[2009] UKFTT 192 (TC)

TC00147

Appeal number

VAT- financing involving sale of business	**MAN/01/972**
Abuse? No financing transaction- Appeal allowed	**MAN/02/120**
as going concern which gave margin treatment –	**MAN /02/133**
	MAN/02/135
	MAN/02/137
	MAN/02/138

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) PENDRAGON PLC
(2) STRIPESTAR LTD
(3) PENDRAGON COMPANY CAR FINANCE LTD
(4) PENDRAGON DEMONSTRATOR FINANCE LTD
(5) PENDRAGON DEMONSTRATOR FINANCE NOVEMBER LTD
(6) PENDRAGON DEMONSTRATOR SALES LTD

Appellants

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: TRIBUNAL JUDGE : ADRIAN SHIPWRIGHT
TRIBUNAL MEMBER: SHEILA WONG CHONG FRICS

Sitting in public in London on 15 -19 and 22-24 September 2008
Roderick Cordara QC and Valentina Sloane, Counsel, for the Appellant instructed by KPMG

Nigel Pleming QC and Phillipa Whipple, Counsel, instructed by the General Counsel and Solicitor for HM Revenue and Customs, for the Respondent

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AMENDED DECISION

Introduction

1. This Decision concerns the appeals (“the Appeals”) against a decision of the Respondents contained in a letter dated 22 October 2001 and the assessments and misdeclaration penalties concerning the transactions carried out by the Appellants made and imposed in consequence of that decision. These are described below. The Appellants and their Appeals are listed in the Appendix.
2. The appeals against the misdeclaration penalties have been consolidated and stood over pending the determination of the Appeals against the decision and assessment. Accordingly, this Decision is not concerned with the penalties.
3. This Decision is not concerned with the detailed figures and so it is a decision in principle.
4. If the parties are unable to agree the figures consequent on our decision within three months of the release of this decision they are to make an application (preferably jointly) to the Tribunal as soon as possible for the matter to be heard (which if possible should be heard by the same persons who heard the matters to which this decision relates).
5. It was agreed that the Parties should have the opportunity to make representations if and when the questions to referred in *Weald* were published. We were informed in due course that the Parties did not wish to make any representations.

The Issue

6 Essentially, the sole issue before the Tribunal is whether or not the transactions were “Abusive”.

7 In particular, the issue was whether the Appellants, or specifically the sixth appellant, PDS, Pendragon Demonstrator Sales Limited, entitled to sell cars and account for that on the basis of the margin of profit that was made, selling cars to third party purchasers or were they obliged to account for VAT on the full price of the sale, irrespective of whether a profit was made?

8 This raises a number of questions including:

(a) Do the transactions concerned result in the accrual of a tax advantage which would be contrary to the purpose of the provisions in question?

(b) Was the essential aim to obtain a tax advantage charge from a number of objective factors?

These and other matters are considered below.

Abbreviations and persons involved.

9 The following abbreviations are used in this decision.

the Appeals	the appeals referred to in paragraph 1 above
the Decision Letter	the respondents’ letter dated 22 October 2001
Pendragon	Pendragon PLC
the Pendragon Group	Pendragon and its associated companies including Arena, PCCF, PDF, PDFN, PDS, PM, Stripestar and Viking
Arena	Arena Auto PLC
PCCF	Pendragon Company Car Finance Ltd
PDF	Pendragon Demonstrator Finance Ltd
PDFN	Pendragon Demonstrator Finance November Ltd

PDS	Pendragon Demonstrator Sales Ltd
PM	Pendragon Motorcycles Ltd
Stripestar	Stripestar Ltd
Viking	Pendragon Viking Ltd
the Captive Leasing Companies	PCCF, PDF and PDFN
the Dealership Companies	Stripestar, PM, Viking and Arena
Societe Generale	Societe Generale SA (particularly, where appropriate its London Branch)
SG Hambros	SG Hambros Bank and Trust (Jersey) Limited owned by Societe Generale and sometimes referred as the Jersey Branch

The Appeals in question

10 As noted above the Appeals are against various assessments etc consequent on the approach taken in the Decision Letter.

11 The Appellants produced a very helpful schedule of appeals which was not disputed. It is reproduced in the Appendix.

12 The consequences of the Respondents' approach was set out in the Decision Letter. The relevant passage read as follows:

"*The Dealership Companies*

In the Commissioners' view the Dealership Companies:

- Should not have accounted for output VAT on selling the cars to the Captive Leasing Companies.
- Should not have deducted any VAT on the leaseback transactions either before or after the assignment of the agreements.
- Should have accounted for any output VAT on the full value of the sales they made as agent of PDS.
- Should have accounted for output VAT on any private use of the "stock in trade" cars on which input VAT has been recovered.

The Captive Leasing Companies

In the Commissioners' view the Captive Leasing Companies:

- Should not have deducted any VAT on the purchase of the cars from the Dealership Companies.
- Should not have charged any VAT on the leaseback transactions.

PDS

In the Commissioners' view PDS should not have accounted for any VAT on the sale of the cars "to customers".

Common Ground

13 Counsel very properly, and if we may say so very helpfully, set out what was common ground. In broad terms, it was common ground between the parties that:

(a) On the legislation properly construed taking into account *Marleasing* and *IDT* and doing so purposively the Appellants and the transactions fell squarely within the terms the relevant legislation.

(b) If the doctrine of abuse did not apply then the Appellants were entitled to the treatment that they contended for.

(c) Other than for VAT purposes financing was obtained.

(d) The cars in question had been sufficiently used to amount to used cars within the *Lincoln Street Motors* Test.

(e) There was no suggestion of any wrong doing.

The Law

Legislation

14 Article 26a of the Sixth Directive is headed "Special arrangements applicable to second-hand goods, works of art, collectors' items and antiques". Motor cars can be second-hand goods. There is no specific provision in the Article for motor cars as there is, for example, for antiques.

15 It provides so far as is relevant:

"A Definitions

For the purposes of this Article, and without prejudice to other Community provisions: …

(*d*) *second-hand goods* shall mean tangible movable property that is suitable for further use as it is or after repair, other than works of art, collectors' items or antiques and other than precious metals or precious stones as defined by the Member States;

(*e*) *taxable dealer* shall mean a taxable person who, in the course of his economic activity, purchases or acquires for the purposes of his undertaking, or imports with a view to resale, second-hand goods and/or works of art, collectors' items or antiques, whether that taxable person is acting for himself or on behalf of another person pursuant to a contract under which commission is payable on purchase or sale; …

B Special arrangements for taxable dealers

[1] In respect of supplies of second-hand goods, works of act, collectors' items and antiques effected by taxable dealers, Member States shall apply special arrangements for taxing the profit margin made by the taxable dealer, in accordance with the following provisions.

[2] The supplies of goods referred to in paragraph 1 shall be supplies, by a taxable dealer, of second-hand goods, works of art, collectors' items or antiques supplied to him within the Community:

—by a non-taxable person, or

—by another taxable person, in so far as the supply of goods by that other taxable person is exempt in accordance with Article 13(B)(*c*), or

—by another taxable person in so far as the supply of goods by that other taxable person qualifies for the exemption provided for in Article 24 and involves capital assets, or

—by another taxable dealer, in so far as the supply of goods by that other taxable dealer was subject to value added tax in accordance with these special arrangements.

[3] The taxable amount of the supplies of goods referred to in paragraph 2 shall be the profit margin made by the taxable dealer, less the amount of value added tax relating to the profit margin. That profit margin shall be equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price.

