

VAT focus

The VAT review for November

Speed read

This month's review covers the CJEU decision in the *United Biscuits* case which may wrap up the long series of cases since the original *Wheels* appeal on the application of the VAT exemption for fund management services to pension funds. There is also confirmation from the CJEU that the mere fact that a third-party benefits from expenditure incurred by a taxpayer does not mean that the taxpayer's ability to recover input VAT on that expenditure is restricted. Another long running case, the *Ocean Finance* economic reality case, has returned to the FTT which has reaffirmed its original 2010 decision that arrangements involving sub-contracting large parts of the business to a connected entity to obtain a VAT advantage were not abusive. Finally, HMRC has released further guidance on the ability of persons to recover input VAT on imports of goods which will be particularly important in the context of postponed accounting due to come in from 1 January 2021.



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United Biscuits case crumbles

In *United Biscuits (Pension Trustees) Limited v HMRC* (Case C-235/19), the CJEU has followed the opinion of Advocate General (AG) Pikamäe in rejecting the contention that pension fund management services fell within the scope of the VAT exemption for insurance in article 135(1)(a) of the Principal VAT Directive (PVD).

The decision is the latest (and perhaps the last?) in a long running series of cases dealing with the VAT treatment of pension fund management. On this occasion, the CJEU has concluded that there was no basis for treating pension fund management as an insurance transaction for VAT purposes (despite its appearance in certain insurance directives).

It had long been HMRC's policy to treat supplies of pension fund management by insurers as falling within the insurance exemption contained in article 135(1)(a). Based on this, the trustees of the United Biscuits pension

fund argued that supplies of such management should be treated as exempt whether provided by insurers or non-insurers alike. HMRC later announced that it would no longer treat supplies of pension fund management by insurers as an exempt supply of insurance with effect from 1 April 2019. The High Court rejected the claim, but the Court of Appeal considered it necessary to refer questions to the CJEU.

The CJEU noted that the fundamental feature of an insurance transaction was that the insured protects themselves against the risk of financial loss by means of payment of a premium. Clearly the investment fund management in this case fell outside that concept.

United Biscuits pointed to the inclusion of 'management of group pension funds' in the First Life Directive and the fact that the CJEU had previously held that the scope of the VAT exemption for 'insurance' must be aligned with the scope of 'insurance' in the wider European insurance directives. However, the court agreed with the assessment of the AG that it was necessary to distinguish between 'insurance' and 'other operations' in that Directive and investment management only fell into the latter category. Those 'operations' were related activities closely linked to insurance activities. They were therefore ancillary transactions, which are covered by the First Life Directive and the legislation replacing it, but do not constitute 'insurance' within the meaning of the directives on insurance matters.

As regards the fiscal neutrality argument, the AG had simply concluded (without any great analysis) that the fact that the UK (incorrectly) granted exemption to pension management services provided by insurers could not constitute an argument for bringing non-insurance activities within the concept of an insurance transaction. The CJEU appears to have given even less time to this argument and completely ignored it in its judgment.

Why it matters

The decision ultimately applies a limited concept of insurance in both the insurance and VAT Directives, requiring the acceptance of risk for the payment of a premium, and pension fund management does not fall within that concept. There are many claims that have been stood behind this decision and those affected businesses will need to carefully consider the decision and its implications for their rejected claims.

Input VAT on expenditure benefiting third parties

The recent decision of the CJEU in *Vos Aannemingen BVBA* (Case C-405/19) confirms that the mere fact that a third-party benefits from expenditure incurred by a taxable person will not prevent that taxable person recovering in full the input VAT on that expenditure.

The case concerned the construction and sale of apartments in Belgium. The taxpayer company (VAB) built and sold apartments which it erected on land belonging to third parties. On the sale of the apartments, the undivided shares in associated land was sold by the landowners directly. As part of the arrangements, VAB contracted for and paid the costs of the sale including advertising and administrative costs as well as estate agents' commission and then deducted the associated VAT in full. The Belgian tax authorities considered that, since the landowners also

benefited directly from these costs, VAB should not be entitled to full input VAT deduction. Following appeals through the Belgian courts, the matter was referred to the CJEU.

