KPMG's Indirect Tax Update

TAX

Highlights

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Our immediate reaction on reading the *Garsington* Brief, in conjunction with the recent *Skipton* and *DFS* cases on the similar issue of input tax attribution, was how easy it seems to be to create a link to an exempt supply and how much more difficult it is when the supply is taxable. Truly there are some strange comments in that Brief. Take the assertion that 'in-house' production costs are not an overhead of a theatre (and hence not automatically residual), because they do not relate to the organisation as a whole. Put another way their treatment as residual is not a given; it must be earned. However, when the organisation's *raison d'être* is to stage shows and thereby generate income both directly and indirectly from that activity, by way of exempt admissions and taxable sponsorship, programme sales, promotional items, show recordings, drinks and snacks in the interval et al, is it not peculiar for HMRC to assert that the 'in-house' production costs are anything other than residual? Also the fact that the programme contains photos of the production and information about the plot and actors is not enough, in HMRC's view, to create a link between the production costs and programme sales seems bizarre when the inclusion of the single word mortgages in an estate agent's advert for houses for sale creates a sufficient link to exempt supplies to make the advertising costs residual. Some consistency is needed here.

The further suggestion that total income may not be a fair proxy for use when calculating the residual recovery rate for these costs, (if residual treatment can be secured) is also a little baffling. Production costs may not be a direct cost of taxable catering and refreshment income, but how can it be right to exclude that income completely to achieve a fair use based recovery result for production costs VAT, (which is what HMRC are suggesting, if the standard method override (SMO) is triggered)? It is the presence of the ticket buying public that generates that catering income and they are only there because the production costs were incurred and a show has been put on. It just seems wrong to omit that income. HMRC saying that a theatre wishing to lodge a back claim must use the partial exemption method in force for the relevant (closed) year to calculate any additional input tax deductible for that year, but then also saying that it must take account of the SMO when carrying out the calculations if its method was the standard method also seems strange. Is that not a directed, backdated change to the standard method by any other name? Can HMRC insist on this? Will this, at last, be the catalyst for a Tribunal to refer the vires of the SMO to the ECJ?

Infraction proceedings against other Member States are always interesting and the Commission has just released details of the latest ones. Many of course concern reliefs and procedures that have no relevance to the UK, but some of the challenged issues could be quite pertinent. The question mark over Hungary's refusal to credit excess input tax on a VAT return if that credit represents unpaid purchases for instance, and the wide discretion that

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Finland and Austria have awarded themselves over certain exemptions, which the Commission is now challenging, might turn out to be quite close to home.

The *AB SKF* hearing aroused much excitement as the Commission suggested a sale of shares in its subsidiary by a management holding company could be treated like a TOGC for the purposes of input tax recovery on the disposal costs. That excitement dissipated rather when the AG firmly concluded that the VAT on the costs would be used in making the share sale and would be blocked assuming the buyer was EU. We shall see what the ECJ says later this month, but on balance we think there is enough difference between a share sale and a share issue, and an asset sale and a share sale, to support the AG's conclusions ahead of the Commission's, and to distinguish the *Kretztechnik* decision too.

Another Tribunal case on the financial intermediary exemption was released this week (*Friendly Loans*). Showing commendable entrepreneurial spirit the appellant converted a wasted lead of its loan broker service into income for it and its sister debt management company by referring unsuccessful loan applicants to that other company, which then negotiated and set up debt repayment plans for a very high number of them. Was the fee the appellant received for this referral service standard rated like a normal lead sale supply or could it actually be exempt? The UK allows exemption for debt negotiation services of the type the sister company provided but there is nothing in the UK exemption that suggests exemption is permissible for arranging a supply of debt negotiation to be provided by another, as debt negotiation is itself viewed as an intermediary service. The sister company also provided payment handling services as it collected the agreed debt repayment amounts from the debtors and passed them to the creditors less its fees. In a most interesting and well reasoned decision the Tribunal found the referral fees were exempt. The appellant was arranging a payment handling service (for which there is a UK exemption as the payment handling involves the transfer of money). The appellant was also bringing together those who needed debt management and a supplier of debt management and carried out a screening and preparatory process for the sister company as well as recommending it to customers. It was not an intermediary of an intermediary but an intermediary bringing together a principal and the principal's customer so that 'negotiation......concerning debts' could take place. Under the wording of the EU Directive that supply was also exempt. So an interesting marriage of the UK and EU law secured the win for the appellant.

