PKF

EU VAT newsletter

EU VAT news – November 2017

Bulgaria/EU - Input tax incurred by developer on infrastructure works recoverable

The Court of Justice of the European Union (CJEU) has delivered its highly anticipated judgment in the case of Iberdrola Inmobiliaria Real Estate Investments (Iberdrola), overruling Advocate General (AG) Kokott's opinion, and determining that input tax is recoverable by Iberdrola subject to certain conditions. This decision may have implications for businesses such as property developers/builders providing works under planning gain agreements. The decision is also of interest in the context of the developing case law which has to be considered when determining whether input VAT is linked to economic (or business) activities, an area of particular concern to the not for profit sector and charities.

In summary, Iberdrola planned to construct a holiday village on land it owned, which would then be leased out on a taxable basis. However, it transpired that in order to connect the holiday village to the existing municipal waste-water pump station, the pump station had to be extensively renovated. Iberdrola therefore agreed to carry out the repair of the waste-water infrastructure for the local authority at its own expense. Iberdrola sought to recover the related input tax on this work, but it was blocked by the Bulgarian tax authorities. This was on the basis that the work was supplied free of charge to the local authority and so it was alleged that it was not used in connection with an economic activity carried on by Iberdrola. The case was referred to the CJEU after an appeal in the Supreme Court in Bulgaria.

The CJEU disagreed with the AG's opinion which had been that there should be no right of deduction for the works supplied free of charge to the local authority. This was on the basis that without the pump station reconstruction, the holiday village could not have been built, and Iberdrola would not have been able to carry out its economic activity. Thus, there was a direct and immediate link between the renovation work and the output tax Iberdrola charged on the lease of the holiday homes. Consequently, Iberdrola was entitled to recover the input VAT as the work on the waste-water pump station was used in the context of its economic activities.

However, the CJEU stated it was for the national court to examine whether the input tax could be recovered in full; if the renovation work on the waste-water pump went beyond the services deemed necessary for this purpose, then the input tax may need to be apportioned.

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UK - Change in the treatment of pension fund management services by insurance companies

Insurance companies providing pension fund management services may need to adjust their VAT treatment following a recent change in HMRC policy.

HMRC published Brief 3/2017 clarifying the VAT treatment of pension fund management services provided by regulated insurance companies. The change removes an insurance company's entitlement to exempt supplies of pension fund management services provided to Defined Benefit schemes.

To date, HMRC has allowed insurance companies to exempt their supplies of pension fund management services when made to Defined Benefit and Defined Contribution pension schemes. From 1 April 2019, the exemption will only apply to Defined Contribution Schemes which qualify as Special Investment Funds; supplies to Defined Benefit schemes will require VAT to be accounted for on the value of these supplies. This will bring supplies made by insurance companies in-line with non-insurance companies.

Following case law developments in 2013, the CJEU found in Wheels Common Investment Fund Trustees Ltd that the service provided in the management of a Defined Benefit scheme was a taxable supply as the pension scheme could not be seen as a Special Investment Fund.

Therefore insurance companies involved with Defined Benefit schemes which have made use of HMRC's exemption policy will need to start preparing for the changes. Such insurers will need to consider the VAT liability of their pension fund management services and make any necessary accounting and tax changes.

If you think your business may be affected by this, please contact our Indirect Tax Team who will be able to check whether VAT is being accounted for correctly, and to discuss the options available to minimise any irrecoverable VAT.

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Belgium – Requirement to hold a compliant purchase invoice for entitlement to input VAT deduction

The Belgian VAT authorities have recently published a Circular Letter in which they clarify their stance on the requirement to hold a compliant purchase invoice, in order to exercise your right to input VAT deduction.

The Belgian VAT authorities confirm that they will also apply a 'substance over form approach' in this respect, further to the rulings of the CJEU in the cases of Barlis and Senatex. This implies that, if an invoice is non-compliant, the Belgian VAT authorities will not reject the input VAT deduction merely for this reason, on the condition that the taxable person can prove on the basis of 'unambiguous and forceful evidence' that the material conditions for input VAT deduction are satisfied. Such evidence must be provided before the end of the VAT audit.

In practice, clients usually have some form of evidence to satisfy the material conditions for input VAT deduction. If this corresponds with a formally compliant invoice, this evidence is generally sufficient. The Belgian VAT authorities are however, significantly stricter in the appreciation of this evidence where the invoice is formally non-compliant (particularly if the description of the supplied goods/services is unclear or inaccurate). This is once again confirmed by the wording 'unambiguous and forceful evidence'.

In summary, it is still very important to possess a compliant purchase invoice in order to support your right to input VAT deduction. The new administrative guidance merely prevents the rejection of input VAT deduction in cases where a taxable person holds a non-compliant invoice but has collected very strong additional evidence, which in practice is not always the case (e.g. for inter-company or management invoices).