For the purposes of this paragraph, the following definitions shall apply:

—*selling price* shall mean everything which constitutes the consideration, which has been, or is to be, obtained by the taxable dealer from the purchaser or a third party, including subsidies directly linked to that transaction, taxes, duties, levies and charges and incidental expenses such as commission, packaging, transport and insurance costs charged by the taxable dealer to the purchaser but excluding the amounts referred to in Article 11(A) (3),

—*purchase price* shall mean everything which constitutes the consideration defined in the first indent, obtained, or to be obtained, from the taxable dealer by his supplier. …

[5] Where they are effected in the conditions laid down in Article 15, the supplies of second-hand goods, works of art, collectors' items or antiques subject to the special arrangements for taxing the margin shall be exempt.

[6] Taxable persons shall not be entitled to deduct from the tax for which they are liable the value added tax due or paid in respect of goods which have been, or are to be, supplied to them by a taxable dealer, in so far as the supply of those goods by the taxable dealer is subject to the special arrangements for taxing the margin. ….

[8] Where he is led to apply both the normal arrangements for value added tax and the special arrangements for taxing the margin, the taxable dealer must follow separately in his accounts the transactions falling under each of these arrangements, according to rules laid down by the Member States,

[9] The taxable dealer may not indicate separately on the invoices which he issues, or on any other document serving as an invoice, tax relating to supplies of goods which he makes subject to the special arrangements for taxing the margin.

[10] In order to simplify the procedure for charging the tax and subject to the consultation provided for in Article 29, Member States may provide that, for certain transactions or for certain categories of taxable dealers, the taxable amount of supplies of goods subject to the special arrangements for taxing the margin shall be determined for each tax period during which the taxable dealer must submit the return referred to in Article 22(4).

In that event, the taxable amount for supplies of goods to which the same rate of value added tax is applied shall be the total margin made by the taxable dealer less the amount of value added tax relating to that margin.

The total margin shall be equal to the difference between:

—the total amount of supplies of goods subject to the special arrangements for taxing the margin effected by the taxable dealer during the period; that amount shall be equal to the total selling prices determined in accordance with paragraph 3, and

—the total amount of purchases of goods as referred to in paragraph 2 effected, during that period, by the taxable dealer; that amount shall be equal to the total purchase prices determined in accordance with paragraph 3.

Member States shall take the necessary measures to ensure that the taxable persons concerned do not enjoy unjustified advantages or sustain unjustified loss.

[11] The taxable dealer may apply the normal value added tax arrangements to any supply covered by the special arrangements pursuant to paragraph 2 or 4. ...”

16 The effect of this is that Member States may apply a margin scheme to second hand goods i.e. tangible movable property that is suitable for further use as it is or after repair other than antiques, gems etc. This includes motor cars. Member states are where appropriate to take the necessary measures to ensure that the taxable persons concerned do not enjoy unjustified advantages. It should also be noted that Article 28o gives wide discretion as to the margin scheme that applies.

17 Article 26a was inserted by EEC Council Directive 94/5, arts 1(3), 4; OJ L60, 3.3.94. The Recitals to which read:

"THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas, in accordance with Article 32 of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (3), the Council is to adopt a Community taxation system to be applied to used goods, works of art, antiques and collectors' items;

Whereas the present situation, in the absence of Community legislation, continues to be marked by the application of very different systems which cause distortion of competition and deflection of trade both internally and between Member States; whereas these differences also include a lack of harmonization in the levying of the own resources of the Community; whereas consequently it is necessary to bring this situation to an end as soon as possible;

Whereas the Court of Justice has, in a number of judgments, noted the need to attain a degree of harmonization which allows double taxation in intra-Community trade to be avoided;

Whereas it is essential to provide, in specific areas, for transitional measures enabling legislation to be gradually adapted;

Whereas, within the internal market, the satisfactory operation of the value added tax mechanisms means that Community rules with the purpose of avoiding double taxation and distortion of competition between taxable persons must be adopted;

Whereas it is accordingly necessary to amend Directive 77/388/EEC".

18 We note that the Appellants acknowledge that the purposes of Article 26a include the prevention of double taxation.

19 The preamble notes the lack of harmonisation in the area and various other matters such as distortion of competition, deflection of trade and double taxation. It does not reveal a clear underlying policy but does want gradual adaptation of the legislation in specific areas. It does not refer to "trapped VAT" nor require "Input VAT" to have been paid. It does make it clear that a uniform basis (presumably a margin scheme) should apply to used goods works of art, antiques and collectors' items. We are inclined to agree with Mr Cordara QC that this is a set of ad hoc arrangements to ameliorate matters till something better was agreed. No clear policy agreement had been reached between the Member States.

20 This was transposed into UK Law by the VAT (Cars) Order 1992 as amended.

21 Article 8 of that Order is headed "Relief for Second-Hand Motor Cars". It provides:

"(1) Subject to complying with such conditions (including the keeping of such records and accounts) as the Commissioners may direct in a notice published by them for the purposes of this Order or may otherwise direct, and subject to

paragraph (3) below, where a person supplies a used motor car which he took possession of in any of the circumstances set out in paragraph (2) below, he may opt to account for the VAT chargeable on the supply on the profit margin on the supply instead of by reference to its value.

5 (2) The circumstances referred to in paragraph (1) above are that the taxable person took possession of the motor car pursuant to—

(*a*) a supply in respect of which no VAT was chargeable under the Act or under Part I of the Manx Act;

(*b*) a supply on which VAT was chargeable on the profit margin in accordance
10 with paragraph (1) above, or a corresponding provision made under the Manx Act or a corresponding provision of the law of another member State;

(*bb*) a supply received before 1 March 2000 to which the provisions of article 7(4) of the Value Added Tax (Input Tax) Order 1992 applied;

(c) a transaction except one relating to the transfer of the assets of a business or
15 part of a business as a going concern which was treated by virtue of any Order made or having effect as if made under section 5(3) of the Act or under the corresponding provisions of the Manx Act as being neither a supply of goods nor a supply of services,

(*d*) a transaction relating to the transfer of the assets of a business or part of a
20 business as a going concern which was treated as neither a supply of goods nor a supply of services if the transferor took possession of the goods in any of the circumstances described in this paragraph.

(3) This article does not apply to—

(*a*) a supply which is a letting on hire;

25 (*b*) the supply by any person of a motor car which was produced by him, if it was neither previously supplied by him in the course or furtherance of any business carried on by him nor treated as so supplied by virtue of article 5 above;

(*c*) any supply if an invoice or similar document showing an amount as being
30 VAT or as being attributable to VAT is issued in respect of the supply;

(*d*) ...

(4) ...

(5) Subject to paragraph (6) below, for the purposes of determining the profit margin—

35 (*a*) the price at which the motor car was obtained shall be calculated as follows—

(i) (where the taxable person took possession of the used motor car pursuant to a supply) in the same way as the consideration for the supply would be calculated for the purposes of the Act;

40 (ii) (where the taxable person is a sole proprietor and the used motor car was supplied to him in his private capacity) in the same way as the consideration for the supply to him as a private individual would be calculated for the purposes of the Act;

(iii) (where the taxable person took possession of the goods pursuant to a
45 transaction relating to the transfer of the assets of a business or part of a business as a going concern which was treated by virtue of any Order made or having effect as if made under section 5(3) of the Act, or under the corresponding provisions of the Manx Act, as neither a supply of goods nor a supply of services) as being the price at which the earliest of his predecessors
50 obtained the goods;

(*b*) the price at which the motor car is sold shall be calculated in the same way as the consideration for the supply would be calculated for the purposes of the Act;

(*c*) in relation to any goods, a person is the predecessor of another for the purposes of this article if—

(i) that other person is a person to whom he has transferred assets of his business by a transfer of that business, or a part of it, as a going concern;

(ii) those assets consisted of or included those goods; and

(iii) the transfer of the assets is one falling by virtue of an Order made or having effect as if made under section 5(3) of the Act, or under the corresponding provisions of the Manx Act, to be treated as neither a supply of goods nor a supply of services;

and the reference in sub-paragraph (*a*) above to a person's predecessors includes a reference to the predecessors of his predecessors through any number of transfers.