The CJEU has held that the mere fact that expenditure incurred by a taxable person also benefits a third party does not prevent that taxable person deducting in full the input VAT paid on that expenditure where there is a direct and immediate link between that expenditure and the taxable person's economic activity and the benefit to the third party is ancillary to the taxable person's business purposes. On the question of whether the benefit to the third party is merely ancillary, the court indicated that 'the benefit to the third party must flow from a supply of services made in the taxable person's own interest'.

However, that would not be the case if there was not merely a direct and immediate link with a supply made to the taxable person (or the taxable person's business as a whole), but also a direct and immediate link with the supplies made by the third party. Accordingly, the court replied if it turned out that part of the services had been used not for the purposes of VAB's construction and building sales, but for the purposes of sales of land by third parties, the existence of a direct and immediate link between those services and VAB's taxable transactions would be partially broken: VAB would not be entitled to deduct the VAT charged on that part of the expenditure. It was, however, up to the domestic court to determine if that was the case here.

Finally, the court held that the mere fact that VAB could have passed on some of the cost of the services to the landowners was not sufficient to prevent it deducting the VAT in full. However, the court did indicate that the fact that it is possible for a taxable person to pass on to a third party part of the expenditure incurred in respect of services, might give some support to the conclusion that that part of the expenditure relates not to the transactions carried out by the taxable person but to the transaction carried out by the third party.

Why it matters

The decision is an interesting one with some clear parallels to the tripartite arrangement cases that have followed *Redrow* in the UK. However, in leaving the decision as to whether the expenditure in this case was, to some extent, directly attributable to the sales of land to the domestic courts to decide on the facts, there will inevitably be a degree of uncertainty around this issue. It is worth noting that, if VAB was ultimately successful in its claim, it would appear to result in full input VAT deduction for costs which are, in part at least, related to exempt sales of land in Belgium.

Abuse of rights

The First-tier Tribunal has reconfirmed its original decision in *Newey (trading as Ocean Finance) v HMRC* [2020] UKFTT 366 some ten years after the original hearing. The long-running case involves arrangements put in place to save VAT on the receipt of advertising services and involved the setting up of a wholly owned Jersey based company, A, to take over loan broking services previously provided by a UK business. However, A continued to sub-contract the administration services of the original UK business in order to enable it to carry on the loan broking activities. The tribunal considered that nothing in the intervening decisions of the CJEU

or the Court of Appeal required it to reach a different conclusion to its original determination that there was nothing abusive in arrangements.

While accepting that the essential aim of the arrangements was to obtain a VAT advantage, the FTT held that the scheme was not contrary to the purposes of the VAT Directives. In particular, since genuine supplies were made by A, there was no basis on which arrangements which prevented VAT (which would have been irrecoverable) being incurred could be abusive.

Following the original decision, the UK courts referred questions to the CJEU. The CJEU suggested that even though, formally, A provided loan broking services and received advertising supplies under the contractual arrangements, 'taking into account the economic reality of the business relationships ... and the matters of fact, it is conceivable that the effective use and enjoyment of the services at issue in the main proceedings took place in the United Kingdom and that Mr Newey profited therefrom'.

When the case returned to the UK courts, the Court of Appeal considered that the FTT had erred in law in its approach to the application of the principle of abuse of law to the facts of this particular case and that the case should be remitted to the tribunal for reconsideration with the benefit of the guidance of the CJEU on 'economic reality'.

In particular, merely choosing a particular structure for tax driven reasons could not make it abusive. The critical question was how the analysis of the transactions from a VAT perspective was affected by the fact that the Jersey structure was set up on the instructions of Mr Newey as part of a tax avoidance scheme designed with the sole objective of relieving him of the burden of irrecoverable input VAT. In this context, the question of artificiality must be assessed by reference to the business relationships actually entered into between Mr Newey and others, with a view to testing whether they reflected underlying commercial reality.

In this context, the Court of Appeal acknowledged that the question of whether arrangements are 'wholly artificial' should not be seen as the sole test of whether contractual arrangements reflect economic and commercial reality. It was clear from the judgment of the CJEU that 'total artificiality' is not an invariable requirement and should merely be seen as a paradigm example of such a case and that 'contractual arrangements can be found to be abusive even if they are genuine and play a part in arrangements which have an overall commercial purpose'.

The FTT has now reaffirmed its original decision. It considered that, based on its findings of fact as to the way in which the business was run, the business relationships actually entered into between the businesses concerned did reflect economic and commercial reality and did not constitute a wholly artificial arrangement which did not genuinely reflect economic reality.

