Analysis

VAT in 2017: endings, beginnings and other twists

Speed read

In 2017, VAT practitioners saw the end of a long-running saga (*Littlewoods*), light in murky areas such as the VAT treatment of pension management services (via *United Biscuits* and *Revenue & Customs Brief 3/2017*), and (through the European Union (Withdrawal) Bill) even a glimpse of a brave new world, not to mention unexpected turns (in cases such as *J3 Building Solutions* that not only surprised, but (at times) defied explanation.

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In 2017, we saw, in the world of VAT, a long-running saga come to an end, the glimmer of a whole new universe, and plot twists that confounded expectation and (at times) defied explanation. In this article, we follow the ghost of the recent past to revisit a few of these intriguing developments.

Restitution

The story in *Littlewoods* [2017] UKSC 70 started in 1973.

By 2004, the taxpayer had been overpaying VAT for more than 30 years. The issue was not whether it was entitled to recover the overpaid tax – it was; and HMRC made repayment accordingly (pursuant to VATA 1994 s 80); the issue was whether the interest on the overpaid amounts (which HMRC was liable to pay) should be simple interest (as provided for in VATA 1994 s 78) or compound interest (as sought by the taxpayer in its claims for restitution).

The case went before the Supreme Court in July of this year. The two issues were:

- whether the taxpayer's claims were excluded by ss 78 and 80 as a matter of English law; and
- if so, whether that exclusion was contrary to EU law.

Unsurprisingly, the Supreme Court confirmed that the claims were indeed excluded by ss 78 and 80. More surprisingly, it held that the exclusion did not contravene EU law.

In 2012, the CJEU had ruled (in *Littlewoods* (Case C-591/10)) that to comply with the EU principle of effectiveness, domestic legislation on the calculation of interest due from the state must not have the effect of depriving the taxpayer of an 'adequate indemnity for the loss occasioned through the undue payment of VAT'. The High Court and the Court of Appeal (in *Littlewoods* [2014] EWHC 868 and [2015] EWCA Civ 515) both interpreted the phrase 'adequate indemnity' to require payment of an amount that would reimburse the taxpayer for the loss it had suffered – compound interest, basically – but the Supreme Court disagreed, and held that simple interest was adequate.

And so the story ends, not just for Littlewoods, but the other 5,000 taxpayers as well who were also claiming compound interest from HMRC. And with the total amount at stake being in the region of £17bn, Christmas really has come early for the government.

One of the consequences of the Supreme Court judgment in *Littlewoods* is that the corporation tax charge (at the enhanced rate of 45%) on restitution interest is now of less significance than originally thought. And whether by coincidence or design, 2017 was also the year the First-tier Tribunal rejected a challenge that the provisions imposing the charge (Part 8C of CTA 2010) were contrary to applicable EU principles – see *BAT Industries* [2017] UKFTT 558 (in which it was also held that the provisions did not infringe the taxpayer's fundamental rights under the European Convention on Human Rights or the Charter of Fundamental Rights of the European Union).

Littlewoods, of course, was not the only case in 2017 that considered restitution in the context of VAT. The other key case was *Investment Trust Companies* [2017] UKSC 29. The core issue there was whether a tax-bearer (i.e. the recipient of a supply) – as opposed to the taxpayer (i.e. the supplier of a supply) – was entitled to claim directly against HMRC where VAT had been overpaid, whether by bringing a claim in restitution or under EU law. The Supreme Court held that although HMRC had been enriched by the overpaid tax, it was at the taxpayer's, and not the tax-bearer's, expense, and that the tax-bearer did not, therefore, have a claim in restitution. It also held that this was not incompatible with EU law, thus dashing any hope the tax-bearer had that the EU held the key to this particular domestic lock.

Pension management

Another case that considered whether tax-bearers were entitled to claim directly against HMRC where VAT had been overpaid was *United Biscuits* [2017] EWHC 2895. Not surprisingly (especially after *Investment Trust Companies*), the High Court held that they were not.

