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Tax Insights

VAT news - June 2017

VAT exemption on restaurant and theatre services provided by educational establishments

Educational establishments that provide other services alongside exempt education could be entitled to a VAT pay-out following the Court of Justice of the European Union (CJEU) decision in the Brockenhurst College case.

The college ran educational courses in catering/hospitality and performing arts. As part of their training, students on these courses carried out duties in the college restaurant, and put on theatre shows for third parties. These services were made available to a selective group of third parties in return for a payment at a discount to the prices offered by commercial concerns.

The CJEU disagreed with the Advocate General's (AG) opinion that the exemption could not extend to such supplies as the recipients were not students. The CJEU has ruled that provided certain conditions are met, supplies of restaurant and theatre services to paying third parties through the educational establishment were "closely related" to supplies of education. Therefore, they could be exempt from VAT.

The conditions which have to be met are:

1. Both the principal supply of education and the services closely related to that education, ie the restaurant or theatre services, must be provided by eligible bodies as provided for in the VAT law – this was not in dispute in this case;
2. Those closely related services must be essential to the exempt activities; and

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3. The basic purpose of those supplies of services must not be to obtain additional income for those bodies by carrying out transactions which are in direct competition with commercial enterprises liable for VAT.

The CJEU considered a number of factors in reaching its decision. The catering functions are all undertaken by students under the supervision of their tutors, and so it was clear that the purpose of operating the training restaurant and theatre, which were tantamount to classrooms, is to enable the students to learn skills in a practical context. Without these facilities the supplies of education would not be as valuable. As such these services underpinned the quality of the principal supply of education.

There were a number of factors which differentiated the services from those of commercial operators. The restaurant and theatre performances were only open to a limited public, such as family/friends of the students, and those that took an interest in the events organized by the college. Also, the meals served in the restaurant were charged at a reduced price, subject to there being sufficient numbers of bookings. These factors emphasized that the aim of the activities was for the students to gain practical experience, and the activities were not in direct competition with commercial businesses.

The CJEU found that the restaurant and theatre services could be regarded as “closely related” to the principal supply of exempt education.

The case has now been referred back to the UK Court of Appeal. If you have any queries or wish to discuss the case in detail, please contact our Indirect Tax Team.

VAT chargeable on wedding venue hire despite the absence of catering facilities

Within the not-for-profit sector it is common practice for additional or spare space to be hired out to generate additional income to meet running costs. Typically such activity will be exempt for VAT purposes as an interest in or a right over land, unless the organization has opted to tax the building. However, issues can arise where further supplies are provided in addition to the letting of a room or piece of land, as the supply could then constitute one of taxable facilities rather than as a passive supply of a room within the exemption.

The VAT treatment of hiring out a venue for a wedding is one of these problem areas; however a recent case has clarified the VAT treatment and decided that VAT is chargeable on such a supply, even if catering is not provided.

Blue Chip Hotels Limited (BCH) let out a room for weddings and civil partnerships at its premises and treated the supply as exempt. A reception could be held elsewhere in the hotel and VAT was charged on this facility. The question considered by the Upper Tribunal was whether the hire of the room for a wedding or civil ceremony was a taxable or exempt supply.

The Upper Tribunal agreed with the First tier Tribunal that the supply was taxable, but for different reasons. The Upper Tribunal held that the service provided by BCH was not simply making the room available to customers; it was the provision of an approved room for wedding ceremonies. The relevant regulations required BCH to provide a person to supervise the use of the room. As a result BCH was not passively providing a room with a few chairs and tables. It was actively exploiting the room by obtaining and maintaining approval for its ceremonial use to the dignified standard required for use as a wedding venue.

If you believe you are impacted by this case please contact our Indirect Tax Team.

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Complications with the construction of buildings for Relevant Charitable Purposes

The case of J & B Hopkins Limited is yet another cautionary tale in the saga of the construction of buildings to be used for a relevant charitable purpose (RCP).