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UK - Charities will not escape Making Tax Digital plans

In our previous edition we mentioned that charities would be exempt from the forthcoming changes but their trading subsidiaries would not. HMRC has now clarified that this exemption will only apply to Corporation Tax returns. Therefore, from April 2019, charities will be required to keep digital VAT records in addition to filing electronic VAT returns. Any VAT adjustments carried out by charities will need to be maintained with their digital records.

As a result of this, charities may find themselves facing extra costs, as it is currently understood that they will be required to purchase specific software to comply with HMRC's new record keeping and filing requirements.

This news is likely to put further strain on charities, many of whom already have to deal with complex VAT calculations. Charities should pay close attention to the proposed changes, further details of which are expected to emerge over the coming months.

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UK - Cost Sharing Exemption not applicable for financial services and insurance sectors

Businesses in the financial services and insurance sectors currently making use of the VAT cost sharing exemption (CSE) provisions may be affected by three recent CJEU judgments, which concluded that the exemption should not extend to businesses in these sectors.

The CJEU published its judgments in the following cases: DNB Banka, Aviva and the infraction hearing of EC v Germany. The first two cases concerned whether the application of the CSE rules (contained in Article 132 (f) of the Principal VAT Directive) could include financial services and insurance (contained in Article 135 of the Principal VAT Directive).

Article 132 sets out the exemptions for certain activities in the 'public interest', whereas Article 135 referrs to 'other activities'. The Advocate General opined that the exemption for Cost Sharing Groups should only apply to the entities mentioned in Article 132, meaning that financial services and insurance companies would not be able to benefit from the exemption. The CJEU agreed with this decision, interpreting the exemptions strictly.

The final case considered whether Germany unfairly restricted the CSE to members who carry on activities in the health profession, whereas the Principal VAT Directive did not limit the exemption to certain groups but only to entities who were carrying out exempt activities. In line with the DNB Banka and Aviva decisions, the CJEU held that Germany was too restrictive in its application of the CSE rules as these should apply to all activities listed in Article 132; however they could not be expanded to include the activities listed in Article 135.

These decisions may be the final nail in the coffin for the use of the CSE; it is anticipated that going forwards, the CSE will only be used by public or not-for-profit bodies. Although the CSE rules were only implemented in the UK in 2012 and have not been taken up on a large scale, they are more widely used in other EU member states.

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European Commission proposes radical changes to the VAT system

On 4 October, the European Commission (EC) announced proposals to amend Directive 2006/112/EC to address some inefficiencies of the VAT system and to tackle VAT fraud. These take the form of some fundamental principles or cornerstones of the VAT system together with a number of quick fixes.

The first step proposed is to change the treatment of B2B cross-border supplies of goods; the European Commission intends to adopt a proposal for a Directive in 2018 providing for the definitive VAT system. These rules will be similar to the current rules for B2C e-services. Under the new rules, the seller will have to charge VAT at the destination country's VAT rates. VAT will be paid in the seller's member state (MS) and a mechanism similar to the Mini One-Stop Shop (MOSS) will be used to account for the VAT. However, this will not apply if the buyer is a certified taxable person (CTP). Instead, a simpler reverse charge system will apply to these businesses.

Among the "quick fixes" there are three other changes being proposed, one of which is to simplify the treatment of call-off stock. The EC is proposing to treat such transactions in the following way: an exempt supply in the MS of departure of goods and an intra-community acquisition in the MS of arrival. Importantly, both parties in the transaction have to be CTP's. The other changes include a modification in requirements to identify a trader and updates to the legislative provisions to simplify ascribing intra-community transportation to a specific transaction in a chain of supplies.

It is hoped that these reforms will simplify the VAT system for those involved in cross-border supplies.

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UK - Application of the VAT zero-rating for charitable buildings

Charities looking to construct new buildings for the local community may be able to benefit from the zero-rating provision.

In the case of Eynsham Cricket Club (ECC) the First tier Tribunal (FTT) considered whether the costs associated with the construction of a new pavilion by ECC, a registered community amateur sports club (“CASC”), for the benefit of its members and the local community were subject to zero-rating. The FTT considered whether, firstly, ECC was “established for charitable purposes only” and qualified as a charity for VAT purposes and, secondly, whether the pavilion was intended to be used solely by the club as a village hall or similar.

The FTT found that the Charities Act 2011 set out that a CASC established for charitable purposes is not to be considered a charity. This ultimately meant that ECC failed to qualify for zero rating for VAT purposes. However, the FTT considered the facts of the case and whether ECC was able to demonstrate that it intended that the pavilion would be a village hall or similar.

