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1. International trade - Clearance of goods using the Flexible Accounting System (FAS)

Clearance of import goods is dependent on Customs identifying and allocating payments to the correct Flexible Accounting System (FAS) account. Customs have issued an information paper to clarify procedures for the clearance of goods using this system.

Importers, agents and business involved in International Trade can find out further details in Joint Customs Consultative Committee (JCCC) Paper (05) 07, which gives advice on how to ensure FAS payments are processed promptly and correctly; identifying areas where problems could arise.

JCCC Paper (05) 07 is available from the import and export section of Customs website www.hmce.gov.uk.

2. VAT - Clarification of the VAT position of share issues following the Tribunal decision in Water Hall Group Plc

This Business Brief article is an update on Customs' position on the VAT treatment of share issues following the decision in Water Hall Group Plc (LON/00/1308).
The decision

In March 1999 Water Hall carried out a placing and open offer of shares. This comprised an offer of shares to existing members of the company, with provision for any shares not taken up to be placed with other existing shareholders or new investors. Input tax was incurred on the professional fees associated with the issue.

The Court of Appeal decision in Trinity Mirror plc v C&E Commissioners (2001) STC 192 has established that the issue of shares in the UK by a company for the purpose of financing its business is an exempt supply under Item 6 of Group 5 of Schedule 9 to the VAT Act 1994. Any input tax attributable to the costs of making the issue is generally not deductible. However, input tax can be deducted to the extent that it is attributable to shares issued to non-EU purchasers.

Some of the purchasers of the Water Hall shares were located outside the EU, but their purchase had been conducted through a UK nominee company. Customs had disallowed the input tax attributable to these shares on the ground that the issue of shares was to the UK nominee (holder of the legal title in the shares). Water Hall argued that the input tax was deductible because the issue of shares was to the non-EU purchaser (holder of the beneficial title). It contended that all the substantive rights and entitlements associated with the shares rested with the beneficial owner and so one should “look through” the nominee and treat the issue as being to the beneficial owner.

The Tribunal found in Customs’ favour, concluding that the legislation did not allow one to look through the holder of the legal title to the beneficial owner. The issue therefore had to be regarded as to the UK nominee with the consequence that the attributable input tax was not deductible. Water Hall did not appeal against the tribunal’s decision.

Action since the Water Hall decision

Customs have been reviewing the legal analysis in the decision and its potential impact. This review has had to take into account other developments in the treatment of shares and is not yet complete.

On 15 December 2004, the European Court of Justice (ECJ) heard the case of Kretztechnik AG - v - Finanzamt Linz (Case C-465/03). The ECJ has been asked to rule upon whether or not a first issue of shares by a public limited company is a supply and whether or not the VAT incurred on the costs of such an issue is deductible input tax. The ECJ is expected to give its decision later this year.
Current treatment of share issue transactions

For the reasons given above, there are doubts as to both the correctness and extent of application of the Water Hall decision.

For the time being, businesses issuing shares in circumstances similar to those in Water Hall should follow Water Hall in recovering input tax and should complete their VAT returns on that basis. Customs will review the position when the judgment of the ECJ in Kretztechnik is known and will issue further guidance to businesses at that time.

Any business that appears to be attempting artificial exploitation of Water Hall to recover VAT on share issue costs will be challenged robustly by Customs.

Note: Business Brief 32/04 contains details of recent changes to the partial exemption rules on share issues and other incidental financial supplies.

Further information

For further help and advice please contact Customs’ National Advice Service on 0845 010 9000.

3. VAT - Supplies of nursery and crèche facilities by a charity

This Business Brief article is issued to clarify Customs’ position on the business status of supplies of nursery and crèche facilities where those supplies are made by a charity. This issue first arose as a result of the High Court case of Yarburgh Children’s Trust (see Business Brief 04/03) and has recently been tested again in the High Court case of St Paul’s Community Project Ltd.

