AAT VAT Update 14 July 2016

In this Month's edition of the VAT update we look at:
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1. BREXIT and the impact on VAT

VAT is a European tax and the vote to leave has led to suggestions that the UK may enact significant changes such as extending zero rating. In such uncertain times and with such volatility in the markets, I doubt whether the UK can afford to extend zero rating. Indeed, if tax revenues fall, as many have predicted, we may even be looking at tax increases.

The Mirrlees report on designing a tax system included at chapters 7,8 and 9 essays on how VAT might be reformed. By broadening the tax base, the headline rate might be reduced. In comparison to our European neighbours, the UK rate at 20% is in the middle of the spectrum of rates adopted by countries but the trend has been to increase rates rather than reduce rates. The Mirrlees report makes an excellent read but its publication in final form in September 2011 failed to produce much reaction or change. http://www.ifs.org.uk/publications/5353

In the short term, I cannot see much change in the tax base or reform of VAT being enacted but if the government is thinking of designing a new 'improved' VAT system, I hope that the opportunity is taken to design a simpler and more logical VAT regime.

Those involved in the appeal process or an argument with HMRC may need to reconsider if they are relying on a relief which is available in the European VAT directive but has not been enacted into the UK VATA. In this context, the 'Life' case at item 4 is an interesting decision and should be read by all those advising charities and suppliers of welfare services.

2. Supplies of teaching staff VATable on full amount including salaries

The existence of Judicial review has been suggested to be a safeguard to taxpayers' rights but in reality and practice, Judicial Review is impractical and ineffective. The Wednesbury principle means that the taxpayer has little chance of success unless the tax authority has acted so unreasonably that no reasonable person could have acted in that way. That is a very high hurdle and it means that where the statute gives a discretionary power to HMRC such as extending time limits or granting concessionary treatment, there is no effective right of appeal against the decision made by HMRC. Experienced practitioners know this.

I was surprised to see ELS Group Ltd, R (on the application of) v HM Revenue and Customs [2016] EWCA Civ 663at the Court of Appeal. This is an appeal from a decision of the Upper Tribunal (Tax and Chancery Chamber) (Proudman J) released

on 2 February 2015 refusing the appellant, ELS Group Limited, permission to apply for judicial review of the decision of HMRC not to allow an ELS Group company (Education Lecturing Services ("ELS")) to take advantage of an extra-statutory concession (BB10/04) relating to VAT on supplies of services by employment bureaux..

ELS' business consisted of the supply of lecturers to colleges of further education in the UK. Employment bureaux can provide at least two kinds of service to their clients. It can act as principal or it can act as agent. For VAT purposes where the bureau acts as principal in the supply of its own personnel to the client then VAT is charged on the whole sum payable to the bureau for the supply of services which will obviously include the cost of the salary payable to the personnel involved. Where the bureau acts only as an agent in finding employment or an employee for its client VAT is charged only on the commission payable to the bureau for the service it provides.

On 9 July 2009 HMRC wrote to ELS to inform the company that they had now decided that the supplies it was making to the colleges were supplies of staff rather than of educational services HMRC were not prepared to allow retrospective use of the concession BB 10/04 because ELS had not at any time done anything to indicate to its customers that it was acting or intended to act as an agent. In the Upper Tribunal ELS sought permission to apply for judicial review of the 21 November decision on three grounds:

> (1) that HMRC was wrong about BB10/04 not being capable of being applied retrospectively;
> (2) that even if the choice to be taxed as an agent had to be made by the date of the relevant supply, that had in fact occurred in this case as part of the arrangements made in 2006-7 for the transfer of the ELS colleges to PNL; and
> (3) that if ELS had failed to make the necessary choice in time and was now too late to do so, that was the consequence of HMRC's conduct in treating the supplies made by ELS as educational under its direction of 23 December 2005 without which it would have changed its business model so as to take advantage of BB10/04 with immediate effect.

Now let us pause for a minute and remember that the commercial uncertainty has existed since 2004 and this dispute concerns 2007 and 2008 so senior management and professional advisers have been distracted from running the business for 9 years or so. The customers are exempt organisations (colleges and further education) and VAT is going to be a cost to the supplier. ELS invoiced the colleges for the entire amount of its charges without VAT on the basis that the supplies were exempt although, as subsequently determined, the exemption was not in fact available.

The Upper Tribunal was right to hold that it was reasonably open to HMRC to conclude as they did in their 21 November 2012 decision letter that ELS had not made a choice to be treated as providing supplies of staff as an agent at any time before the letter of 8 April 2008 and that the inclusion of a VAT element in the £21.76 college rate was at best a contingency in the event that the claim for exemption failed.

