



Your in-house VAT Consultants

VATease Monthly VAT Newsletter May 2006

Most of the developments to be reported in this month's VATease VAT newsletter come from case law rather than any particular action by HM Revenue & Customs. There is information that will be of relevance to suppliers of education, hotels and catering businesses and businesses considering artificial separation to avoid VAT registration.

Supply of "Private Tuition" by employees and/or Limited Companies

The one ongoing VAT issue that we're asked about more than any other at the moment is HM Revenue & Customs' appeal against the Tribunal's decision in Empowerment Enterprises Ltd.

Currently, supplies of "private tuition" are exempt from VAT only when supplied and performed by a sole proprietor or partner. If they are actually performed by an employee, sub-contractor or supplied by a limited company then they are taxable at 17.5%.

In 2005 a VAT Tribunal ruled that this contravened EU law and that private tuition should be exempt regardless of the status of the supplier or performer. This would have the effect of making supplies of teaching of any subject ordinarily taught in a school or university exempt from VAT no matter who is supplying it.

HMRC have appealed this decision to the Court of Session. The hearing was originally to be on 15 and 16 March but has been deferred until 4 and 5 July. A decision will come sometime after that.

It is worth noting that a case recently referred to the European Court by German courts (*Werner Haderer v Finanzamt Wilmersdorf*, Case C-445/05) could restrict exemption to supplies made directly to students. Even if this is the result of the ECJ case, this would not affect UK businesses unless the UK Govt. changes UK law to reflect the outcome.

Electronic Distance Learning Package

Staying with the education theme, the Tribunal recently ruled the supply of some educational software packages to students could qualify for VAT Exemption as distance learning package.

Carousel Fraud

In the first VAT Tribunal decision since the ECJ ruled in the Bond House Systems / Optigen case, the Tribunal overturned HMRC's decision to disallow an input VAT claim by a mobile phone dealer. The Tribunal agreed there had clearly been a circular series of transactions undertaken solely to defraud VAT. However, HMRC had not provided evidence to show 'any complicity by [the appellant company] in the organisation of the carousel, nor any actual knowledge on its part that elsewhere in the series there was fraudulent activity'.

Exemption of Postage Charges by non-Royal Mail Suppliers

The European Commission has started proceedings against the UK because UK legislation exempting postal services does not comply with EU legislation.

UK law currently allows only The Royal Mail to exempt postal services. However, EU law requires postal services to be exempt regardless of who supplies them. The actions being taken by the EC could lead to the UK being forced to widen the scope of the current exemption.

Artificial Separation of Businesses

VATease has recently witnessed the resurgence of businesses asking for advice on separating businesses into two or more legal entities to avoid VAT registration.

A recent VAT Tribunal case is a timely reminder of the risks that this presents. An ice-cream salesman tried to argue that his shop was run as a partnership with his wife but his ice-cream van was run as a sole trader. As separate businesses he argued they were both below the VAT registration threshold. HMRC formed the opinion that they were not, in fact, separate legal entities. HMRC decided that he ran both businesses as a sole proprietor and assessed for the undeclared VAT as the joint turnover had exceeded the threshold some years previously. The salesman appealed but the VAT Tribunal agreed with HMRC and, to add insult to injury, awarded costs against the salesman as well.

Goods Supplied by Mail Order

Grattan, the well-known mail order business, recently went to VAT Tribunal to try to delay the time at which it accounts for VAT on its sales. All of its delivered goods are supplied on approval - the customer could return the goods up to 14 days after delivery. Grattan formed the opinion that the time of supply was not until the 14 day period had passed and didn't account for VAT until this time.

HMRC did not agree and assessed for VAT to be declared at the time payment was received. The Tribunal agreed and dismissed the company's appeal, awarding costs to HMRC too.

Abusive Practice - HMRC obtain right to disclosure of documents

In the recent Halifax ECJ case, the Judge appears to have introduced into UK VAT law an "Abuse of Rights" principle. If a business sets up transactions that, whilst legally correct, are done solely to avoid VAT contrary to the intentions of EC law, HMRC can redefine those transactions to ensure VAT is declared as it should have been.

