VAT update – May 2016

In this edition of the VAT update we look at:

1. Composite supply clarification on angling fees
2. Input VAT on acquiring single farm payment units recoverable
3. European Commission plan to modernise VAT
4. Tripartite contracts and the right to recover input VAT on a report for the lenders

1. Composite supply clarification on angling fees

Stocks Fly Fishery ('the Fishery') is based at Stocks Reservoir in the Forest of Bowland. The reservoir is 360 acres in size and has several miles of fishable shoreline. It is kept stocked by the Fishery with various kinds of trout, and attracts both bank and boat anglers.

An angler wishing to fish for sport for say half a day pays £13 and this is inclusive of VAT at the standard rate. However, if the angler wishes to keep some of the fish caught, they might pay £17.50 and this allows them to take 2 trout. The Fishery had been accounting for standard rate on the £17.50 but on reflection they submitted a repayment claim for the four years which are in date arguing that the additional £4.50 was for the supply of a zero rated food.

If two supplies were being made: one of fishing (taxable at the standard rate) and another of fish (trout) for human consumption (taxable at the zero rate), a substantial repayment would be due. The fishery argued that the sum of £4.50 should correctly be treated as zero-rated as explained in VAT Notice 742 paragraphs 6.4.1(a) to (c).

In summary, HMRC's case is as follows:

1 This was a single supply: Chalk Springs Fisheries (1987) (LON/86/706) Roger Cambrai Haynes (1988) (LON/87/624) and Card Protection Plan Ltd v Commissioners of Customs and Excise Case C-349/96 [1999] 2 AC 601; [2001] UKHL 4;

2 This was not a case in which the Fishery was making a separate charge solely for the fish taken away, within the meaning of Public Notice VAT 742 Paragraph 6.4.1(b), so as to allow the separate charge to be zero-rated as a supply of those fish;

3 The dominant purpose is fishing. The supply of fish is an ancillary purpose.

The tribunal decided that an angler had, as their primary or dominant purpose, the enjoyment and the recreational aspects and challenge of the sport in beautiful surroundings. This is to a large degree corroborated by the fact that a large proportion of anglers at the Fishery do fish simply for sport. An angler had no right to recover any money if they did not catch any fish.

HMRC were right to refuse the repayment claim as the supply was a single supply and standard rated.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j8976/TC04994.pdf

2. Input VAT on acquiring single farm payment units recoverable

Frank Smart & Son Ltd carries on a farming business in Aberdeenshire. This appeal is concerned with the company's entitlement to repayment of VAT amounting to £1,054,852.28 which it paid on its purchase of 34,477 units of Single Farm Payment Entitlement (SFPE). These units, which are tradeable, entitled the company, subject to fulfilment of conditions, to benefits under the EU Single Farm Payment (SFP) scheme. The issue arising in the appeal is whether the SFPE units were services used or to be used for the purposes of the company's taxable business supplies, so as to entitle it to repayment of the VAT charged on them.

Input tax can only be recovered if the expenditure is related to the making of taxable supplies. The primary position adopted by HMRC was that the SFPE units had been acquired for the purpose of obtaining the income from SFPs; that is, for the purpose of a non-economic activity outside the scope of VAT. Alternatively, it was submitted that the FTT had erred in law in holding that there was a direct

and immediate link between the cost of acquiring the SFPE units and the company's taxable economic activity so as to entitle them to a deduction of input tax.
It is the function of the First Tier tribunal to find the facts and a decision of the FTT can only be overturned on a point of law or if the evidence showed clearly that the facts found by the FTT were wrong. The UT ruled that the FTT was entitled to find that the purchase of the SFPE units was a 'wholly integrated feature of the farming enterprise'. In other words the input VAT incurred was recoverable as part of the overheads of the business. The UT ruled that the FTT was entitled to find that where costs were part of the business' overheads they formed a cost component of the price of the company's products, here beef cattle (which is a taxable zero rated supply), thus establishing the required link to enable input VAT recovery.

http://www.bailii.org/uk/cases/UKUT/TCC/2016/121.html

3. European Commission plan to modernise VAT

The European Commission has published a 14 page consultation paper proposing a single EU area for VAT. In the UK with the EU referendum approaching, this discussion paper might seem of dubious relevance. VAT now urgently needs reform:

- It needs to be simpler for businesses to use. Compliance costs are significantly higher in single market trade than in domestic trade, while complexity is stifling business, especially small and medium-sized businesses (SMEs)
- It must combat the growing risk of fraud. The "VAT gap" between expected revenue and revenue actually collected is estimated at EUR 170 billion, while cross-border fraud alone accounts for EUR 50 billion of revenue loss each year;
- It needs to be more efficient, in particular at exploiting the opportunities of digital technology and reducing the costs of revenue collection;
- It must be based on greater trust: trust between business and tax administrations, and between EU tax administrations.

