VAT focus

Airtours and input tax: a new hope?

Speed read

The taxpayer's appeal in *Airtours Holidays Transport Ltd v HMRC* is yet another case addressing the fundamental question in VAT in transactions involving multiple parties: 'Who supplied what, to whom?' Interestingly, HMRC's arguments in the case suggest a possible method for taxpayers to recover input tax in situations involving 'third-party consideration'.

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It is clearly a year for new instalments in familiar, long running sagas to generate huge viewing figures, and to throw up some big surprises for even their most ardent fans. In that vein, the taxpayer's appeal in *Airtours Holidays Transport Ltd v HMRC*, which was heard by the Supreme Court on 25 February 2016 (and watched live by literally tens of people on the Supreme Court website), represents the next episode in the ongoing series of attempts by the highest courts in both the UK and Europe to articulate clearly how multi-party commercial arrangements should be analysed for VAT purposes. In the course of the hearing, HMRC also gave new hope to taxpayers seeking to deduct input tax in situations involving 'third-party consideration'.

In short, the case concerns services supplied by PwC in the context of the restructuring of debts owed by Airtours to a number of banks ('the banks'). Airtours paid for those services, and sought to deduct (as input tax) the VAT charged by PwC. HMRC maintained (successfully before the Court of Appeal) that PwC's supplies had been made to the banks, and not to Airtours; Airtours had simply paid 'third-party consideration" for those supplies and so had no entitlement to deduct input tax.

Like the earlier appeals concerning *LMUK/Aimia* [2013] UKSC 15, *WHA* [2013] UKSC 24, *Newey* (Case C-653/11) and *Secret Hotels2* [2014] UKSC 16 (among others), Airtours' appeal addresses that most fundamental question in VAT: 'Who supplied what, to whom?' It is to be hoped that their Lordships provide further clarification as to the correct approach in analysing that question in multi-party commercial arrangements. However, the purpose of this note is not to address that question, but instead to highlight the position adopted by HMRC on a related issue that may not ultimately be addressed in the court's judgment. Can a taxpayer who is the recipient of a supply deduct, as input tax, *VAT paid by another person* in respect of that supply (i.e. 'third-party consideration')?

HMRC addressed this issue in response to Airtours' argument that if it was not entitled to deduct the VAT that it paid to PwC, then this would amount to a breach of the fundamental VAT principle of fiscal neutrality. Airtours argued that all of the parties to the transactions were businesses, and so somebody should *prima facie* be able to deduct VAT. For those readers who were not glued to the live streaming of the hearing, HMRC's position on the issue was set out as follows (starting at 34:06 in the afternoon session, the video of which can be viewed at www. bit.ly/1VXGsdf): 'It is not at all clear that the consequence of a third-party consideration analysis is that no one can reclaim the input tax.'

> HMRC has given new hope to taxpayers seeking to deduct input tax in situations involving 'third-party consideration'

HMRC pointed to the words of article 17(2)(a) of the Sixth Directive (now article 168(a) of the Principal VAT Directive), which provides for a right to deduct input tax, as follows: 'Insofar as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay … value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person.'

HMRC submitted that under that provision: 'There is no express requirement that the tax be paid by [the person seeking to deduct input tax]. All that is necessary is that he be the recipient of the supply, and that he uses the supply to make taxable supplies.'

HMRC noted that the issue had not been explored in Airtours' appeal as the banks had not made a claim to recover input tax, both because they made exempt supplies, and also because they had never received an invoice for the supplies (as required under article 178(a) of the Principal VAT Directive). Nonetheless, counsel for HMRC concluded: 'As a matter of principle, I do not concede that payment is a necessary condition for exercising the right to deduct. In other words, it is the recipient of the supply who has the right to deduct, not necessarily the person who pays for it.'

These statements constitute express recognition by HMRC, before the highest court in the land, that (subject to satisfying the relevant invoicing requirements) it is at least arguable that a taxable person can deduct, as input tax, VAT paid by a third party. This proposition will probably come as a surprise to many practitioners, and may offer a commercially practical route of avoiding irrecoverable input tax in multi-party transactions involving 'third-party consideration'. It may also afford scope for taxpayers to make historical claims to recover input tax where it was previously thought that there was no possibility of doing so.

HMRC stopped short of positively asserting that taxpayers can claim to deduct input tax in these circumstances. It is always possible that HMRC will reverse its stance. Nonetheless, in the light of HMRC's submissions advisers should:

- read the decision of the Supreme Court in *Airtours* when it is released to see whether the issue is addressed;
- review any current arrangements involving 'third-party consideration' to see whether the recipient of the supplies could make a claim to recover input tax; and
- review any arrangements from the last four years to determine whether a claim is available to recover historical input tax. ■

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▶ *Airtours Holidays Transport v HMRC* (CA decision, 30.7.14)
▶ *Airtours* and VAT in tripartite situations (Gary Barnett, 5.8.14)