Cost sharing exemption: two AGs disagree

You say tomayto, I say tomahto.

In this journal ('Cost sharing: all shook up?', *Tax Journal*, 31 March 2017), we reported on the position taken by one advocate general (AG) in two opinions – *DNB Banka* (Case C-326/15) and *Aviva* (Case C-605/15) – concerning the cost sharing exemption (CSE) in article 132(1)(f) of the Principal VAT Directive. This is an update of that article, following the release on 5 April of another AG's opinion on the same topic, in *Commission v Germany* (Case C-616/15).

Eether/either… The CSE is only 76 words long. Yet, unusually, the two AGs disagree completely on a number of issues, including a fundamental one: the scope of the exemption. Contrary to the opinions in *DNB Banka* and *Aviva*, in *Commission v Germany*, the AG considers that a cost sharing group (CSG) needs not be a taxable person; and, most importantly for the financial sector, that this exemption does not apply only to supplies of services by a CSG to members with exempt activities in the public interest sector but can also apply (subject to the other conditions being fulfilled) to supplies of services to members with any exempt (or non-business) activity.

The EU Commission brought infraction proceedings against Germany because it has limited the scope of the CSE to supplies where members are doctors, exercise paramedical professions or carry on exempt activities in the hospital and medical care sector. Germany's position is based on the wording, position, drafting history and objectives of CSE (the AG in *DNB Banka* and *Aviva* based her, albeit less restrictive, conclusions on similar arguments).

The AG in *Commission v Germany* also uses a schematic, teleological and textual approach to the CSE but disagrees with Germany and the other AG. He affirms that the purpose of the exemption is to avoid members of a CSG having to pay irrecoverable VAT on services supplied by the CSG and this applies to any exempt or non-business activity of the members. Nothing in the text of the Directive or case law suggests the CSE should be restricted and the public interest heading of article 132 should not of itself limit the scope of the CSE to public interest exemptions. The CSE's position in the Directive is solely the result of careless drafting and nothing more.

Germany also supported its position on the basis of a general risk of distortion for all non-health CSGs. In *Commission v Germany*, the AG considers that an examination of whether a risk of distortion exists is required in each case, whether the CSG members are in the health sector or not.

In summary, Germany limits the CSG exemption to the exempt health profession; the AG in *DNB Banka* and *Aviva* limits it to CSG members with exempt activities listed in article 132; and the AG in *Commission v Germany* concludes that it can apply to CSG members with any exempt activity. Three different conclusions based on the same arguments. You say tomayto, I say tomahto indeed!

Neether/neither… The AG also considers that a CSG is not a taxable person. In coming to that position, he first considers the concept of group, which does not necessarily have legal personality and may be based on a simple contractual agreement. He then compares the CSG with VAT groups and considers that, like VAT groups, CSGs are transparent. The Directive should therefore not have referred to CSGs' supplies to their members as 'exempt' but should have excluded such supplies from VAT in the same way that intra VAT group supplies are disregarded. A mere recovery of a share of costs is, in fact, not a supply for VAT purposes.

Let's call the calling off off? Those members of CSGs in the banking and insurance sectors will now wait expectantly for the CJEU's judgment in these cases. Only one of the AGs can be right. ■

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Leadley: claims by executors

Executors cannot claim s 131 relief on shares.

Section 131 of ITA 2007 provides income tax relief where a person subscribes for shares in an unquoted trading company which subsequently become of negligible value. The recent case of *HMRC v Leadley* [2017] UKUT 111 (TCC) considered such a claim, and the issue was simply this: if the owner of the shares dies before making a claim, can the claim be made by his executors?

Mr Leadley had invested in a company and by 5 April 2010, his shares had become valueless. His tax return for the year 2009/10 would ordinarily be filed by 31 January 2011 – but he was killed in May 2010. He had not, of course, filed his tax return by then.

In January 2011 when his executors submitted his tax return, they included a claim for the relief. HMRC refused the relief on the grounds that only the person who owned the shares can make the claim; he was dead, so bad luck.

The executors said, 'OK, we owned the shares in the company when the claim was submitted, so please can we have the relief?' Er no; by the time the executors acquired the shares, they had already become of negligible value so the executors could not make the claim either.