United Biscuits was the latest development in the long-running saga on the VAT treatment of pension management services. In *Wheels* (Case C-424/11), the CJEU ruled that such services did not amount to the exempt 'management of special investment funds' within article 135(1)(g) of the Principal VAT Directive (PVD) where the pension concerned was a defined benefit pension. On the other hand, in *ATP* (Case C-464/12), it ruled that such services would be exempt within article 135(1)(g) where the pension was a defined contribution pension. *United Biscuits* was not concerned with the exemption provided for in article 135(1)(g), but rather with the exemption applicable to insurance transactions (VATA 1994 Sch 9 Group 2).

HMRC policy had been to treat pension management services as exempt where they were supplied by insurers (but not where they were supplied by non-insurers). The taxpayer's claim in *United Biscuits* was that even the supplies by non-insurers should be exempt. This was rejected by the High Court, which held that the 'management of group pensions funds [*was*] not an (*sic*) VAT-exempt activity, whether carried out by insurers or non-insurers'.

The High Court judgment came on the heels of *Revenue & Customs Brief 3/2017*, in which HMRC states that 'the policy of allowing insurers to treat their supplies of … pension fund management services as VAT exempt insurance is to be discontinued … from 1 April 2019. HMRC understands, however, that the great majority of pension fund management services provided by insurers are supplied for defined contribution pension funds and therefore qualify (and have

always qualified) for exemption … following the judgment in *ATP*.

Construing construction

Whether the erection of a building that incorporates part of a pre-existing building constitutes 'construction' of a building for the purposes of VATA 1994 Sch 8 Group 5 – being pertinent to whether certain land or land-related supplies are zero-rated – has always been a less than straightforward question. Note 16 of Group 5 provides that 'construction' for these purposes does not include the conversion, reconstruction or alteration of, or (save where additional dwellings are created) the enlargement of or extension to, an existing building. Note 18 of the same provides that a building continues to be an 'existing building' until it is demolished completely to ground level (subject only to the retention of a single or (for corner sites) a double façade where required for statutory planning purposes).

In *Astral Construction* [2015] UKUT 0021, the Upper Tribunal looked at the erection of a nursing home that incorporated part of a pre-existing church, and its judgment – that the question was one of fact, degree and impression (which, in that case, resulted in zero-rating) – was subsequently interpreted by the First-tier Tribunal in *J3 Building Solutions* to mean that whether an operation that involved the incorporation of an 'existing building' constituted 'construction' could be determined simply by comparing the original structure with the new structure without reference to note 18 (see [2016] UKFTT 0318). This has now been rejected by the Upper Tribunal (see [2017] UKUT 0253).

On the face of the two Upper Tribunal judgments, *Astral Construction* does not sit well with *J3 Building Solutions*. Thankfully, HMRC has now provided clarification (and just in time for the holidays). In *VAT Information Sheet 07/17*, HMRC states (among other things) that:

- following the Upper Tribunal judgment in *Boxmoor Construction* [2016] UKUT 091, it now accepts that the retention of a 'very minor part' of an existing building may be ignored as *de minimis* provided it is small enough; and
- although it considers that scenarios such as was considered in *J3 Building Solutions* – where an operation incorporating two and a half walls of an 'existing building' was not regarded as 'construction' – to be far more common, it does accept that where the nature of the works is such that 'the size of the addition to the existing building greatly exceeds the original building and the function changes', the analysis in *Astral Construction* – and thus zero-rating – could apply.

In other news...

2017 also saw finales for *British Film Institute* (Case C-592/15) and *English Bridge Union* (Case C-90/16), with the CJEU ruling (in the former case) that it was legitimate for the UK to exclude cinema admissions from the exemption (provided for in article 132(1)(n) of the PVD (VATA 1994 Sch 9 Group 13 in the UK)) applicable to 'certain cultural services', and (in the latter case) that duplicate bridge (as an activity with only a negligible physical element) was not a 'sport' for the purposes of the exemption provided for in article 132(1)(m) of the PVD (VATA 1994 Sch 9 Group 10 in the UK).

