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1. In VAT the legal contract often determines the result

It is relatively rare for tax cases to appear before the Supreme Court (SC) but HMRC have recently lost a couple of cases because the HMRC analysis of the legal contracts was defective. They lost a National Insurance Contributions case because their contention that sums paid into a discretionary trust were earnings of a potential beneficiary was not sustainable and ignored the fact that the beneficiary had a contingent entitlement that might never come to fruition.

In [The Commissioners for Her Majesty's Revenue and Customs \(Respondent\) v Secret Hotels2 Limited \(formerly Med Hotels Limited\) \(Appellant\) 2014 UKSC 16](#), the case turned on whether Secrets Hotels 2 Ltd acted as principal or as agent. HMRC argued that the company acted as principals supplying holiday accommodation to tourists whereas the analysis of the contract made it clear that the company merely acted as agents of the hotels supplying the holiday accommodation.

Lord Neuberger, President of the SC, gave the leading judgement which was unanimously supported by the other judges and he found in favour of the taxpayer.

Secret Hotels2 Ltd (formerly called Med Hotels Ltd, and known as "Med"), marketed holiday accommodation, consisting of around 2,500 resort hotels, villas, and apartments in the Mediterranean and the Caribbean, through a website, www.medhotels.com ("the website"). An hotelier who wished his hotel to be marketed by Med had to enter into a written agreement with Med headed "global hotels – Terms and Conditions for allotment contracts".

A potential customer would book a holiday through a form on the website, which set out standard "Booking Conditions", which included, of course, terms as to payment. The customer had to pay the whole of the sum which he had agreed with Med to pay for the holiday ("the gross sum") before the holiday-maker arrived at the hotel. However, Med only paid the hotel a lower sum ("the net sum") in respect of the holiday concerned, pursuant to an invoice which was rendered by the hotelier when the holiday had ended. HMRC assessed Med for VAT in respect of the relevant period on the basis that tour operators' margin scheme (TOMS) applied (articles 306-310 Directive 2006/112/EC ("the Principal VAT Directive")). HMRC's analysis was that Med booked a room in a hotel for the net sum, which it paid to the hotelier when the holiday had ended, and Med supplied the room to its customer in return for the gross sum, which it received in advance of the holiday. In other words HMRC argued that the company acted a principal. On HMRC's analysis based on TOMS resulted in their assessing Med to liability for VAT in respect of the relevant period in the sum of £7,119,702.

The company's argument was that it was within article 306.1(b). This was on the basis that it was, during the relevant period, a "travel agent" which was "acting solely as an intermediary". Med's analysis of the position was that, through Med's agency, the hotelier supplied a hotel room to a customer for the gross sum, and that Med was entitled to the difference between the gross sum and the net sum as a commission from the hotelier for acting as the hotelier's agent.

A legal analysis of the contracts decided that (i) the contractual arrangements between Med and the customers established that Med was contracting as agent for the hotelier, and (ii) the contractual arrangements between Med and the hoteliers were consistent with that conclusion. The issue must be determined by reference to the proper law of the contract or contracts concerned, and, in so far as the

subsequent conduct of the parties is said to affect that nature and character, the effect must also be assessed by reference to the proper law of the contract or contracts.

Paragraph 36 - "In my view, both the Accommodation Agreement and the website terms make it clear that, both as between Med and the hotelier, and as between Med and the customer, the hotel room is provided by the hotelier to the customer through the agency of Med, and the customer pays the gross sum to the hotelier, on the basis that the amount by which it exceeds the net sum is to be Med's commission as agent."

The taxpayer won but had to go to the Supreme Court and that must have imposed a significant cost. What a pity that HMRC could not have analysed the contracts properly in the first place.

2. New VAT registration limits apply from 1 April 2014

[Statutory Instrument: 2014/703 and Explanatory Memorandum](#). The Value Added Tax (Increase of Registration Limits) Order 2014. Registration is compulsory if taxable turnover exceeds £81,000 and deregistration is permitted if taxable turnover will be less than £79,000

3. VAT fuel scale charges effective from 1 May 2014

Businesses must use the new scales from the start of the next prescribed accounting period beginning on or after 1 May 2014. [You can view the new charges here](#) (PDF 46 K).

4. Revised VAT notice 700/63: Electronic Invoicing

[Revised VAT notice 700/63](#) cancels and replaces Notice 700/63 June 2007. It has been updated to reflect the changes in invoicing regulations of 2013. It also contains revised content to reflect the technological advances since the previous version.

Electronic invoicing is the transmission and/or storage of invoices, in an electronic format without the delivery of paper documents. The electronic format may be a structured format such as XML or an unstructured format such as PDF.

Electronic invoicing offers many advantages over traditional paper invoices. The rapid electronic transmission of documents in a secure environment may provide for:

- structured data for auditing
- improved traceability of orders
- decreased reliance on paper reducing storage and handling costs
- rapid access/retrieval
- improved cash flow
- security/easier dispute handling

This list is not exhaustive but does indicate some of the principal benefits.

5. HMRC publish a summary of recent changes (three pages)

HMRC publish quarterly VAT Notes. [VAT Notes 1 2014](#) is three pages long and contains a summary of all recent changes to the VAT rules and announce future changes so they are worth a read.

6. HMRC published new guidance on VAT for refunds from manufacturers

Under EU law the net amount of VAT collected by HMRC on a supply to a final consumer cannot be greater (nor less) than that due on the total amount paid by the final consumer. If the final consumer receives a refund or reimbursement of the purchase price, then the total amount paid by him or her will be reduced and the VAT previously accounted for must be adjusted accordingly.

The European Court of Justice in the case of Elida Gibbs (C-317/94) held that a manufacturer was entitled to adjust its VAT to take account of reimbursements paid directly to final consumers under a promotion scheme. The same principle applies when a manufacturer makes a refund direct to a final consumer but in the past HMRC wrongly refused to entertain such claims.

HMRC now accept that refund payments of this type can in some cases represent reductions in the consideration received by the manufacturer.

The Government has therefore introduced a new Regulation 38ZA which expressly provides for adjustments in both Elida Gibbs reimbursement and dissatisfied customer refund scenarios. Manufacturers may therefore be entitled to seek recovery of VAT not already adjusted in past periods subject to the normal capping rules of four years.

The new Regulation takes effect from 1 April 2014 and covers any refund (as defined in that regulation) made in a VAT period that ends on or after that date. The term refund includes a cash payment in respect of damaged or faulty goods and a cash reimbursement paid under a promotion scheme (such as "cash back" deals or money off vouchers). In either case, the payment must represent a reduction in the consideration for the final supply of the goods.

The following are examples of where manufacturers are able to adjust their VAT:

- payments in relation to "money back" promotions
- payments for faulty products
- payments for damaged products; payments made where the customer is generally dissatisfied with a product rather than being able to demonstrate a fault or damage
- payments made in connection with product recalls for safety, health or quality issues

You can read more about the detail by following [VAT Information Sheet 03/14](#). This information sheet explains HMRC's policy on the application of the new regulation. If you have clients affected by this change in policy and practice I recommend making protective claims to HMRC as soon as possible because the 4 year time limit is likely to be strictly enforced.

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The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.

The next VAT update will be on the website on 14 May 2014