According to the commission and to sum up, VAT needs to be modernised and rebooted. Reaching this goal will not be easy. The current system has proved difficult to reform and the requirement for unanimity between all Member States to change anything presents a serious challenge. Yet increasingly business as usual is not an option.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/action_plan/com_2016_148_en.pdf

4. Tripartite contracts and the right to recover input VAT on a report for the lenders

The criteria adopted by banks before making a loan have become stricter and some banks insist on an independent report before they will authorise a loan. In such a case, the question may become who is the customer and who can recover the input tax? Banks in such a case will not be able to recover the input tax which is incurred because the bank is making an exempt supply of loan finance.

The independent reviewer and report writer will wish to limit their exposure to risk and is likely to define in their engagement letter for whom the report is written and for what purpose. The terms of the engagement letter may be critical in determining whether VAT is a cost or can be recovered.

It is rare for tax disputes to get to the Supreme Court so they may make an interesting read. Lord Neuberger gave the leading judgement in favour of HMRC but in a 3-2 majority decision I sympathise with Airtours in **http://www.bailii.org/uk/cases/UKSC/2016/21.html**

Point at issue: whether Airtours Holidays Transport Ltd (formerly MyTravel Group plc), is entitled to recover, by way of input tax, Value Added Tax ("VAT") charged by PricewaterhouseCoopers LLP in respect of services provided by PwC and paid for by Airtours.

Facts: Airtours had been in serious financial trouble and wished to restructure its business. To do so it needed the financial support of many lending institutions and these sources of finance appointed PwC to prepare a report. The original terms under which PwC were appointed were contained in a letter dated 5 November 2002 ("the Letter"), which was addressed "To the Engaging Institutions", and headed "Silver Group plc [a code name for Airtours] and its subsidiaries …". The Letter contained a number of provisions, including the following:

> Para 1, which confirmed that PwC had "been retained by the Institutions as defined in para [4] to provide … 'the Services'", which were set out in an Appendix to the Letter, and as I shall refer to them. They included items such as "Current trading position", "historic cash utilisation", "Review of accounting policies and issues", and "Budget for year to 30 September 2003".
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> Para 4, which stated that the Report was "for the sole use of the Institutions who have expressly agreed to this letter … by countersigning below", and that the information and advice given by PwC could be passed to the Institutions, to whom PwC were prepared to "assume a duty of care" if they countersigned the letter.

I have underlined and emboldened the words "sole use" because I think it illustrates a mistake made. The outcome would probably have been different if Airtours had been included in the list of customers who could use the report. In tax it is often the way that things were done which determines the outcome. Airtours contracted with PwC to pay its fees, rather than one in which Airtours received something of value from PwC to be used for the purpose of its business in return for its payment.

The Court of Appeal had found as a majority for HMRC denying Airtours the input tax but the dissenting judgement observed that the economic reality was that Airtours were paying for something to help them make taxable supplies. This is the old form and substance argument but in deciding in favour of denying the recovery of input tax, the Courts are relying on the exclusion within the engagement letter.

Lord Neuberger's judgment is an interesting analysis of contract terms and contract law. Para 23 of the judgment is the key which states: "Not least because the Terms are in a standard form, which has been poorly adapted, and whose provisions are inconsistently drafted, the issue whether PwC had a contractual obligation to Airtours to provide the Services to the Institutions is not entirely easy. Nonetheless, I have reached the clear conclusion that PwC's commitment to provide the services as described in the Contract was a contractual commitment to the "Engaging Institutions", and not to Airtours."

The dissenting judgement of Lord Carnwath at para 81 observes: "To rest on a narrow legalistic approach to the construction of the contract seems particularly inappropriate in a case where the distinction between services to Airtours and services to the Banks is unlikely to have been seen as of any practical significance to the parties, and probably for that reason was not addressed in detail in that contract. Nor was it ever put to the test. Once PwC had been engaged, there was never any question of its not completing its task, with the co-operation of both Airtours and the Banks, and for the benefit of both. A hypothetical analysis of how the contract might have been given effect in circumstances which were never contemplated and never happened, seems a sterile exercise."

I think that there is a clear lesson here. Airtours did not receive any supply from PwC (despite the fact that the company was the party liable to pay for the work) and hence that it was not entitled to reclaim the VAT charged by PwC. If you have a client in similar circumstances and requiring an independent report for financial institutions, make sure that the client is included in the customers who may use the report.

Derek Allen
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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. There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 31 May 2016.