Briefing

The VAT review for May

Speed read

In *Zipvit Ltd*, the Supreme Court has referred to the CJEU questions concerning the availability of input VAT recovery where a supply was historically incorrectly treated as exempt. In *NHS Lothian Health Board*, the Court of Session has suggested that the tribunals have taken an overly strict approach to the evidence required to support historical claims for input VAT recovery going back as far as 1973. The correct contractual analysis of arrangements and its importance for the VAT analysis is again a feature of the *Virgin Media* case on prompt payment discounts. Finally, the government has announced a number of indirect tax measures in the wake of the coronavirus pandemic.

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VAT invoices and input VAT

Following the CJEU's clarification of the Royal Mail's VAT exemption in *TNT Post UK* (Case C-357/07), it became clear that postal supplies made by the Royal Mail to Zipvit Ltd, although originally treated as exempt, should have been standard rated. However, as Royal Mail treated the supplies as exempt, it neither charged VAT nor provided Zipvit with a VAT invoice in respect of the supplies. In addition, HMRC was either out of time to claim output VAT from the Royal Mail or considered that the Royal Mail would have had a defence of legitimate expectation to such a claim, based on HMRC's published guidance at the relevant time. Accordingly, no VAT was paid on historical supplies covered by the CJEU judgment. Nevertheless, Zipvit sought to recover input VAT on those supplies on the basis that the amount it had paid should, retrospectively, be treated as having been VAT inclusive.

Article 168(a) of the Principal VAT Directive (2006/112/EC) provides that a trader who is a taxable person has an input VAT entitlement for 'the VAT due or paid … in respect of supplies to him of goods or services'. Zipvit argued that the amount it paid must be treated as having included an amount of VAT embedded in the sum paid. On the other hand, HMRC pointed to the fact that the amount paid by Zipvit was VAT exclusive and the contractual arrangements between the Royal Mail and Zipvit required Zipvit to pay any VAT on top of the commercial price for the supply. As such, to allow Zipvit to reclaim input VAT now would have both involved a financial windfall for Zipvit and an unmerited retrospective re-writing of the commercial arrangements. HMRC also argued that asymmetrical reliance on the Directive is not permitted, whereby a trader both takes advantage of an exemption in national law (which is not in fact authorised by the Directive) in relation to supplies and seeks to deduct input VAT in relation to those supplies.

Even if the supply to Zipvit should be treated as including embedded VAT, Zipvit did not hold a VAT invoice. However, Zipvit contended that the case law of the CJEU indicates that there is an important difference between the substantive requirements to be satisfied for a claim for input tax and the formal requirements which apply in relation to such a claim (including those in relation to the production of a VAT invoice in accordance with article 226). The approach is strict in relation to the substantive requirements, but departure from the formal requirements is permissible if alternative satisfactory evidence of the VAT which was paid or is due can be produced by the trader. Zipvit contended that it had provided such evidence of the embedded VAT. Whilst HMRC accepted that it has a discretion to accept other evidence, it contended that it was correct not to accept any such evidence as to do so would result in an unmerited windfall for Zipvit, by obtaining in effect a reduction in the commercial price it had had to pay for the services.

The Court of Appeal held that the absence of a VAT invoice specifying the amount of VAT payable prevented Zipvit recovering input tax on those supplies. The Court of Appeal concluded that VAT invoices are crucial in allowing HMRC to verify that VAT has been charged by a supplier.

On appeal to the Supreme Court, however, the court has concluded that neither of these issues are *acte clair* (*Zipvit Ltd v HMRC* [2020] UKSC 15). Accordingly, it was necessary to refer questions to the CJEU to determine the appeal, both concerning the question of 'embedded VAT' in these circumstances and concerning the importance of the need for a VAT invoice.

Why it matters

The strict requirement for a VAT invoice to recover input VAT in the UK is of universal interest. The *Zipvit* case is also the lead case behind which sit a large number of taxpayers who find themselves in similar circumstances as a result of contractual obligations with the Royal Mail. The ultimate decision will, therefore, be important both financially and also in refining the ability of a trader to claim as input VAT part of the commercial price paid in such circumstances.