To access the highlights podcast, please click here.
To access the full podcast, please click here.

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From the Tax Authorities

Revenue & Customs Brief 62/09 – Partial Exemption – VAT deduction by theatres on production costs

HMRC have released a Brief on its revised policy on input tax recovery on production costs. The change in policy follows the *Garsington Opera* Tribunal Decision

The Garsington Tribunal

This case concerned whether in house opera production costs have a link to taxable supplies such as sponsorship, touring, programmes, CDs, intellectual property rights and occasional supplies of props and equipment. HMRC argued that the VAT incurred on the production costs was a cost component of the exempt ticket sales only and should be blocked. *Garsington* successfully argued there was a link to both taxable and exempt supplies and the VAT was therefore residual.

The case was similar to *Mayflower Theatre Trust* (CA 2007) who also successfully demonstrated a link between production costs and taxable supplies. However in *Mayflower* the costs related to bought in complete productions rather than the costs of putting a production together 'in house'. The Court of Appeal in *Mayflower* only found the necessary link between the production costs and the taxable sale of programmes as the production provided the editorial content of the programme. The Tribunal in *Garsington Opera* appeared to go further, finding links between the production costs and a whole range of taxable supplies. For example the Tribunal found there was a link to the sponsorship income as the sponsorship was production specific and sponsors had priority rights to tickets. The Tribunal also concluded the production inputs were essential to the supply of the semi staged production and found a link between the costs and the concept licences which exploited the productions. Similarly hiring or selling costumes and equipment used in the productions also exploited the productions and there had to be a link between the costs and the CD sales as without the production costs there would be no production to record.

HMRC's policy

The Brief sets out HMRC's view that production costs will always be directly and immediately linked to exempt admissions to the show. Production costs only become partly deductible (residual) if there is 'a firm intention to make taxable as well as exempt supplies when the costs are incurred'. The Brief adds that production costs are not 'overhead costs' just because they relate to the organisation as a whole. HMRC go on to provide examples of when production costs relate to taxable supplies and that confirm such costs will remain residual even if the intention to make those supplies is subsequently frustrated. The examples given are clearly defined sponsorship, touring of the production and recording of the show for later sale. The Brief makes a specific reference to *Mayflower* to support its view that general corporate sponsorship does not make production costs residual. The brief also gives examples of when costs are indirect and therefore are not residual. These include the mere inclusion of performer profiles in programmes.

As expected HMRC go on to refer to the standard method override (SMO). Therefore, where the standard method results in a substantial over recovery of input tax, HMRC will expect businesses to apply the SMO. The Brief suggests that where production costs are residual but the taxable supplies are small in comparison the SMO might be triggered. With regards the use based calculation required, HMRC say calculations should be as simple as possible whilst achieving a fair result. They suggest a fair calculation could be to look at the relevant supplies which have a direct link to the production in proportion to box office sales and apply this to the residual input tax on production costs. The Brief invites claims for under claimed input tax and going forward suggests any theatre that may be affected by the SMO may wish to consider seeking a special method.

To read the Brief in full click here.

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Revenue & Customs Brief 63/2009 Amusement Machine Licence Duty and 'Stacker'

HMRC has published its view that an amusement machine playing a game called 'Stacker' satisfies the requirements for licensable gaming machine liable to Amusement Machine Licence Duty (AMLD). It is deemed a game of chance because the length of time players have to react when playing the game is so small that a player cannot win on the basis of skill alone. This element of chance means that the machine is liable to AMLD.

To read the Brief in full click here.

Notice 702/10 VAT: Tax warehousing

This new notice gives information on the VAT treatment of goods entered into, supplied within, and removed from tax warehouses in the UK, together with the treatment of supplies of services associated with those goods.

Click here to read the notice.