(6) Subject to paragraph (7) below, where the taxable person is an agent acting in his own name the price at which the motor car was obtained shall be calculated in accordance with paragraph 5(*a*) above but the selling price calculated in accordance with paragraph 5(*b*) above shall be increased by the amount of any consideration payable to the taxable person in respect of services supplied by him to the purchaser in connection with the supply of the motor car.

(7) Instead of calculating the price at which the motor car was obtained or supplied in accordance with paragraph (6) above, an auctioneer acting in his own name may—

(*a*) calculate the price at which the motor car was obtained by deducting from the successful bid the consideration for any services supplied by him to the vendor in connection with the sale of the motor car;

(*b*) calculate the price at which the motor car was supplied by adding to the successful bid the consideration for any supply of services by him to the purchaser in connection with the sale of the motor car,

in either (or both) cases excluding the consideration for supplies of services that are not chargeable to VAT".

22 The Value Added Tax (Special Provisions) Order 1995 SI 1995/1268 deals with the VAT Treatment of certain transactions including Transfers of a business as a going concern and the assignment of HP rights and goods to a bank or financial institution.

23 It provides in Article 5:

"(1) Subject to paragraph (2) below, there shall be treated as neither a supply of goods nor a supply of services the following supplies by a person of assets of his business—

(*a*) their supply to a person to whom he transfers his business as a going concern where—

(i) the assets are to be used by the transferee in carrying on the same kind of business, whether or not as part of any existing business, as that carried on by the transferor, and

(ii) in a case where the transferor is a taxable person, the transferee is already, or immediately becomes as a result of the transfer, a taxable person or a person defined as such in section 3(1) of the Manx Act;

(*b*) their supply to a person to whom he transfers part of his business as a going concern where—

(i) that part is capable of separate operation,
(ii) the assets are to be used by the transferee in carrying on the same kind of business, whether or not as part of any existing business, as that carried on by the transferor in relation to that part, and
(iii) in a case where the transferor is a taxable person, the transferee is already, or immediately becomes as a result of the transfer, a taxable person or a person defined as such in section 3(1) of the Manx Act.
(2) A supply of assets shall not be treated as neither a supply of goods nor a supply of services by virtue of paragraph (1) above to the extent that it consists of—
(*a*) a grant which would, but for an election which the transferor has made, fall within item 1 of Group 1 of Schedule 9 to the Act; or
(*b*) a grant of a fee simple which falls within paragraph (*a*) of item 1 of Group 1 of Schedule 9 to the Act, unless the transferee has made an election in relation to the land concerned which has effect on the relevant date and has given any written notification of the election required by paragraph 3(6) of Schedule 10 to the Act, no later than the relevant date.
(3) In paragraph (2) of this article—
"election" means an election having effect under paragraph 2 of Schedule 10 to the Act;
"relevant date" means the date upon which the grant would have been treated as having been made or, if there is more than one such date, the earliest of them;
"transferor" and "transferee" include a relevant associate of either respectively as defined in paragraph 3(7) of Schedule 10 to the Act.
(4) There shall be treated as neither a supply of goods nor a supply of services the assignment by an owner of goods comprised in a hire-purchase or conditional sale agreement of his rights and interest thereunder, and the goods comprised therein, to a bank or other financial institution".

Authorities

24 We were provided with a number of bundles of authorities which we have carefully read and considered. The contents were too numerous to elaborate here.

The Evidence

23. We were provided with nine bundles of documents. These were agreed bundles of documents and the documents were all admitted in evidence no objection having been taken to any of them.

25 We were provided with Witness Statements for:

(a) David Robertson Forsyth, Finance Director, Pendragon PLC;
(b) Peter de Rousset-Hall, formerly Managing Director of Ford Credit; and
(c) Kevin Ingram, Partner and Head of London Securitisation Group, Clifford Chance LLP.

26 These stood as evidence-in-chief. Mr Forsyth and Mr Ingram were cross-examined.

27 We found the evidence of Mr de Rousset-Hall and Mr Ingram interesting and informative. However, it was necessarily general and not specific to the particular transactions before us.

28 Mr Forsyth's evidence was necessarily more concerned with the particular transactions and circumstances. However, we are conscious of the requirements

of objectivity and so have considered the evidence in the light of that requirement.

29 Mr. Pleming was not sure about the relevance and admissibility of some of the evidence to be led given that it was objective considerations that must decide much that was in issue here rather than a person's subjective views. He helpfully raised the point before the evidence was heard and wished us to bear it in mind. We have done so. However, he did not formally object to the admission of that evidence and so it was admitted and we heard it.

Findings of Fact

30 From the evidence we make the following findings of fact.

The Pendragon Group

31 The Pendragon Group is the largest car sales group in Europe with sales in excess of five billion pounds in 2006. We were not provided with the turnover figures for earlier years but we consider that they would have been significant.

32 Pendragon says of itself that it is the largest independent operator of franchised motor car dealerships in the UK. It also operates motor car dealerships in California, USA. Pendragon sells a broad range of makes of motor cars and commercial vehicles.

33 Pendragon became a public limited company when the vehicle division of Williams PLC was de-merged in 1989.

34 Pendragon's principal areas of business were:

(a) Sale of new cars;
(b) Sale of use cars; and
(c) Service and parts.

35 The Pendragon Group consists of a considerable number of companies. At the relevant time these included:

(a) Pendragon PLC which was the holding company of the group. Its business was mainly the sale and hire of motor vehicles;
(b) The Dealership Companies (i.e. Stripestar, PM, Viking, and Arena) which were UK trading subsidiaries in the Pendragon Group;
(c) PM, Viking and Arena were members of the Pendragon PLC VAT group;
(d) Stripestar was separately registered for VAT purposes;
(e) The Captive Leasing Companies (i.e. PCCF, PDF and PDFN) which were members of the Pendragon Group but were separately registered for VAT.

36 Standard & Poor's observation on the Pendragon Group was that it operated in "highly fragmented, competitive and cyclical markets". It also noted that it is in an asset intensive industry and had an aggressive growth strategy and financial profile.

Demonstrator Cars etc.

37 We remind ourselves that the cars in issue here were all demonstrators and so were cars that have been used as demonstrators for a number of months before they were sold. They were not equivalent to brand new cars almost by definition. They were accepted by the parties as used cars.

38 Demonstrators were described by Mr Cordara as "cars that customers—potential customers, are invited to use to drive on the road, or loan cars/courtesy cars, cars which perhaps customers for repair services are lent while their own vehicles are being repaired or, indeed, cars which were being hired out to third parties".

39 We accept this description[1]. The demonstrators were all being used on the road for a number of months and so were used goods within Article 26a.

40 The Decision Letter on the second page third paragraph says "... as the cars were bought new and sold as used cars (having been used as demonstrators, loan vehicles and hire vehicles, it was likely the profit margin will be nil, or at least very low". Having been used as demonstrators we do not see how, without more, they could have been sold as new cars.

41 We record here that the Decision Letter also says in the third paragraph under heading J, "that each of these transactions had the purpose of avoiding VAT and at the same time was part of the mechanism by which SG Hambros provided finance to Pendragon. The transactions were bound together in the sense that they were pre-planned, and would inevitably take place according to the plan, and also in the sense that there was considerable contractual interdependency among them. Thus (for example) the TOGC Agreement (by which PDS agreed to purchase SG Hambros' business) reduced Pendragon's potential liability to Societe Generale under the Account Deed. We agree with that and find that it is indicative of financing rather than abuse.

