KPMG's Indirect Tax Update

TAX

Highlights

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After a gap of several weeks we have seen some Tribunal decisions released and some make very interesting reading. The *Skipton* case on input tax attribution looks at the concept of a direct and immediate link between input tax and exempt activities, in order to decide whether advertising costs incurred by an estate agent had any link to mortgage services, making the relevant VAT residual rather than fully recoverable. HMRC argued that the costs had a link to all the activities as they promoted the entire business, and the mortgage side could not be ignored. This was an argument they had rejected in *Royal Agricultural College*, where brochures advertising the college were not deemed to have a sufficient link to any taxable sales to students that the college might make once the students enrolled and so the VAT related only to exempt supplies of education. The Tribunal had agreed with HMRC in the *Royal Agricultural College* case, and the *Skipton* Tribunal took a similar and logical line in finding for the taxpayer. An advert can not promote something it does not mention. Therefore if adverts of houses for sale made no mention of mortgages, they could not be promoting the exempt business, and the input tax was not residual but recoverable in full.

Is it too much to ask that HMRC adopts a consistent policy in key areas even where that policy may be to the taxpayer's benefit in certain fact patterns, rather than taking diametrically opposing views in different cases? How will a tax payer know what constitutes a sufficient link to a supply, when it seems much easier in HMRC's view, to create a link to an exempt supply than a taxable one?

A similar outcome occurred in the *Ultralase* case where HMRC argued, contrary to arguments they had made with equal vigour a few weeks earlier in the *Burke* case, that any supply in a regulated medical institution was exempt even if it was not medical care (presumably not the sales in the hospital shop). Again it was left to the Tribunals to apply the consistent approach HMRC had not applied and to conclude in both cases that the supplies had first to be medical care before they could be considered for exemption.

In another example of how several VAT cases on similar issues often seem to be heard close together, the meaning of medical care was considered in the *Allan Carr* case. This concerned the famous way to stop smoking without the use of nicotine replacement therapy or will power, by understanding why you smoke and the negative impact that nicotine has on you. The man on the Clapham omnibus would probably not immediately consider that smoking cessation therapy provided by non-medically qualified therapists was medical care, and HMRC viewed the supplies as taxable, but the Tribunal disagreed. Nicotine addiction was an illness, and the sessions aimed to cure that illness, thus saving the NHS costs of future care. The supplies met the definition of medical care.

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Exemption did not require the care supplier to be medically qualified - he merely had to be supervised by someone so qualified. The Tribunal then went on to conclude that there was sufficient involvement by a doctor in the process to amount to appropriate supervision in the circumstances, hence exemption applied. This shows therefore that although exemptions must be strictly construed, they can be wider than you might first think. This case was a further example of HMRC interpreting the law using guidance that did not reflect the law. HMRC's guidance stated that the service had to require medical supervision to be exempt when supplied by an unqualified supplier - this was too strict by comparison to the law. Interestingly in 1997 an earlier Tribunal had ruled the services to be taxable; the appellant had taken steps since then to achieve the exemption.

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

From the Tax Authorities

Revenue & Customs Brief 52/09 Guidance on VAT and Excise Wrongdoing penalties

HMRC have published technical guidance on the new VAT and Excise Wrongdoing penalties which will be implemented on 1 April 2010. This Business Brief gives an overview of how the new system will work. Click here to read the Brief.

Revenue & Customs Brief 55/2009 Bingo Duty: Rank High Court Ruling

HMRC announce following the *Rank Group* High Court ruling that they maintain their view of the law on the applicability of VAT to Mechanised Cash Bingo (MCB) and do not accept that the ruling extends to encompass par fees charged on all bingo. They have sought leave to appeal the High Court decision. Click here to read the Brief.

HMRC arrests in suspected carbon credits MTIC fraud

The Central Office of Information has released details of seven arrests as part of an operation into a suspected £38 million VAT fraud involving emissions allowances (carbon credits). This follows the UK's zero rating of such supplies with immediate effect from 31 July to prevent such frauds. To read the press release in full click here.

Withdrawal of Notice 719 refunds for 'do it yourself' builders and converters

This notice, which supplied information to people building or converting their own property, or having a property built or converted for them, has now been withdrawn. For guidance see VAT431NB for new builds and/or VAT431C for conversions.

Notice 700/6 VAT Rulings

This notice cancels and replaces Notice 700/6 (April 2008). Changes include updates to some references to guidance on VAT and tax payers' rights if they disagree with HMRC. Click here to read the Notice.