Recent JCCC (09) Papers

HMRC have released the following JCCC Customs Information Papers:

64 Inward Processing - Sugar
65 Revised Notice 200
66 Changes to part removal of consignments from Temporary Storage
67 Amendments to Customs Civil Penalties
68 Completion of import and export declarations
69 Tariff Preference: cumulation of origin - EC and the Western Balkan countries

EU News

EC decisions concerning infringement procedures against eleven EU countries

The EC on 8 October published ten press releases concerning infringement procedures in the field of taxation against eleven EU Member States. Seven of these press releases are with regards to VAT.

Reduced VAT rate on horses - The EC has decided to refer Austria, France, Germany and Luxembourg to the ECJ because they are applying a reduced rate of VAT to horses, and in particular race horses. Reduced rates may not be applied to the supply of race horses, since these are not intended for human or animal consumption.

Inclusion of car registration tax in the taxable base on which VAT is calculated for road vehicle supplies - The Commission understands that the car tax levied in Austria, despite some minor or ancillary differences, is basically identical to the Danish one examined by the Court in case C-98/05; it is a one-off tax payable on the acquisition of the motor vehicle or as a condition for bringing it into use in the territory of the MS concerned. In the light of this, the Commission has taken the view that the criteria of the EC Court in Case C-98/05 must be applied to the car tax levied in Austria.

Application of certain exemptions - The EC has formally requested Finland and Austria to change their legislation as regards the application of certain exemptions under the VAT Directive. The requests take the form of a reasoned opinion. If the relevant national legislation is not amended to comply with the reasoned opinion, the Commission may decide to refer the matter to the ECJ.

In Finland, under the national Income Tax Act, only entities of public interest that are liable for income tax for commercial activities are considered as taxable persons for VAT purposes. All other entities of public interest are excluded from VAT. Moreover, several activities carried out in the public interest which should be exempted from VAT according to the VAT Directive are not according to Finnish legislation.

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The Commission considers that the Austrian VAT exemption for services closely linked to sport or physical education supplied by non-profit-making organisations to persons taking part in sport or physical education is too wide, since it applies, without any restriction, to all activities carried out by associations of public interest, whose objective is to exercise or promote sport. The Austrian VAT law also exempts all the running business of theatres, museums, zoos, natural preserves and botanical gardens, which goes beyond what is allowed under the Community law for certain cultural services.

Super-reduced rate for the first performances of a work – The EC takes the view that France cannot extend the scope of application of the super-reduced rate of VAT that it is authorised to apply, on a temporary basis, to the first performances of a work. France has extended this to the first 140 works where drinks are available also, which is incompatible with Article 99 and 110 of the VAT Directive. The EC have launched the second stage of infringement proceedings.

The refund of unduly paid VAT and other taxes - The Commission has addressed two Reasoned Opinions to Greece under Article 226 EC concerning its treatment of requests for the refund of unduly paid taxes including VAT. The rights taxpayers derive from Community law include the right to obtain the repayment of taxes paid when they are levied by Member States in violation of Community law. The Commission considers that by not adopting the appropriate legal and administrative measures to enable the exercise of the right of reimbursement in respect of VAT charged on road assistance services in contravention with the VAT Directive, Greece has failed to fulfil its obligations under EC law.

VAT reimbursement rules – The EC has called on Hungary to modify the relevant provisions of its VAT legislation which preclude Hungarian taxable persons from claiming reimbursement of input VAT where the underlying supply has not been financially settled by the taxable person. The request takes the form of a reasoned opinion, the second step of infringement procedure.

Travel agents' scheme – The EC has formally requested Spain to amend its legislation with regard to the application of the special VAT 'margin' scheme for travel agents. If Spain fails to comply with the reasoned opinion within two months, the Commission may refer the matter to the ECJ.