Motor Finance

42 Mr. Forsyth gave evidence (which was not challenged or objected to) as to "Economic and Financing Issues". We accept his evidence on this and on the other matters he covered. We do not accept Mr Pleming QC's invitation to reject his evidence. However, we do bear in mind Mr. Pleming QC's reminder on objective factors.

43 He said that the Retail Motor industry, like any other industry, faces funding and liquidity issues as a result of the general economic cycle (e.g. interest rate changes). Various fiscal measures (e.g. fuel and company car tax) "also impact the industry" (sic).

44 He told us further that motor dealerships are very capital intensive businesses. This is because of various matters including the cost of premises and investment in stock of both new and used cars. He said an average dealer would carry about 3 to 4 months of new car stock and about 45 days of used car stock. This has to be financed. The carrying cost can be significant which makes it very important to the business. This is something that anyone considering the transactions objectively must bear in mind. It is part of the objective setting in which they must be considered.

Mr.Forsyth's funding tenets at Pendragon

45 Mr. Forsyth said that he always held four tenets as regards financing. These were:

"1: Sufficient funding in place plus an additional safety margin to cover contingencies "headroom";
2: Ensure that the funding is committed within a range of repayment dates;
3: Avoid dependency on a single source of financing; and
4: Always consider the overriding fact that running out of money means the liquidation or reconstruction of the company. This is a high price to be paid by the employees and other stakeholders of business".

46 Pendragon had expanded greatly over a relatively short period. This had to a large extent been financed by borrowings which were consequently considerable. Pendragon had a relatively small number of financiers when Mr. Forsyth arrived.

[1] This seems to accord with the approach in the Decision Letter.

Mr. Forsyth wished to increase the number of potential lenders particularly as Pendragon wished to expand further. This, we find, was objectively part of sensible risk management.

47 Pendragon's gearing and headroom were of great concern to potential lenders particularly as Pendragon wished to expand further. We were shown figures and a chart for the relevant period setting out how close to various limits at various times Pendragon's position was. For reasons of commercial confidentiality we do not record the detail here. The parties agreed that we should do this.

48 Suffice it to say objectively the company would be in a much better position if it had a greater range of potential financiers, much greater headroom and healthier gearing and a better range of repayment dates. It would certainly have benefited from a greater number of payment dates as the bunching of repayment dates and their effect on headroom etc was potentially very difficult as the documents produced showed starkly. This all made further sources of funding finance very important objectively to Pendragon and the Pendragon Group. We find this as a primary fact on the basis of a number of objective criteria. These include the information that would have been available to a third-party lender such as gearing and other lending ratios. The documents in question are in the Bundles and so available to the Court should it require them.

49 Pendragon had considerable need for funding from a diversity of sources particularly bearing in mind Mr Forsyth's four tenets. However, although devised for Mr Forsyth we consider that they were also objective factors which we can properly take into account. We do take them into account as objective factors.

Central Aim etc

50 We have carefully considered the position here in the light of these objective factors and all the circumstances of the case from an objective perspective. We consider that the obtaining of finance in all the circumstances of the case was the predominant, principal or a central aim of the transactions and we so find as a primary fact on the basis of objective factors.

51 This was clearly the case for the first tranche and we consider it also to be the case, though less certainly, for the second tranche. This is not to suggest that we are wavering as to the finding concerning the second tranche. We are not because the shortening was because of Budget uncertainty and not because finance was not needed. Again we find this on the basis of objective factors.

52 We find, having considered all the evidence and circumstances, that it is not "… apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage." The essential aim was finance.

"Financing Proposals"

53 As the company is listed "on balance sheet" borrowings would have an impact on the share price. Trade credit did not have such an effect especially in the short-term. Consequently, various financing initiatives were considered and/or undertaken. We were shown a considerable number of financing proposals. Documentation and was contained in the bundles. These include an arrangement from Coopers & Lybrand relating to demonstrator vehicles which was said to save VAT which Pendragon did not implement.

54 Mr. Forsyth told us he used the various funding proposals put in front of him as a means of meeting different banks and other potential financiers.

55 In October 2000 what were described as "tax efficient demonstrator finance" transactions were introduced (to use a neutral term) to Mr. Forsyth by KPMG. This required the use of an independent bank. Societe Generale were to be involved to whom Mr. Forsyth was introduced although he had been in touch with them before. This was at a time when Pendragon were renegotiating their borrowing facilities. The safety margin in the group's headroom was much smaller than was desirable. Extra sources of funding were thus highly desirable. At that time two 45 day tranches of up to £20m funding with potential VAT savings were even more so from a financing perspective.

56 Mr. Forsyth said in his witness statement (paragraph 69) "tax efficiency was a consideration, but not the main factor in my decision. The primary objective is to ensure the continued funding needs were met at a time when trading conditions were extremely difficult". This was the period of the "Rip Off Britain" campaign and changes in the block exemption orders etc.

57 We accept that this is Mr. Forsyth's personal view and so subjective. However, we consider that it reflects what an outsider looking in at Pendragon objectively would have thought and we so find.

58 We find that this is part of the setting for the transaction which is necessary to consider to give an objective view to the transactions and are objective factors to consider. Whether something is not commercial needs to be considered in the light of the objective commercial context in which transactions take place.

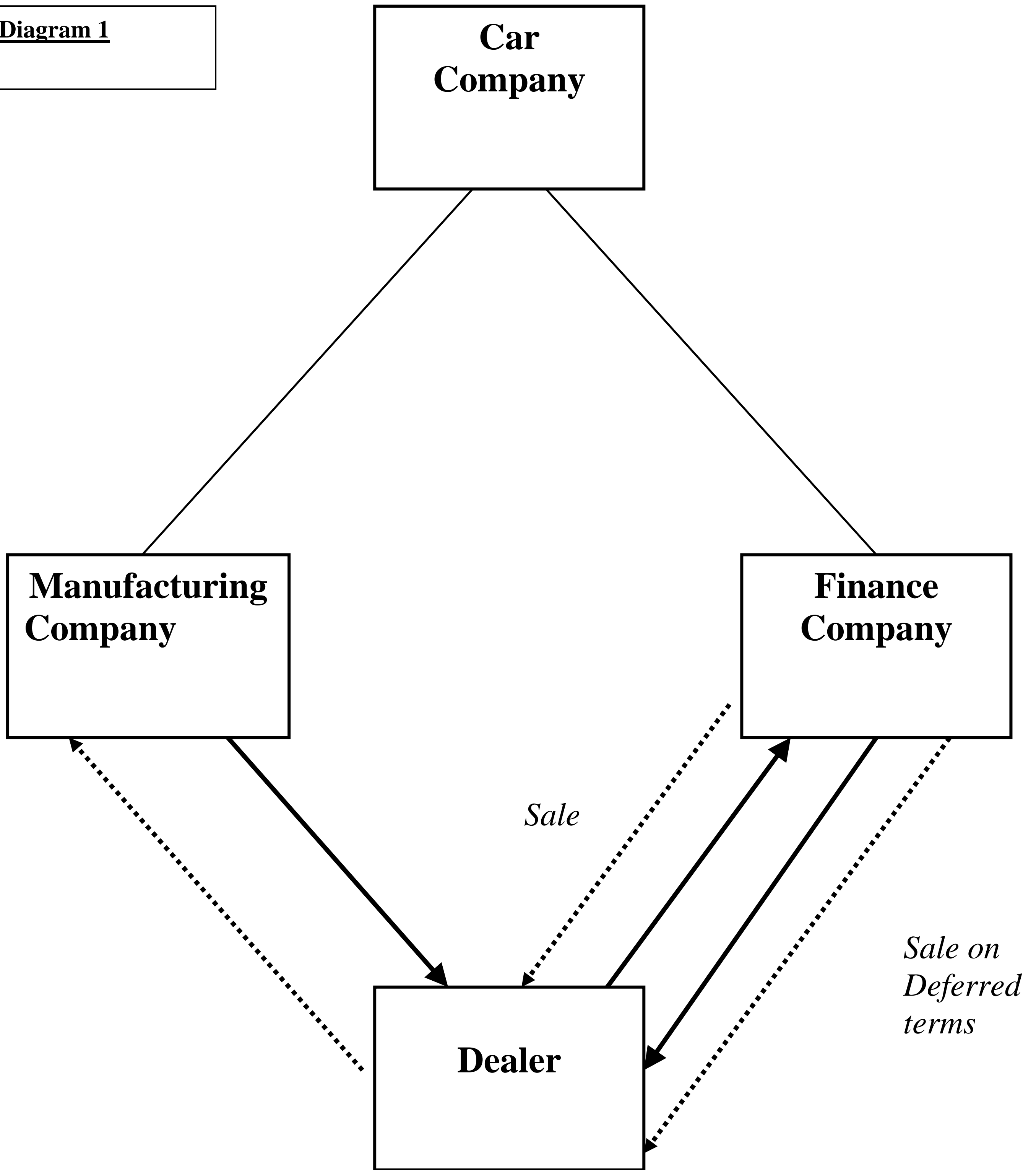
Finance and The Manufacturers Finance Arms

