



KPMG's Indirect Tax Update

TAX

Highlights

So should the US be able to build its new UK embassy free of VAT? It would seem that the 'special relationship' is going through a slight sticky patch as the Treasury is saying VAT is due on construction of UK property (and is presumably also refusing to refund that VAT to the US). The headlines do not highlight the difficulties for the builder, who is presumably stuck in the middle with HMRC expecting him to account for VAT that his prestigious customer does not want to pay. But perhaps the most telling part of this story is the comment by the Foreign Office (FT 28 August 2009) whether it pays local VAT on overseas contracts: 'It depends on local circumstances. Sometimes we do, sometimes we don't'. This may have surprised many – but to the VAT expert it is clear that this is the only reasonable and responsible reply that the spokesman could have given.

Recovery of pre registration and, for companies, pre incorporation VAT can be a complex issue as the *Oaks Pavilion* case demonstrates. It is outside the normal VAT parameters and as such, of course, the rules must be tightly observed to ensure that VAT is not claimed if it has no link with taxable supplies made post registration, which is why the appellant had much of its claim disallowed. However as the Tribunal Chairman pointed out, it is unsatisfactory that HMRC interpreted and applied the relevant Regulation incorrectly in two aspects, (which was the reason the appellant had part of his appeal (for the post incorporation but pre registration VAT) allowed).

HMRC argued that the appellant had to meet two mutually exclusive conditions to be able to claim the relief allowed under the Regulation, because the two parts of the Regulation are linked by an 'and'. HMRC's analysis would have required the company to be a taxable person before it even existed. Clearly a case where the bare words on the page did not produce a 'sensible' result and a more purposive approach was therefore needed to give the Regulation its proper effect.

The other area of confusion concerned whether building materials incorporated into the two houses the company was building had been 'consumed' such that they were not on hand at registration. HMRC said that they had been consumed, but the Tribunal disagreed. They were not consumables. The correct question to ask was whether they had been used in making pre-registration supplies. Here the Tribunal did not consider that the issue of local authority Certificates of Completion in respect of the houses meant that the company had made supplies on that date (which was before registration). The Tribunal looked at the date the company invoiced the construction supplies and was paid for them (after registration) to decide when the supplies were made. The company was therefore able to claim VAT incurred pre registration which it used to make those taxable supplies after registration.

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Is there perhaps some muddled thinking in Revenue and Customs Brief 56/09 dealing with artificial leasing structures? HMRC say that the intention of the Directive is thwarted if an individual can (effectively) acquire and use a yacht for private recreational activities VAT free. Consequently such structures may be abusive under *Halifax* (on the presumption that their essential aim is to secure a VAT advantage). But if the purchase is routed through a company and the individual pays a market rate for use of the yacht then firstly he has not acquired the yacht and secondly he is paying irrecoverable VAT on the private use. Surely if there is a challenge to be made it is not based on *Halifax* but the more fundamental argument of whether there is in fact a business here sufficient to allow the company to register and recover VAT if the individual is the only customer? On that note HMRC say that yachts supplied in the UK must always bear UK VAT as they are used for recreation and pleasure and hence are excluded from our zero rate rules. However the UK's zero rating for ships, as is the case with the zero rating for aircraft, (where the Commission is already taking infringement proceedings against the UK) is out of step with the Directive. The Directive zero rates sea going vessels, used for carrying passengers for reward.

Finally the *Walk the Walk in Action Limited* (WWA) case highlights the asymmetry of the rules on interest in VAT cases. HMRC issued an assessment and adjusted a VAT return. Subsequently these actions were largely reversed as WWA was able to demonstrate its entitlement to much of the VAT that had been assessed for and adjusted. It therefore claimed interest in compensation for the loss it suffered as a result of HMRC's actions. The Tribunal found that the law did not allow for such a claim. HMRC had acted on the basis of the evidence available to it at the time, and consequently it had not made any error of the kind that would oblige it to pay interest.

