Changes for Revenue & Customs Brief 12/ 20: VAT on early termination fees and compensation payments

Indirect Tax

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HMRC published Revenue & Customs Brief 12/ 20: VAT early termination fees and compensation payments on 1 September 2020. This set out HMRC's revised view that most early termination, cancellation fees and damages were subject to VAT and that this change had retrospective effect. The CIOT has been engaging with HMRC on the scope of the new guidance to reflect this revised view.

Ongoing engagement by stakeholders

HMRC published Revenue & Customs Brief (RCB) 12/ 20: VAT early termination fees and compensation payments on 1 September 2020, which indicated that following judgments of the Court of Justice of the EU in Meo (Case C-295/ 17) (tinyurl.com/agmri91f) and Vodafone Portugal (Case C-43/ 19) (tinyurl.com/bmmf44t7), its revised view was that most early termination, cancellation fees and damages were subject to VAT and that this change had retrospective effect of up to four years even though, historically, these payments were deemed as outside the scope of VAT.

The Joint VAT Consultative Committee (JVCC), on which the CIOT is represented, set up a sub-group to look solely at the issues arising from RCB 12/20 (tinyurl.com/m5fuztuz), and the first meeting of this group was held in October. The discussion points at this meeting included:

- the validity of the four year retrospective effect;

- legitimate expectation where taxpayers had relied on HMRC's earlier guidance/trade body agreements indicating that compensation was outside the scope of VAT;
- clarity on the scope of RCB 12/ 20 when dealing with supplies that are not subject to VAT, for example exempt or zero-rated; and
- additional examples for particular types of transaction, including dilapidations payments.

As a result of this meeting, HMRC confirmed that it would engage with JVCC stakeholders by sharing their revised draft guidance so that feedback could be provided prior to its publication. HMRC also informed its frontline staff to cease in taking any recovery actions based on RCB 12/20 while the points raised were considered.

CIOT actions

The CIOT submitted its observations and recommendations on the revised draft guidance to HMRC in January, and simultaneously requested that RCB 12/ 20 be updated on GOV.UK with a 'health warning' to alert taxpayers that its position was changing. The CIOT also raised the health warning issue to the Guidance Strategy Forum, suggesting that there should be a consistent policy that alerts taxpayers (and its own frontline staff) of upcoming significant guidance changes to affected webpages in GOV.UK.

HMRC revised position

On 25 January, HMRC published (tinyurl.com/ypdgwotj) the good news that the updated VAT treatment stated in RCB 12/ 20 would only apply from a future date rather than having a four year retrospective effect, though the future date of application has yet to be confirmed at the time of writing.

Further, HMRC confirmed that revised guidance and a new RCB would be forthcoming, including guidance on what to
do where taxpayers have changed the VAT treatment due to RCB 12/20 but subsequently need to make adjustments. Until the new RCB is published, taxpayers can revert to the earlier VAT accounting position of treating it as outside the scope or continue treating the income based on the VAT liability of the underlying supply. Note that there was no confirmation on whether any particular types of compensation would be excluded. It is anticipated that the JVCC stakeholders will be

provided with a second version of the draft guidance before its publication and HMRC aim to have the new RCB and updated guidance published by 1 March 2021, or as soon as possible thereafter.