59 Manufacturers have, as is well known, in house finance arms. These provide finance to retail customers but also provide finance the deal and it works for vehicle stocks. Usually the dealer will buy vehicles from the manufacturer. This will involve a period of credit some of which has an interest free period and then is interest bearing. This is usually structured as follows:

1 Purchase from the manufacturer by the dealer;
2 Sale by the dealer to the Finance Arm; and
3 Sale back by the Finance Arm to the dealer on deferred terms.

Mr. Forsyth told us that this is apparently standard practice in the industry. This was not challenged and as we have no reason to doubt it we accept that this is the case.

57. This can be represented diagrammatically as follows (see Diagram 1):



5

Ownership

Money

Transactions

58. As a result of such a structure the dealer gets deferred terms but the manufacturer has sold the car. The finance company credit is usually payable on demand. The single age identifier on the registration plates for a year made for a significant spike in new car sales in August at the time. This together with bonus payments requires careful cash flow management.

The Transactions in question

59. Mr Forsyth sent a memo to all directors on 25 October, 2000 headed "Demonstrator and Company Car Finance Schemes". This referred to various discussions with various banks including Societe Generale. Mr. Forsyth said "We have been in discussions with various banks regarding the financing of our demonstrator company cars. Societe Generale has made a proposal for the business.

The structure involves us assigning HP contracts to the bank, which will be entered into between our PDF companies and the dealerships. The benefits of the transactions are:

- It secures a source of new funds for the group.
- It provides the opportunity to increase margins on sale of vehicles by approximately an additional 15 per cent of net selling price (eg a £20, 1000 sale price making a margin of £1,000 would now make a margin of £4,000). On an initial tranche of £20,000,000, we therefore expect to make an additional £3 million of profit.

I have attached a copy of the bank's term sheet for information. This proposal is subject to credit committee approval, which they are confident of obtaining and have agreed to progress the documentation in parallel with progress of the various initial approvals.

I would like the Board's approval to progress the transaction".

60 The term sheet provided that SG Hambros would be the lessor with Societe Generale as guarantor and Pendragon as lessee. There was an implicit interest rate ("IIR") of LIBOR plus 0.75 per cent. There was to be an arrangement fee of £100,000 and two "earn out" fees of £125,000 and a further £75,000 respectively contingent upon acceptance of the VAT treatment. The bank thus shared in any VAT saving. This is not uncommercial nor indicative of abuse.

61 Mr. Forsyth was given approval to progress the transaction at a board meeting held on 27 October 2000. On 1 November, 2000 Pendragon confirmed Societe Generale's appointment on the terms set out in the term sheet.

62 Illustrative Invoices were produced for the sale of cars from Viking to PDF dated 16 November, 2000 and for rental from Viking raised by PDF in November again on 16 November 2000. These tie-in with the documents described below. These documents were subject to English law as the proper or applicable law.

63 Agreements referred to as the Vehicle Demonstrator Hire Agreements were entered into on 16 November 2000 between PM, Viking, Arena, and Stripestar Limited and The Captive Leasing Companies.

64 These allowed a dealership to offer to hire a vehicle from PDF. An HP agreement was to arise immediately in respect of the vehicle on the acceptance of the offer by PDF. The offer was to be made by submitting a sales invoice for the vehicle. The hire terminated on sale of the vehicle. The hirer could sell as agent of PDF and was entitled to a percentage rebate of the net proceeds. This created an HP agreement between the dealer and PDF. It

was what was described as a "hybrid agreement" as it was designed to obtain a particular VAT treatment. It provided that title would not pass to the Dealership Company until a period after payment in full. This is not that unusual in an HP type of agreement nor uncommercial. We agree with Mr Cordara QC that a plain "vanilla lease" would have had the same effect and we so find.

65 The clause in question read as follows:

"8 Option to Purchase

When the Hirer has made all the payments under the Hire Agreement to the Owner of the Goods the Hirer will have the option, seven days after the Hire Agreement ends, of purchasing the Goods from the Ownerc for the Option to Purchase Price specified in the Agreement Schedule. The Hirer will not have this option if all payments have not been made with the hiring of the Goods has been terminated. The option will remain open for seven working days only. Until this option has been exercise the Goods remain the property of the Owner and, for the avoidance of doubt during or after the Period of Hire will the Hirer acquire any ownership in the Goods whether legal, or equitable, beneficial, economic or otherwise. If an option to purchase fee of £10.00 will apply per vehicle or such other amount from time to time notified in writing by the Owner and is payable upon exercise the option to purchase. Title to the Goods will pass from the Owner to the Hirer 14 days after exercise of the option to purchase".

In our experience this is not an unusual or uncommercial term in an HP contract and we so find.

66 At a meeting of PDF Limited held on 17 November 2000 in SG Hambros Bank & Trust (Jersey) Limited's offices in Jersey consideration was given to the assignment of the hire agreements and the goods comprised therein entered into with the Dealerships by PDF to SG Jersey. Documentation including a deed of assignment and banking documentation were considered and various approvals given.

67 The various banking agreements included an Account Deed between Pendragon PLC and Societe Generale, a deed of assignment between PDF, Pendragon Demonstrator Finance November Limited and SG Hambros and deeds of assignment between the Captive Lessor Companies and SG Hambros. The accounts deed charged a Pendragon PLC account in favour of Societe Generale. The deed of assignment dealt with arrangements between SG Hambros and Societe Generale.

68 There was also a £20,000,000 term facility agreement between them which was supported by the deed of assignment. This effectively gave an extra £20m facility to Pendragon for 45 days or so potentially in two tranches. This is a significant objective factor to be taken into account in considering the transactions. We consider that objectively this is an important indicator of the commerciality of the transactions and shows that they were not uncommercial operations and we so find. This is not to say that the funding was not done in a VAT efficient way but that is something that the ECJ says is permissible.

69 We were shown bank statements which confirmed the movement of money which we find did take place.

70 The assignment was made on the 17 November 2000 between (1) PDF and (2) SG Hambros which was referred to in the parties as the Borrower whereas the rest of the agreement refers to the Assignee.

71 Recital B provides "the Assignor (1) and the Assignee (2) wish the Assignor forthwith to assign to the Assignee the benefit of the Agreement and the goods comprise therein, upon the terms and subject to the conditions set out herein". It seems that the agreement is capable of being corrected under the "slip rule" and we have assumed this to be the case. If that were not so there would be no assignment to SG Hambros and the chain of title would collapse. It was corrected in the 22 February 2001 document.