The case concerned a sub-contractor (the appellants) entering into a contract with the main contractor, Rok Building Ltd (Rok), to assist in the construction of a new place of worship for a charity. Rok issued the appellant a zero-rating certificate and in return the appellants zero-rated its supplies to Rok. However, Note 12 of Schedule 8, Group 5 of the VAT Act states that the zero-rating for RCP buildings only applies to supplies made by the main contractor. As the appellants were a sub-contractor, the supplies should have been subject to VAT at 20%, and HMRC raised an assessment for this VAT.

Unfortunately for the appellants, Rok was then placed in liquidation so once the erroneous invoices were discovered by HMRC, the appellants could not issue VAT only invoices to Rok. The tribunal determined that HMRC's assessment was valid, it did not lead to an HMRC windfall, and the appellants did not have any directly enforceable EU rights which would preclude HMRC from issuing the assessment. The appellant was therefore faced with an irrecoverable VAT cost due to not checking the validity of the certificate issued by Rok.

It is worth noting, on a wider point, that the requirement to issue certificates only applies to the construction of relevant residential (e.g. student accommodation, hospices, care homes etc) and relevant charitable buildings. If the construction relates to dwellings then the appellant would have been able to correctly zero-rate their invoices.

Following the *Longridge-on-the-Thames* case last year, this case acts as another timely reminder of the complications related to the provisions for the zero-rating of buildings. We would advise clients planning any construction works to seek advice at the planning stage so any potential pitfalls can be avoided before it is too late.

Input VAT incurred on the acquisition of leasing goods for free was not recoverable

This case is a useful reminder of the need to consider the VAT position of supplies at the outset when first structuring transactions. It appears that VAT was not considered early enough (if at all) in this scenario and consequently, input VAT reclaimed on equipment leased for no consideration was not recoverable as it could not be directly and immediately linked to taxable supplies.

In summary, JDI International Leasing Limited (JDI) leased in, and then bought, tools from a UK VAT registered trader. For reasons which were not made clear in the case, JDI then leased the tools to a Netherlands connected company for no consideration. The supplies of the tools to the group's customers were made by the Dutch company. JDI then made profitable supplies of spare parts needed to maintain the tools.

As JDI was not VAT registered it made a claim to HMRC to recover the VAT incurred on the lease and purchase of the assets under the EU 13th Directive. This was on the basis that the VAT incurred in making the free supply was linked to its overall business activities including the supply of spare parts.

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The First Tier Tribunal (FTT) disagreed with this and held that, although JDI had an economic activity of selling spare parts, there was not a direct and immediate link between this taxable activity and the VAT incurred to make the supply of tools for no consideration. The FTT considered the principles established in Sveda and the Associated Newspapers cases, but decided that that the facts were sufficiently different in that they could not support JDI's argument (i.e the facts did not speak for themselves). The Tribunal could not see a convincing or objective link between the lease and purchase of the tools and the business of selling spare parts. Moreover, the Tribunal determined that JDI was not acting as a taxable person when it acquired the goods.

Whilst the facts in this case are unusual it illustrates clearly the importance of planning for the VAT consequences. Had JDI agreed to supply the tools for a consideration the VAT consequences should not have adversely impacted its business. Please contact our Indirect Tax Team if you have any concerns following this decision.

Update HMRC to tackle VAT evasion by overseas sellers using online marketplaces by using 'split payments

Measures which came into effect from September 2016 now enable HMRC to tackle online VAT fraud by overseas traders selling goods in the UK. We reported on this change back in our March 2016 VAT newsletter and understand that many overseas traders have now registered for UK VAT.

To help tackle non-compliance by overseas on-line retailers, HMRC is now considering solutions including the use of a 'split payment' method. In this case when a payment is made online, the payment is split between the net and VAT amounts, with the VAT being directly paid to HMRC by a designated party in the payment process.