ECC submitted that Saturday afternoons during the cricket season were “sacrosanct” for the club and similarly Friday nights were to be used by the club’s under 9’s team. With the exception of these times the community could hire out the pavilion pending ECC’s agreement and the payment of fees, not dissimilar to a village hall. HMRC argued that the pavilion was built principally for the use of the club rather than the wider community and that the village hall within Eynsham would discount the use of the pavilion as a village hall. The FTT disagreed with HMRC’s points regarding the construction services, finding that the pavilion was intended to be used as a village hall or similar. However, the appeal ultimately failed as ECC was not a charity.

ECC lost the case due to the complexities of charity law, and not HMRC’s argument that sports clubs’ facilities available for the wider community do not qualify for zero-rating. Had ECC been established differently, it would have been able to obtain zero-rating on the construction costs of the pavilion. The case shows that charitable organisations looking to construct new buildings to be used by the local community as a village hall or similar can benefit from the VAT provisions for zero-rating.

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UK - Were computer platform services made to investment managers subject to the financial services exemption?

Fund managers involved in Special Investment Funds (SIF's) may wish to consider whether the services they supply or receive qualify for exemption following the recent ruling by the FTT.

In the case of BlackRock Investment Management (UK) Ltd, the appellant (Blackrock) received services from Blackrock Financial Management Inc (BFMI) which were essentially the use of an investment management computer platform.

The case considered whether the supply of use of an investment management computer platform to an investment manager would fall under the financial services VAT exemption. The FTT considered that, in principle, where the platform is being used by the investment manager to manage SIF's, such a supply falls within the VAT exemption. This is because the platform services formed a distinct whole, and were specific to, and essential for, the management of SIF's.

The second issue the case looked at was whether it was possible to apportion the consideration received between supplies of SIF's and non-SIF's, as the computer platform was used by investment managers to manage both types of funds. The FTT found that the appellant received a single supply of platform use which was standard rated for VAT purposes.

On this basis, the Tribunal found that although the supply of managing a SIF on its own would be considered exempt from VAT, because the services were considered a single supply of platform use, it was not possible to apportion the use between exempt and standard rated; since the computer platform was predominantly used to manage non-SIFs, the whole supply was subject to the reverse charge at 20%.

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UK/EU - compound interest claim rejected

The long-running saga involving Littlewoods Ltd (Littlewoods) and HMRC appears to have come to an end, with the Supreme Court ruling in favour of HMRC, in a case which could have cost the Exchequer up to £17 billion.

The issue was whether a taxpayer could apply for compound interest in place of simple interest for repayments of VAT due from HMRC. The Supreme Court overruled the Court of Appeal’s decision and considered that the payment of simple interest provided “adequate indemnity” for the taxpayer.

Between 1973 and 2004, HMRC incorrectly charged Littlewoods £205 million of VAT. HMRC subsequently repaid Littlewoods the £205 million together an additional simple interest of £268 million. Littlewoods, however, considered the payment of simple interest did not provide adequate commercial restitution and brought a claim against HMRC in the region of £1.25 billion, calculated on a compound basis and on the grounds that such interest was due under the common law of restitution.

The Supreme Court rejected Littlewoods’ argument stating that simple interest should be applied in accordance with s.78 of the VAT Act 1994, and that common law claims for compound interest would effectively rule this section redundant.

The Court also considered whether EU law required the payment of compound interest. The CJEU had declared that it was for national law to determine the type of interest that applied, and that the widespread practice of other EU member states’ was to award simple interest. Thus the Court did not believe that Littlewoods had been deprived of “adequate indemnity”, and rejected the claim for compound interest.

Certainly, had the Supreme Court ruled in favour of Littlewoods there would have been far reaching and potentially detrimental consequences for the HMRC as we understand there were approximately 5,000 additional cases behind Littlewoods. HMRC can now breathe easy as, after around 10 years of litigation, this appears to be the end of the road for compound interest claims.

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Greece – New reverse charge introduced

A new reverse charge has been introduced in Greece from 1 August 2017 affecting domestic supplies of mobile phones, console gaming devices, laptops and tablets. From this date, business to business domestic supplies of the aforementioned goods will not be subject to VAT, and instead the purchaser will be required to account for the VAT as well as recover the input VAT through its VAT return. The Greek Government hopes that the introduction of this VAT mechanism will go some way towards preventing carousel fraud and general tax avoidance within the EU and worldwide.

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Netherlands – Telecommunications reverse charge to become mandatory

A voluntary reverse charge for business to business supplies of telecommunication services in the Netherlands was introduced for taxable persons with immediate effect from 2 June 2017. It has now been announced that this measure will become compulsory from 1 September 2017.

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This newsletter is compiled from contributions from firms within PKFI. If you have a news item that you consider should be included in the next issue, please email details to Luigi Lungarella of PKF Littlejohn. Luigi can be reached on llungarella@pkf-littlejohn.com or +44 20 7516 2228.