

## **Protective assessments**

The Court of Appeal has dismissed an appeal by Courts plc (the taxpayer) on the validity of a protective assessment issued by HM Customs and Excise (Customs) to protect their position while the judicial process in *Primback* (concerning the value for VAT purposes of goods sold on interest free credit) was ongoing. Customs were ultimately successful in the *Primback* litigation.

### **Background**

The taxpayer carried on a retail business and during eight consecutive three-monthly VAT periods from 1 October 1997 to 30 September 1999, it offered its customers 'interest free credit'. The credit was provided by a finance company, to which the customer paid the price of the goods by instalments. In return, the finance company deducted a finance charge when accounting to the taxpayer for the sales proceeds. In accordance with the Court of Appeal's decision in *Primback*, the taxpayer accounted to Customs for VAT on the sale price of the goods less the finance charge.

In December 1999 Customs raised protective assessments with a view to protecting their position pending the outcome of their appeal in the *Primback* case. The assessing officer, acting on internal Customs' advice, completed a VAT641 form but did not process it; it remained on the file and a VAT655, which would ordinarily have been sent to the taxpayer, was not generated. Instead Customs sent a letter to the taxpayer informing it of the situation.

In May 2001 the European Court of Justice ruled, on a reference by the House of Lords in *Primback*, that the taxable amount was the price paid by the customer to the finance company and the House of Lords gave effect to that ruling by allowing Customs' appeal in *Primback*.

Following the decision in *Primback* the assessing officer completed another VAT641 and sent a VAT655 notifying the taxpayer of the assessment in late 2001.

The VAT Tribunal and High Court rejected the taxpayer's challenge to the assessment being made out of time. The taxpayer appealed.

### **Decision of the Court of Appeal**

The Court of Appeal dismissed the taxpayer's appeal. It described the taxpayer's argument as based wholly on technicalities and having no merit. The Judge who delivered the leading judgment commented in the opening line that the case shows the risks Customs run when 'attempting to deal fairly and straightforwardly with a taxpayer'.

*Because of the length of time that cases can take to be finally decided, protective assessments on other taxpayers in similar circumstances, issued within the statutory time limits, are the only way Customs can protect the revenue in cases where the length of the litigation process would mean accounting periods fell out of time if no action was taken to assess until the end of the judicial process.*

The taxpayer's case hinged on the fact that the assessing officer had no input in the decision to assess but was merely told to do so; the protective assessment had never been formally processed; and the "debt" it created had not been posted to the taxpayer's VAT ledger account with Customs. So the taxpayer maintained that it was not valid.

A further question related to whether a protective and an "ordinary" assessment (representing amounts validly payable to Customs at the time the assessment was issued) could co-exist for the same accounting period without one cancelling the other. All the taxpayer's arguments failed.

## **Implications**

This decision means an assessment can in some circumstances be validly made and create a debt without having to be processed - processing is a mere clerical procedure. It confirms that protective assessments are valid even though the debt they create is not due at the time and may never become due, i.e. the uncertainty does not invalidate them. It also indicates that a protective and normal assessment can validly co-exist for the same period. These are all important points for Customs to have confirmed.

## **New VAT disclosure rules**

*These have proven to be a hot topic. We have already seen that the scope of these rules extends to many business e.g. those in the charitable sector, which may have seen themselves outside the scope of the rules.*

The VAT disclosure rules are different from the direct tax rules, principally because the VAT rules place the onus to disclose on the taxpayer rather than the “promoter”. This article summarises the understanding of 4 Eyes Ltd of the key requirements around the new rules and highlights some considerations for businesses. This article is not comprehensive and businesses are strongly advised to take specific advice where necessary.

### **Schemes which must be notified to Customs**

There are two categories of “schemes” which must be notified to Customs:

- 1) Designated Schemes – specified in law;
- 2) Hallmark Schemes – schemes which carry one of the characteristics typically associated with VAT avoidance arrangements.

