AAT VAT update 14 May 2014

In this month's edition of the VAT update we look at:

1 HMRC shames itself by failing to recognise a reasonable excuse
2 HMRC publish the results of the review to extend VAT exemption for higher education
3 New e-mail address for flat rate scheme applications
4 HMRC's VAT event for businesses supplying digital services
5 Revised Notice 700/63: Electronic invoicing
6 Littlewoods' claim for compound interest on a repayment and HMRC brief
7 Avon's claim to input tax on demonstrator goods sold to agents

1. HMRC shames itself by failing to recognise a reasonable excuse

Mistakes happen but HMRC should learn from mistakes. HMRC appears shabby and unprofessional when it fails to recognise that a business has a reasonable excuse and is doing everything possible to keep people in work and meet its tax bills.

In Electrical Installation Solutions Ltd v Revenue & Customs [2013] UKFTT 419, the judge criticised HMRC for relying on the dissenting judgment of Scott L J in the way in which HMRC have done in their Manual, correspondence, Statement of Case and in their submissions to the Tribunal. Indeed, he consider HMRC's VAT Civil Penalties Manual paragraph 10534 in this respect to be incorrect and misleading.

HMRC should hang its collective head in shame for its lack of judgement and pursuit of penalties in this case. HMRC sought two VAT default surcharges for the periods, respectively, 03/12 and 06/12. The issue in the appeal is, broadly, whether the Appellant had a reasonable excuse for failing to pay its VAT on time in respect of the two VAT periods under appeal.

The Appellant's business was established in 2006 and specialised in the design, installation and maintenance of electrical equipment for the food industry. The business grew until 2009, by which time the Appellant employed 35 operational staff and eight management/office staff.

The company was adversely affected by the economic downturn following the financial crisis. It made staff redundant, sold cars previously used by departing staff and reduced its overheads from 11% to 5 – 6% of turnover. It approached HMRC and obtained time to pay arrangements, negotiated a larger overdraft facility from its bank and the directors and shareholders remortgaged their houses and injected additional capital by way of loans to the company.

If the company had been able to collect monies within its trading terms, it would have had sufficient funds to pay its VAT in a timely manner. Unfortunately, its customers were slow to pay and the age of debts increased as customers took longer to pay and often sought to negotiate discounts and refunds.

Section 71(1)(a) VATA 1994 was considered in the leading case of *Customs and Excise Commissioners v Steptoe* [1992] STC 757. The Court of Appeal held by a 2:1 majority that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency – the underlying cause of the taxpayer's default – might do so. L J Scott gave a dissenting judgement but the law of legal precedent was established by the majority decision.

The company submitted its VAT returns in good time. But its cash flow did not allow it to pay its VAT on time but it then paid the VAT as soon as it was able. Slow paying debtors led to an insufficiency of funds. The tribunal found that the insufficiency was caused by the downturn in orders and the cash flow problems caused by customers extending their period of payment of the Appellant's invoices.

The tribunal ruled that the Appellant company: "took all reasonable steps to avoid the insufficiency, including cutting its costs by virtue of redundancies, reducing directors' salaries and cutting overtime and travel time and reducing its fleet of managerial cars, seeking new markets (the construction industry), injecting fresh shareholder loans, increasing its overdraft with its bankers and negotiating extended credit with some of its suppliers. In short, the Appellant acted in a proactive manner to keep

its business afloat, maintain its cash flow and settle its liabilities as best it could. It is hard to see what more the Appellant could reasonably have done except to go into administration (an outcome which was likely to have been of no benefit to the Appellant or to HMRC). In reaching this conclusion we are fully aware that the Appellant's financial difficulties lasted over two years. In our experience, it is not unusual for a business of the size of the Appellant's to take this period of time to retrench, refocus and turn itself around." [Paragraph 46]

This company contributed over £750,000 each year by way of PAYE, VAT and corporation tax and HMRC should have tried to act in the public interest. HMRC failed miserably and their misinterpretation is really a disgrace. The court ruled that the company had a reasonable excuse and the penalty was not due. It ruled that "In our view, having regard to the very significant difficulties being experienced in its trade, the Appellant did all that could reasonably have been expected of it to make timely payment of the VAT due."

http://www.bailii.org/uk/cases/UKFTT/2013/TC02813.html

2. Revenue & Customs Brief 18/14

This HMRC brief announces the result of a Government Review into possible extension of the VAT exemption for further and higher education.