Code of Practice 10

HMRC have updated their Code of Practice 10 reflecting some expansion of text on statutory clearances and statutory approvals. It also includes amendments to the text on 'Complaints' to reflect changes in HMRC's complaints handling process. Click here to read the revised Code of Practice 10.

Anti-avoidance: spotlights

HMRC have selected six avoidance schemes that they consider ineffective in order to discourage potential users by giving warning that use of these schemes will probably be challenged. VAT artificial leasing, which makes use of different rules in Member States about the interpretation of leases with an option to purchase is included as one of the six schemes. Previously in the *RBS GmbH* Tribunal case, the Tribunal concluded that the way to tackle such issues (where a VAT benefit arose from different rules in different Member States) was not to disallow VAT, but to harmonise the rules, in line with the Directive. Click here to read the spotlights.

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Recent JCCC papers

HMRC released the following JCCC (09) Papers

57 Changes to the delivery method for Flexible Accounting System (FAS) Statements
56 Contact details for Customs, International Trade & Excise Written Enquiries
55 End Use relief / Anti Dumping Duty Chinese Bicycle parts
54 Tariff quotas: Agricultural products from Turkey, new code for Box 36 of the Single Administrative Document
53 Authorised Economic Operators (AEOs)
52 Extension of derogation from rules of origin for core spun yarn - Swaziland
51 New Data Element Required on the Customs Declaration
50 Cancellation of Trader Unique Reference Numbers JCCC and CIPs

Rates of Exchange for Customs and VAT purposes

HMRC have published the rates of exchange to be used when any foreign currency amount has to be converted to sterling in the determination of the value for customs and VAT purposes for the period from 1 September 2009 to 30 September 2009. Click here to see the rates.

In the Courts

First Tier Tribunals

TC00136 Allen Carr Easyway (International) Ltd - smoking cessation therapy is supply of supervised medical health care – tax payer win

The VAT Tribunal has concluded that the provision of the Allen Carr method of stopping smoking can be an exempt supply of medical health care, which, although not supplied by a qualified medical practitioner, was supervised by one. HMRC argued that the sessions supplied to clients did not involve a supply of medical care provided by a medical practitioner in the exercise of his profession, nor were they directly supervised as such. The therapists were not medically trained or qualified, the work did not require medical supervision or medical expertise and the doctor did not control the delivery of the service but made sure that any medical questions asked by patients were properly dealt with so his role was purely advisory. Under the terms of HMRC's guidance VAT was due on the fees paid. The service was not the same as that offered by doctors in the NHS which focussed on will power and nicotine replacement, neither of which the Allen Carr method viewed as necessary. Two services with a common aim were not necessarily the same service and therefore could be taxed differently without breaching neutrality.

The Allen Carr service involved five hour group therapy sessions during which reasons for smoking were established and the patients would agree they were addicted to nicotine not smoking. Any medical issues and concerns around withdrawal symptoms and the impact of stopping smoking on pre existing conditions would be raised. Methods of stopping would then be discussed - will power and nicotine replacement were not viewed to be necessary as once the client knew why they smoked, accepted that nicotine is not the answer to stress or boredom but instead caused stress or boredom, and understood what smoking did to them, stopping would be easy. The final part of the session involved relaxation/hypnotherapy.

The Tribunal accepted that nicotine addiction is an illness and that the aim of the service provided at the clinic was to cure that addiction, which would result in lower costs to the Health Service. Thus the service was medical care. The therapists did not have to be qualified - the aim of the VAT law was to tax the unqualified unsupervised cowboy but the doctor had sufficient input to count as appropriate supervision for the circumstances of the case (the *Moss* case referred). So the service was exempt.

In the 12 years since an earlier Tribunal had concluded the services were not directly supervised by a qualified person, and were not supplied by a medical practitioner in the exercise of his profession either, the appellant had been in regular contact with HMRC and had appointed a doctor to work part time on its behalf (four hours a week), thus leading to a different outcome this time.

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This decision calls into question some of HMRC's guidance around the scope of the medical exemption. If HMRC do not appeal we may therefore see some changes to guidance to bring it more in line with the law, and make it more consistent.

Click here to read the case in full.