A “scheme” is any arrangement, transaction or series of transactions.

Designated schemes have to be disclosed where the turnover of the business exceeds £600,000 per annum. Customs have powers to add to the list of Designated Schemes as and when they consider it necessary. (See below for a list of Schemes currently included).

Hallmark Schemes are those which have as a feature one of the specific hallmarks set out in the legislation. Where a scheme carries any one or more of these particular hallmarks and has as its main or one of its main purposes the obtaining of a tax advantage, then disclosure will need to be made where the business entering into it has a turnover of more than £10m per annum.

So far, seven such hallmarks of avoidance have been included in the new legislation. (See below for a list of the hallmarks). The taxpayer is responsible for disclosure, although in the case of a Hallmark Scheme a third party such as a promoter may notify the scheme(s).

A scheme must normally be notified by the taxpayer within thirty days of either the due date of the “affected return” or the date the “affected claim” is made. A return or a claim is “affected” if the scheme results in the taxpayer claiming a higher amount of VAT or paying a lower amount of VAT than would have otherwise been the case or attains a timing advantage. For Hallmark Schemes the taxpayer (or other person making a voluntary notification) must notify Customs of the scheme, including how it works, the hallmarks present and the legislation upon which the scheme relies. However, this disclosure requirement for Hallmark Schemes can be avoided providing the taxpayer holds a scheme reference number already issued by Customs.

### **Penalties**

The penalties for failure to disclose are 15 percent of the VAT saving under any Designated Scheme and a fixed penalty of £5,000 for a Hallmark Scheme. There is a “reasonable excuse” defence which negates the penalty but the application of this is currently unclear.

### **Implications**

The VAT Disclosure Rules apply to all returns submitted for VAT periods commencing on or after 1 August 2004. *Businesses will need to consider implementing processes to try to ensure that both existing and new schemes are identified and notified to Customs in line with the reporting requirements.* This is

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likely to involve additional cost to the business. Furthermore, there is a lack of clarity around the scope of the terms used. In particular, by defining "Scheme" and "Tax Advantage" as Customs have done, then any arrangement which does not maximise the amount of VAT payable is potentially caught. For example, if a business intends to enter into a bona fide transaction and has two possible structures, one of which creates a VAT cost and one which does not, then it is sensible commercial practice to adopt the lower cost route.

In theory, businesses on quarterly VAT returns do not need to disclose schemes to Customs until 30 December 2004 at the earliest. However, this date is fast approaching and businesses should already be taking the necessary steps to consider previous arrangements which continue to result in the submission of affected returns, and going forward, ensure the implementation of processes to ensure the business can comply.

#### **Listed Schemes**

1. First grant of a major interest in an occupied building by the builder to recover VAT on refurbishments costs etc
2. Payment Handling Services supplied by retailers
3. Value shifting of standard rated retail supplies to linked zero-rated or exempt supplies
4. Sale and leaseback arrangements to defer irrecoverable VAT
5. Extended approval period to defer payment of VAT on retail goods
6. VAT groups – schemes to reduce irrecoverable VAT payable on third party supplies
7. Training/Education by non-profit-making body to create VAT exempt supplies
8. Training/Education by non-eligible body to avoid irrecoverable VAT

#### **Schemes carrying Hallmarks of avoidance**

The following schemes have the hallmarks or provisions either associated with or generally included in schemes aimed at avoiding VAT, namely:

1. Confidentiality conditions prohibiting a person from sharing details of a scheme
2. Sharing of a tax advantage between any person party to the scheme and a promoter
3. Contingent fee arrangements payable by the scheme user to a promoter
4. Prepayments made between connected persons
5. Funding of supplies between connected persons by way of share subscription or loans
6. Offshore loops where certain services are supplied off shore and back to the UK to remove a VAT cost
7. Certain property transactions between connected persons where a partly exempt person makes a grant in relation to land on which building work has/will be carried out.