Vat update – 14 December 2016

AAT VAT Update 14 December 2016

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1. Floor area used to apportion pub and flat

I understand that HMRC has an informal agreement with the Brewers' Society that where an option to tax concerns a supply of both commercial and residential property, for example a pub with living accommodation, that the split between commercial and residential should be 90%/10%. The agreement dates from 1989.

In Mathews v R&C [2016] UKFTT 0694 , Mr and Mrs Matthews had bought a pub "The Dog and Partridge" ("the Property") with an existing tenant where the pub included a flat for the pub manager. The Property is a double-fronted, modestly sized building constructed in 1777. At ground floor level, there was (at the time of Mr and Mrs Matthews' purchase of it) a bar area, two open plan rooms and a toilet. There was also a further toilet in the outhouse. The commercial areas of the Property (together, "the Public House") also included a beer cellar and a beer garden. At first floor level, there was a residential flat with three rooms, a kitchen and a bathroom ("the Flat").

The sole access to the Flat was through a staircase in the main bar and so there was no independent access (although there was potential for creating an external access if the toilets were reconfigured). The roof space was also accessed via the Flat, although this had not been converted into accommodation and could only be used for storage.

However the tenant left shortly after purchase and the pub could not be commercially run. The tenant was in default over the rent. The couple had registered for VAT and the property had an option to tax (Schedule 10 to the Value Added Tax Act 1994). Mr and Mrs Matthews decided to cut their losses and sold the Property on 17 September 2012 for the sum of £52,500. The purchaser of the Property ("the Purchaser") intended to (and, it seems, did) convert the Property into a restaurant.

The couple had been unable to obtain planning permission to convert the property into residential accommodation but their thinking had been to so do. A sale of residential accommodation would have been exempt. But HMRC viewed the sale as commercial property and it was eventually sold to a purchaser intending to convert it into a restaurant.

HMRC applied the informal agreement mentioned above and assessed output tax in the sum of £7,634 5 for the VAT period 11/12 arising out of the sale of a property. Mr and Mrs Matthews did not file any VAT returns in the period 11/12, wrongly assuming that there was no need to as (on their case) no output tax was payable and no input tax was being claimed.

Mr and Mrs Matthews argued that no VAT was payable as the Flat represented the whole of the value of the Property and so the residential percentage should be set at 100%. He had researched the position extensively but he was not an expert on property valuation and so his evidence, whilst not ignored counted for little.

He submitted (as HMRC frankly accepted) that the informal agreement with the Brewers was not binding upon him. Crucially, he also made the point that the 90% commercial and 10% residential

apportionment could not be relevant to a disused public house as there was no business for the Flat to be subservient to. He said that a 'one size fits all' approach does not apply to a failed public house with no turnover. HMRC disagreed and took the view that the ratio should be 90% commercial and 10% residential in accordance with HMRC's established approach to public houses with residential service accommodation.

I feel sorry for Mr Matthews because he did not appear to understand that the onus of proof lay with him and he failed to produce the quality of evidence which was required to win his case. He failed to produce any evidence as to the separate rental yields beyond the housing benefit allowances for similar sized residential properties. He declined to adjourn the hearing to allow him to introduce an expert witness qualified to give a valuation of the domestic property.

Given that the pub was not viable and could not be sold as a going concern, the brewers agreement did not apply and did not produce a fair result. The tribunal used floor space as a method of apportionment and that the correct apportionment is two thirds commercial and one third residential.

This still leaves Mr and Mrs Matthews with a default surcharge penalty albeit reduced. In tax, this decision shows that if Mr Matthews had been properly advised and produced the right quality of evidence he should have won his argument and would not have needed to pay VAT or the penalty.

http://financeandtax.decisions.tribunals.gov.uk/judgmentfiles/j9403/TC05426.pdf

2. HMRC brief 16/2016 clarifies pre- registration input tax recovery

This brief sets out HM Revenue and Customs policy on deduction of VAT relating to assets used by the business prior to its VAT registration. It clarifies when, and to what extent, VAT is deductible and what to do if the correct treatment has not been applied.

Subject to the normal rules on VAT deduction:

- VAT on services received within 6 months of EDR and used in the business at EDR is recoverable in full
- VAT on stock is deductible to the extent that the goods are still on hand at EDR (for example apportionment may be required)
- VAT on fixed assets purchased within 4 years of EDR is recoverable in full, providing the assets are still in use by the business at EDR

Full recovery only applies if your business is fully-taxable. If you're partly-exempt, have non-business activities, or need to restrict VAT deduction for any other reason, you'll need to take that into account when calculating your deductible VAT.

https://www.gov.uk/government/publications/revenue-and-customs-brief-16-2016-treatment-of-vat-incurred-on-assets-that-are-used-by-the-business-prior-to-vat-registration/revenue-and-customs-brief-16-2016-treatment-of-vat-incurred-on-assets-that-are-used-by-the-business-prior-to-vat-registration

3. Place of supply rules clarified for airshow advertising services

In Finmeccanica Global Services Spa v HM Revenue and Customs [2016] EWCA Civ 1105, the Court of Appeal has upheld the decision of the Upper Tribunal that the supply was of advertising services and the place of supply was at Farnborough airshow.