72 Pendragon entered into an account deed with Societe Generale, the parent of SG Hambros on 17 November 2000. This was a condition precedent to the making of the facility agreement between SG Hambros and Societe Generale.

73 On 17 November 2000 SG Hambros assigned to Societe Generale all its rights under the vehicle hire agreements as security for a £20,000,000 term facility of even date.

74 On 27 December 2000 PDS and SGH entered into an agreement for the acquisition of the business of the hire of motor cars carried on by SGH. This was governed by English law. This was a fairly standard form business sale agreement. It included the usual provisions as to VAT and transfer of a business as a going concern.

75 Similar documentation (in near identical form) between essentially the same parties was entered into in February 2001. The deed of assignment was dated 22 February as were most the other documents. The transfer of the business of the Hire of vehicles was made on 5 March 2001. The Purchaser was Pendragon Demonstrator Sales Limited.

76 This structure may be represented diagrammatically as follows (see Diagram 2):

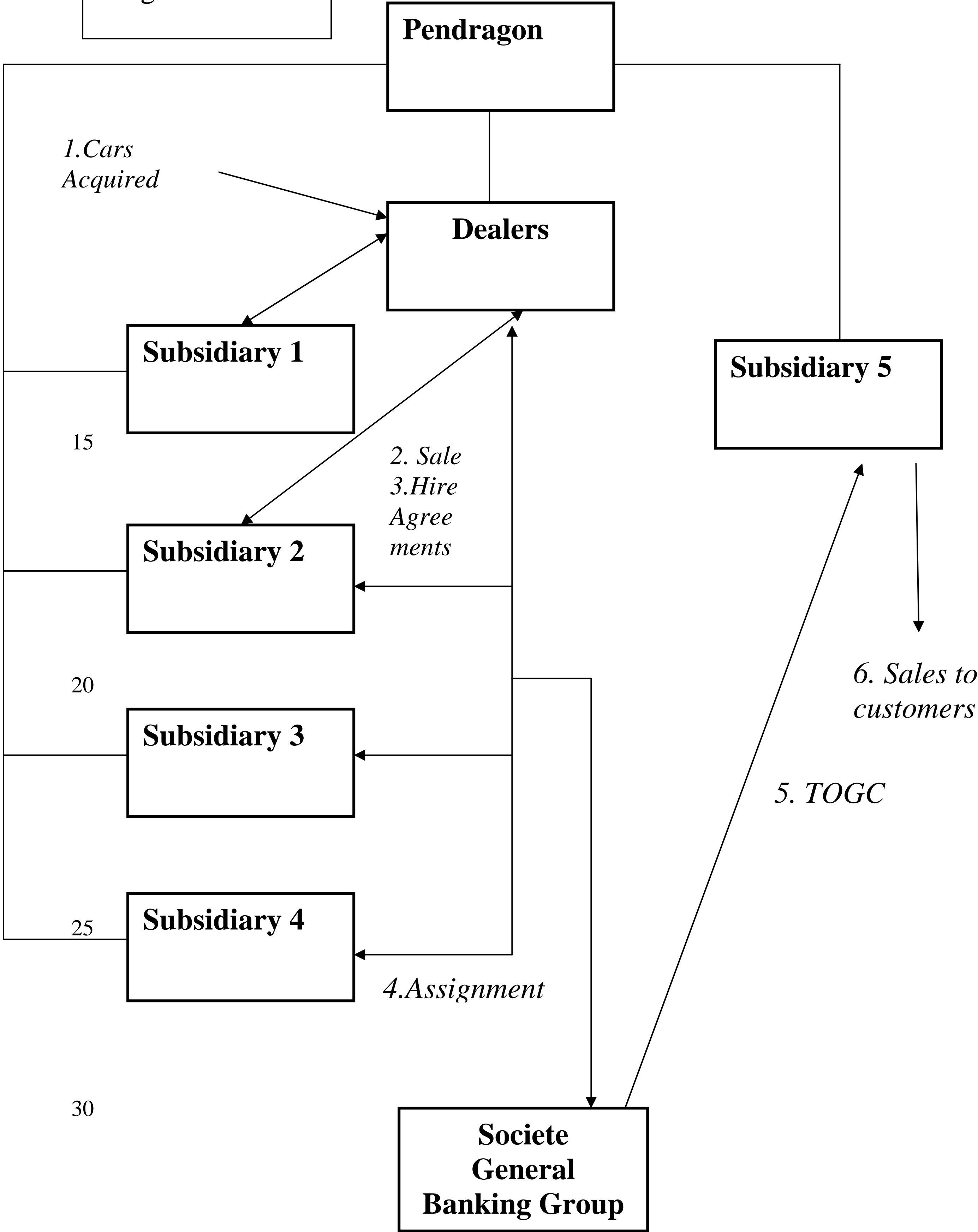


Diagram 2
Pendragon
1.Cars Acquired
Dealers
Subsidiary 1
15
2. Sale
3.Hire Agreements
Subsidiary 5
Subsidiary 2
20
6. Sales to customers
Subsidiary 3
5. TOGC
25
Subsidiary 4
4.Assignment
30
Societe General Banking Group

77 These transactions should be compared with those of a normal sale and leaseback transaction or finance from the manufacturers finance arm (see Diagram 1). The essential elements of finance and security of the same person as was the commercial need to the manufacturer to be able to record sales were included and we so find.

78 We find the transactions were not self cancelling or evidently uncommercial not for profit contracts. The £20m facility is particularly significant here as an objective factor. It is not to be categorised as a non commercial operation and HMRC have not sought to do so.

KPMG's Involvement

79 Much was made by the Respondents of the involvement of KPMG as the "authors, promoters and peddlers of an abusive tax avoidance scheme".

80 As well as entering into an engagement letter with Societe Generale Pendragon employed KPMG to advise on VAT matters. They also consulted Leading Counsel.

81 A draft engagement letter was sent to David Forsyth bearing the date 23 March 1999 headed VAT Advisory Services: Margin Scheme. Under the heading "Scope of Services" it said "KPMG will assist Pendragon in implementing a VAT planning arrangement, the intention or which is to limit the VAT accountable on disposal demonstrator and service the loan of cars to the profit margin achieve consider the sales value ("the Scheme"). An outline of the Scheme is attached at Appendix 1. We will provide advice on the structure and implementation of the Scheme ellipsis ultimate responsibility for the implementation operation of the scheme will remain with Pendragon."

82 The draft letter attached terms of business and dealt with suggested fees.

83 After a confidentiality agreement had been entered into a briefing note was sent under cover of a letter dated 29 March 1999.

84 It was said in this note:

"… KPMG has developed an arrangement in response to the ... July 1997 changes which we believe successfully limits the output tax liability on disposal of the vehicles to the value of the margin achieved.

A key feature of our implementation package is the use of a third party, rather than a captive financial institution. We have been in discussion with a suitable Bank which has expressed an interest in participating in the arrangement and we can arrange an introduction to Pendragon".

85 This fits well with Mr. Forsyth's desire to meet more bankers in the light of Pendragon's need for finance.

86 The notes also said "… The use of an established third party bank, rather than a captive finance house, will more easily meet the "financial institution" requirement of SI 1995/1268 Article 5(4) which is not defined in the legislation; additionally this will aid the defence against any challenge on *Furniss v Dawson* or *Ramsay* principles". This is not abusive and we so find.

87 Under the heading "Risk Evaluation" it said:

"This is a very aggressive arrangement which is almost certain to be challenged by the Commissioners of Customs and Excise. In view of this, and the high value of the potential savings, KPMG view it as essential that the transactions are properly disclosed to the commissioners. Subject to this being done, if only of the arrangements is unlikely to create any additional VAT liability for Pendragon and only default interest will be payable:"

88 Pendragon sent the signed engagement letter to KPMG under cover of your letter dated 18 January, 2000. The terms were essentially the same as those in the draft.

