What's on

Indirect Tax

02 October 2015

Action by members – We welcome all comment by members. We cannot always respond personally to all emails but do try to keep members informed. To comment on any issue in ITV please email indirecttax@ciot.org.uk.

Engagement with HMRC, the EU and other policy makers

We have had a number of recent interactions with HMRC including:

- A meeting with HMRC policymakers to discuss proposed legislation that would potentially restrict the amount of deductible UK VAT attributable to the management of foreign branches. This was in addition to a submission made to HMRC on the subject. HMRC have recently advised that as a result of feedback received from respondents, the proposed legislation will not be tabled in August as originally planned and will now be re-examined.
- On 10 June, the Chairman, Vice Chairman and technical officers met with a number of people from HMRC led by Ian Stewart, Director of Indirect Tax Directorate. We agreed a number of actions ranging from highlighting priority areas of HMRC's guidance that need improvement to working closer with HMRC in our VAT educational activities. Members of the Indirect Taxes Sub-Committee have been provided with notes of the meeting.
- We have also agreed to provide additional input into HMRC's Joint VAT Consultative Committee (JVCC) to ensure the agenda items better reflects taxpayer-led issues. We are working together with our representative on the JVCC, Tony Jackson, to strengthen HMRC's understanding of the needs of taxpayers.
- Our Vice Chairman, Alan McLintock, attended a meeting of HM Treasury's VAT Forum on 22 June 2015 discussing issues such as Skandia, the standardised VAT return, the work of the OECD, the future of VAT and the digital economy.
- Our representatives have also attended HMRC's Land and Property Liaison Group, The Finance Liaison Group and other specialist forums.

We are arranging discussions with the European Commission on selected VAT topics and of course continue to be represented by Tarlochan Lall and Peter Mason on the VAT Expert Group set up by the European Commission. We are expecting a number of technical documents to be released within the next month or so including coverage of Welmory, Skandia and proof of export issues.

Budget – 8 July 2015

We prepared a Press Release on the removal of the exemption from Climate Change Levy for certain renewable energy supplies. Our call on the Government to produce a 'roadmap' setting out its plans for the future of environmental taxes was mentioned in the Finance Bill debates on two occasions. See below for further details of future work in this area.

We will be making a submission to HMRC on Climate Change Levy and the proposals to extend the "use and enjoyment" provisions in VATA 1994. The latter is an attempt to prevent perceived avoidance of VAT on repairs undertaken under UK insurance contract. The use and enjoyment provisions will be further extended at a later date. Please send any comments you may have to indirecttax@ciot.org.uk.

Default surcharge – update

We have recently reported on on-going work with HMRC regarding the default surcharge where we commented on draft letters that HMRC intended to use to warn taxpayers of impending action. Having been brought into use in June, we have been informed by HMRC that the new communications are having a positive impact. We are continuing to liaise with the Indirect Tax Process team to encourage further improvement.

Prompt payment discounts

We surveyed members for comments on how the changes to the default surcharge regime was affecting them. We received 62 responses. We will be reviewing the comments and will write to HMRC if appropriate.

The CIOT's Dispute Resolution and Litigation Group

Members have again expressed concern that important opinions of the Advocate General are not released in a timely manner in English (Skandia, Sveda and Saudaçor being three recent examples of important cases and there have been more cases since). We are considering writing to the Court again to suggest that they might consider prioritising cases that are translated to reflect those most important to the different countries but are undertaking further research before doing so. A draft response has been prepared for consideration.

Last month we mentioned a survey of members on taking appeals to the First-tier Tribunal. The results are currently being analysed in preparation for the next meeting of the DRLG on 1 October. The results of the survey questions that concern the charging of fees in the FTT and UTT will be used to inform the response to the current Ministry of Justice consultation on Tribunal fees.

Property issues

Draft Revenue & Customs Briefs

HMRC asked members of the JVCC for comments on four draft revenue and customs briefs concerning buildings that form dwellings, permitted development, facades and annexes. See below for details.

Option to Tax delays

We continue to receive reports from members of excessive delays in the time it takes for the Option to Tax National Unit to respond to options that have been notified. With examples of it taking upwards of 40 working days and HMRC acknowledging a peak of 30-60 days, we are writing to HMRC to impress upon them the impact this is having on, often, time critical transactions.

Further details of this can be found in our article in Tax Adviser. To assist with our submission, please provide brief details of any delays experienced to indirecttax@ciot.org.uk.

Excise duty

Alcohol Wholesaler Registration Scheme – action required

The Alcohol Wholesaler Registration Scheme (AWRS) is being introduced on 1 October 2015 by HMRC, aimed at tackling alcohol fraud. This significant legislative change will require most business-to-business vendors of duty-paid alcohol to be approved by HMRC as wholesalers of alcohol. Trading "wholesale" in this context means trading in any quantity of alcohol.