TC00146 Skipton Building Society – estate agent advertising costs – residual or fully recoverable – tax payer win

The Tribunal in the *Skipton* case has concluded that VAT incurred by Connells estate agent (a member of the Skipton VAT group) in advertising houses for sale related only to taxable supplies of estate agency services, as long as the advert made no mention that the advertiser also offered mortgage services which would generate exempt income. If there was no mention of the mortgage service in the advert the opportunity to arrange mortgages could not be seen as an aim of the advert but was instead a consequence of the success of the advert in attracting potential house buyers to visit the branch or web site, who might then take out a mortgage with Skipton or another lender, arranged by Connells. This was an insufficient link to exempt supplies, adopting the same approach as taken by the Tribunal in the *Royal Agricultural College* case, where the costs of advertising the College were found to have only an indirect link to the taxable supplies made by the College in the bar and shop to students who enrolled in response to the adverts and hence the VAT only had a direct link with exempt supplies of education, (which is the line HMRC had also adopted).

However the Tribunal also concluded that the slightest mention of mortgages, even the inclusion of just the single word mortgages in a strap line, was enough to create a sufficient link to exempt supplies and make the VAT residual. If the advertiser mentions something he supplies he must be intending to promote that supply in the advert, even if that is not the primary purpose of the advert.

This is a useful decision as the Tribunal is clear that if the exempt supply is not mentioned in the advert at all, the advertising VAT has no direct link to exempt supplies, contrary to HMRC's assertion that all the adverts promoted the business as a whole, including the exempt activities, (which generated significant income and were not incidental to the income from arranging house sales), hence all the VAT was residual. The Tribunal contrasted *Dial a Phone* as in that case the insurance was mentioned in the adverts.

Click here to read the case in full.

TC00142 Ultralase Medical Aesthetics Ltd – aesthetic cosmetic treatments – tax payer win

This concerned the scope of the health exemption. As well as offering laser treatment for eyes, Ultralase operate clinics offering cosmetic beauty procedures like skin peels, removal of excess facial hair etc. The clinics were state regulated institutions but the focus of advertising etc was very much on beauty treatments designed to improve the patient's appearance and self confidence, not medical treatments to cure or treat disease or disorders. People did not need to be referred to the clinics by a doctor and the clinics would turn away anyone they thought needed to see their own doctor for medical concerns such as clinical depression. You may remember in the recent Burke case the appellant was arguing for exemption for Intense Pulsed Light (IPL) treatment to remove excess hair and HMRC successfully argued that the IPL treatment offered by the appellant was taxable, because it did not comprise medical treatment of any disorder. However in the *Ultralase* case, the appellant had been accounting for VAT on the supplies of the cosmetic treatments but HMRC had concluded the supplies were exempt and assessed for £400,000 to disallow input tax claimed on equipment and set up costs (expenses significantly exceeded income in the period in question).

The basis of HMRC's argument was that as the clinics were state regulated, any procedure carried out there was exempt. However the appellant argued that in order for the exemption to apply, the service had first to be one of medical care, and aesthetic cosmetic treatments of this kind did not comprise medical care as defined in cases such as *Dr Peter d'Ambrumenil* (C-307/01). The reason for the health exemptions in the Directive was to ensure a VAT cost did not prevent people from seeking the medical treatment they needed, (in the event such treatment was not available free of charge). The exemption was not there so that wealthy people could avoid paying VAT on procedures that had no medical basis and were simply to make themselves feel more attractive. There was a clear difference

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between someone who needed facial surgery after an accident and someone who wanted a bump on their nose removed, for purely aesthetic reasons.

This decision gives us some useful pointers about where the dividing line between exempt health care and taxable cosmetic procedures should be drawn. It would seem the way clinics attract and screen patients, the procedures on offer, how these are described and the benefits they offer, and the referral process could all have a bearing on the VAT liability. It is possible therefore that the same procedure, carried out in the same state regulated location, by the same doctor, on two different people, could have a different VAT liability, but fiscal neutrality would not be breached because the procedures would not have the same purpose – one might be needed medically, and hence qualify for exemption, while the other was pure vanity, hence taxable.

Click here to read the case in full.

TC00135 Moorbury Ltd – must HMRC restate all the transactions and thus the output tax declared by Moorbury must be netted off against the input tax assessed by HMRC? – tax payer win

Moorbury and Sunnyglen were subsidiary companies of the Cumbria Institute of Art (now part of the University of Cumbria). The companies were established to instigate a 'Halifax arrangement' seeking to recover significant amounts of VAT on the construction of a new campus in 1999.