Potential Withdrawal of Sri Lanka's GSP Plus Benefits

In the near future, duty-free concessions for 7,200 Sri Lankan origin products may be removed if the EU decides to withdraw the country's Generalised System of Preferences (GSP) Plus preferential trade treatment. In 2008, and under the GSP Plus regime, the EU was the largest export market for Sri Lankan goods, accounting for 36 percent of its total exports. The EU Commission is scheduled to meet and discuss the future of Sri Lanka's GSP Plus benefits on 15 October 2009. The outcome of such discussions may result in decisions varying from the retention of benefits, their withdrawal, or their conditional retention. The effective date of any future withdrawal will depend upon the conclusions reached by the EU Commission and whether its decision is approved by the EU Council, which has ultimate decision-making authority in the EU.

The EU Commission's discussions will mark the conclusion of a year long investigation imitated on 14 October 2008 into certain human rights violations allegedly committed by the government of Sri Lanka that occurred during the country's recent civil unrest. Sri Lanka's human rights record is relevant insofar as GSP Plus treatment is conditioned upon a beneficiary country's adherence to certain international conventions concerning human rights. Under EU regulations, contravention of these human rights conventions may serve as the basis for the withdrawal of a beneficiary country's GSP Plus benefits. The EU Commission's investigation was launched for the purpose of determining whether Sri Lanka still qualifies for GSP Plus preferential trade treatment and, by regulation, should be completed within one year. In August of this year, the EU Commission's specially appointed panel of experts issued an interim report based on its investigation which concluded that Sri Lanka had not effectively implemented its obligations under these human rights conventions.

Should Sri Lanka's GSP Plus benefits be withdrawn, the Sri Lankan apparel and ceramics industries will likely be most impacted and EU retailers can expect to encounter increased sourcing costs in the purchase and importation of Sri Lankan goods, projected at a 10 percent increase.

If you have any queries relating to this, please contact Simon Clarke (020 7311 2410).

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Proposal regarding exemption from VAT on the final importation of certain goods

The final proposal on the amendments to Articles 143(b) and (c) of the VAT Directive has been released. This proposal is not intended to make any changes of substance but follows the Commissions policy of recodifying legislative acts after no more than ten amendments. The original proposal was put forward in September last year. Following a number of meetings and amendments the European Council has been invited to adopt the Directive at its next meeting. To read the proposal for the Directive click here and for the note to the European Council click here.

UK News

Michael Page International – HMRC seeking to recover VAT repayment

There have been numerous reports this week of Michael Page International (MPI) facing a £40 million VAT bill. For the article in The Times on-line click here. The article does not confirm that HMRC have issued a recovery assessment to clawback a previous refund made, but states following review of the payment the Revenue were "of the view that the claim in whole or in part should not have been paid". The article quotes the repayment made was £37.4 million which was in respect of "part settlement of an alleged overpaid VAT bill". However even details of the values is not clear as the article talks about an overpaid VAT amount, net of fees, of £26.5 million and £10.9 million of interest again net of fees.

So what was the claim for and what period did it cover, and why is it being revisited? Information is limited and is based on articles in the press. It would seem this challenged refund was a small part of a larger claim with the other element (for the *Fleming* period) not having been paid as yet.

The reports refer to VAT overpaid on placements of temporary staff, suggesting VAT should not have been paid on the total amounts invoiced but just MPI's fee so presumably the claim was around whether MPI was an agent or was using the now defunct staff hire concession to give the same VAT outcome as an agency arrangement. It is of course not known what caused HMRC to revisit the refund. However what this story does do is serve as a reminder of the powers HMRC have to issue recovery assessments where they conclude a refund should not have been made. They have two years to do this and it is not necessary for any new facts to emerge - they can just change their mind. Of course any such decision to claw back a claim can be appealed and HMRC must act reasonably but it is all extra costs and time for a taxpayer (and its advisers no doubt), who may have thought the issue was settled once they had received the money and who may indeed have even spent the money in question.

News

KPMG VAT Package website – sign up now

As a result of the implementation of the VAT Package across the EU, from January 2010, most business to business supplies of services will be taxed where the customer is established. VAT registered customers receiving services from abroad must account for VAT by way of reverse charge as a basic rule. Businesses will also be required to submit a return to their local tax authorities in respect of cross border services supplied, the 'EC Sales List for Services'. In addition, a new electronic foreign Eighth Directive VAT refund procedure will be in place.

