Transaction flows and systems challenges

Indirect Tax

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Angela Fearnside reports on the annual ATT/CIOT indirect taxes conference

This year’s ATT/CIOT indirect taxes conference covered charities, VAT grouping, intercompany transactions, holding companies, foreign branches, pension fund costs and customs duty changes.

Chaired by Peter Dylewski from KPMG and Chair of the CIOT Indirect Tax Sub-committee, delegates chose a morning session of VAT or customs duty, coming together later for the afternoon's impressive line-up of speakers.

Charity sector – current hot topics

Peter Jenkins, of Peter Jenkins Associates, opened with his report on the Charity Tax Group's activities in three key areas:

Direct mail – a dramatic end to the zero-rating of charity mail packs prompted the CTG to work on mitigating the impact of HMRC's re-characterisation of the services as standard-rated direct marketing. Charities were urged to consider future arrangements and take action to ensure they benefit from transitional rules.

Extending s 33 VAT refund scheme – search and rescue and particular other charities now benefit from this but there remains a policy tension. In 2013 the European Commission rebuffed the historical view that extending the scheme to charities (private bodies) was illegal. A general rebate scheme remains undesirable, largely on the grounds of affordability, but it is acknowledged that some charities are enmeshed with state bodies and deserve a level playing field. Deserving cases seeking ring-fenced extensions would receive a 'good audience'.

Business rates review – attention must be paid to eligibility for relief as a result of Chancellor George Osborne's announcement that proceeds from business rates are to stay with local authorities. A shift to regional policing and collection may cause inconsistency, with possible state aid implications.

Skandia – practical concerns for industry

Alan McLintock, from Ford Motor Company and FCE Bank, brought to life the complexities and uncertainties faced by businesses in the post-Skandia era (*Skandia America Corp (USA), filial Sverige* (case C-7/13)), focusing on what these mean for businesses, in particular:

- what do we know (and not know) about the impact of Skandia?
- identifying and assessing previously untracked intra-group transactions;
- understanding the economics of de-grouping; and
- how to properly reflect VAT risk when it cannot be accurately quantified.

Reflecting on how difficult it is to establish the approaches taken by other EU member states, the UK's response has been one of caution, recognising that businesses here risk losing out if there is a push for a one-size-fits-all model.

The VAT Expert Group's (VEG) paper recommending *Skandia* should be construed narrowly to the specific facts of the case was welcomed by Alan and its view that VAT grouping is an important simplification measure that should not be jeopardised. Recognising the paper remained work in progress and guidance was limited, he asked how businesses could work out how to treat their cross-border intercompany transactions?

Mapping out a cross-border footprint

Using the example of a UK VAT group billing its Belgian branch for head office support services, Alan presented the challenge of how to account for a non-supply out of the UK (being within the VAT group) that is seen by Belgium as a taxable reverse charge supply (under 'establishment only' VAT rules).

First, businesses need to be capable of identifying intercompany transactions that have not needed to be recognised for VAT purposes since *Ministero dell'Economia e delle Finanze and another v FCE Bank plc* (case C-210/04) (FCE) nearly 10 years ago. How will systems cope with one side of a transaction requiring a different VAT code or blocker? This becomes overwhelming when an international business begins to map out its European footprint.

Insourcing or centralising services, such as staff costs, present another difficulty. Imagine that an employee of a Belgian branch is seconded to the UK VAT group. Under *Skandia* 'establishment only' VAT grouping rules, this is a supply between separate taxable persons. Moreover, after January 2016, the UK business must apply a reverse charge to the 'supply' from Belgium with potential irrecoverable VAT costs that would not have existed before.

So, should businesses remain VAT grouped or consider de-grouping? Do you suffer less cost by de-grouping? What happens to an agreed partial exemption method if you do de-group? What are the commercial risks and contractual changes? Finding out the answers to these questions is a major task for many businesses.

Does *Skandia* apply to goods? There are contradictions. The CJEU decision suggests the principles apply to all supplies – goods and services. The VEG paper recommends restricting this treatment to services only. Where does that leave taxpayers? Applying the CJEU decision to practical examples only highlights the risks involved. What if high values of goods are moved cross-border and retrospective action is taken by a member state to pursue a VAT liability?

Alan's key message was that establishing a compliance footprint and undertaking the necessary changes would be part of a major project that involved accounting and documentation controls and processes, understanding transaction flows and systems challenges. Effective project governance is critical, made all the more challenging by the backdrop of uncertain case law.