Under the arrangement Moorbury accounted for £588,000 output tax for supply of 'construction' services to Sunnyglen. Sunnyglen sought to recover the VAT charged by Moorbury as input tax, and Moorbury sought to recover as input tax supplies received from third party contractors. HMRC assessed both Sunnyglen and Moorbury for the input tax claimed and, at the time, invited Moorbury to submit a voluntary disclosure for the allegedly overpaid output tax. Moorbury never submitted a voluntary disclosure.

Following the ECJ Judgment in *Halifax*, the University of Cumbria accepted that the structure was abusive and the Halifax principles applied. HMRC sought to recover input tax that it had assessed but refused to net off the output tax accounted for by Moorbury on the grounds that no voluntary disclosure had been submitted and they were now out of time to repay the VAT.

Moorbury appealed (initially along with Sunnyglen but the Sunnyglen appeal was subsequently withdrawn before the hearing) claiming that under the principles laid down in *Halifax*, HMRC must restate all the transactions and thus the output tax declared by Moorbury must be netted off against the input tax assessed by HMRC notwithstanding any time limit issues.

The Tribunal agreed that it was an obligation of the tax authority to correct both sides of an abusive transaction, essentially there should have been no need for Moorbury to submit a protective voluntary disclosure for the output tax it had accounted for since HMRC should have made the adjustment at the time it assessed for the input tax recovered. The fact the output tax exceeded the input tax was not relevant. One interesting point is comments made by the Tribunal chairman about costs, as is usual the parties can go back to Tribunal if they cannot agree costs but the Chairman's comments seem to suggest that he will be less than sympathetic to Moorbury given that, despite winning the appeal on the principle point, there would have been no need for the appeal if Moorbury had simply followed HMRC's invitation at the time of raising input tax assessments to submit a voluntary disclosure for the output tax.

Click here to read the case in full.

TC00132 Kevin Almond – DIY Builders Scheme – tax payer win

Mr Almond purchased a semi-detached house in the Whittlesey Conservation Area. The property is over a hundred years old and in poor condition. After discussion with the local planning department and the conservation officer, Mr Almond demolished the house except the existing street-facing façade and part of the wall bounding the adjoining property. He consulted HMRC's Notice 719 (VAT refunds for DIY builders and converters) and received confirmation that he would be entitled to a VAT refund. The refund claim however was subsequently refused by HMRC on the

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ground that the retention of the façade was not a requirement but rather a recommendation of statutory planning consent and hence the work could not be counted as a new build.

The Tribunal found in favour of Mr Almond and accepted that he complied with note 18(b) of Group 5 Schedule 8, VAT Act 1994. The Tribunal pointed out that whether the local authority "might have granted some form of planning approval which would have allowed for the demolition of the front façade is purely hypothetical". The fact is clear that "Mr Almond did not apply for consent to demolish the house in its entirety (and because the property is in a conservation area, consent to demolition would be required), and no such consent was given". Interestingly, HMRC have now announced that Notice 719 is withdrawn.

Click here to read the case in full.

TC00144 Sophie Holdings Ltd – Time limit for making assessments – tax payer win

This is a reassessment of a Tribunal decision released in May this year taking account of missing written submissions from HMRC. Sophie Holdings Ltd (SHL) submitted a VAT registration application in October 2003 stating its intention to undertake a substantial reconstruction of a property, (which would have meant that the sale of that property was taxable, and related input tax deductible). The original Tribunal concluded that HMRC had sufficient evidence to raise an assessment then (i.e. 2003) since it was obvious from the Permission and Consent letters etc provided by SHL that the property would not satisfy HMRC's 'substantial reconstruction' conditions and hence the sale would be exempt. HMRC 'appeared to have failed to appreciate the significance of the information' and therefore were out of time in making assessments under s.73 (6)(b) VATA 1994 as the timing of the assessments were more than 12 months from the date when evidence of facts sufficient in the Commissioners' opinion to justify making assessment, came to their notice, and more than two years after the end of the accounting periods.

In the later written submission, HMRC argued that the original intention to make taxable supplies had not been carried out as initially put forward hence they were entitled to assess from March 2006, as that was when the Commissioners became aware of the changed situation. The Tribunal upheld its original decision and pointed out that the test of original intention means the right of receiving input tax exists regardless of whether the onward later supply turned out to be an exempt supply. It is only when the intention changes that input tax adjustments are required. Here there had been no change of intention, taxable supplies could never have been made and so the input tax was always irrecoverable. HMRC could have known that from the outset in 2003 and should have disallowed the VAT then.

Click here to read the original decision released on 6 May 2009.
Click here to read the later decision released this week.

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