Flexible approach required to historical VAT reclaims

In *NHS Lothian Health Board v HMRC* [2020] CSIH 14, the Court of Session has suggested that EU principles require the UK tax tribunals to take a flexible approach to the requirement that a taxpayer must provide evidence of the amount of a VAT reclaim in historical cases.

The case concerned a claim for the repayment of input VAT for the period from 1974 to 1997. The taxpayer had operated laboratories which were used mainly for NHS work (non-business) but partly for taxable non-NHS work (business activity). However, input VAT attributable to this business activity was not reclaimed under the general practice at that time. Following the *Fleming* case (*Fleming (trading as Bodycraft) and Condé Nast Ltd v HMRC* [2008] STC 324), the taxpayer sought to recover that historical VAT. It was essentially accepted that the board had had a right to recover the VAT, but HMRC rejected the claim on the basis that there was insufficient evidence as to the correct amount of recoverable input VAT. Both the First-tier Tribunal (FTT) and Upper Tribunal accepted HMRC's argument.

The Court of Session recognised that the fundamental problem in most historical claims is the availability of evidence to support a claim for repayment. Financial records may have been destroyed, in whole or in part, and the consequent lack of primary documentation may make proof of a claim difficult or impossible. That was the situation here, though the board had evidence from the year 2006/07, which had been accepted by HMRC. However, the tribunals considered extrapolating those figures back to 1974 was 'not sufficiently precise' for the claim to succeed.

The Court of Session stressed that it was important to bear in mind the EU principles of effectiveness and proportionality in this context. The fundamental right to repayment of overpaid VAT, guaranteed by EU law and the principle of effectiveness, meant that even if the taxpayer's methodology for calculating the amount of repayment were rejected, HMRC and the tribunals were not permitted to completely reject the taxpayer's claim for repayment of input VAT solely on the basis of difficulties of proof. Moreover, the appropriate course was for the tribunals to make findings of fact on the basis of the evidence that was available and to rely on those in determining an appropriate amount of repayment of input VAT.

In historical claims, where much of the evidence is inevitably lacking, the tribunals should proceed on the basis of the evidence that is available, adopting a flexible approach. The critical question is whether, on the basis of that evidence, it is possible to hold that the taxpayer has proved its calculation of unrecovered input tax on a balance of probabilities; in other words, whether the taxpayer's calculation is, at a general level, more likely than the contention that no unrecovered input tax, or a much lesser amount of such tax, is due.

It should be noted, however, that the court also indicated that the responsibility for the failure to make the claims when full evidence was still available is an important feature. In *Fleming*-type cases, that responsibility will often lie with the state due to the existence of legislation that did not satisfy the EU law right to recover input tax.

Why it matters

There remain many unresolved cases of historical *Fleming*-style input VAT reclaims. Many are unresolved due to similar problems with proof and evidence. This decision will give hope for those taxpayers that their claims may now be resolved to their satisfaction. However, given the importance of the decision, it seems highly likely that HMRC will appeal to the Supreme Court.

Prompt payment discounts

In *Virgin Media v HMRC* [2020] UKUT 100, the Upper Tribunal confirmed the earlier decision of the FTT that the consideration for VAT purposes paid by monthly payment customers of Virgin Media for the provision of a connection to a telecoms network and related telephony services was not affected by the availability of a cheaper annual saver price.

Virgin argued that the provisions of VATA 1994 Sch 6 para 4 were applicable. At the time, these provided that where goods or services are provided on terms allowing a discount for prompt payment, the consideration for VAT purposes was the discounted price, whether or not payment was actually made in accordance with those terms. Virgin offered both a monthly contract price (at £13.90 per month) or a lower annual saver price (at £120 per annum). It argued that the prompt payment discount provisions meant that it was only liable to account for VAT on the basis of the lower annual saver price, even in relation to its supplies to monthly customers.

The Upper Tribunal has essentially agreed with the analysis of the FTT that the contractual arrangements involved two different sets of supplies to saver and monthly customers. Whilst the underlying service provided to both customers was the same, the different pricing reflected the different contractual terms and obligations/entitlements. In particular, the monthly contract allowed customers the flexibility to terminate on one month's notice, whilst the saver contract entitled a customer to 12 months service but with no right to terminate. The arrangements in this case did not simply provide for a prompt payment discount, but involved different contractual rights and obligations.

