Where next for VAT?

Indirect Tax



01 February 2015

John Voyez looks at the trends in VAT planning and compliance

Key Points

What is the issue?

The changing relationship between HMRC and the VAT adviser is examined as well as the future role of the VAT adviser in an evolving business environment

What does it mean for me?

The article highlights the areas and approach of the VAT practitioner in the future, with a focus on planning to make clients compliant

What can I take away?

The business environment is changing, and the way we as advisers have operated in the past is changing too, along with advances in technology. We need to be open-minded to change and the challenges this will pose

This article looks at trends in VAT planning and compliance in the past, in current times, and where those trends may be heading in the future from the perspective of the VAT profession's approach versus that of HMRC. Readers will no doubt have their own ideas and opinions which will have been shaped by their personal experiences in the profession; working in a Big 4 firm, an 'A' tier firm, a smaller firm, the legal profession, in industry, or within HMRC.

Where we were

This is not intended to be a history lesson, but it is worthwhile reflecting on the VAT environment from which we have emerged. If we return to the end of the 1980s and early 1990s, the interests of the VAT profession and HM Customs & Excise as they were then called (referred to as HMRC throughout the rest of this article) were almost diametrically opposed. In those days, while the tax authorities were focused on a rigid implementation of what the press regularly referred to as a draconian penalty regime and almost every article on VAT seemed to focus on proportionality, the VAT profession had by then matured, and was engaged in what one might think of as the early days of aggressive tax avoidance. For those with long memories, these early VAT arrangements took many forms with varying degrees of sophistication, ranging from VAT group entry and exit schemes at one level to so-called 'toothbrush' schemes, making use of the ability to generate small amounts of taxable supplies to obtain high levels of overhead VAT recovery not otherwise achievable.

However, it was not long before the mist disappeared from before HMRC's eyes when they realised what the profession had been up to 'behind their backs', and the anti-avoidance era was launched. Prepayment schemes were countered by HMRC with the introduction of anti-forestalling legislation, and sale and leaseback structures, previously accepted by the Revenue, suddenly became the unacceptable face of VAT planning, resulting in the complex anti-avoidance legislation we have today for some property transactions. By the mid-to-late 1990s the focus of the

profession on VAT planning arrangements had, to an extent, shifted down a gear, as HMRC's focus moved away from blind emphasis on compliance and towards countering planning structures. One might say that the direction of the profession and HMRC had become more aligned by
this time.

But all was not well in the VAT garden, and by the early 'noughties' the name of Halifax began to be heard more frequently. VAT advisers without any knowledge of French suddenly found the phrase 'abus de droit' tripping off the tongue. Readers not absorbed in the world of VAT need only recognise that Halifax put in place a complex structure which ensured that otherwise irrecoverable VAT incurred on the development of a call centre by a financial services business became recoverable. As a reaction to Halifax and ongoing avoidance planning, by 2004 HMRC introduced legislation in relation to the disclosure of VAT avoidance schemes. However, businesses continued to play the VAT avoidance game, and there were several notable EU case law decisions just after the turn of the century.

Where we are today

Following *Halifax plc and others v C&E Commrs* [2006] STC 919, case C-255/02, the European Court of Justice decided a number of landmark VAT cases in which one might say that possibly the letter of the law had been followed, but not the spirit of the law. HMRC initially considered the *Halifax* decision to be the answer to all their problems in the fight to tackle VAT avoidance.

In essence, two tests were recognised by the courts: is there a tax advantage contrary to the purpose of the Sixth Directive? And is the essential aim of the arrangements to obtain a tax advantage?

However, the impact of *Halifax* has been eroded over the years by a procession of cases in which the European Court was not always inclined to invoke *Halifax*. Many of these cases involved a cash flow advantage for the taxpayer, but not necessarily an out-and-out VAT saving.

Weald Leasing (C-103/09) involved a cash flow advantage, *RBS Deutschland* (C-277/09) an arbitrage on the place-of-supply rules to avoid any taxation, *Paul Newey (trading as Ocean Finance)* (C-653/11) led to a substance-over-form debate as to where services were 'consumed', and *Pendragon* [2013] EWCA Civ 868 produced a

VAT recovery advantage. Although the message coming out of the courts recently seemed to be that obtaining a cash flow advantage did not amount to egregious planning, in the case of *University of Huddersfield Higher Education Corporation* [2014] UKUT 438 (TCC), the court initially found in favour of the appellant. But this decision has now been reversed, with the arrangements now considered unacceptable.