HMRC has issued a 'call for evidence' seeking opinions on alternative methods for collecting VAT for online businesses, and we would suggest taxpayers who have any concerns to get in touch with our Indirect Tax Team to discuss these proposals in further detail

Historical VAT bad debt relief claims

Following the publication of HMRC's first VAT Brief for 2017, HMRC is inviting VAT repayment claims for bad debt relief in the period between 1989 and 1997.

HMRC has set out details of the evidence it will require from businesses to substantiate claims for historical VAT bad debt relief, following the Court of Appeal (the Court) judgments in the British Telecommunications plc and GMAC UK plc cases. These cases dealt with legislation that existed from 1978 until 1997. The Court found that, although certain conditions concerning insolvency and the passing of title were disproportionate, claims should only be admitted for supplies made between April 1989 and March 1997. Businesses will need to supply evidence that VAT has not been reclaimed previously, which must meet the conditions listed in VAT Notice 700/18.

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As a result of the GMAC case, HMRC has clarified the policy position in relation to historic bad debt relief. They are now inviting repayment claims for bad debt relief in the period between April 1989 and March 1997, so long as satisfactory evidence can be provided that bad debts were incurred at the time. Such historical bad debt relief claims will not be subject to the four-year capping provisions. We would encourage all our clients to check what records are still available from April 1989 to March 1997. Where there is any evidence of any outstanding bad debts for which VAT relief was not claimed at the time the potential to make a claim now exists.

Our Indirect Tax Team can assist with making historic bad debt relief claims and can draw on the experience gained in making such claims previously.

Lower VAT rate on e-books on the horizon

The European Parliament has voted in favour of a proposal to lower the VAT rate on e-books from the standard rate to any reduced rate charged by member states. The new Directive should allow member states to charge VAT at the same rate on all publications, whether they are published online or on paper.

However, the EU's Economic and Financial Affairs Council (ECOFIN) later failed to reach agreement following concerns raised by the Czech representative. It is expected that this will delay any changes to the VAT rate on e-books for several more months.

AG opinion – should hire purchase agreements be categorized as a supply of goods or services?

The recent Advocate General (AG) opinion in the Mercedes-Benz Financial Services UK Ltd (MBFS) case attempted to offer some clarity on the VAT treatment of hire-purchase agreements, most notably whether they should be treated as a supply of goods or services for VAT purposes. Businesses that offer similar agreements to customers may be affected by this decision.

MBFS offered hire-purchase and leasing products. It also offered a hybrid agreement called 'Agility'. Under this agreement, the lessee had an option to purchase the vehicle after the expiry of the lease term by paying a final amount which was around 42-48% of the initial price of the vehicle. The instalments payable over the term of the agreement corresponded to the remainder of the initial price plus financing costs. Around half of the customers took up the option.

For VAT purposes, a lease is generally treated as a supply of services, whereas a hire-purchase agreement is treated as a supply of goods (as it is expressly contemplated that ownership in the goods will pass at the end of the hire term). Under Article 14(2) (b) of the Principal VAT Directive the following shall be treated as a supply of goods:

"the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment;"

The Agility agreement contained features associated with both lease and hire-purchase agreements and was therefore harder to classify.

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The AG gave his interpretation of when a leasing agreement should be treated as a supply of goods and listed 3 key factors required for there to be a supply of goods:

- The agreement should contain an ownership transfer clause;
- Transfer of ownership must follow the normal course of events (i.e. a series of events envisaged by the agreement including a purchase option) but not one in which the lessee has a genuine choice to make as to whether to exercise a purchase option or not; and
- Transfer of ownership must take place at the latest upon payment of the final instalment.

The AG found that the Agility agreement did not appear to satisfy the necessary requirements and the motor vehicle finance product could not be a supply of goods. Even though the customers had an exclusive right to exercise the purchase option, they had to pay a significant amount of money to do so. It could not be said that in the normal course of events ownership would transfer to the lessee. We await the CJEU decision to see whether this opinion is followed. This could have significant implications for the motor trade, and our Indirect Tax Team can offer guidance in this area.

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