There was much-needed (but, for the finance and insurance sectors, unhelpful) clarification on the scope of the cost-sharing exemption provided for in article 132(1)(f) of the PVD (VATA 1994 Sch 9 Group 16 in the UK), which applies to services, supplied by an independent group of persons carrying on an exempt or non-taxable activity, that are directly necessary for the exercise of that activity. In *DNB Banka* (Case C-326/15), *Aviva* (Case C-605/15) and *Commission v Germany* (Case C-616/15), the CJEU ruled that the exempt activity the group of persons must carry on in order to avail of the cost-sharing exemption had to be an activity in the public interest – i.e. an activity that was exempt by virtue of article 132 of the PVD, which set out exemptions for 'activities in the public interest' – and not an activity such as the provision of insurance or finance, both of which were exempt by virtue of a different article of the PVD: article 135, which set out exemptions for 'other activities'. The CJEU also ruled, in *Commission v Germany*, that the activity the group of persons must carry on in order to avail of the cost-sharing exemption was not restricted to an activity in the health sector.

In the Upper Tribunal judgment in 'the other *Wheels* case' (*Wheels Private Hire* [2017] UKUT 0051), it was held that the expanded VAT concept of 'insurance' extends to the provision of insurance cover by a taxi business to its drivers. If nothing else, the case finally brings the ruling of the CJEU in *BGZ* (Case C-224/11) into 'mainstream' VAT discussions in the UK.

We also saw the publication of the European Union (Withdrawal) Bill, which, when enacted, will repeal the European Communities Act 1972 while retaining such EU law as apply in the UK immediately before (Br)exit day. Of particular interest (especially to VAT practitioners) is how it:

- preserves (in clause 5(2)) the principle of the supremacy of EU law in relation to 'the interpretation, disapplication or quashing of any enactment or rule of law passed or made before exit day';
- provides (in clause 6(2)) that a court or tribunal may still have regard to rulings of the CJEU on or after exit day (but only where it considers it appropriate to do so); and
- deals (in clause 6(3)) with how questions on the validity, meaning and effect of retained EU law are to be decided, and (in clause 6(5)) how the Supreme Court is to decide whether to depart from retained EU case law.

Waiting in the wings

2018 will see (among other things):

- DASVOIT come into effect (on the disclosure of avoidance schemes in relation to VAT and certain other indirect taxes);
- MiFID II come into force (with implications for the VAT treatment of the provision of research);
- the introduction of VAT in GCC (Gulf Cooperation Council) countries; and
- how the recommendations in the OTS (Office of Tax Simplification) report on simplifying VAT play out.

It will (no doubt) have its own smattering of endings, beginnings and twists – all leading to 2019, when we will, of course, have … Brexit. ■

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- Supreme Court ruling in *Littlewoods* (Nick Skerrett, 9.11.17)
- Cases: *Littlewoods and others v HMRC* (7.11.17)
- Cases: *United Biscuits (Pension Trustees) and another v HMRC* (7.12.17)
- News: Construction services and zero-rated relief (6.12.17)
- *J3 Building Solutions*: interpreting note 16 (Graham Elliott, 19.7.17)
- Cases: *HMRC v J3 Building Solutions* (12.7.17)
- Cases: *HMRC v British Film Institute* (22.2.17)
- Cases: *The English Bridge Union v HMRC* (31.10.17)
- CJEU rules on the cost sharing exemption: surprise, surprise? (Karen Killington & Carine Epardaud, 12.10.17)
- Cases: *HMRC v Wheels Private Hire* (28.2.17)
- Tax and the Great Repeal Bill (Lydia Challen, 27.7.17)
- The post-Brexit interpretation of UK VAT law (Richard Iferenta & Raymond Hill, 12.10.16)