HMRC's perspective on recent VAT developments

Bruno Giordan, from HMRC, updated delegates on the VAT recovery position of holding companies. At the time of the conference HMRC is dealing with more than 250 cases, this is a key issue. Recent case law (*BAA, Polysar, Cibo, Floridienne, Securenta* and the CJEU decision in *Larentia & Minerva*) has led to HMRC accepting that holding companies making mixed supplies (including the non-business activity of holding shares) – none of which are exempt – can recover VAT in full. HMRC is withdrawing from some litigation and preparing revised guidance.

The partial exemption issues for foreign branches since the CJEU decision in *Le Credit Lyonnais v Ministre du Budget, des Comptes publics et de la Reforme de l'Etat* (case C-388/11) (*Credit Lyonnais*) were still being reviewed, although revised draft regulations have been issued. This was acknowledged as a good example of the CIOT's representations highlighting unintentional consequences that HMRC had listened to and recognised.

On the cost-sharing exemption, HMRC intends for this measure to be used by small operators coming together – akin to VAT-grouping. Cost-sharing is not seen by HMRC as intended for bigger corporate groups that are trying to make purchases without incurring reverse charge VAT costs.

Barbara Farndell, of HMRC, explored the changes to the pension sector resulting from *Fiscale Eenheid PPG Holdings BV cs te Hoogezand* (case C-26/12) (PPG) and *ATP Pension Service A/S v Skatteministeriet* (case C-464/12) (ATP). VAT recovery is

now possible if the employer contracts directly for services but HMRC acknowledge there are commercial difficulties. To help to resolve this, the transitional period is to be extended and further guidance issued.

Barbara discussed qualifying criteria for special investment funds for fund management exemption purposes and confirmed that a consultation would be issued on the extension of the use and enjoyment provisions.

Customs duty update

Thanks goes to **Phil Challen** who reports on the customs duty sessions chaired by **Philip Brigstock**, of Quadrel. The conference focused exclusively on the implementation in May 2016 of the Union Customs Code and will affect most importers. The UCC is a major revision of the Community Customs Code that dates from 1992, itself a consolidation of multiple discrete provisions that date from 1977.

Tim Cornell, head of HMRC's International Trade Development Liaison Officer group, gave an overview of the changes. He focused on the big-ticket changes to customs valuation, the criteria for becoming (and remaining) an authorised economic operator, the duty relief procedures and the potential opportunities from centralised clearance and self-assessment.

Bert Gevers, of Brussels law firm Loyens & Loeff, commented on the first sale for export valuation changes, before explaining how several EU tax authorities are taking the 'trusted trader' concept of AEO into the fields of direct tax, excise duty and export control/sanctions work.

Phil Challen, Regulatory and Technical manager for GE in Europe, discussed how royalties and licence fees have to be treated for customs purposes. In almost all cases the 'condition of sale' criterion is considered met, as a result of which the only remaining test is whether a payment for an intangible relates to the imported goods. This will always be the case for trademarks if the imported item is marketed under that trademark, regardless of whether it is affixed before or after import.

As a result, the (rebuttable) default position will be that any trademark is dutiable, so it behoves companies to find out before 1 May what royalties and licence fees are paid, and to what extent those relate to any imported goods.

There then follows the question of how any affected royalties have to be apportioned among imports after May 2016 – which will severely test how well HMRC can cope. It seems that this particular tax does have to be taxing!

John Carlin, of Carillon Millor, explored actions that need to be taken between now and May 2016 particularly for those affected by the changes to the first sale for export arrangements. He urged companies to assess the true value that duty reliefs add to their business – particularly if they forego them in favour of claiming preferential trade arrangement status.

The conference finished with a lively debate on the possible impact of a BREXIT.

The work of the OECD

Stéphane Buydens, VAT policy advisor at OECD, gave us an insight into how the OECD helps to foster prosperity and fight poverty through economic growth and stability. Drawing up guidelines and best practice that, while not legally binding, have political commitment and strong influence on such a global level that it brings about tangible change, the organisation is supported by 34 member countries as well as the European Commission, the World Bank and the International Monetary Fund (IMF).

VAT is the IMF's tax of choice, advising developing countries to introduce it to balance their budgets. With more than 160 countries having a VAT/GST system (100 introduced in the past 20 years), more economies are raising revenue this way. Interestingly, the US still retains its local sales tax system but is increasingly engaging in the VAT debate.