The new scheme will affect many businesses who would not be classified as "traditional" wholesalers or even consider their business to be "wholesale". In addition, retailers will have to check that their suppliers are approved by HMRC. HMRC will start to register existing wholesalers in a window from 1 October – 31 December 2015. We understand failure to comply will lead to severe sanctions as HMRC gets tougher in the fight against alcohol duty fraud. Alan Powell explains this in further detail in September's edition of Tax Adviser.

Vapour Recovery Scheme: HMRC consultation

Affecting businesses in the petrol supply chain, including oil producers and petrol retailers, the Vapour Recovery Scheme is an extra-statutory concession that enables producers to claim a credit of duty already paid on petrol vapour that has escaped when petrol is loaded and unloaded in the supply chain. HMRC now acknowledge that this ESC is ultra-vires and are consulting on two options to replace it. The consultation can be accessed via this LINK.

In addition to excise duty, there are commercial implications, tax neutrality and unjust enrichment issues. We are currently preparing a submission on this issue.

Warehouse approval delays

Following our recent submission (see below), we have been invited to meet with HMRC to explore this further and discuss action that HMRC have taken recently to strike a balance between facilitating trade and exercising effective control over these regimes.

Environmental Taxes

The surprise announcement in the Summer Budget that the Climate Change Levy (CCL) exemption for renewable energy is to be removed poses questions about the future of environmental taxation. We have called on the Government to produce a 'roadmap' setting out its plans for the future of environmental taxes, to help the renewable energy industry and business in general take long-term investment decisions.

CCL was introduced as an 'environmental tax' – intended to change polluting behaviours and to assist in meeting the UK's obligations for reduced carbon emissions. The exemption encouraged use of renewable sources of energy over traditional carbon fuels. The removal of the exemption effectively turns CCL's status from an environmental tax into a revenue raising tax on energy – almost £4 billion over the life of this Parliament. Affecting generators of renewable source electricity, energy market participants and suppliers of such electricity to business and public sector consumers, the complexities arising for both suppliers and business customers may be more than suggested in the Budget announcement and additional energy costs to businesses will either have to be absorbed or, more likely, passed on through higher prices.

There will be a transitional period from 1 August 2015, during which electricity suppliers may be able to continue to exempt renewable source energy generated before that date. The length of the transitional period will be discussed with interested parties.

The announcement that the Government intends to consult in the Autumn over business energy taxation is welcomed by the CIOT, particularly where the focus is on simplification and certainty. The CIOT's Environmental Taxes Working Group, led by John Brewis, will continue to monitor developments in this area and it is currently preparing a submission on the impact of the CCL changes to the Public Bill Committee Sittings stage of the Finance Bill. If you would like to be involved in the Environmental Taxes Working Group please email indirecttax@ciot.org.uk.

Footnote: We were pleased to note that our Press Release (see under Budget – 8 July 2015), which called for the publication of an environmental taxes roadmap clearly struck a chord with some MPs – it was referred to at least twice in the Parliamentary debates on the Finance Bill.

The Office of Tax Simplification

The OTS has issued a paper on areas for simplification. We will be writing to them to suggest further areas that merit examination including partial exemption, the treatment of charities and issues arising because of delays in the option to tax unit.

Pre-registration input tax

HMRC used to allow a deduction in full for VAT incurred on goods acquired before registration but 'on hand' at the date of registration. However, members have made us aware of a recent shift in HMRC policy that appears to have been made without any public announcement and without amending or publishing new, clear guidance. It is taking some taxpayers and their advisers by surprise that HMRC now require an apportionment to be made to reflect use of the goods prior to registration.

We see there are two issues to be addressed:

1. Communication & Guidance

   Whilst there may be valid technical reasons to apportion pre-registration input tax on goods on hand at the date of registration, it has not been the practice to do so until recently. There has been no public announcement of a policy change and it is only HMRC Internal manuals (VIT32000) that refer to a use based apportionment. VAT Notice 700 does not make this clear and has not been updated to reflect the change. Taxpayers looking at the guidance on the Gov.uk website are given a simpler picture and can understandably conclude that all pre-registration VAT is recoverable subject to the 4 year cap for goods and 6 month cap for services. This disparity in practice and guidance is both confusing and misleading for business.

   Given the change in policy, the concept of legitimate expectation could warrant the introduction of a transitional period allowing persons who planned the set-up of a business on the assumption that the VAT would be deductible under what was previous practice to have the benefit of it.