3. New e-mail address for applications for the flat rate scheme

The flat rate scheme is designed to help small businesses by taking some of the work out of recording VAT sales and purchases. If you use the scheme you apply a single percentage to your turnover in a VAT period. The result is the VAT you pay to HM Revenue & Customs (HMRC).

The main benefit of the scheme is the time saved recording VAT on sales and purchases. This can also take some of the stress out of completing VAT returns at the quarter end. And because you can easily calculate how much VAT you owe on takings, it can help you to manage cash flow. HMRC will now accept application by e-mail. You can Download a VAT 600 FRS Flat rate scheme application. And fill it in on your computer and send it to frsapplications.vrs@hmrc.gsi.gov.uk. HMRC have published Revised Notice 733: Flat Rate Scheme for small businesses which has been updated to reflect the new email address for online applications.

4. VAT event for businesses supplying digital services (Opens new window)

HMRC is organising a VAT place of supply of services and VAT Mini One Stop Shop event in London on 2 June 2014. Businesses affected by the changes being introduced on 1 January 2015 are invited to attend.

5. Revised Notice 700/63: Electronic Invoicing

This notice cancels and replaces Notice 700/63 June 2007. It has been updated to reflect the changes in invoicing regulations of 2013. It also contains revised content to reflect the technological advances since the previous version.

6. Littlewoods' claim to compound interest on a repayment and HMRC brief

Littlewoods Retail Limited and Others claimed a refund of overpaid VAT in respect of commissions on mail order sales. This VAT was repaid together with simple interest due under VAT Act 1994. They then argued that the interest already paid to them was not adequate and that they were entitled to compound interest both as a matter of European Community law and also as a matter of English domestic law.

The High Court ordered a reference to the Court of Justice of the European Union (ECJ) for a decision as to whether Community law required payment of compound interest. It was heard in the Grand Chamber of the ECJ on 22 November 2011.

The judgment of the European Court was delivered on 19 July 2012. The European Court ruled that there is no EU Law right to compound interest but returned the matter to the UK Courts to determine whether the UK's interest provisions comply with general EU principles.

The issue was heard in the High Court during a 3 week hearing in October and November 2013. The Court considered the implications of the ECJ judgment and, as well as considering the national rules for payment of interest, the Court considered the quantum of any amount due if simple interest was found not to be adequate. Each side put forward a different approach to show how the benefit of overpaid tax might be quantified, if necessary. In March 2014 judgment was delivered by the High Court which found compound interest to be due as claimed taking into account the 'exceptional' circumstances of Littlewoods situation. The Court also held that that the current statutory provisions relating to VAT did provide an appropriate amount of interest in many cases.

HMRC's view is that there is no Community law right or domestic law right to compound interest and that section 78 of VATA 1994 provides an exhaustive statutory scheme by which only simple interest is payable. Some might think that HMRC are poor losers but I'll not comment on that.

HMRC does not agree with the judgment and considers it to be at odds with the requirements of European law and how Parliament intended VAT law to work. Accordingly, this is not the end of the litigation as HMRC has received permission to appeal the judgment to the Court of Appeal.

In view of the above, HMRC will apply for any claims for compound interest already lodged with the High Court or County Court to continue to be stayed pending the final determination of the Littlewoods litigation.

HMRC's position in relation to Tribunal appeals is unchanged, namely that these should continue to be stood over until there has been a final determination as to the availability of compound interest in the United Kingdom.

Any new requests for compound interest will continue to be refused. You can read the full opinion of HMRC which was published on 6 May at: http://www.hmrc.gov.uk/briefs/vat/brief2014.htm

7. Avon's claim to input tax on demonstrator goods sold to agents

Revenue & Customs Brief 19/14
This brief explains HMRC's position following the Avon First Tier Tribunal decision to make a reference to the European Court of Justice.

HMRC directed Avon that it must account for VAT on sales, by its non VAT registered representatives, at their open market value. This was to ensure that VAT is accounted for on the full price charged to final consumers.

As part of their business Avon sell samples and demonstration items ("demo items") to their representatives. These can be used as sales aids. Representatives pay VAT on these supplies. Avon invited the FTT to interpret the UK legislation and/or the Notice of Direction to allow it to recover the input tax its representatives incurred on the demo items on the basis that these were costs of the supplies on which it was obliged to account for output tax.

HMRC policy remains that, VAT incurred by unregistered representatives of Avon on their purchase of demo items cannot be offset against VAT on the sales to final consumers.

Derek Allen

14 May 2014

The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.

This podcast concentrated on VAT. The next VAT podcast will be on 13 June 2014
There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 30 May 2014.