The 50th anniversary of VAT: some of the cases to celebrate

Indirect Tax

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21 March 2023

On 1 April 2023, VAT will raise its cricket bat and celebrate its half-century birthday. Here are some of our favourite VAT cases from the last 50 years with important practical issues.

Key Points

What is the issue?

Past tribunal cases provide important guidance and advice on how to deal with complex issues. For example, the 1999 case of *CPP Ltd* is still the landmark case on whether a bundle of goods or services subject to different rates of VAT and sold as a single package is a multiple or single supply.

What does it mean for me?

The fact that the judges can sometimes reach different decisions based on the same facts confirms that VAT is not the 'simple tax' it was intended to be in 1973. VAT must be considered at the planning stage of any complex deal or transaction.

What can I take away?

VAT raises £143 billion for the Exchequer each year and continues to be one of the most important taxes in the UK, despite our departure from the EU. Complex topics such as partial exemption, HMRC powers of assessment, and land and property must be given priority to ensure that returns are correct. VAT is unlikely to be abolished for a long time!

VAT is now 50 years old. That is an impressive milestone. It was first introduced to the UK on 1 April 1973 – being famously described as a 'simple tax' – and has become more important with the passing of time: the standard rate of 8% back in the 1970s increased to 15% under the Thatcher government in the 1980s; to 17.5% in the 1990s; and finally to 20% in 2011 under the Coalition government. Will the next stop be 25%? Who knows…?

To celebrate the anniversary, I will consider some of the most high-profile tribunal cases from the last 50 years and focus on their practical implications. My thanks go to fellow author Alex Millar for helping me with the list.

Best judgment

HMRC has the power to issue a ‘best judgment’ assessment if it thinks that VAT has been underpaid on a past return. The legislation at Value Added Tax Act (VATA) 1994 s 73(1) has been the subject of hundreds of tribunal cases – mainly relevant to output tax issues – but the most important case is perhaps *Pegasus Birds Ltd* [2004] EWCA Civ 1015.

HMRC issued an assessment for £658,388 based on underdeclared VAT inclusive sales of parrots totalling – pause for dramatic effect – over £4 million. That is a lot of off-record birds flying around, you might think; the director said that VAT had only been underpaid by £50,000.

The first appeal went in favour of the taxpayer on the basis that the VAT evaded was only a fraction of the amount assessed by HMRC and the assessment should therefore be withdrawn. However, the Court of Appeal ruled that the burden was on the taxpayer to show what was the correct amount of tax due and that HMRC was only obliged to use the information at its disposal to issue a best judgment assessment.

If the officer had acted dishonestly, the assessment would be treated as having not been made but that was not the case. To quote from the tribunal report: ‘The tribunal should remember that its primary task is to find the correct amount of tax, so far as possible on the material available to it, the burden resting on the taxpayer.’

Reference: HMRC VAT Assessments and Error Correction manual: VAEC1440

Input tax on motor cars

The legislation about input tax being blocked on the purchase of new cars that will be made available for private use has been in place since the 1970s. It is a revenue winner for the Exchequer because input tax is only claimed where the vehicle is a tool of trade, such as a taxi firm, driving school or car hire business. Input tax can also be claimed if a vehicle is used as a genuine pool car. I enjoy telling the tale about a client who asked if his new BMW might qualify: ‘Only if it is made available to all your staff and kept overnight at the office rather than your home,’ was my reply. It was never mentioned again.

The most famous case about input tax and cars involved the legendary *Mr Christopher Upton (t/a Fagomatic)* [2002] EWCA Civ 520, who gave HMRC a great run for its money. It was a bit like a non-league football team beating a Premier League giant in the first game of a two-leg cup competition, before losing in the final minute of the second match. If he had won his case in the Court of Appeal, the VAT floodgates from other businesses would have surged with more power than Niagara Falls during the rainy season. Mr Upton argued that his Lamborghini Diablo car was only used to deliver cigarettes to the premises of his business customers and never used for private journeys, and that had always been his intention since the day he bought the vehicle. The purpose of the vehicle was to portray a successful image to his London nightclub customers.

The lower courts agreed with him but the Court of Appeal ended his four year battle with Customs and Excise in 2002, noting that his car insurance included cover for private use and was therefore available to him in a private capacity. The officer was correct to disallow his input tax claim of £19,571.

Business or non-business?

