

## AAT VAT update 14 April 2015

In this month's edition of the VAT update we look at:

1. HMRC tried to charge a penalty for using the wrong form
2. Pre-registration services input tax limited to 6 months
3. Finance Act 2015 passed
4. HMRC guidance on children's clothing containing fur
5. Estimate of the VAT tax gap published
6. VAT Notice 700 updated
7. Pension fund management costs

### 1. HMRC tried to charge a penalty for using the wrong form

In *Palau & Anor v Revenue and Customs* [2015] UFTT 38, the appellants used the wrong form after seeking advice from HMRC about their entitlement to use the DIY builder's scheme. Although there was no loss of tax, HMRC issued a penalty assessment for £1,408.49 imposed on the Appellants under Paragraph 1(1) Schedule 24 Finance Act 2007 and based on the VAT claimed wrongly using the wrong form.

The appellants owned the property to be converted into two separate flats. They understood that they would likely be eligible to apply for a rebate of VAT incurred in the works of conversion under the provisions of the DIY House builder's Scheme (established under Section 35 Value Added Tax Act 1994) ("the Scheme"). The appellants contacted the HMRC advice line stating their wish to apply the DIY House builder's Scheme following which an application form (VAT431NB) and accompanying notes were sent out to them for completion.

The form's declaration goes on to deal with VAT registered persons and Charity builders neither of which applied to the Appellants at the time (although the Appellants did subsequently register for VAT and in fact recovered £10,887.54 which is more of the input VAT they had laid out in the costs of the conversion than they had applied for under the Scheme £9,389.98).

HMRC were seeking a penalty of 15% of the tax claimed using the wrong form. Is this proportionate? Is this even sensible given that by using the wrong form having been advised by HMRC, they were claiming less than they were actually entitled to claim if they registered for VAT and completed the correct forms?

I worry about cases like this because HMRC internal review should have stopped this appeal proceeding. It is wrong on so many levels that HMRC should never have raised a penalty and it should never have been necessary to go to tribunal. I have to accept that human beings make mistakes (as Messrs Palau and Laughran did when completing the wrong form) but HMRC should have procedures in place to test the HMRC contentions and prevent actions which are a blatant abuse of Human Rights and disproportionate in comparison to the alleged offence.

Where the document concerned is one which is designed to ascertain or confirm eligibility to make the claim itself and which, because it has been accurately and honestly completed by the claimants must necessarily result in the claim being disallowed, it is difficult, if not impossible, to argue that the requirements for the offence contemplated by paragraph 1 (1)(c) of Schedule 24, FA 2007 are satisfied.

Although HMRC seems to lack common sense and reasonable judgement, the First Tier Tribunal discharged the penalty assessment. HMRC needs to learn from such mistakes and ensure that taxpayers can rely on the advice given by HMRC and that HMRC only take action which is correct and proportionate.

<http://www.bailii.org/uk/cases/UKFTT/TC/2015/TC04251.html>

## **2. Pre-registration services input tax limited to 6 months**

I do not want to be critical of HMRC in these podcasts but I am concerned that HMRC are making too many mistakes and, in particular, seeking penalties when the taxpayer has a reasonable excuse for the error which has occurred. Tax is complex and it can be difficult to distinguish between an error arising from carelessness and an error arising because of a mistaken view of complex law.

In *Sam Smith t/a Heliops UK v Revenue and Customs* [2015] UKFTT 24, an airline pilot was seeking to recover the input VAT on his expenses of training to be a self employed pilot. Captain Smith claimed pre-registration input VAT incurred from 9 November 2011 to 3 March 2012 inclusive in relation to helicopter pilot training. His argument was that this expenditure was not on a service but on an intangible asset that was capital expenditure and so was not disallowed by the six month time limit in Regulation 111 of the VAT Regulations 1995 (SI 1995/2518). He adopted this view despite being told at a VAT inspection visit that the input VAT incurred in training of £2004 was not allowable because it was out of time.

In January 2013 Captain Smith applied for VAT voluntary registration which was to be effective from October 2012. He then submitted his claim to recover the input VAT incurred when training to be a pilot despite the invoices being dated for 2011 and appealed HMRC decision to refuse the claim seeking first an internal review and then taking the appeal to the First Tier Tribunal. He had a number of arguments, all of which were wrong and which included HMRC had the decision to waive the time limit and he was being treated unfairly because others were able to recover the input VAT for pilot training.

The amount of the penalty is £771.54; none of that amount is suspended.

In essence, Captain Smith believed that the pilot training expenditure created a capital asset. He was correct in that belief which is supported by the HMRC guidance at BIM 35660 which states:

“Where attendance is required to give business proprietors new expertise, knowledge or skills, which they lack, it brings into existence an intangible asset that is of enduring benefit to the business. We take the view that the expenditure is therefore of a capital nature.”