So, where are we today? While undoubtedly VAT avoidance planning continues, HMRC have been successful in attacking perceived avoidance and there is no longer the same appetite for aggressive planning. The focus of the profession today is more on 'getting it right' or, at least, planning for our clients to be compliant. For many of us that means good old basic VAT advice, helping our clients who have little desire to see their names splashed across the business pages for unacceptable VAT planning arrangements, and identifying the best business-driven structures for the activities they engage in. Dare one say, helping HMRC's 'customers' pay the right amount of tax at the right time? Although it is clear that HMRC's resources are constrained, it would be helpful sometimes if they recognised this and were prepared to work more with the professional adviser on resolving client issues.

Today, the profession and HMRC are more aligned in their focus on the balance between VAT planning and compliance than 20 to 25 years ago, and certainly it has been an interesting journey. *Halifax* has not been the panacea HMRC thought it would be; arrangements do not cease to be economic activities simply because they may be part of an avoidance arrangement; and the threshold for finding abuse is different from the immediate post-*Halifax* era.

It would be interesting to undertake a view of the journey taken by some of our European neighbours over the same period. Experience indicates that today many EU member states take a much more rigid view on VAT compliance and the imposition of penalties, which in some countries are treated as a criminal offence rather than a civil wrong.

Where we are going

Having emerged from an era in which the profession and HMRC could not be much further apart in terms of their focus on planning versus compliance, we are now in a time where most VAT advisers see their job for the client as being about good

housekeeping. Where the VAT profession and HMRC may be headed in the future remains uncertain. Whether we will see a cyclical return to a higher level of planning activity being undertaken by the profession, with HMRC reacting to such trends, or whether the interests of both will remain more aligned remains unclear. However, there are some interesting issues to consider that may point the way.

The future of tax collection

In December 2010 the EC issued a green paper On the future of VAT – towards a simpler, more robust and efficient VAT system tailored to the single market, which included many interesting comments

And it seems clear from the EC's more recent publication, The implementation of the definitive VAT regime for intra-EU trade, that we have finally settled on the destination system of taxation but with issues to be resolved over who should collect and pay the VAT due. There are also other views that the mini one-stop-shop (MOSS) used for e-commerce supplies might be introduced for all B2C supplies. These changes might involve a major rethink on how VAT should be administered.

Following on from the above, as technology advances and we all submit electronic VAT returns and settle our accounts over the internet, the rationale for making a single VAT payment (or repayment) at the end of every accounting period has little sense. There have already been discussions on real-time accounting for VAT, where the payment of the tax on sales and the recovery of it on costs happens automatically in the cloud.

This could result in obviating the need for VAT returns and payments and reduce the risk of fraud.

The tax gap

While not wishing to underplay the importance of collecting the right amount of tax, it is worthwhile pointing out that indirect taxes make up about 15% of the so called 'tax gap' (however that might be measured). Of this, VAT avoidance arrangements are estimated to make up just over 1% of the total indirect tax gap. In other words, the amount of VAT avoided relative to the total tax take is a very small percentage of the total compared with the resource HMRC have dedicated to tackling this

problem.

Fit and proper test

Businesses are already required to have a senior accounting officer responsible for the tax relationship with HMRC, and there is a statutory requirement in the charity sector to certify that the organisation is not managed or controlled by anyone who might misuse or exploit reliefs. HMRC state that they may decide a person is not ‘fit and proper’ if that person has been involved in the past in designing or promoting tax avoidance schemes. Might we expect HMRC to extend its fit-and-proper test into other areas as part of its compliance drive in the future? This also raises the question of HMRC’s future regulation of the tax profession.

VAT avoidance disclosure regime

This has gone from high numbers when the disclosure rules were first introduced to only a handful. It is not known whether this reflects HMRC’s success in tackling avoidance, or whether businesses are unaware of the requirements. It should be noted that, under VAT rules, the onus is on the business to report use of a scheme rather than the promoter, as is the case for direct tax. HMRC have therefore indicated that they wish to strengthen and improve the DOTAS and VAT avoidance disclosure regimes (VADR) to bring them more into line, and to ensure they remain effective in detecting tax avoidance and the users of the schemes. There is also a proposal to bring VAT into line with the new accelerated payments regime for direct tax.