Some of the asymmetry in the treatment of HMRC and taxpayers with regard to interest will change with FA 2009. In a move to align the tax and VAT rules on interest HMRC will pay interest where they have received too much VAT as a result of taxpayer error (under the current rules they only pay interest on VAT overpayments where there has been an official error by them), but the significant differential between the default and statutory interest rates will remain.

To access the highlights podcast, please click [here](#).

To access the full podcast, please click [here](#).

From the Tax Authorities

Revenue & Customs Brief 56/09 VAT treatment of yacht chartering or leasing activities

Further to HMRC Brief 11/07, the aim of this Brief is to clarify HMRC's view of the VAT treatment applying to the purchase and use (eg leasing and chartering) of pleasure craft and sets out HMRC's approach to artificial structures. Click [here](#) to read the brief.

Recent JCCC papers

HMRC released the following JCCC (09) Papers

[59](#) Revised public Notice 306 and 308 - temporary admission

[58](#) New data element on the customs declaration - currency of invoice

VAT Online Services events

HMRC plan to phase out the use of paper VAT returns from 1 April 2010. This will cover businesses with an annual turnover of £100,000 or more excluding VAT, and all newly registered VAT businesses. HMRC are holding a series of events this year to offer taxpayers help on this change. Click [here](#) to read the news.

Updated Notice 200: Temporary Admission

Notice 200 provides advice for importers/exporters about relief from import duties on a range of goods imported for temporary use. Click [here](#) to read the Notice.

UK News

Financial Times: US resists £50 million VAT claim on embassy work

Financial Times reports on 28 August 2009 that the US is standing firm against UK's demands to pay up to £50 million in VAT on its new embassy building in south London (moving from its current site in Mayfair). The US insists that under international protocol it should not have to pay tax on the building project. The UK Treasury has refused to deviate from its official guidelines that if construction services are carried out on a UK property, they fall within the 'VAT place of supply of services' rule. Click [here](#) to read the article.

Guardian: Darling's VAT cut 'had no effect on consumer spending'

Despite the Treasury claim the 2.5 percent VAT cut has put the equivalent of almost one percent of gross domestic product back into the economy, the Guardian reports a survey that interviewed 2,000 consumers finding that the majority of people believed the VAT cut had not prompted them to spend more on goods or services. Click [here](#) to read the article.

In the Courts

First Tier Tax Tribunal Cases

UKFTT 186 Walk the Walk in Action Limited (WWA) – whether interest due on subsequently reduced assessment – no – tax payer loss

In 2005 discussions took place concerning WWA's attribution of input tax between business and non business activities. In the absence of 'substantive' responses from the taxpayer HMRC issued an assessment based on best judgement in August 2006. A reduction was also made to the 06/06 return reducing the net repayment from £235,000 to £94,000. WWA did not appeal against the assessment. Correspondence continued until 2008 when HMRC agreed in light of information provided, to a reduction of the assessment and payment of most of the input tax on the 06/06 return. WWA was paid just over £62,000 by HMRC. WWA subsequently made a claim for interest which was rejected by HMRC. WWA argued that it should be treated fairly on the basis that as HMRC charged interest on payments due to HMRC, HMRC should pay interest on amounts it owed. It argued interest was simply compensation for the time value of money lost and that HMRC had made an error by making an excessive adjustment to the 06/06 return. HMRC simply stated there are good reasons why interest is asymmetric, VAT is only due in circumstances prescribed by legislation and the Tribunal has no inherent jurisdiction to award interest. In reaching its decision the Tribunal confirmed it was confined by the relevant legislation. S78 requires HMRC to have made an error in order for interest to be payable. Although HMRC had at times been slow in their dealings the making of the assessment in best judgement in 2006 and the adjustment of the 06/06 credit did not comprise an error. For completeness the Tribunal added interest was also not due under s84(8) either as in this case the credit was paid without recourse to the Tribunal.

Click [here](#) to read the case in full.

