Vat update – 14 September 2016

AAT VAT Update 14 September 2016

In this Month's edition of the VAT update we look at:
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1. Communal Leisure facilities in retirement village denied zero rating

In tax the outcome can be different if minor changes in the procedure occur. There are times, when reading a tax case which involves a charity and the zero rated construction of a building which has self-contained dwellings for the elderly, that the strict interpretation of the law produces what appears to be an unfair result.

Notice 708 makes it clear that communal leisure facilities within the new building and for the sole use of the residents can qualify for zero rating. But in St George's Augustinian Care v Revenue and Customs [2016] UKFTT 567, the swimming pool and other leisure facilities were available to the other residents in a retirement village which was being built in phases, the last of which was this new building Rafael Court. The second floor contains five self-contained apartments which are accepted to qualify for zero rating.. The first floor comprises a gym and dance studio, therapy room and games and hobbies room. There is an indoor swimming pool, changing room and spa on the ground floor and this was the disputed expenditure with HMRC arguing it fell to be standard rated. There is also a café, kitchen, launderette and hair salon on the ground floor and it is not in dispute that this is standard rated. These communal leisure facilities are not solely for the residents of the third floor apartments but for the use of all residents of the retirement village.

The First Tier tribunal considered the interpretation of Group 5 of Schedule 8, VATA 1994 recognising that zero rating has a specific social policy objective but must be interpreted strictly. St George's Augustinian Care had obtained a ruling from HMRC in 2005 concerning another building on their retirement village site, that communal facilities could be zero-rated provided they were for the exclusive use of the retirement village residents. Planning for a further extension of the retirement village was approved in 2004. The construction of the Raphael Court building in dispute was completed in June 2016. HMRC argued that the earlier ruling was incorrect and certainly did not bind HMRC to the construction of Raphael Court.

The tribunal agreed with HMRC that the communal leisure facilities on the ground floor was standard rated. What is equally clear is that if the whole development had occurred at one time and simultaneous to all the building being constructed one had contained a swimming pool then zero rating might have been available. It shows that in tax, it ain't what you do but the way that you do it. In this case they did it incorrectly.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05316.html

2. Tax uncertainty post BREXIT

The debate at report stage of the bill on 6th September discussed a number of VAT items including the reduced rate on energy saving materials but although much was said, it is clear that we need to await the autumn statement which I believe is to be delivered on Wednesday 23 November 2016.

There was also some debate on further devolution of VAT to the Scottish Parliament.

I expect Royal assent to Finance Bill by Thursday 15th September but if you suffer from insomnia or want hints about political thinking then reading the debate, which is heavy going, might help:

http://hansard.parliament.uk/Commons/2016-09-06/debates/16090632000002/FinanceBill

The latest version of the 662 page Finance Bill
is: http://www.publications.parliament.uk/pa/bills/lbill/2016-2017/0061/17061.pdf

3. Did the Financial services exemption extend to web based introduction?

If Dollar Financial UK Limited paid for introductory leads were these web based introductory leads acting as advertisers or a mere conduit for introductions to pay day loan companies?, If the lead generating web sites were mere conduits then the services would be standard rated. First Tier Tribunal Judge Barbara Mosedale decided that the company which performed some basic checks did enough to come within the exemption and was providing exempt introductory services.

Dollar Financial UK Ltd (DF) business, and that of companies in its group, is the making of small, short-term loans to private individuals, often referred to as pay-day loans, as its normal customer is looking for a loan to tide him or her over until the next pay-day. At the period in issue the typical loan made by the appellant was a few hundred pounds for up to 30 days. Its business was accepted as being exempt from VAT. The issue between the parties was the VAT status of certain supplies made to the appellant by overseas suppliers on which the appellant had accounted for VAT under the reverse charge. In 2013, it sought to recover VAT on the supplies made 2010-2013 on the basis that they were properly exempt. HMRC refused the claim.

Two supplies were in dispute:

(1) Supplies by 'leadgens' to MEM/PEX; and

(2) Certain supplies by Allsec Technologies Limited ('Allsec') to MEM/PEX.