Finmeccanica Global Services SpA ("FGS") is part of a group of mainly Italian companies ("the Group") which are leading suppliers of aeronautical, aerospace, defence and security equipment. Its products include aircraft (they have a participation in the Eurofighter Typhoon project), helicopters,

space stations and security systems. To promote the sale of their products they set up displays at major aeronautical and aerospace events including the Farnborough air show. FGS is the Group service company and it purchases the goods and services necessary to mount those displays. This includes cleaning, transport and security as well as the construction and organisation of the display enclosure.

Each of the relevant Group companies was established and registered for VAT in Italy. One of the operational companies in the Group is Westland, an English company, but this can be ignored for present purposes. It is also accepted that the supplies made by FGS to the other Group companies were not made to a fixed establishment outside Italy and that the enclosure at the Farnborough air show was not a fixed establishment of FGS. FGS therefore invoiced the Group companies for the cost of the services it supplied and included and accounted for Italian VAT. It then sought to recover the UK VAT which it had paid in respect of the goods and services which it purchased in connection with the establishment and operation of the Farnborough enclosure. Under the Refund Directive (Council Directive 2008/91EC of 12 February 2008) and its predecessors, the UK VAT is not recoverable if FGS made any supply in the UK. The issue therefore on this appeal is whether the supplies it made to other Group companies in connection with the enclosure were made in the UK for VAT purposes. The provisions of Article 9 have been transposed into domestic legislation by s.7 and Schedule 5 to the VAT Act 1994 ("VATA") and by the Value Added Tax (Place of Supply of Services) Order 1992. For the period from 1 January 2010, the relevant rules can be found in Schedule 4A and 5 VATA.

Overturning the decision of the FTT which had found in favour of FGS, the Upper Tribunal, Mrs Justice Rose, concluded that the place where the relevant services were supplied was Farnborough, where the airshow was held. The Court of Appeal agreed with her, commenting that '… it can readily be said that there was here one place of actual consumption: Farnborough ….' Since this means that FGS was supplying services in the UK, its VAT refund claims were invalid, as HMRC had argued.

http://www.bailii.org/ew/cases/EWCA/Civ/2016/1105.html

4. Draft Finance Bill 2017 clauses published

On 5 December 2016 the Government published draft clauses for next year's Finance Bill adding another 398 pages of legislation and supported by Explanatory notes running to 287 pages. It might look like VAT practitioners only need to read and understand one section on VAT and a little on administrative changes but the details is to be found in Schedules 14 and 21.

I find it difficult to find the relevant documents on the Government's website and the search engine does not seem to be very good. The draft clauses are available for consultation at:-

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574680/newbook_book.pdf

You can even find a helpful overview not just of the legislative changes but also secondary legislation at https://www.gov.uk/government/publications/finance-bill-2017-draft-legislation-overview-documents/overview-of-legislation-in-draft

5. Input VAT on MBO costs recoverable

There have been several interesting decisions of the First Tier Tribunal recently but space and time obliges me to be selective. Heating and Plumbing Supplies Ltd (HPSL) engaged one firm to provide legal and banking advice and another to provide commercial and tax advice in connection with a Management Buyout (MBO).

The aim of the buyout was to promote growth and efficiency in the business by rewarding, incentivising and motivating its management and employees. The buyout was achieved by a newly-formed group company (HPSGL) buying the shares of HPSL, the two companies being VAT grouped.

HPSGL had not made any supplies and HMRC contended there was no direct and immediate link between the costs incurred and the taxable supplies.

The First Tier Tribunal decided that the services were not provided solely to facilitate the acquisition of shares with a view to receiving a dividend, but for the wider purpose of the appellant's business as a whole, and hence that the costs were overheads of the business. The appeal against HMRC's refusal of the input VAT was allowed.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05480.html

6. Input VAT on remote bridge repair costs could be recovered by Durham Cathedral

Durham Cathedral had an obligation to repair the Prebend's Bridge. This is some distance from the Cathedral and is used by the general public. HMRC decided not to allow the recovery of the input tax incurred because there was no direct link to the taxable supplies that the Cathedral made and because the bridge was some distance away from the Cathedral. The FTT has held that input VAT incurred by Durham Cathedral on the repair of the Bridge could be considered as having a direct link to the Cathedral's economic activities as a whole. As a result, input VAT incurred on repair costs could be recovered according to the business's input VAT recovery profile which used a special method of partial exemption based on the business activity being 65%.

This is an interesting case to read because it considers the interpretation of Article 168 of the Principal Directive as well as section 24 VATA 1994. The judgment also considered the decision delivered on 22 October 2015 in Case C-126/14 *'Sveda' UAB v Valstybine ˙mokesc ˇiu ̨ inspekcija prie Lietuvos Respublikos finansu ̨ ministerijos, third party: Klaipe ˙dos apskrities valstybine ˙mokesc ˇiu ̨ inspekcija* EU:C:2015:712 [2015] STC 447 (" *Sveda*"). Paragraphs 51 to 53 inclusive deserve to be carefully noted. There were some circumstantial differences between the case of Durham Cathedral and Sveda but these were not significant. The FTT considered the bridge repair costs did have a direct and immediate link to the Cathedral's overall economic activities and so a proportion of the input VAT could be recovered.

http://www.bailii.org/uk/cases/UKFTT/TC/2016/TC05477.html

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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 31 December 2016.

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