BEPS

Many tax advisers would have you believe that BEPS is all about direct tax. It’s not. A quick look at the action points reveals that many of them have as much to do with indirect taxation as direct.

The digital economy (action point 1) is the most glaring example and causes issues for both tax worlds around the concept of establishment in the digital environment where a digital presence or establishment may be somewhere on a digital cloud. Who has the taxing rights in this case? It seems that the indirect tax world has stolen a march on the direct tax world with the new approach to taxation of B2C

supplies from 1 January, and direct tax practitioners are recognising that they may have something to learn from their indirect tax colleagues.

Other action points with an indirect tax angle include ‘Neutralising hybrid mismatch’ (action point 2), which looks at avoiding double or no taxation – see RBS Deutschland; ‘Countering harmful tax practices by taking transparency and substance into account’ (action point 5) – see Paul Newey; ‘Disclosure of aggressive tax planning’ (action point 12) – see new proposals for VADR; ‘Make dispute resolution more effective (action point 14) – see the EU trial on cross-border VAT clearances for transactions.
Office of Tax Simplification

Among all this, let’s not forget UK plc. The UK is ranked 14th of 185 in the World Bank Survey for competitiveness. The OTS paper, Competitiveness review, highlighted the need to make compliance easier for businesses. This includes simpler VAT returns and easier identification of the correct VAT liability of supplies; identifying rights to recover VAT; dealing with tax changes; easier to interpret legislation; easier to undertake cross border trade and so on.

Confédération Fiscale Européenne

The CFE recently published a paper on European tax adviser priorities in EU policy and identified goals for the next five years. These included requirements on the need for clear and certain tax law; the need for transparency and fairness related to disclosure obligations; a recognition of taxpayer rights; respect for the role of the tax adviser; resolution of double or no taxation issues; facilitation of VAT compliance and harmonisation of legislation; and a need to foster competitiveness in the market place.

Planning to be compliant

If we bring together all of the above, the role of the VAT adviser appears to be to ensure their clients are compliant, and making them aware of how changes may affect their business. It means advising clients on a range of issues including:

- VAT recovery on professional fees associated with corporate transactions in the light of the BAA decision, and how the transactions should be structured to

ensure recovery. See also the recent amendments to HMRC internal guidance.
- Management charges following the *African Consolidated Resources v HMRC* [2014] UKFTT 580 (TC) and *Norsemen Gold v HMRC* [2014] UKFTT 573 (TC) cases, and the mood music on this front coming out of HMRC policy. Such charges should be 'real' and have substance.
- To whom services are provided following the *Airtours Holidays Transport Ltd v HMRC* [2014] EWCA Civ 1033 decision and the ability to deduct VAT.
- The future for intra VAT group charges in the light of the decision in *Skandia America Corp v Skatteverket case* C-7/13. If intra group charges are to become taxable, is there an upside for supplies to non-UK branches?
- Calculating recoveries within cost-sharing groups to ensure an exact reimbursement of expenses incurred following the *West of Scotland Colleges Partnership v HMRC* [2014] UKFTT 622 (TC) decision.
- Special partial exemption methods following decisions in cases such as *Fazenda Publica v Banco Mais SA* case C-183/13 and *Lok'nStore Group plc v HMRC* [2014] UKUT 288.
- Establishment issues and taxing rights following the *Welmory sp. z o.o v Dyrektor Izby Skarbowej w Gdańsku* C-605/12 case.

The ability to recover VAT on investment management changes related to employee pension funds. See HMRC's recent briefs.

There is certainly plenty to keep the VAT adviser busy.

In summary, Napoleon Bonaparte said 'not one cent should be raised unless it is in accord with the law', while the modern day riposte from HMRC might be to say it is about making our 'customers' pay the right amount of tax at the right time. Lord Keynes said: 'The avoidance of tax is the only intellectual pursuit that carries any reward.' I wonder what Napoleon and Lord Keynes would make of where we were, where we have been, and where we might be going.

The views expressed in this article are very much the personal views of the author.