2. The technical position and the interaction of UK and EU Law The technical nuances of this issue are complex. Whilst there may be valid arguments that the correct position is to have a use based apportionment, it raises the question of whether this is authorised by the current UK VAT legislation when

read in conjunction with Indirect Tax Voice | Issue 03 | August 2015 15 the relevant EU law?

The theoretical position under EU law is that a person is a taxable person if they commence an economic activity (as opposed to the UK legislation "business"). However, the relief for small businesses allows Member States to exempt the turnover of a business where it does not exceed a particular threshold. The actual wording of Article 282, PVD is “The exemptions … provided for in this section shall apply to the supply of goods and services by small enterprises.” (emphasis added). This means that the business is a ‘taxable person’ but if its turnover is under the registration threshold, its supplies are exempt. Art 289 states that if you are exempted from registration by virtue of the special provisions for small businesses you are seen by EU law as a taxable person exempt from VAT who “shall not be entitled to deduct VAT…”

However, UK law has not properly implemented the PVD correctly as it treats a person who is not registered (or required to be registered) by virtue of VATA 1994 as not being a taxable person. The deduction of VAT incurred prior to registration is governed by reg 111, VAT Regulations 1995/2518. This allows a person who has registered as a taxable person under VATA 1994 to treat VAT incurred on goods and services supplied prior to registration as input tax. Under UK legislation it is not in fact “input tax” but is treated as such at the discretion of the Commissioners.

For services, the VAT can only be recovered if it was incurred not more than six months prior to registration. In respect of goods, the goods must be on hand at the date of registration ie they must not have been supplied or consumed.

Thus, if VAT is incurred before registration and is wholly used for the purposes of taxable activity occurring after registration, the whole of the VAT is deductible. However, if VAT is incurred on supplies before registration and is used wholly or partly for what are supplies that are exempted from VAT, then to that extent the VAT should not be deductible because under UK law it is not input tax as defined but VAT that is treated as input tax. (Note: there was a tribunal case that said that the de-minimis limits do not apply to preregistration VAT.)

HMRC now appear to have withdrawn from their previous practice of allowing full deduction (which they were allowed to apply) and are now interpreting the UK law (regulation 111) in accordance with EU law. Note that regulation 111(2)(a)(ii) prohibits a deduction for goods that have been consumed unless HMRC otherwise agree so it is arguable that they may well be applying the correct policy (from an EU law perspective).

In summary, the UK legislation appears to permit an apportionment, but as HMRC’s previous policy was to allow full deduction, there does appear to be an issue with legitimate expectation. The change in policy should arguably have been applied only after reasonable notice was given to taxpayers. We shall be writing to HMRC calling for a policy announcement to be made along with updated, consistent guidance and for a transitional period before the policy change is implemented to allow businesses to adjust. We have recently brought these issues to HMRC’s attention at the Joint VAT Consultative Committee along with the ATT. We welcome your comments on this issue.

Additional technical issues to note – pre registration input tax:

- The UK has not implemented the PVD correctly in relation to the adjustment mechanisms in articles 184 to 192 of the PVD. These articles provide for the adjustment of the deduction of VAT. There are two circumstances: change in use of capital items and change in use of other goods or services. In the UK, the adjustments are provided for in the capital items scheme and regulations 108 and 109 but, as noted, there are then separate provisions in regulation 111 which need to be read in the context of articles 184 et seq. In essence, they constitute partial implementation of the change of use provisions.

- Regulation 111 potentially allows adjustments that would not apply to a business that had changes of use covered by regulations 108 or 109 or the capital items scheme; eg an asset (that is below the capital items threshold) used initially for exempt use but later used for taxable use. Regulation 109 does not apply because the initial use was for exempt supplies and the fact that they are subsequently used for taxable supplies does not change that because regulation 109 only applies if the change occurs between initial attribution and first use of the supplies. There is thus a distortion that should be examined if HMRC now wish to apply the rules under EU law correctly.
- Separately, persons who are taxable persons have an obligation under EU law to notify the relevant tax authority (HMRC) that they have become a taxable person (article 213 of the PVD) but it should be noted that a taxable person who is not entitled to a VAT deduction does not have to be identified (article 214(1)(a) of the PVD). Therefore, a UK business that is not VAT registered (entitled to small business relief) is technically making supplies that are exempt from VAT with no entitlement to deduct VAT. Consequently the business does not have to register for VAT but contrary to what is said in UK law, he or she nevertheless remains a taxable person.
- This issue raises once again the problem of how to deal with VAT on capital goods. The effect of regulation 111 is to allow the use of the capital items legislation for goods that are not capital goods under the normal definition. We have previously argued that the Capital Items Scheme should allow small businesses a choice as to whether or not to apply the scheme in certain circumstances. We referred to Chard Bowling Club to illustrate the issue that can arise.