Currently VAT accounts for 20% of the world's tax revenue – a phenomenal proportion that should command more attention from policymakers and businesses alike. VAT brings in twice the revenue of corporate income taxes and 21 out of 34 countries have increased the rate since 2009. Consequently, there is a strong need for common principles on international VAT. Guidance to develop consistent legislation at a global level can aid smooth interaction between different regimes. For example, different countries seek to tax international services where consumption takes place but there can be considerable variation in establishing how to define this. Inconsistency can lead to non- or double taxation.

Wanting fewer exemptions, the OECD sees diversions from the norm as distortive and a cause of political difficulties. It only favours general rules with limited exceptions where a ‘significantly better result’ is given.

The OECD International VAT/GST Guidelines set standards on VAT neutrality and a destination-based regime for cross-border services to business-to-business (B2B) and business-to-consumer (B2C) entities. The aim is to ensure that VAT targets private consumption, not businesses, and sales are taxed in the country of consumption. These guidelines have been endorsed as the global standard by the G20 countries and the OECD Global Forum on VAT (more than 100 countries and international organisations). They will be put to the OECD Council to adopt as an OECD recommendation this year. The Guidelines are connected with the OECD BEPS programme where action 1 (digital single market) is intrinsically linked to VAT.

What did the panel think?

Bruno Giordan, Barbara Farndell, Stéphane Buydens and **David Jordorson**, of the Association of British Insurers, discussed territorial scope and how this can be shaped in future given the increasingly global nature of business. How are we to work out where a business should pay VAT and who has the right to deduct when evolving international trade tests the boundaries of the tax as we know it?

The proposed extension to the use and enjoyment provisions led to a passionate debate about creating a simpler, fairer tax system while preventing avoidance. Is it right that tax authorities should aim for compliance from 100% of taxpayers even if that results in a burdensome and distorted regime? Stéphane and David agreed the starting point should be to make the system workable for the compliant majority yet consider it a great result if simpler, general rules catch 80% of the tax base. While admitting that this approach was tempting, Bruno was concerned that the 20% would grow as loopholes are exploited. Fundamentally, how can HMRC let 20% of the tax take get away?

The impact of international compliance on small businesses was raised with the perception (following the recent MOSS experience) that a critical mass is needed before cross-border trade is worthwhile. There was sympathy for this view from all panel members with HMRC keen to reassure that it has been championing facilitative measures for small business on the European stage. Stéphane acknowledged the UK’s hard work on this issue.

Reaching consensus that VAT grouping is a good thing, the panel agreed that simplifications and exemptions are often like black holes, creating distortions around the margins. Should BREXIT happen, some would welcome the freedom to remove zero rates and 'clean up the system', or conversely extend zero-rates and have less conflict about the grey areas. There was total agreement that VAT was here to stay.

Case law update

Roger Thomas QC, of Pump Court Tax Chambers, concluded the conference with a proposition that, despite the landmark *Halifax v CCE* [2006] STC 919 decision being 10 years old, we still do not fully understand what 'abuse of rights' means. Recent case law in *University of Huddersfield Higher Education Corporation v CCE* [2006] STC 980, *Pendragon plc and others v RCC* [2015] UKSC 37 and *Massey and another trading as Hilden Park Partnership v RCC* [2015] UKUT 405 (TCC) continues to evolve our thinking and refine and define abusive practice.

Examining whether economic activity may have some explanation other than the mere attainment of a tax advantage, the Upper Tribunal in Huddersfield decided that a lease/leaseback tax deferral scheme that had always intended to collapse the lease once the scheme had worked was not a genuine commercial arrangement and was abusive. This is in contrast to *RCC v Weald Leasing Ltd* (case C-103/09). In Pendragon, a complex structure involving the mismatch of rules for hire purchase, second hand margin scheme and the transfer of a going concern was found to have five commercial objectives by the tribunal. But the Supreme Court later decided the scheme was abusive because it was sufficient that special features of those objectives had no commercial rationale beyond the tax benefit.

Exploring the limitations of the s 80 capping rules, Roger considered other lines of authority for restitution if an EU member state has been unjustly enriched because of a mistake of law. Examining the VAT liability case, *J P Morgan Fleming Claverhouse Investment Trust plc and another v CRC* (case C-363/05) [2008] STC 1180 alongside the unjust enrichment cases *Reemtsma Cigarettenfabriken GmbH v Ministero delle Finanze* (case C-35/05) [2008] STC 3448 and *Danfoss A/S v Skatteministeriet* (case C-371/07) [2009] STC 701 along with other UK restitutionary principles, he explored extending the time scales of a claim to six years after identifying the mistake of law.

Thanks goes to all those involved in organising and running the conference. The CIOT’s European Branch will be running its annual indirect tax conference on 11 February 2016.