We have developed a free website for our clients that sets out the key changes in every EU Member State, provides contacts across Europe in all sectors, and gives you access to our latest thinking on the key issues. Please speak to your usual KPMG advisor to request access to the site.

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In the Courts

UKFTT 247 Friendly Loans Ltd – passing on of payment plans – acting as financial intermediary and so fee exempt – taxpayer win

The appellant was a loan broker which passed details of its unsuccessful applicants on to a sister company that offered exempt debt management/negotiation services. These services comprised working out affordable payments, negotiating a payment plan with creditors and passing the monthly payments collected, less fees, on to the creditors. The appellant was paid fees for referring the unsuccessful applicants to the sister company. The disputed issue was the liability of these fees. HMRC argued it was a standard rate lead referral fee and the financial intermediary exemption could not apply as the appellant was providing services to another intermediary – the appellant said it was acting as a financial intermediary and the fee was exempt.

The appeal was allowed. The appellant identified potential customers for the other company through a screening process and provided the company with a completed electronic application form that contained the necessary information on income and debts that were the basis of any debt management services subsequently provided to the customer. The appellant was intent on ensuring that the customer obtained a financial product and it recommended the sister company's services. There was a high take up of the services by the referred customer. This was more than just selling leads on a disinterested basis. It brought persons together with a view to the making of financial contracts. Those persons were the principal supplier and customer in any potential subsequent (exempt) debt management contract. That contract also included payment handling services. The appellant was therefore negotiating financial transactions and acting as an intermediary in relation to payment handling services and the fee was exempt.

Click here to read the case.

UKFTT 243 Trans Medium Ltd – viewed the director remuneration payments as a profit distribution for the purpose of the VAT exemption condition - taxpayer loss

Trans Medium provided IT training and was precluded from distributing its profits. It therefore argued that its supplies of education were exempt as it was an eligible body. However it did pay remuneration to its directors, who were a married couple and the sole shareholders. The company had the aim of making profits and was run for the profit of the directors who controlled it and had a financial interest in it. Although the remuneration paid out was strictly an expense which reduced profit, rather than a (precluded) distribution of profit, the Tribunal viewed the payments as a profit distribution for the purpose of the VAT exemption condition. Therefore the company was not an eligible body and its supplies were not exempt.

Click here to read the case.

UKFTT 245 Baljit Singh – no time limit applying to compulsory registrations – taxpayer loss

The appellant was told by HMRC in August 2008 that he should have been registered from 1 September 2003. He argued that HMRC were too late to register him as they would have been out of time to assess him for VAT due in 2003 if he had been registered then but not paid the VAT due. However as there is no time limit applying to compulsory registrations the appeal was dismissed. The Tribunal did not accept that the same time limit principles should apply to assessments and registration.

Click here to read the case.

UKFTT 236 Resteel Trading Ltd – when did the debt payable become due – arrangement viewed to be a time to pay indulgence – taxpayer loss

This appeal concerned refusal of bad debt relief and whether the claim for relief was made within time.
The appellant argued that there had been a legally binding variation of the supply agreement between it and a (connected) customer, which allowed for an indeterminate deferral of the time when payment for supplies made by the appellant to this customer fell due, so that the customer was not trading while insolvent. The actions of the supplier in not chasing for payment, not invoking the retention of title clause or enforcing its security showed that the debt was not due.

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Therefore the argument was that the debt only became due when the customer went into administration, and the claim for relief could only be calculated once the dividend to the supplier had been paid. HMRC argued the debt was due under the normal terms of the agreement (60 days after invoice date) and the supplier had simply allowed an unspecified time to pay period. Therefore the claim for bad debt relief was out of time as it was more than three years and six months after the date when the payment for the supplies became due. The Tribunal viewed the arrangements as a time to pay indulgence and not a binding variation of the supply agreement as it was too vague and uncertain, and so the claim was out of time.

Click here to read the case.

UKFTT 192 Pendragon Tribunal Case – were cars margin scheme cars – yes – were arrangements abusive – no – essential aim was to obtain finance – tax payer win

Further to the article in last week's Indirect Tax Update 39/09, an article was written in the Weekly Tax Matters newsletter on this case (page 5).

