VAT update

April 2018

In this month's update we report on the publication of the draft agreement on the UK's withdrawal from the EU; the Government's "split payment" collection model for online sales by non-UK sellers; and HMRC's revised guidance on the cost sharing exemption. We also comment on three recent cases involving the VAT recovery of input tax in relation to fund management charges; clarification on the time limit for input VAT recovery; and the scope of the VAT exemption for payment services.

News

Draft agreement on UK's withdrawal from EU

On 19 March 2018, the European Commission published the draft legal text of a withdrawal agreement. The draft highlights the progress which has been made in the negotiations which took place between the UK and the Commission on 16-18 March 2018. If agreed and ratified in its current form, Article 121 provides for a transitional period for Brexit to 31 December 2020. more›

Consultation on VAT split payment collection model

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Any comments or queries?

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Volkswagen – CJEU provides guidance on the time limit for input VAT recovery

In *Volkswagen AG v Finančné riaditeľstvo Slovenskej republiky* C-533/16, the CJEU has confirmed that Member States cannot impose time limits on input tax recovery that deny claims before the taxable person is in a position to exercise its right to recover. **more›**

DPAS – AG opinion on scope of VAT exemption for payment services

In *HMRC v DPAS Ltd* (Case C-5/17) the Advocate General (AG) has opined that dental payment plan administrative services are not exempt from VAT under Article 135(1)(d) of Directive 2006/11/EC (the Principal VAT Directive). **more›**

About this update

The VAT update is published on the final Thursday of every month, and is written by members of RPC's Tax team.

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News

Draft agreement on UK's withdrawal from EU

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The Commission has also proposed the ongoing jurisdiction of the Court of Justice of the European Union (CJEU) over matters referred to it before the end of the transitional period. If agreed, then there would still be time for the UK courts to make further references the CJEU (as in *Cambridge University*, discussed further below) and for the Commission to pursue infraction proceedings against the UK.

A copy of the draft agreement is available to view here.

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Consultation on VAT split payment collection model

On 13 March 2018, HMRC and HM Treasury launched a consultation on a "split payment" model for collecting VAT on online sales by non-UK sellers. This is in response to the growth in online shopping which, in the view of the Treasury, is resulting in significant losses of VAT to the Exchequer. The aim of the consultation is to explore possible options for how a potential split payment mechanism could work to combat online VAT fraud.

The Government's favoured approach is for VAT to be collected by merchant acquirers or payment service providers registered as trusted to comply with the rules (or by payment card issuers if there are none). The amount collected would be calculated using a net effective rate determined for each non-UK business, updated annually according to the preceding year's VAT liability (or using the standard rate if the business did not communicate calculation information to the VAT collector).

Throughout the consultation period HMRC will continue one-to-one meetings with stakeholders and run collaborative workshops to test emerging views over the spring and summer. HMRC invites all those with an interest to get in contact to make arrangements to attend a workshop.

Anyone wishing to contribute and provide comments in response to the consultation are requested to do so by 29 June 2018, by email to: indirecttax.projectteam@hmrc.gsi.gov.uk.

Details of the consultation are available to view here.

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Revenue & Customs Brief 3/18 – revised HMRC guidance on VAT cost sharing exemption

On 22 March 2018, HMRC published Revenue & Customs Brief 3 (2018), which sets out changes to the VAT exemption for cost sharing groups following various CJEU decisions on its scope.

Of the immediate effects, from 22 March 2018:

- the cost sharing exemption (CSE) will be restricted to certain categories of exempt business, such as education, health and welfare, and fundraising charities, but excluding, among others, banking insurance and property business. There will be interim measures for existing cost sharing groups that have operated the previous guidance correctly. In any case of avoidance or abuse, HMRC will apply any guidance from the court from the date of the judgment
- HMRC policy will be amended to restrict the CSE to members located in the UK. It will no longer be permitted to apply the exemption for transactions with members located in other EU member states. The CSE is not available for members located outside of the EU, and this will remain the position, and
- a CSE will not be permitted where an uplift has been charged on transactions for transfer pricing purposes. It will remain the position that the CSE will not be permitted in any other case where exact reimbursement cannot be evidenced.

A copy of the guidance is available to view here.

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Cases

University of Cambridge – VAT recovery of input tax in relation to fund management charges

In *HMRC v The University of Cambridge* [2018] EWCA Civ 568, the Court of Appeal has decided to refer a number of questions to the CJEU, concerning whether a university was entitled to recover a proportion of input tax incurred on the payment of professional fees for the management of its endowment fund.

Background

The University of Cambridge makes two types of supplies: (i) exempt supplies of education; and (ii) certain taxable supplies consisting of commercial research, sales publications, consultancy services and other supplies. It receives donations, which it invests into its substantial endowment fund. The fund invested those monies in a range of securities which generated around £40m of income in each of the relevant years, covering 6% of the university's total expenditure.

In 2009, the University submitted a claim for recovery of input tax of £182,501, on the basis that it should be treated as residual input tax and recoverable pursuant to the partial exemption special method.