In the earlier case of Yarburgh, the Court decided that the charity was not making supplies by way of business. Despite that decision, Customs’ position remained that the provision of nursery and crèche facilities in such circumstances was a business activity for VAT purposes. However, in the more recent case of St Paul's, the Court’s decision has again gone in favour of the charity. The Court found that the intrinsic nature of the enterprise was not the carrying on of a business, identifying the distinguishing features as the social concern for the welfare of disadvantaged children, lack of commerciality in setting fees and the overall intention simply to cover costs.
Customs do not agree that these features point to the activities being non-business because we consider that the charity is making supplies of services for consideration in much the same way as a commercial nursery. However, taking into account all the circumstances in this case, Customs have decided not to appeal further.

This means Customs will now accept that the provision of nursery and crèche facilities by charities, along the same lines as those in Yarburgh Children’s Trust and St Paul’s Community Project Ltd, is not a business activity for VAT purposes.

**Background**

Both Yarburgh Children’s Trust and St Paul’s Community Project Ltd are charities which undertake to provide nursery and crèche facilities for pre-school age children as part of their charitable objectives. Both organisations charge fees for their services, which are set at a level designed to ensure that they merely cover their costs. They both undertook construction of new nursery premises. Such supplies would normally be subject to VAT but there are provisions in UK law which allow construction work to be zero-rated where buildings are used by a charity otherwise than in the course of business. Zero-rating can be beneficial to charities, if they undertake exempt activities and the amount of VAT they recover would be heavily restricted. Customs denied zero-rating on the grounds that these charities were making business supplies. The High Court has taken the opposing view that neither charity is in business for VAT purposes.

**Customs’ policy**

It remains Customs’ long standing policy that a business activity is possible even in the absence of a profit motive. Customs believe that this approach is consistent with UK and EC legislation and is supported by a number of decisions of the UK and European Courts. Many charities with activities not motivated by profit and whose fees are subsidised by public funds or donations benefit from such activities being business for VAT purposes, because they are able to recover VAT incurred in relation to those activities. It would not be beneficial for the charity sector as a whole if charitable activities were all regarded as non-business, as it would deny them recovery of input tax. In cases that are not broadly in line with St Paul’s or Yarburgh, Customs shall continue to apply the business test, in order to determine whether the supplies concerned are being made by way of business.
What constitutes a business activity for VAT purposes?

As neither UK nor EC legislation has provided an exhaustive definition or test for determining if an activity is business, the meaning of business and economic activity has emerged from a body of case law. This has given rise to the business test, which consists of six elements or indicators that the Courts have seen as being characteristic of a business. These are not a checklist and a business may have some, but not all, of the features indicated. Instead they are a set of tools designed to help compare activities where there is some uncertainty about their nature with features of activities that are clearly business. In most cases, it will be clear that an activity is business but, where difficulties arise, Customs will apply this business test. The elements of this test were set out in Business Brief 04/03 and are reproduced below.

- **Is the activity a serious undertaking earnestly pursued?**
  (This considers whether the activity is carried on for business or daily work rather than pleasure or daily enjoyment.)

- **Is the activity an occupation or function that is actively pursued with reasonable or recognisable continuity?** (When considering this test one should consider how frequently the supplies will be made.)

- **Does the activity have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made?**

- **Is the activity conducted in a regular manner and on sound and recognised business principles?**

- **Is the activity predominately concerned with the making of taxable supplies for a consideration?** (This has in many instances been seen as the most important and arguably the most problematic indicator. In the appeal of The Institute of Chartered Accountants England and Wales, the House of Lords found that the test must be read as asking 'what is the real nature of the activity' i.e. is the real nature of the activity the making of taxable supplies for consideration or is it something else?)
• Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?

Further Information

For further help and advice please contact Customs’ National Advice Service on 0845 010 9000.

The views expressed in this Business Brief are those of HM Revenue & Customs.

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