A borrower using a leadgen's website would be asked by the website to complete an online application form if s/he wanted to apply for a pay day loan. When the form was completed, the borrower was asked to hit the 'submit' button. When s/he did so, the leadgen would electronically and normally in a matter of seconds if not less, pass on the application form to one of its customers, one of which was the appellant. The borrower would see a 'searching' symbol on the website and would not know what was going on behind the scene.

If the application form was passed to the appellant, and if the appellant chose to accept and pay for the lead, which decision it would also make electronically in a matter of seconds, the borrower would then be presented with a page of the appellant's website offering the loan including the terms of the loan. The borrower could accept the loan by hitting a button 'accept', and then electronically signing the loan documentation, following which, in a short space of time, the loan would be deposited in the borrower's bank account.

The leadgen would keep offering the borrower's application to its customers on its ping tree until the referral was accepted and a loan offer was made or until it exhausted its list of customers (in which case the borrower would not get a loan offer but might be offered some other kind of financial service). The appellant might be anywhere on the ping tree and would not necessary be the first lender to whom a leadgen offered a lead which met the appellant's basic lending criteria: that would depend on whether another lender was prepared to offer the leadgen more for the lead.

The appellant only entered into contracts with leadgens on whom they had carried out satisfactory due diligence, which met the necessary regulatory conditions, and whose online application forms asked the questions to which the appellant required answers. Those questions were:

(a) Whether the applicant was over 18 years of age;

(b) Whether the applicant was UK resident and entitled to work in UK;

(c) Whether the applicant had a monthly net income of at least £900;

(d) Whether the applicant had a UK current bank account with associated debit card.

(e) A valid mobile phone and email address.

The validity of the number and email address would be checked electronically. The leadgens were paid commission by the appellant where the introduction led to a loan offer being made to the borrower.

Allsec would ring a borrower who had been made an offer of a loan by the appellant but not accepted it (by 'signing' the online documentations). The object of the phone call was to get the borrower to enter into the loan contract. The conversions phone calls would be made by Allsec to any potential borrower to whom the appellant had made a loan offer, whether or not the borrower had come to the appellant via a leadgen or otherwise. Allsec was paid by how much time was spent by its agents in Live Chat.

Group 5 of Schedule 9 enacts **Art 135**

1. Member States shall exempt the following transactions:

(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;

(b) the granting and the negotiation of credit and the management of credit by the person granting it;

The FTT judgement sets out:
To summarise my findings of law, to be within 'negotiation of credit' legislation and case law shows that there are the following rules:

(1) Exemptions should be interpreted strictly.

(2) What matters is the nature of the supply and not identity of supplier.

(3) An intermediary can act entirely electronically

(4) While the exemption is static, the services covered by it can evolve.

(5) An intermediary will be remunerated for intermediation but will not be a party to the contract between borrower and institution

(6) Negotiation can be exempt even if no contract results

(7) An intermediary does not have to undertake the entire mediation

(8) An intermediary can be one in a chain of intermediaries

(9) Intermediation does not include the carrying out of back office functions

(10) Intermediation does not include advertising or acting as a mere conduit.

(11) An intermediary is someone who (a) introduces two parties, one looking for a financial product and a person providing it; (b) or is someone who negotiates the terms of such products as between the borrower and lender; or (c) is someone who concludes a contract on behalf of one or other parties;

(12) An intermediary who carries out introductory services (11)(a) must do more than merely advertising or acting as a mere conduit as (per (10)) that is not within the exemption: that extra could be assessing the suitability of the service provider to provide the loan or the suitability of the borrower to receive the loan.

There is no legal relationship between the borrower and leadgen. Despite this, the services provided by Leadgens were within the exemption.