The case concerned whether or not input tax incurred in relation to the management of an investment fund could be reclaimed even though it is agreed the investment is not carried out as an economic activity.

The First-tier Tribunal (FTT) and the Upper Tribunal (UT) both dismissed HMRC's appeal and held that as the income realised from the fund was used to support the university's economic activities, input tax associated with the professional management of this fund could be regarded as residual input tax. HMRC appealed to the Court of Appeal. It argued that the fees were directly and immediately linked to the non-taxable transactions carried out by the fund managers and could not therefore be an overhead for VAT purposes.

Court of Appeal's decision

The Court of Appeal concluded that the issue was unclear and referred the matter to the CJEU.

The Court noted that both the FTT and UT had emphasised the purpose of the fund's investment activity, which indicated they might have adopted a purely purpose-based test. However, the Court noted that such an approach was rejected by the CJEU in *Sveda* C-126/14. In addition, in the Court's view, the UT had incorrectly relied on the decision in *Kretztechnik* AG C-463/03. *Kretztechnik* was concerned with activities designed to recapitalise a company, rather than to provide investment income as in the present case. In doing so, the UT failed to make any distinction between capital-raising and income-generating transactions.

The Court held that HMRC was correct to state that the generation of investment income by a taxpayer who was not carrying on a business dealing in shares was to be treated as outside the scope of VAT, because it was equivalent to a private owner disposing of his own property which was not an economic activity. However, the Court was nevertheless required to decide whether the use of the fund managers' services to produce the income should be treated as consumed by the non-taxable activity they were involved in, or whether there was a sufficient

link, for the purposes of Article 168 of Directive 2016/112, with the economic activities that the income subsidised.

The Court considered recent judgments concerning input tax recovery, including *Iberdrola* C-132/16 and *Sveda* and the correct approach to be taken to the issue of attribution in the instant case. The Court concluded that the application of those judgments to the university's situation was unclear. A non-business activity could, in principle, break the link that is necessary for input tax recovery. However, was ownership of the fund the relevant type of non-business activity? On that point the Court decided to seek the CJEU's guidance. In particular, the Court sought guidance on whether it should look through the passive receipt of fund management services to the ultimate purpose of the services in supporting the university's activity.

Comment
This outcome will be disappointing to partially exempt entities with similar types of investment funds that derive income or capital for the benefit of their overall economic activities. The reference to the CJEU will delay clarity in this important area.

It is interesting to note that neither party considered the relevant case law to be unclear and did not propose a reference to the CJEU. The Court of Appeal made this decision of its own volition.

A copy of the judgment is available to view here.

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Volkswagen – CJEU provides guidance on the time limit for input VAT recovery

In *Volkswagen AG v Finančné riaditeľstvo Slovenskej republiky* C-533/16, the CJEU has confirmed that Member States cannot impose time limits on input tax recovery that deny claims before the taxable person is in a position to exercise its right to recover.

Background
This case concerned goods that were supplied to Volkswagen in Slovakia between 2004 and 2010. At the time of the supplies, the suppliers did not include VAT on their invoices that were issued to Volkswagen. They wrongly (but in good faith) concluded that the supplies were "financial compensations" and were not, therefore, subject to VAT.

In 2010, the suppliers realised their mistake and corrected their error, issued new invoices charging VAT and accounted for the VAT. Volkswagen filed a claim to recover the input VAT in respect of all revised invoices.

The Slovak tax authority rejected part of the claim (worth €1.3m) as being time-barred. It argued that the right to recover VAT arose on the date of delivery of the goods and accordingly the right to claim VAT for the period from 2004 to 2006 had expired.

The domestic court referred to the CJEU a number of questions which were intended to determine whether Volkswagen could reclaim the input VAT for the earlier periods.

The Advocate General (AG) released his opinion on 26 October 2017. He considered that the commencement date of the limitation period could not solely be referable to the time when the goods were supplied. In his view, in "exceptional cases", like the present case, the right to deduct should be linked to the actual payment of VAT.

The AG noted that the time limit applied equally to claims for input and output VAT. If the Slovak tax authority was prepared to accept the output VAT due, it should also accept that that taxable person has the right to deduct input VAT. Anything else would be contrary to the principle of fiscal neutrality. As Volkswagen had acted in good faith, it would be disproportionate to deprive it of the right to deduct in these circumstances.

CJEU decision

The CJEU agreed with the AG's opinion and ruled that in principle Volkswagen should be entitled to exercise its right of deduction.

The CJEU confirmed that although the right to deduct VAT is a fundamental principle of the common system of VAT established by EU legislation which ensures neutrality of taxation of all economic activities, it is nonetheless subject to substantive and formal requirements or conditions.

The CJEU ruled that although the right to deduct VAT arises at the time the VAT becomes chargeable under Article 167 (in this case, the moment that the goods were delivered), Article 178 provides that it can be exercised only once the taxable person has an invoice which refers to VAT.