89 KPMG agreed to provide the services for a non refundable fee of £25,000 plus VAT payable on implementation of the arrangements. In addition, should the Scheme be successful, a contingent fee equal to 10 per cent of the VAT savings resulting from the Scheme during its first year of operation, with a cap on the contingent element only of £250,000 plus VAT. The contingent fee was payable nine months after implementation but was refundable should the Scheme be challenged by Customs within three years of implementation and VAT become payable.

90 This is all very interesting but suffers from the same potential difficulty as that Mr Pleming objected to concerning Mr. Forsyth's evidence. This sets out the subjective view of what KPMG thought it was selling. KPMG seemed to think it was selling a means of reducing VAT on demonstrator cars which also involved the provision of third party finance.

91 When read with Societe Generale's engagement letter which provided for a facility of up to £20,000,000 for two 45 day periods it does not follow that the essential aim of the transactions for Pendragon was VAT avoidance rather than finance.

92 KPMG were, we find, engaged to advise on a VAT arrangement. We do not consider that because Pendragon took VAT advice it necessarily follows that the essential aim of the arrangements was abusive.

93 The description of the VAT arrangements as very aggressive is in the context of HMRC challenge and possibility of penalties and is to be read in that context. Merely because something might be challenged by HMRC it does not follow that it is necessarily abusive.

94 We find KPMG's engagement to advise on a VAT scheme or put another way how Pendragon "may choose to structure their business so as to limit their tax liability" does not of itself make what was done at abusive.

95 KPMG's belief as to what it was doing would be a subjective and not an objective matter.

The Submissions of the Parties

The Appellant's Submissions in outline

96 In essence, Mr Cordara QC for the Appellants argued that there was no abuse of law or rights here as all that was involved was the obtaining of finance. As there was no abuse of law which was the sole point the Respondents relied on the Appeals must be allowed with costs.

97 In more detail he submitted:

(a) the "essential aim" of the transactions was the financing of the business as is clear from the company's circumstances. The Commissioners do not dispute that finance was obtained. They accept Pendragon received an exempt supply of finance;

(b) *Halifax* (paragraph 73) allows the trader to choose how the trader conducts its business. The ECJ effectively permit the taxpayer the right to choose between alternative means of achieving the business objective even on the basis of tax considerations provided there is no abuse;

(c) the evidence shows by reference to objective criteria that the essential aim was not a tax advantage. This is because there was an independent commercial purpose (obtaining finance) for the business and therefore the arrangement was not artificial. There is no obligation on taxpayers to structure the business in the most VAT disadvantageous way.

(d) There are two issues in an abuse of rights question. These are

   i. whether abuse of rights as explained by the ECJ in the context of interpretation and application of the Sixth VAT directive (contrary to VAT purposes test) is relevant;

   ii. if it is whether or not the conditions particularly of the essential aim test are satisfied in the particular case.

(e) the abuse of right principle as explained in *Halifax* is, effectively, a principle of interpretation of EC law;

(f) in order for the principle to have application in the present appeal the provisions relied upon by the Appellant for the efficacy of the arrangements must represent Community law or be the provisions of domestic law "which transposed relevant Community provisions". Where the UK in simply implementing the provisions of the directive is acting within the scope of the discretion allowed to it under the directive, or pursuant to a specific derogation, the principle of abuse will not apply.

(g) The Appellant relies on a number of domestic provisions which have no obvious vires in Community Law. It is questionable whether Article 5(4) of the Special Provisions Order has its vires at all in Article 5(8) of the Directive. To the extent that the provision is not ultra vires it is not the transposition of the provisions of Community law and so the principle of abuse cannot apply.

(h) There is no vires for Article 8 (2) (a) of the Cars Order and again to the extent that the provision is not ultra vires it is not the transposition of the provisions of Community law and so the principle of abuse cannot apply.

(i) Abuse of rights requires the right to be identified that is being abused. Accordingly, the respondents must show that a particular provision (not the system) is being abused so there is an abuse of rights or of law. It is necessary to know what it is alleged is being abused.

(j) For reasons of certainty, proportionality and legitimate expectation there cannot be a generalised doctrine of abuse of the system and so the provision being abused must be identified and in so far as that is not concerned with Community law the doctrine of abuse cannot apply.

(k) The Appellants acknowledge that the purposes of Article 26a include the prevention of double taxation. As regards the sales by PDS this is irrelevant as double taxation is not involved. Where unconnected parties are involved in a chain of transactions one should have regard to each person and to each transaction looking at the links in the supply chain.

(l) A margin scheme taxes profit. It has little in common with the approach in Article 2 of the First Directive. Accordingly, what is in issue here is the scope of the margin scheme. This is not formulated by reference to a generic principle. The Member States had not agreed

one. The changes were ad hoc arrangements to ameliorate the position somewhat until something better was agreed.

(m) It is trite law that a state cannot rely on the direct effect of a directive against the taxpayer (see *Becker, Marshall* and *Kofoed*). By deploying the abuse doctrine the respondents are trying to get round *Becke*r etc. The UK always has the remedy of legislation.

(n) For abuse to apply the two conditions set out in *Halifax* have to be fulfilled. They are not fulfilled here:

   i. as the essential aim was finance; and
   ii. the tax advantage was not contrary to the purpose of Community law.

(o) Abuse is applicable only in very clear cases (see *Halifax* paragraphs 88-99 and *Kofoed*).This is not such a case.

(p) The function of abuse is not to permit the member state to amend domestic law retrospectively. It only applies were the two *Halifax* conditions are clearly fulfilled which is not the case here.

Accordingly, the Appellants' appeals should be allowed.

HMRC's Submissions in outline

98 In essence, Mr Pleming QC for HMRC argued that this was a case of abuse such that the Appellants could not take advantage of the margin scheme nor any other benefits attributable to the implementation of an abusive scheme.

99 These were arrangements which fell within the European Law overarching general anti avoidance principle that a person cannot rely on European Law matters for an abusive purpose. Abuse could be in respect of a general matter rather than of a specific provision. The doctrine of abuse could apply without the need to identify a particular provision that was being abused. It was sufficient if it was abusive of the European system of VAT.

100 In more detail he submitted:

(a) It is accepted that Pendragon has achieved "formal application of the conditions laid down" but that was not sufficient for.

(b) Abuse and *Marleasing* are alternatives – even where a scheme "passes" the language of the domestic provisions, read through a Marleasing lens, it may fail the "overarching anti-avoidance principle"

(c) The fact that the law was subsequently changed in an attempt to prevent avoidance is irrelevant, and the argument that it vindicates the earlier position is not supported by any authority. A subsequent change of law by the introduction of a specific anti-avoidance measure by amending SI (almost always prospective, rather than retrospective) does not mean that Parliament has somehow "forgiven" abusive schemes.

(d) The issue for Tribunal is which category does this scheme fall into i.e. abusive or non-abusive. Schemes are to be considered, case by case, by the Commissioners and, if challenged, by the Tribunal. The subsequent change of law, if anything, lends substance to the Commissioners' submissions in any given case that the tax advantage obtained under the old law was "unintended".

(e) A key question in the appeal (perhaps the key question) is the determination of the "essential aim" of the Scheme? Halifax (and other cases) makes it clear that the answer to that question is to be based on objective factors. But it is still essential aim that is to be determined.

(f) HMRC submit that the correct approach, in a case such as this where financing has been provided as part of the scheme by which the tax advantage has been obtained, is to ask whether the arrangements were (on the one hand) designed as a finance raising transaction/scheme which happened to have an incidental VAT benefit or (on the other hand) designed as a VAT saving scheme/transaction which happened to require a provision of finance. If the latter, the essential aim of the scheme was to obtain a VAT advantage.