Why it matters

Whilst the decision is limited to its specific facts, it does indicate that merely sub-contracting large parts of a business' operations to a connected but separate entity in order to obtain a VAT advantage will not of itself render those arrangements abusive or contrary to economic and commercial reality. It is important

that contractual arrangements reflect reality, and so operational implementation of any such arrangements is critical. However, this may not be the end of the road for this long running case as it seems highly likely that HMRC will seek to appeal the decision once again.

Review of import VAT deductions

HMRC has published *Revenue & Customs Brief 15/2020* presenting its conclusions on its review of the ability of non-owners to recover import VAT as input VAT. This may arise where, for example, a business sells the goods just before importing them into the UK so ownership and title has passed to the new owner, but the business that sold the goods acts as 'importer of record' on UK import declarations and pays the import VAT.

The review restates HMRC's previous position (set out in *Revenue & Customs Brief 2/2019*) that the correct position is that only the owner of goods may generally recover import VAT as input VAT, even where that import VAT is paid by another business.

The brief addresses several concerns regarding the application of the policy. In particular, HMRC looked at a number of specific examples including agents, warehousing and goods imported under a number of special procedures. As regards agency arrangements, HMRC points out that there is, though, the option under VATA 1994 s 47 for the agent to be treated as importing and supplying the goods as principal. In these circumstances, the agent can reclaim the import VAT as input tax, but it must treat the transactions as a supply by them and charge and account for VAT on the onward sale.

Why it matters

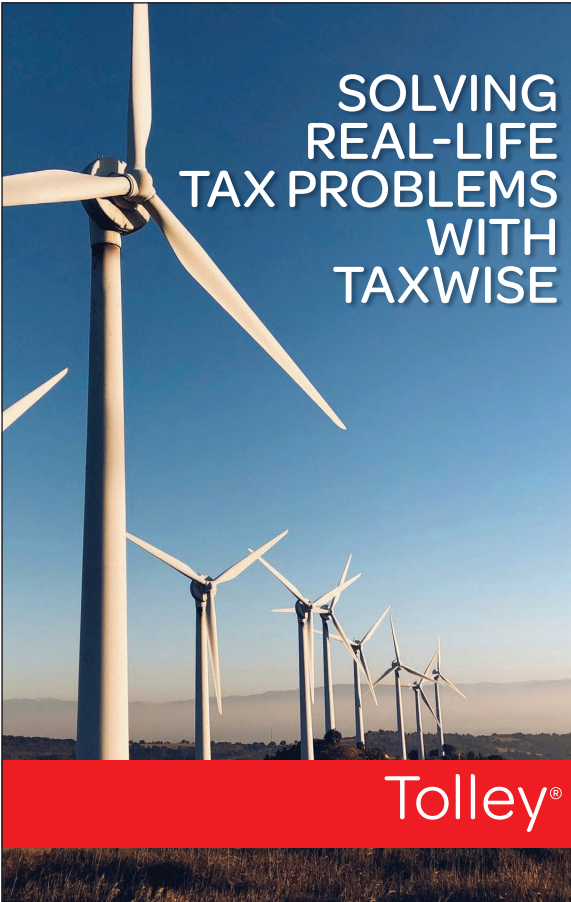
Ensuring the correct administration of customs procedures, including identification of the 'importer of record', will become even more important after the end of the transition period. The brief also explains the interaction with postponed VAT accounting from 1 January 2021 when it may be important to ensure that it is the relevant UK business that is importing the goods as owner so that they can declare and recover import VAT on the same VAT return, subject to the normal rules on input tax deduction.

What to look out for

- The closing date for responses to HM Treasury's call for evidence on VAT grouping is 20 November 2020.
- On 12 November, the CJEU is expected to hand down its judgment in *Sonaecom* (Case C-42/19) concerning the ability of a holding company to recover input VAT on costs associated with an aborted acquisition.
- Judgment of the CJEU is expected on 12 November in *ITH Comercial Timișoara* (Case C-734/19), which also concerns questions in relation to the right to deduct VAT in relation to investment expenditure where the intended taxable transactions to which it has been attributed are subsequently abandoned. ■

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- ▶ Cases: *United Biscuits v HMRC* (14.10.20)
- ▶ Cases: *Vos Aannemingen BVBA v Belgische Staat* (7.10.20)
- ▶ Cases: *P Newey (t/a Ocean Finance) v HMRC* (24.9.20)



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