More generally, the Upper Tribunal considered that the difference between a set of terms which provided for £13.90 per month and a different set of terms which provided for £120 for 12 months could not be said to involve 'a discount for prompt payment'. The fact that one was less than the other did not make it a 'discount' and even if it did, the discount was not 'for prompt payment'.

Why it matters

The decision is another which emphasises the importance of the contractual terms to the correct VAT analysis. However, it should be noted that the provisions dealing with prompt payment discounts were amended with effect from 1 May 2014. They now only apply where the payment is actually made in accordance with the terms so that the discount is actually obtained.

Covid-19 VAT measures

Deferral of quarterly UK VAT payment

The government has announced that businesses will be temporarily relieved of the need to make their next quarterly UK VAT payment. Any VAT payable between 20 March and the end of June 2020 is deferred. This relief is automatically available for all businesses and there is no requirement to make an application. Businesses may continue to pay VAT as normal, but if they do take advantage of the deferral then any deferred VAT will be payable by 31 March 2021. VAT refunds and reclaims will be paid by the government as normal and businesses will still need to submit their usual VAT returns in this period.

Where the VAT payment is collected by direct debit, the direct debit will need to be altered or cancelled or the money may be collected automatically.

There are some restrictions on the relief. For example, it does not apply to import VAT or any VAT due under the VAT mini one stop shop (MOSS) scheme.

Relief for imports of medical equipment

Separately, the government also announced relief for imports of certain medical equipment. From 31 March until 31 July 2020, certain imports of medical and protective equipment brought into the UK from non-EU countries during the Covid-19 pandemic will not attract import VAT and customs duty. The equipment covered will include items such as protective equipment and clothing, cleaning equipment and disinfectants, test kits and ventilators.

The relief is subject to a number of conditions. It will apply where the goods are imported:

- for distribution or to be made available free of charge to those affected by, at risk from or involved in combating Covid-19;
- imported into the UK for donation or onward sale to the NHS; or
- for disaster-relief agencies' own use.

The goods must be imported by or on behalf of an organisation based in the UK which is: a state organisation, including state bodies, public bodies and other bodies governed by public law; or other charitable or philanthropic organisations approved by the competent authorities.

Why it matters

The unprecedented challenges thrown up by the Covid-19 have led to unprecedented government action. The temporary VAT deferral for all businesses and specific exemption for imported medical and protective equipment are just two measures among many introduced to lessen the economic impact of the pandemic and secure timely supplies of necessary medical equipment.

What to look out for

- The CJEU judgment in *Dong Yang Electronics* (Case C-547/18) concerning the circumstances when a separate legal entity such as a subsidiary should not be capable of being treated as a fixed establishment of another entity is due to be released on 7 May 2020. The advocate general's opinion suggested a far more restrictive approach to fixed establishment by agency than historically applied.
- The CJEU decision in *AGROBET* (Case C-446/18) concerning the question whether a tax authority is able to defer the refund of excess VAT even though only a small part is still the subject of an ongoing tax inspection is due to be delivered on 14 May 2020.
- The deadline for comments on HMRC's consultation document, *Notification of uncertain tax treatment by large businesses*, which was originally 27 May 2020, has been extended to 27 August 2020. ■

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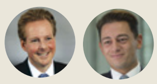
- Cases: *Zipvit v HMRC* (3.4.20)
- Cases: *NHS Lothian Health Board v HMRC* (22.4.20)
- Cases: *Virgin Media Ltd v HMRC* (22.4.20)
- 20 questions on tax and Covid-19
- Peter Clements, Sarah Bond, Josh Critchlow & Laura McDaniel, 22.4.20)

1. Tax and Covid-19
Peter Clements, Sarah Bond, Josh Critchlow & Laura McDaniel (Freshfields) provide an in-depth review.



2. How to handle tax appeals
A 20 questions guide, by **Adam Craggs & Constantine Christofi (RPC)**.

3. Notifying HMRC of uncertain tax treatments
Creating transparency or confusion? **Ian Hyde** and **Matthew Greene** (Osborne Clarke) examine what's proposed.

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