This unanimous decision of the Court of Appeal reaffirms my belief that judicial review is in practice unlikely to succeed and provides no protection to taxpayers' rights. In this case,HMRC correctly ruled that ELS was not an 'eligible body' (so it could not exempt its supplies) and that ELS was making supplies of staff, meaning

that its supplies were subject to VAT on their full value, including the teachers' salaries.

http://www.bailii.org/ew/cases/EWCA/Civ/2016/663.html

3. Mobile Phones for the handicapped are zero rated

Decisions of the First Tier Tribunal are only persuasive and do not establish legal precedent. The FTT has ruled that a mobile phone adapted by preloading with special software which translates text into sound could benefit from zero rating. In IANSYST Ltd v R&C [2016] UKFTT 0372, the company appealed an HMRC decision made in 2014 that supplies of mobile phones and tablets with a software package pre-installed ("**Capturatalk**") do not qualify for zero-rating for the purposes of VAT.

The relevant zero-rating provisions are found in Group 12 of Schedule 8 to VATA 1994 which allows for zero-rating of certain drugs, medicines and aids for the handicapped. Specifically, zero-rating is allowed under Item 2(g) for:
(Item 2) The supply to a handicapped person for domestic or his personal use, or to a charity for making available to handicapped persons by sale or otherwise, for domestic or their personal use, of
…(g) equipment and appliances not included in paragraphs (a) to (f) above designed solely for use by a handicapped person.

When arguing that the supply must be standard rated, HMRC submitted that the mobile devices that are being supplied by Iansyst are the same before the installation of the Capturatalk software as any other mobile devices available on the market and that the installation of the software does not change the item itself. The phone is still a phone and the tablet computers are still tablet computers. Capturatalk, like any other piece of software or application, uses the mobile device as a platform but does not change the device.

HMRC also submitted that the Capturatalk software itself had not been designed solely for use by handicapped persons because all the elements of the software were of general use by non-handicapped persons, e.g. voice recognition software is used for dictation.

The FTT ruled that the fact that a non-handicapped person could and would use a mobile device with similar software installed (e.g. apps for dictation) prevents it from being capable of meeting the requirement of Item 2(g). The FTT found that the package as a whole allowed a handicapped person to use the device differently from the way in which a non-handicapped person would use it and to use it more effectively than such a handicapped person would be able to use it without the technology installed.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9107/TC05126.pdf

4.Social welfare services supplied by a non - profit making organisation exempt.

In Life Services Ltd v R&C [2016] UKFTT 0444, the company was not a charity. It provided health and welfare services but was not regulated by the Health and Social care Act. The issue was whether the company's services were exempt and within Item 9 Group7, Schedule 9 VATA. And the company argued that the provisions of Article 132(1)(g) of the Principal VAT Directive entitled it to exemption even if the VATA did not.

The company is a non profit making organisation which provides day care services for adults with a broad spectrum of disabilities, principally learning problems. Its clients include those with: severe autism, Down's syndrome, severe behavioural difficulties, learning disabilities, and Crohn's disease.

While at the appellant's premises the clients engage, with more or less assistance from the appellant's staff depending on the nature of their disability, in a range of activities which vary from day to day and from client to client. These activities include cooking, forms of exercise (walking and swimming and sometimes horse riding often dressed up as games to make them more appealing), help with everyday living (such as learning to turn on a light switch), money skills, social skills, feeding, washing and personal hygiene, oral health, and toileting.

Under guidelines which are similar to, and possibly more exacting than, those applied by the Care Quality Commission ("CQC"), Gloucestershire County Council monitors and inspects the appellant's service provision The appellant's outcomes are reviewed regularly by the Adult Social Care Directorate of the Council.

This is a lengthy judgement because it involves the rules of statutory interpretation and several pieces of diverse legislation. But the FTT judge concludes at Paragraph 98: "I therefore conclude that by recognising charities and not recognising the appellant, Note 9 breaches the principle of fiscal neutrality. As a result I must find that the appellant's supplies of welfare services are exempt and allow the appeal."

The FTT noted that there were no fiscal neutrality problems with the services provided to Gloucester County Council, because if VAT was charged on the service, the council would be able to recover the input VAT. In the context of 'Life's supplies to third parties, however, it was at a competitive disadvantage to charities and regulated bodies providing competing services.

http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9177/TC05197.pdf

Derek Allen
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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 July 2016.