The CJEU considered that the possibility of exercising the right to deduct VAT, without any temporal limit, to be contrary to the principle of legal certainty. The CJEU has previously held that a limitation period, the expiry of which has the effect of penalising a taxable person who has not been sufficiently diligent and has failed to claim the deduction of input VAT, by making him forfeit his right to deduct, is compatible with the Principal VAT Directive.

It was apparent in the present case that the taxable person (Volkswagen) did not demonstrate a lack of diligence and there was no abuse or fraudulent collusion with its suppliers. In such circumstances, it was objectively not possible for the taxable person to exercise its right to recover VAT before the limitation period expired as it had neither been in possession of the invoices nor aware that VAT was due. Accordingly, Slovakia could not deny VAT recovery on the grounds that the national limitation period had expired before the request for recovery was made.

Comment

The approach adopted by the CJEU in this case is helpful to taxpayers as it ensures that input VAT recovery should not be precluded where a taxable person acts in good faith but does not pay VAT until sometime after a supply takes place.

It should be noted that the CJEU's finding in this case was based on the fact Volkswagen had been sufficiently diligent and there had been no abuse. The UK rules should therefore be read with this important proviso in mind. The outcome may well have been different had there been a lack of diligence or abuse.

A copy of the CJEU's judgment can be viewed here.

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DPAS – AG opinion on scope of VAT exemption for payment services

In *HMRC v DPAS Ltd* (Case C-5/17) the Advocate General (AG) has opined that dental payment plan administrative services are not exempt from VAT under Article 135(1)(d) of Directive 2006/11/EC (the Principal VAT Directive).

Background

Dental Plan Administration Services Ltd (DPAS), a UK based company, provides dental plan administration. Following the CJEU's decision in *AXA Denplan* (C-175/09), DPAS restricted its contractual arrangements to ensure that its services were provided to patients rather than to dentists, as was the case in *AXA Denplan*.

As a result of its restructuring, DPAS contended that its supplies of services to patients, for which it charged a plan fee, qualified as an exempt transaction concerning payments (within article 135(1)(d) of the Principal VAT Directive. Its supplies to patients were, essentially, payment facilitation involving direct debit payments and forwarding on amounts due to the dentists. In addition, since this supply was made to patients rather than to the creditor dentists, it could not amount to "debt collection". Debt collection, as a subcategory of transactions concerning payments and transfers, is excluded from the VAT exemption.

HMRC disagreed, arguing that the necessary functional analysis of the transactions made clear that DPAS did not effect any transfers or payments and the services did not qualify for the exemption.

The FTT agreed with DPAS and held its services were correctly exempted from VAT. On appeal, the UT considered that it was not clear whether DPAS's services consituted "transactions concerning payments or transfers". The UT also expressed doubt as to the scope of the exclusion for debt collection. In light of this, the UT decided to refer a number of questions to the CJEU relating to the correct interpretation of the exemption and the correct construction of "debt collection" in this context.

AG's opinion

The AG concluded that the services provided by DPAS were "mere physical, technical or administrative services" and were therefore subject to VAT.

The AG acknowledged that the CJEU decision in *AXA Denplan* cannot be reconciled with either earlier or later case law of the Court on the scope of the exemption under Article 135(1)(d). In the AG's view, there was no doubt that the correct approach to the scope of the exemption is as set out by the CJEU in *Bookit* (C-607/14) and *National Exhibition Centre* (NEC) [2016] STC 2132, and not *AXA Denplan*. In particular, Article 135(1)(d) only applies to transactions that have the effect of making the legal and financial changes characteristic of transfers of money.

The AG noted that DPAS obtained the authority to request the transfer of money in the name and on behalf of the patient, from the patient's bank, but the AG considered this was merely an administrative task concerned in the moving of money between bank accounts. Whilst DPAS' supplies were essential in order for the banks to complete the payment transfers, that in itself was insufficient. DPAS did not itself debit or credit the respective bank accounts and therefore did not qualify for the exemption.

Having opined that the services did not amount to payments or transfers, the AG went on to consider the issue of debt collection. The AG noted that the arrangements were introduced to take advantage of the decision in *AXA Denplan*. There was no substantive changes to the services, and the literature provided by DPAS to its customers (both dentists and patients) reflected this. The material emphasised that the changes were "purely administrative" and made "no practical difference to the current arrangements". As a result, the AG considered that the restructuring should be considered irrelevant; the economic reality of the arrangements being determinative. If the services were debt collection before the restructuring, they remained debt collection after the restructuring and fell outside of Article 135(1)(d).

Comment

The AG recognised the tension between CJEU case law in this area but ultimately considered that elements of *AXA Denplan* had been wrongly decided. He preferred to follow the approach adopted in *Bookit*, which suggests a narrower function-based approach to the exemption.

It will be interesting to see if the CJEU follows the AG's approach. If it does, this will potentially affect businesses that are involved with initiating and processing payments pursuant to a direct debit mandate. Questions will also arise concerning the circumstances in which a non-financial services business effects a payment or transfer.

A copy of the AG's opinion is available to view here.

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