The phrase ‘Lord Fisher tests’ stood the test of time until last year about whether an activity is classed as business or non-business.

Lord Fisher [1981] STC 238 organised shooting events for friends on his estate and charged a fee that was intended to cover costs, rather than make a profit. Customs and Excise decided that the income was VATable because it related to standard rated sales made in the course of business; however, Lord Fisher's representatives argued that it was a private activity and was outside the scope of VAT. The tribunal identified six different tests about whether a business or non-business activity exists and these tests have been very useful to charities and not-for-profit organisations since then.

However, HMRC changed its policy last year to take account of more recent case law; namely, *Wakefield College* [2018] EWCA Civ 952 about whether the provision of further education courses to subsidise fee-paying students was an economic activity. The Court of Appeal ruled in favour of HMRC, noting that the courses were an important part of the college's activities and fees paid by the students were significant. See ***HMRC's revised policy: two new business tests.***

Two new business tests

To decide whether an activity is business or non-business, an entity must consider the following two questions:

1. Does the activity result in a supply of goods for consideration?
2. Is the supply made for the purpose of obtaining income?

Note: The tests must be applied for each separate activity, rather than being considered for the entity as a whole.

For further information, see 'Is activity deemed to be business or non-business for the purposes of VAT', Tax Adviser (September 2022).

Reference: HMRC VAT Business/Non-Business Manual VBNV30200

What is a mixed supply?

As I ask this question, I can hear fellow VAT anoraks shouting out 'he's going to mention CPP' with as much excitement as a teenager getting an upgraded mobile phone for their birthday.

The European Court of Justice case of *Card Protection Plan Ltd* (Case C-349/96) considered whether the company was supplying exempt insurance or a standard rated administration service for its card protection business, or a combination of both. It was the first major judgment made by the European Court of Justice about mixed supplies and produced a helpful checklist to determine whether a supply is a single or multiple supply. Here are the main tests:

- Is there one principal supply with the others being incidental to the main supply? If so, the VAT charge is wholly based on the rate for the principal supply.
- Is each supply an aim in itself, or is one of them a way of enhancing the enjoyment of the main supply? For example, a zero-rated programme included as part of a hospitality package at a sporting event enhances the enjoyment of the sport for the delegates.
- How do customers perceive the supply? For example, in the case of a single price being paid for a zero-rated train journey on the Orient Express and a standard rated four-course meal with champagne, the

> customer expects to receive both supplies and would complain if one of them was not provided… particularly the champagne! Output tax must be apportioned because it is a mixed supply.

Other cases

Here is a summary of other important cases:

***Halifax and others* (Case C-255/02)**

This case probably represented HMRC's best-ever victory in the European Court of Justice because it confirmed that the department has the power to disallow input tax if there is an abuse of rights.

The case involved a complex chain of companies that was intended to give input tax recovery on the construction of a new call centre for a business whose supplies were mainly exempt from VAT. The arrangements produced a tax advantage that was contrary to the purpose of the legislation and that was wrong.

***Royal Opera House Covent Garden Foundation* [2021] EWCA Civ 910**

The curtain finally came down on the opera house in 2021 about whether fees paid to production companies for putting on shows only related to the exempt sales of tickets to watch the performance and were therefore input tax blocked with partial exemption, or whether they could be partly claimed as residual input tax because they also increased the sales of standard rated catering.

The Court of Appeal ruled that the direct link was only with the ticket sales and HMRC was right to fully disallow the input tax claimed. *Questa è la fine.…* This is the end – for now.

***Marks and Spencer Plc* [2009] UKHL 8**

HMRC decided that an output tax refund on the historic sales of zero-rated tea cakes – which had been incorrectly treated as standard rated by M&S – was blocked by 'unjust enrichment' because M&S had passed on the VAT cost to its customers rather than absorbing the tax within its own pricing structure. After a 14 year legal battle, the ECJ agreed that a refund of £3.5 million should be paid to M&S, a decision that was supported by the House of Lords when the case was remitted to the UK. (VAT Notice 700/45 ss 9 and 10)

Famous quote

To finish this anniversary article on a humorous note, VAT enthusiasts will never forget the famous words of Lord Justice Sedley in his report after the Court of Appeal case of *Royal & Sun Alliance* [2022] EWCA Civ 17:

> 'Beyond the everyday world, lies the world of VAT; a kind of fiscal theme park in which factual and legal realities are suspended or inverted.'

Here's to the next 50 years!