For Allsec, the evidence was that the service did not comprise actual negotiation of terms of the loan so it was not within (11)(b). And so far as (11)(c) was concerned, while the Allsec operatives were expected to explain the benefits of the loan to the borrower, there was no evidence whatsoever that they had power to alter the terms of finally the loan or accept a borrower who did not quite meet the appellant's lending criteria. In other words, Allsec was carrying out of back office-type functions, which the lender could do itself but has chosen to outsource. This is not exempt intermediation.

The judge concluded at paragraph 152: . I find that livechat was not the exempt negotiation of credit but standard rated supply of principally back-office functions. The appeal is dismissed in so far as it relates to the Livechat supplies."

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05334.html

4. Boating charity conducted an economic activity for VAT despite relying on subsidies

Longridge on Thames is a charity which provided boating and water based activity to young people. The charity sought to obtain zero rating on the construction costs of its new building and the VAT involved was £135,000.

HMRC took the view that the fees charged by the charity (which were often below cost) had a direct link to the service the recipients received and that it was carrying out an economic activity. The charity relied on volunteers and what it charged young people was heavily subsidized. The charity had succeeded at the FTT and UT. But HMRC appealed to the Court of Appeal and the three judges have unanimously overturned the lower tribunals decisions and ruled in favour of HMRC.

This is really a horror story because the cost of litigation and going to the Court of Appeal probably exceeds the £135,000 VAT at issue and which the charity sought to recover on the construction of the new building. The judgement in Longridge On the Thames v Revenue And Customs [2016] EWCA Civ 930 is a worthwhile read because the issue of what is an economic activity is an important one for many charities.

The primary activities of the respondent, Longridge on the Thames ("Longridge") are the provision of water-based and other outdoor activities (for both recreational and educational purposes) and the giving of instruction in how to undertake such activities. It provides these to people of different ages, although its focus is on youth. Longridge operates from a site on the banks of the Thames in Marlow. It makes a charge for these facilities but that charge may be adjusted to meet the ability of the end-user to pay insofar as donations or receipts from other activities permits this. It is not registered for VAT and therefore does not charge VAT on its supplies.

Longridge has recently built a new training centre. It had to pay VAT on the construction of the building amounting to some £135,000. It now wants to recover that sum. It contends that the supplies made on constructing the training centre should be zero-rated under Items 2 and 4 of Group 5 of schedule 8 to the Value Added Tax 1994 ("VATA 1994"), The building was intended for use solely for relevant charitable purposes within the meaning of Note (6) to Group 5. A zero-rated supply is a taxable supply chargeable at a zero rate and entitling the supplier to recover all of the input tax attributable to his zero-rated supplies.

The concessionary charges were not an indicator against the existence of an economic activity because the economic activity springs from the receipt of income, not profit. This led to the decision that "there was a misdirection of law by the FTT and UT which vitiates the decisions below is inevitable. There is no room in this situation for Mr Thomas' invocation of the principle that an

appellate tribunal should not in general set aside an evaluation made by the tribunal which made the findings of fact.

Accordingly in my judgment, Longridge conducted an economic activity for VAT purposes and the right order in this case would be to allow the appeal of HMRC and to dismiss Longridge's appeal against HMRC's determination that it was carrying on economic activity or business for VAT purposes." Lady Justice Arden

http://www.bailii.org/ew/cases/EWCA/Civ/2016/930.html

5. Alert: Potential claims to recover VAT on dwellings

In publishing Brief 13(2016) HMRC announce a change in their practice for construction and supply of buildings that are designed as dwellings or undertaking conversion services of non-residential buildings.

https://www.gov.uk/government/publications/revenue-and-customs-brief-13-2016-vat-the-liability-treatment-of-a-dwelling-formed-from-more-than-one-building/revenue-and-customs-brief-13-2016-vat-the-liability-treatment-of-a-dwelling-formed-from-more-than-one-building

This brief has been published on 23 August 2016. Those who have constructed or converted eligible buildings into new dwellings, consisting of more than one building that hasn't previously been treated as zero-rated (for example, works of construction and eligible conversion services) may submit claims for overpaid VAT with retrospective effect up to 4 years from the date of the publication of this brief.

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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.

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 September 2016.