However, how does HMRC prove that the transactions were implemented solely to avoid VAT? In the first case since the Halifax decision, HMRC have won an important ruling against the mobile phone company MM02. MM02 implemented a scheme involving an Irish company the HMRC opined was solely for the purpose of VAT avoidance. The Tribunal has ruled that MM02 must disclose documents including tax advice received regarding the scheme in order that the Tribunal can examine the reasons why it was implemented.

HMRC Working with Large Business

HMRC have published a booklet entitled "Large Business Service - Working with Large Business". It sets out how HMRC intends to work with large companies.

HMRC VAT Notes 1 2006

HM Revenue & Customs have released **VAT Notes 1 of 2006**. VAT Notes are a very important part of HMRC's information dissemination. They are included in VAT returns sent to all registered businesses. VAT & Duties Tribunals have in the past therefore ruled that businesses can be assumed to be aware of any information contained in them.

All VAT registered businesses must therefore make themselves aware of the contents of VAT Notes and take action on anything affecting their VAT declarations

This edition of the VAT notes includes:

1. A list of revised and updated VAT Notices
2. Changes to the liability of hotel conference & function facilities
3. The outcome of the Bond House & Optigen case re carousel fraud assessments
4. The liability of company formation services with ancillary printed matter

5. The affect of the Halifax, BUPA and University of Huddersfield cases on VAT avoidance schemes
6. The implications of Court of Appeal judgment in IDT Card Services Ireland Limited on avoidance schemes involving phone cards
7. The liability of beauty treatments using Class 3B or 4 lasers and/or intense pulse light machines
8. The introduction of a specialist helpline for Charities VAT and direct tax queries
9. The withdrawal of concession to submit EC Sales Lists by plain paper schedules
10. A reminder to keep your registered details up to date
11. A reminder of the new Option to Tax form VAT 1614
12. A supplement with a very brief guide to some of the VAT changes announced in the 2006 budget

Pregnancy - Reasonable Excuse for late payment of return

A doctor was one day late paying his VAT return and received a default surcharge. At Tribunal he gave evidence that his wife had been in hospital at the time in the late stages of pregnancy. The Tribunal allowed the appeal and lifted the surcharge.

VATease Comment: This would appear to fly in the face of most reasonable excuse appeals. It usually requires the reason to have come as "a bolt out of the blue", something that is entirely unexpected. As a doctor, this taxpayer should surely have realised there was a possibility that he would be busy toward the end of his wife's pregnancy and arrange for earlier submission and payment of his return.

HMRC to Target Hotels, Restaurants and Caterers

According to the Telegraph, HM Revenue & Customs are to undertake an exercise to clamp down on suspected missing VAT declarations from the hotel and catering industry. The article states that HMRC believe that up to 20% of the £5bn believed to be due in VAT from hotels and restaurants may be going missing due to a combination of fraud and error.

VATease has considerable experience in dealing with VAT assessments issued by HMRC on businesses within the catering industry, especially those calculated using "invigilation" techniques such as covert observations of a business over a period of time. If you or your clients operate within the catering industry and receive such an assessment, please be sure to take advantage of VATease's **free assessment review**.

Jaffa Cake - Cake or Biscuit

One of the more ridiculous, and probably most famous, cases in VAT history is the Jaffa Cake case. Is it a chocolate biscuit (standard rated) or a chocolate covered cake (zero rated).

The 1991 VAT Tribunal settled the argument once and for all and now a new documentary will bring the argument to public attention. **The Sunday Herald** reports that a Scottish student has already won awards with his low budget film and is in discussion with Channel 4 to produce a version for television.

Retirement of Executive Consultant

Terry plant has announced his retirement from VATease with effect from 30th April 2006, by which time he had completed in total over 30 years in the VAT regime.

Simone Hurst, Principal Consultant at VAT ease said "I would like to thank Terry for the excellent contribution he has made to VATease during his 41/2 years here. I wish him well for the future."

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(including acquisitions from the EC)

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