I am sure that all followers of this podcast series are familiar with the effect of deeming provisions such as s5(2)(b) which deems anything done for consideration and not a supply of goods to be a supply of services. We know that HMRC are right to refuse the claim because the deemed supply of services in 2011 is out of time but should they charge a penalty of 35% which is at a level for deliberate defaulters?

In my view, HMRC lack judgement in assessing a penalty. Such conduct is abusive and does not respect the spirit of the law but technically Captain Smith had been informed of HMRC's opinion and in claiming something to which he was not entitled he did so deliberately and his claim was wrong.

The tribunal criticised HMRC for not directing Captain Smith to Article 14 Council Directive 2006/112/EC of 28 November 2006 (“the VAT Directive”) and commented:

“If it had been open to us to do so, we would have been inclined to reduce somewhat the penalty which has been imposed on Captain Smith, in recognition of his openness in making clear to HMRC his wish to have the merits of his input tax claim tested on appeal. However, we see no basis on which to question the decision of HMRC in respect of the application of para 11 of Sch 24; they considered the question of special circumstances, and concluded that no special reduction should be made.”

The penalty of £771.54 was confirmed. Practitioners need to be very careful if in future they want to test an interpretation of the law. This decision stinks, it is unjust, unfair and morally

wrong. It is not legal precedent but might constitute persuasive authority to be considered in another appeal process until it is overturned (as it should be).

<http://www.bailii.org/uk/cases/UKFTT/TC/2015/TC04237.html>

### **3. Finance Act 2015 passed**

The history of the UK tax legislation is not good. Defective legislation is all too often enacted producing unintended consequences. After 2 days of debate, which I think is totally inadequate and quite irresponsible; the Finance Act 2015 received Royal Assent on 26 March enacting another 300+ pages of legislation.

#### **Value added tax**

##### **s.66.VAT: refunds to certain charities**

##### **s.67.VAT: refunds to strategic highways companies**

May I remind you that the registration threshold has increased to £82,000 (from £81,000) and deregistration to £80,000 (from £79,000)

Read the full detail of the Finance Act at:

<http://www.legislation.gov.uk/ukpga/2015/11/contents/enacted/data.htm>

### **4. HMRC guidance on children's clothing containing fur**

HMRC have updated notice 714 which deals with zero rating on children's clothing with the main change to be found at paragraph 3.1 which deals with fur.

<https://www.gov.uk/government/publications/vat-notice-714-zero-rating-young-childrens-clothing-and-footwear/vat-notice-714-zero-rating-young-childrens-clothing-and-footwear>

### **5. Estimate of the VAT tax gap published**

On 18 March a revised updated estimate of the UK VAT tax gap was published. The VAT gap for 2013-14 is estimated at around 10.3 per cent of the estimated VTTL. This equates to £12.1 billion.

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/413361/Second\\_estimate\\_of\\_the\\_VAT\\_gap\\_for\\_2013-14.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413361/Second_estimate_of_the_VAT_gap_for_2013-14.pdf)

### **6. VAT Notice 700 updated**

On 1 April a new general VAT guide was published

<https://www.gov.uk/government/publications/vat-notice-700-the-vat-guide/vat-notice-700-the-vat-guide>

The technical content of this notice is largely unchanged from the January 2015 edition, although there are a number of minor amendments, updates and improvements. The main amendments concern the changes to the treatment of prompt payment discounts from April 2015.

| Section | Change   |
|---------|--|
| 7       | Updated to take account of the changes affecting prompt payment discounts from 1 April 2015.                 |
| 18      | New sub-paragraph added to take account of the changes affecting prompt payment discounts from 1 April 2015. |

## **7. Pension fund management costs**

A business brief 8/2015 was published on 26 March 2015 This brief follows on from Revenue and Customs Brief 43 (2014) about HMRC's position following the CJEU judgment in PPG Holdings BV C-26/12 concerning an employer's entitlement to deduct VAT paid on pension fund management services. <https://www.gov.uk/government/publications/revenue-and-customs-brief-8-2015-deduction-of-vat-on-pension-fund-management-costs/revenue-and-customs-brief-8-2015-deduction-of-vat-on-pension-fund-management-costs>

HMRC has received enquiries in respect of the impact of the PPG decision on VAT recoverability relating to:

- other types of service (such as legal, actuarial and accounting services)
- other types of pension scheme (such as defined contribution and hybrid)
- VAT Groups that include a corporate trustee and a sponsoring employer
- trustees that charge employers to run their pension schemes

HMRC has been discussing these matters with interested parties and intends to provide further guidance in the summer.

Derek Allen  
03 April 2015

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

This podcast concentrated on VAT. There will be a general tax podcast updating AAT members on recent developments and decisions available on the website on 30 April 2015.