The First-tier Tribunal decided that the executors had a valid claim because executors stand in the shoes of the deceased and are therefore able to make such claims as the deceased could have made had he lived. The tribunal expressed the position as follows: 'By virtue of their common law legal status as his personal representatives, the executors stand in the shoes of Mr Leadley and are treated, and were intended by Parliament to be treated, in so far as Mr Leadley's chargeability is concerned as if they were Mr Leadley.'

The FTT may have had in mind the following extract from the judgment in *Rickless v United Artists* [1987] 1 All ER 679: 'Personal representatives are not the agents of the deceased; their powers rest not on the authority given to them by the deceased but on a quite separate authority given to them by the law to stand in the place of the deceased.'

The tribunal might also have had regard to the case of *Otter v Church, Adams, Tatham & Co* [1953] 1 All ER 168 in which it was said that: 'what vests in the personal representatives is the right of action which was previously vested in the deceased', and in which reference was made to *Raymond v Fitch* [1842], which showed that: 'as a matter of common law all choses in action which are not of a purely personal nature such as an action for slander, survive and pass to the personal representatives'.

HMRC appealed against the decision and during the course of the hearing before the Upper Tribunal, it produced an internal HMRC memorandum which contained the following passage: 'we have the situation where if a taxpayer is knocked down on her way to her accountant's office to sign a negligible value claim, no one can make a capital loss on the asset whereas if she is knocked down after signing the claim a capital loss will be available. This seems extremely harsh.'

I am sure everybody would agree that this is extremely harsh, but what on earth has an internal HMRC memorandum got to do with it? Is this memorandum relevant to the court in determining the meaning of s 131? What if the taxpayer had produced a letter from his adviser, or even perhaps counsel's opinion, saying that relief was available? Would that have been relevant to the court in interpreting the provision?

Anyway, the essential point, however harsh, is reasonably clear. To make a valid claim under s 131, it is necessary for the person who owns the shares at the relevant time to make the claim. Accordingly, the executors need to be treated as the person who owns the shares for this purpose. If they cannot be so treated, they cannot make the claim.

The FTT said that they could, but the Upper Tribunal held that this was mistaken. It said that the deceased and the executors cannot be equated. In support of this conclusion, it explained that TCGA 1992 treats the two as distinct and provides in s 62 for personal representatives to be deemed to acquire the assets of a deceased person on his death for consideration equal to their market value without a disposal.

We hear a lot about purposive interpretations when HMRC seeks to deprive a taxpayer of a relief – but sadly, it never seems so keen on purposive interpretations when they benefit the taxpayer. The FTT thought that a purposive interpretation was appropriate here but, unfortunately for the executors, the Upper Tribunal took a different view. ■

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VAT and *VWFS*

It may be some time before we have agreement on what proportion of residual input tax finance houses should recover.

In June 2008, HMRC assessed Volkswagen Financial Services Ltd (VWFS) for £498,866 in relation to how it had recognised hire purchase transactions in its partial exemption special method (PESM). In HMRC's view, if a finance house like VWFS sold a car for £15k on a three-year HP deal at 5% APR, then it should recognise the interest and ancillary charges (some of which were subject to VAT) in its PESM, but it should exclude the £15k. VWFS bought the car for £15k from the VW dealer, and sold it for £15k to the customer. Crudely, there was no 'added value' which could support VWFS' overhead costs, and those costs should therefore be principally attributed to the VAT-exempt interest income.

Almost ten years later, and after four rounds of litigation, the Supreme Court has decided ([2017] UKSC 26, reported at page 5) that guidance is needed from the CJEU in order to rule on HMRC's approach. According to the Supreme Court's press release the questions to be referred to the European Court will include: 'where general overhead costs attributed to HP transactions … have been incorporated only into the price of the taxable person's exempt supplies of finance, does the taxable person have a right to deduct any of the input tax on those costs?'

(Typically, it takes around 18 months from a reference being made for the CJEU to deliver a judgment. Therefore, there is a reasonable chance of the Supreme Court receiving an answer before the UK leaves the EU).

Although finance houses typically make no profit on the sale of a car on HP, they have responsibilities towards purchasers (as shown, for example, by the fact that cars can be returned to them halfway through a deal). Against that background, HMRC's expectation that the cars should simply be disregarded appears difficult to accept.