To access the newsletter click here.

ECJ Diary

Thursday 15 October

Hearing - Data I v O (C-370/08) – Customs Classification of electrical adapter

This case referred from the German Courts looks at the Customs classification of electrical adapters, which are designed to provide the electrical connection between an automatic programming machine and electrical components to be programmed. It questions whether they should be classified under heading 8471 of the Combined Nomenclature. If the first question is answered in the negative the second question goes on to ask whether similar adapters with 'memory-chip' should be covered. To read the questions in full click here.

Thursday 22 October

Opinion - Commission v Ireland (C-221/08), Commission v Austria (C-198/08) and Commission v France (C-197/08) – Minimum price on cigarettes infringes community law – Excise Duty should be used to reduce consumption

This case concerns Infringement proceedings against Ireland, Austria and France for the practice of fixing minimum prices on cigarettes. The Commission believe that such fixing of minimum prices infringe Community law, distort competition and benefit only manufacturers, by safeguarding their profit margins. To achieve the objective of reducing tobacco consumption, the Commission advocates increasing the excise duty on cigarettes. To read the Commissions earlier press release on the Infringement proceedings click here and here. To read the applications in full click here, here and here.

Judgment - Swiss Re Germany Holding – (C-242/08) – Whether transfer of re insurance contracts was exempt or taxable

In the Opinion the AG concluded that the transfer of 195 re insurance contracts from an insurance company in Germany to an associate insurance company in Switzerland, some for a negative consideration, is not an exempt supply of insurance, but is a taxable supply of services, supplied where the supplier belongs (current default rule for services). The referring German court had already concluded this could not be a transfer of a business as a going concern (TOGC) as there was no "transfer of an independent part of an undertaking, including tangible elements and, as the case may be, intangible elements which together, constitute a part of an undertaking capable of carrying on an independent economic activity". So the AG was simply considering whether the supply was goods or services and whether it was exempt or taxable

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Thursday 29 October

Judgment – AB SKF C-29/08 – whether input tax can be deducted on disposal of shares in a subsidiary

The case concerns whether SKF, a holding and management company in Sweden, can deduct input tax on services (e.g. share valuation, negotiation and legal advice) purchased in the course of disposing of shares in its subsidiary. The AG opined that the disposal of a parent company's entire shareholding in its managed subsidiary is an economic activity but is not a transfer of assets under Article 5(8) as this can not 'neutralise' the application of exemption. The AG was of the opinion that the disposal of shares in a subsidiary is VAT exempt. Therefore costs incurred in disposing of shares in a subsidiary/controlled company have a direct and immediate link with an exempt supply and therefore, do not carry a right to deduct input VAT on those services. Finally, if the share disposal is exempt the fact that the transaction is carried out in two or three successive stages is of no relevance to the fact that input tax is restricted on supplies with a direct and immediate link to that transaction. To decide otherwise would treat differently otherwise comparable transactions.

To read the opinion in full please click here.

Judgment - Rakvere Lihakombinaat - C-140/08 – Customs Classification of frozen mechanically separated chicken

This case referred from the Estonian Courts looks at the Customs classification of frozen mechanically separated chicken. To read the questions in full click here.

Judgment - Commission v Finland - C-246/08 – Non taxation of services

This case concerns Infringement proceedings against Finland and excluding from the scope of VAT the services supplied by public legal aid offices. Currently in Finland, legal aid provided by an attorney working for a public office in return for a partial contribution is not subject to VAT. However, when the recipient of legal aid has chosen to be assisted by a private attorney, the same services fall within the scope of the tax and are charged VAT. The Commission believe this treatment is contrary to EU law. The VAT Directive calls for the taxation of services provided by public authorities where doing otherwise would give rise to significant distortions of competition. To read the application click here. The opinion was released in July but is not available in English.

To read the Commission's earlier press release on the infringement proceedings please click here.

Hearing – Swiss Caps – Cases C-410/08 to 412/08

These questions refer to Customs classification of various oils, additions of other substances and the impact of the casings on their classification. To read the references click here, here and here.

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