.

The Court of Session allowed the Board's appeal and referred the case back to the FTT for reconsideration.

Comment – this is a major victory for the Board having failed at both the FTT and the Upper Tribunal previously. The Court of Session considers that, once there is evidence that has been accepted to support the principle of a claim (which there was in this case), then a total rejection of the claim cannot be justified. Each case is likely to turn on its own facts and evidence but, where such facts and evidence are present and are accepted, such a rejection would be a breach of the principle of effectiveness.

Upper Tribunal – Rank Group PLC & Ors

Whether the FTT had erred in law when it confirmed that the principle of fiscal neutrality had been breached

The dispute in this case goes back many years and concerns the VAT liability of income derived from gaming machines. The UK had differentiated between so-called section 16/21 machines – which were exempt from VAT and section 31/34 machines which were liable to VAT at the standard rate. Rank Group PLC had lodged a claim with HMRC to recover the VAT that it had paid between October 2002 and December 2005. HMRC refused the claim and the company appealed to the First-tier Tax Tribunal.

In a previous hearing at the Court of Justice, the Court ruled that the EU law principle of fiscal neutrality would be breached if the same or similar supplies were treated differently for VAT purposes. To assess whether two supplies are similar, the Court of Justice also established that account must be taken of the point of view of a typical consumer. Essentially, two supplies of services are similar where they have similar characteristics and meet the same needs from the point of view of consumers. With that ruling in mind, the FTT concluded that, from the point of view of the average consumer, there was little, if any, difference between the playing of section 16/21 machines and section 31/34 machines. As such, the FTT concluded that the EU law principle of fiscal neutrality had been breached and that, as a result, Rank's claim was valid.

HMRC appealed to the Upper Tribunal arguing that the FTT had erred in law because it had accepted actual data of consumer activity on the relevant machines instead of establishing the real reasons for a consumer choosing one machine over another. HMRC argued that the use of actual data did nothing to discern the reasons behind the choices made by consumers. However, the Upper Tribunal dismissed HMRC's arguments confirming that, in its judgment, the FTT was correct to take account of and give weight to actual data that was available as evidence rather than speculate or hypothesize the reasons why a consumer would choose one supply over another. There was no error of law.

Comment

The EU law principle of fiscal neutrality confirms that where two supplies (of goods or of services) are identical (or very similar) then they should not be treated differently for VAT purposes.

In this case, HMRC treated supplies from certain machines as exempt from VAT but treated very similar supplies from other machines as liable to VAT.

The Court of Justice has ruled that such a difference in treatment might offend the principle if, taken from the point of view of a typical consumer the different supplies have the same characteristics and meet the same needs of the consumers in question.

In assessing whether the different supplies had the same characteristics and met the same needs of the consumers, the FTT took account of and gave weight to actual playing data in respect of the machines in question. HMRC considered that actual playing data was the wrong yardstick but the Upper Tribunal considered that the FTT was perfectly within its rights to take account of real data rather than hypothetical argument. HMRC's appeal was dismissed.

Covid – 19 – HMRC allows deferment of import VAT & duty payments

Customs Duty and Import VAT

We understand that HMRC made the following announcement on Friday 10 April 2020 (Good Friday):

"***Duty deferment account holders who are experiencing severe financial difficulty as a result of coronavirus and who are unable to make payment of deferred customs duties and import VAT due on 15 April 2020 can contact HMRC for approval to enter into an extended period to make a full or partial payment, without having their guarantee called upon or their deferment account suspended. The account holder should contact the Duty Deferment Office at 03000 594243 or by email cdoenquiries@hmrc.gov.uk or the COVID-19 helpline on 0800 024 1222. Account-holders will be asked to provide an explanation of how coronavirus has impacted their business finances and cash flow***."

This statement appears to contradict a previous announcement on 3 April 2020 that the VAT deferment arrangements (announced as a result of the Coronavirus pandemic) do not apply to the payment of import VAT.

Whilst there is no record of the latest announcement on HMRC's 'VAT: Latest Documents' website, the statement has appeared on the CIOT's website and appears to be genuine.

We understand that businesses seeking to defer payment of deferred import VAT and customs duty had difficulty contacting HMRC on the numbers published in the statement or by email.

It is hoped that HMRC will confirm the arrangements in time for any VAT and duty payments due on 15 May 2020. Businesses that are struggling to pay the import VAT and duty due to the financial problems caused by the 'lockdown' require clearer guidance on the implications in respect of their deferment accounts and guarantees.

Comment

HMRC announced on 3 April 2020 that the deferment of VAT payments did not apply to the payment of import VAT that was due during the deferment period.

On 10 April 2020 (Good Friday), it seems that HMRC has had a change of heart.

Businesses that operate a duty deferment account would have been due to make a payment of import VAT and duty on 15 April 2020 by direct debit. HMRC's announcement confirms that where a business is experiencing severe financial difficulty as a result of coronavirus they can seek approval from HMRC to defer that payment.

It is not clear whether the offer will extend to payments due in May and June 2020.

There are also implications flowing from non-payment of a deferment account liability including suspension of the facility itself and the potential for deferment guarantees to be called upon.

HMRC should clarify its policy as a matter of urgency.

Contacts

Karen Robb
T +44 (0)20 7728 2556
E karen.robb@uk.gt.com

Nick Warner
T +44 (0)20 7728 3085
E nick.warner@uk.gt.com

Alex Baulf
T +44 (0)20 7728 2863
E alex.baulf@uk.gt.com

Daniel Sherwood
T +44 (0)1223 225616
E daniel.sherwood@uk.gt.com

Nick Garside
T +44 (0)20 7865 2331
E nick.garside@uk.gt.com

Paul Wilson
T +44 (0)161 953 6462
E paul.m.wilson@uk.gt.com

Claire Hamlin
T +44 (0)161 953 6397
E claire.a.hamlin@uk.gt.com

Morgan Montgomery
T +44 (0)121 232 5126
E morgan.montgomery@uk.gt.com