The alternative transaction count method suggested by VWFS, which gave equal weighting to the finance and vehicle supply elements of each transaction (i.e. 50% residual input tax recovery) might be simple to operate, but would also arguably fail to reflect the complexity of what a finance house does. It would be much more favourable to finance houses than the 15% recovery that was historically applied by many taxpayers under a method agreed with the Finance Houses Association (but which was withdrawn in 2000). HMRC would probably be on stronger ground if the proceedings were testing the validity of the transaction count method, rather than focusing on whether HMRC's 'value-added' approach can be justified.

How, then, is this issue likely to be resolved, if neither of the methods advanced by the parties are considered to fairly reflect how input tax is used? Will there be a wider impact for other taxpayers?

If the CJEU were to endorse HMRC's reasoning, then it could potentially impact any business which operates a linked pricing model. Should mobile phone operators ignore handset sales; or video game makers disregard sales of consoles; or printer manufacturers recognise sales of ink, but not printers? HMRC's interest in this area was seen in 2008 in Camden Motors, when they argued that car dealers were largely in business in order to generate finance and insurance commissions rather than to sell cars. That case ended in defeat for HMRC at the First-tier Tribunal, but if HMRC's 'value-added' approach to partial exemption is endorsed by the Supreme Court and CJEU in VWFS, then there is a clear risk that similar challenges will reappear in other industry areas.

If the CJEU rejects HMRC's theory, then it might mean that VWFS enjoys 50% recovery for some historical VAT quarters, but it will not necessarily provide a template for other finance houses. HMRC appear to have made a strategic error in VWFS, in advancing their preferred argument that car sales should be excluded without putting forward any appropriate alternatives. Such alternatives will, however, need to be considered by all other finance houses which have been unable to recover input tax on overheads over the last decade, but have been submitting claims to protect their positions.

Whatever the eventual outcome of the litigation, it therefore seems that agreement over what proportion of residual input tax finance houses should recover is still some years off. ■

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Case tracker update

New developments in tax cases include:

- *Associated Newspapers* [2017] EWCA Civ 54 (VAT: supply of vouchers): HMRC seeking leave to appeal to SC;
- *BMW (UK) Holdings Ltd; Standard Chartered plc* [2016] UKUT 434 (TCC) (VAT groups & right to repayment): taxpayer applied to CA for permission to appeal;
- *Capernwray Missionary Fellowship of Torchbearers* [2015] UKUT 368 (TCC) (VAT: building used for religious courses): UT refused permission to refer to the CJEU. Taxpayer withdrew appeal;
- *Distinctive Care Ltd* [2016] UKFTT 764 (TC) (tax tribunal procedural): taxpayer appealed to UT;
- *Finmeccanica Group Services SpA* [2016] EWCA Civ 1105 (VAT: place of supply): decision is final;
- *Gala 1 Ltd* [2016] UKUT 564 (TCC) (VAT groups and overpaid VAT): taxpayer applied to CA for permission to appeal;
- *Kati Zombory-Moldovan*[2016] UKUT 433 (TCC) (VAT: supply of a plot for a stall not a supply of land): decision final;
- *Newey (Ocean Finance)* (Case C-653/11) (VAT: advertising services): CA due to hear HMRC's appeal on 30 Jan 2018;
- *Norseman Gold* [2016] UKUT 69 (TCC) (VAT: holding company carrying on an economic activity): taxpayer applied for permission to appeal to CA. Hearing date is 10 May 2017;
- *NT ADA Ltd (formerly NT Jersey Ltd)* [2016] UKFTT 642 (appealable decisions): HMRC has appealed to UT. Hearing date is 6 Feb 2018;
- *Taylor Clark Leisure plc* [2016] CSIH 54 (VAT: time limits for repayment claim): HMRC has been granted permission to appeal to SC;
- *Travel Document Service and Ladbroke Group International* [2017] UKUT 0045 (TCC) (loan relationships: unsuccessful avoidance scheme): taxpayer appealed to CA. Hearing date: by 6 Mar 2018.
- *University of Newcastle Upon Tyne* [2017] UKFTT 145 (TC) (VAT: supplies by university recruitment agencies): appeal allowed in part. HMRC is not appealing.

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