HMRC - VATSC37600 - Specific Examples

This section should be read in conjunction with the rest of VATSC36400.

The Law Society’s letter to the Solicitor’s office at Customs and Excise of 18 June had listed examples of where they had sought Customs and Excise guidance on specific issues. There were raised for discussion, and the following answers given:

Customs and Excise confirmed that Press Notice 82/87 covered only payments made after proceedings had commenced. If it was clear that payments had been made before proceedings had been commenced, but such payments would not be within s.3(2)(b), (now S5(2)(b)) Customs and Excise would extend outside the scope treatment to such payments.

In the area of involuntary supplies (eg a dispute concerning right of light for which damages are awarded) Customs and Excise confirmed that only damages in respect of past infringements would be outside the scope. Where a settlement covered past infringements, and also permission to continue in the future the conduct which gave rise to those infringements, Customs and Excise would accept a reasonable apportionment. The Law Society asked about the case where the court required a party to give up a right (eg a right of light or an intellectual property right) in exchange for a payment from the other party. Customs and Excise said that this was a difficult point which they would need to consider further. Article 6(l) of the Sixth Directive was relevant where it referred to “tolerating an act or situation” as a possible supply for VAT purposes. Questions concerning rights of light can cause problems. Much depends on whether a payment is made in return for the right to take someone else’s light or whether it is compensation for the loss of light subsequent to an adjacent building being constructed. It could be argued in exceptional circumstances that the court is deciding what level of consideration is due in return for the granting of the right. However, it is thought that in the majority of cases the payment will be damages imposed upon the payer by the court and therefore outside the scope of VAT. For example, in cases where the court decides that light may be taken and that compensation is payable this will be seen as outside the scope of VAT - there is no consensual element.

Where litigation has involved a supply on which VAT had already been accounted for (but the price was not paid) and the result is a reduction in the price paid for the supply, it may be necessary for a supplier to issue a credit note in order to recover part of the VAT which he had previously accounted for and which he had not received. Customs and Excise confirmed that in such a case, the credit note could be accepted as valid and it would prima facie be necessary for the recipient of the supply to repay to Customs and Excise the tax which he had already claimed back.

By way of clarification as to when damages were considered to be compensatory and when such payments would constitute consideration for taxable supplies, Customs and Excise offered the example of a local authority digging up a pavement in front of a parade of shops. Compensation for loss of trade suffered as a result of their action paid by the local authority to a shop keeper would not be regarded as a taxable supply. However, if a shop-keeper was paid by the local authority to allow them to work on his land, the payment would be consideration for a taxable supply. Customs and Excise said that they would want to consider in greater detail the question of warranty claims. For example, in a standard rated property transaction, where a warranty had understated the rent and the contract provided for a reduction in the purchase price in such a situation, the procedure set out in 3 above would apply, and the vendor would have to issue a credit note to recover that part of the VAT previously accounted for. The example of net assets of a business having been overstated in warranties given on sale was not so relevant since if it was a question of shares, it would be in the realm of exempt supplies anyway. Compensation in these circumstances would be regarded as outside the scope unless the agreement provided for a reduction in price.

Where the settlement involved cross supplies (other than the mere surrender of the right of action) tax would be payable by each party, without netting off, according to the nature of the supply. The situation may arise that there may be a consideration paid in return for a party agreeing to enter into an agreement. For example, in the property industry, reverse premiums may be paid to a potential tenant in consideration of the tenant agreeing to enter into a property lease or for agreeing to carry out building, refurbishment or demolition works, as in the cases of Neville Russell and Battersea Leisure. If the supply under the agreement was eg free services, VAT would not be due.

Customs and Excise confirmed that interest on damages is outside the scope of VAT. It has been confirmed in the European decision in BAZ Bausystem AG v Finanzant Munchen fur Korperschaften [1982] ECR 2527 that interest would not increase consideration for a supply. If an international breach had occurred, the same basic principles should be followed. For example, Schedule 5 to the VAT Act 1994 should not apply to a cross border giving up of rights. Apparently, the Dutch and the Germans had had bilateral discussions and had confirmed that they would apply outside the scope treatment on the same basis as in the UK.

Previous page