Oaks Pavilion Ltd – recovery of pre-incorporation/registration costs – appeal partly allowed

Mr Coram conducted building operations for two houses behind his own residence, and leased out both after completion (exempt supplies). During the development, in order to recover VAT on building materials incurred in the course of construction, his accountant advised him to form a company, Oaks Pavilion Ltd (OPL), that would undertake a 'constructing new build house' business, for which it charged Mr Coram as the owner of the land. The service of OPL would then be treated as zero-rated, allowing it input tax recovery on related costs. Mr Coram and his accountant asked HMRC to confirm the VAT position and believed they obtained the confirmation. OPL eventually became VAT-registered from 30 April 2006. In October 2006, HMRC disallowed most of the input tax claimed by OPL on the first VAT return except a small amount incurred on supplies made to it after its registration on the basis that the claims for the earlier expenditure did not meet the conditions of Regulation 111 VAT Regulations 1995 (Exceptional claims for VAT relief – pre registration and pre incorporation VAT).

The Tribunal dismissed OPL's appeal for much of the recovery of VAT on pre incorporation expenditure because this was incurred before Mr Coram, who formed OPL, (on 23 February 2006) decided, (on 22 February 2006), that OPL would conduct a property construction business. Consequently the expenditure could not be 'for the business of the company' as there was no business anticipated at that time (see Regulation 111). The Tribunal allowed the expenditure incurred by OPL itself after its incorporation (under Regulation 111(1)(a)) as this was for the purposes of a business about to be conducted by OPL, which would result in OPL making taxable supplies. HMRC had argued that the VAT on the building materials fell outside Regulation 111 because the materials were consumables which had been consumed before OPL was VAT registered because the two houses were complete before OPL registered. Thus the goods were not on hand at registration and had been used in making supplies before registration (such supplies block a right to recovery) so did not meet the conditions of Regulation 111. Also HMRC argued that any claims made by a company under Regulation 111 had to meet both 111 (1) (a) and (b) and these claims did not. The Tribunal disagreed with HMRC's interpretation of Regulation 111 VAT Regulations 1995 in two respects:

- (1) The building materials were goods that had not been consumed pre registration as they still existed. Hence input tax recovery cannot be denied under 111 (2) (a) (ii). The Tribunal concluded that the construction services were not supplied until OPL was paid (in September 2006) and as this was post registration OPL could claim the VAT incurred on materials on and after incorporation;
- (2) A company claiming deductions for pre-incorporation expenditure can not satisfy both Reg111(1)(a) and (b) as these are mutually exclusive, since Reg111(1)(a) assumes the taxable person exists when the VAT is incurred, but is just not VAT registered, whereas 111 (1)(b) assumes the taxable person does not exist at all when the VAT is incurred. Therefore HMRC were wrong to argue that a company had to meet both conditions to be able to recover the VAT.

Click [here](#) to read the case in full.

ECJ Diary

The ECJ resumes this week after summer break. We reported previously the following two Judgments would be released this Thursday. We will bring you our analysis next week.

Thursday 3 September

Judgment C-2/08 – Fallimento Olimpiclub

In the *Fallimento Olimpiclub* case the AG opined that the national court should dis-apply a domestic rule laying down the principle of res judicata, where the transaction concerned was actually designed solely to obtain a tax advantage and thus constituted an abusive practice. Put simply the AG considers that local court decisions which purport to have settled an issue cannot 'trump' the application of the abuse principle.

To read the opinion and the questions click [here](#).

Judgment C-37/08 – RCI Europe

The AG said in her opinion on 2 April 2009 that the place of supply of enrolment and subscription fees in respect of a timeshare exchange club should generally be treated as supplied where the supplier is established. However, the treatment of the 'exchange fees' is still unclear. The AG's opinion was that these supplies either fall under the Tour Operator's Margin Scheme (TOMS) (taxed where the supplier is established) or in the absence of meeting the conditions of TOMS they are taxed where the property, in relation to which the exchange right is exercised, is located. To read the opinion and questions click [here](#).

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