(g) On this correct approach it is irrelevant whether the user of the scheme happened to require finance (in the same way that *Halifax* required call-centres, or in *WHA* the MBI policies required vehicle prepaid services and claims handling to be sources for the insurer) or whether there was some more peripheral additional benefit for the scheme user.

(h) The authorities, particularly *Halifax*, provide some assistance to the tribunal charged with characterising the scheme at issue. But in the end, the decision is one for the fact finding Tribunal, based on the evidence before it. There is no definitive guidance in any case – nor could there be in the context of an overarching principle designed to prevent tax avoidance across a wide range of schemes abusing different rights in law.

(i) The KPMP design brief in this case was to save VAT by allowing the sale of cars via the margin scheme, when no consumption VAT had ever arisen in respect of those cars.

(j) The Appellants' expert evidence does not take their case forward.

(k) The Tribunal here, in common with the Tribunal in *Halifax*, and the Court in *Parts Service* and *WHA*, must examine the essential reason behind the very specific structure in front of it, and not deal in general discussion as to whether the structure includes elements common in other structures.

(l) The picture is clear from the contemporaneous documentation. This was a tax avoidance scheme. The purpose was to allow Pendragon to save VAT on the sale of cars by paying only on the margin and not on the full consideration received. On any sensible objective analysis of the evidence, the essential aim was tax avoidance.

(m) The Commissioners submit that the Tribunal has open to it two approaches to Mr Forsyth's evidence. First, the Tribunal can determine, in the normal way, whether it accepts that evidence as true. If the Tribunal does not accept that there was a funding need which drove the adoption of this scheme, then that is an end of the matter: the conclusion that this was, first and foremost, a tax driven scheme is quite simply unavoidable. There is no need to engage with difficult issues as to whether the relevant evidence is subjective or objective.

(n) The alternative approach, which only comes into play if the Tribunal thinks that Mr Forsyth's evidence is or may be true on this issue, is to consider the status of that evidence within the existing case law parameters. In that event, the Commissioners remind the Tribunal of clear authority to the effect that subjective intention is not relevant. And at its highest, Mr Forsyth's evidence is squarely in the box labelled "subjective intention" and it is not relevant to the analysis – indeed, it is probably inadmissible.

(o) Many of the Appellant's arguments have been cut away by *WHA*, which binds this Tribunal as an authoritative statement of the abuse principle as it stands in domestic law.

(p) At paragraph 12 of *WHA* Lord Neuberger posed the four questions, answered in sequence above. It is submitted that questions 3 and 4 as they arose in *WHA* were determinatively answered in that case and, save for passing reference, do not require extensive analysis in order to resolve this case. The key questions are (1) and (2), which restate the two criteria in *Halifax*.

(q) The Commissioners contend that Pendragon has achieved an unintended tax advantage. The first criterion is fulfilled. Pendragon has done so by putting in place a carefully structured, deliberate, expensive scheme purchased from KPMG. Each step was ordained to ensure that the desired tax advantage was secured by it.

(r) The one feature, on which Pendragon rests its counter-argument, is that it obtained some short term finance by means of the scheme: that, so it contends, was the real commercial purpose of the elaborate structure. The evidence is overwhelming against Pendragon in this respect. The Margin II scheme did what it said on the box: it secured margin scheme treatment for the cars subject to it. The use of the third party offshore financier was a necessary step in obtaining that tax treatment and was not an end in itself. The second *Halifax* criterion is met.

Accordingly, the Appeals should be dismissed.

Discussion

Introduction

101 It is accepted, in this case, that the transactions in question met the requirements of UK legislation properly interpreted (including *Marleasing* and *IDT*) on a purposive approach for treatment under the Margin Scheme. Accordingly, the sole the issue is whether the Doctrine of Abuse applies to deny this treatment.

102 This requires us to consider a number of questions which arise from the submissions of the parties before deciding the case by answering Lord Neuberger's helpful question in *WHA*. These include:

(a) What is the Doctrine of Abuse?
(b) Is Abuse a matter of interpretation?
(c) Is tax planning permitted?
(d) What is the test?
(e) Who is to decide what?
(f) Does Abuse of law require a provision to be identified that is abused?
(g) Can the doctrine apply to the abuse of the system?
(h) How does this fit in with Lord Neuberger's four questions in *WHA*?
(i) How are the transactions to be reharacterised given third-party bank involvement?

A simpler set of questions to raise than to answer.

103. We note that the reference in *Halifax* was on the basis that the transactions had been entered into with the sole intention of obtaining a tax advantage[2]. It

[2] ECJ paragraph 82. "In any event, it is clear from the order for reference that the VAT and Duties Tribunal considers that the sole purpose of the transactions at issue in the main proceedings was to obtain a tax advantage".

was correctly accepted by the parties that following *Part Service* this was to be treated now as "essential aim".

104. Both parties in this case accept that 'Abuse' can apply in the VAT context. The more difficult question is what it is and how it works.

5 105. We have use as a working hypothesis that abuse in UK VAT is a matter to be applied in considering the result that would otherwise be the case after applying the VAT provisions to the facts realistically found where European matters are involved to see whether that result abuses those European rights. If there is abuse the result must be altered.

10 **What is of the Doctrine of Abuse?**

Introduction

106. Abuse is a doctrine of the ECJ. It derives in part from the civilian legal systems. Under the most legal systems the "rights" of a person under it are not absolute but have to be related to the rights of others and the extent of those

15 rights determined. This can be as a result of, for example, purposive interpretation of legislation or judge made case law. The extent of a particular right or privilege of one person has to be determined against the rights of others[3]. In English law, the Courts are mostly concerned with who has the better right to something rather than absolute rights[4].

20 107. However, any system needs to be able to protect itself against misuse. As the AG in *Halifax* said at "73. As Advocate General Tesauro stated[Opinion in *Kefalas* [1998] ECR I-2843, para 24]: '… any legal order which aspires to achieve a minimum level of completion must contain self-protection measures, so to speak, to ensure that the rights it confers are not exercised in a manner

25 which is abusive, excessive or distorted. This requirement is not at all alien to Community law …'

I am of the view that the common system of VAT is likewise not immune to the risk, inherent in every legal system, that actions may be taken which, despite formally complying with a legal provision, amount to abusive

30 exploitation of the possibilities left open by that provision, contrary to its purposes and objectives".

108. The starting point in considering Abuse and VAT has to be the *Halifax* case (actually three referred cases heard together[5]). We have considered this case and *WHA* in particular as they are concerned with VAT.

35 109. Abuse is a developing area and may not be the same in all contexts. As was noted in the Opinion Statement of the CFE ECJ Task Force on Abuse[6]:

"10. Accordingly, abusive practices arise when, despite formal compliance with the conditions set by tax law, the taxpayer enjoys in substance an advantage that conflicts with the purpose of the tax provision. The European Court of Justice added that such situation can be seen from objective elements that prove that the essential aim of the transaction was to obtain such tax advantage: a matter that does not occur when the

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[3] One person's right to do a particular action has to be balanced against another person's right to be free from interference by such action

[4] Cf rights to chattels and land law

[5] *Halifax plc and others v Customs and Excise Commissioners (Case C-255/02) ;BUPA Hospitals Ltd v Customs and Excise Comrs* (Case C-419/02) [2006] STC 967; *University of Huddersfield Higher Education Corp v Customs and Excise Comrs* (Case C-223/03)

[6] See Opinion Statement of the CFE ECJ Task Force on the Concept of Abuse in European Law, based on the Judgments of the European Court of Justice Delivered in the Field of Tax Law November 2007

economic activity carried out may have some explanation other than the mere attainment of tax advantages.

11. Although explicitly quoting the *Halifax* decision, the *Cadbury Schweppes* decision worded abuse slightly differently and considered as abusive practices all wholly artificial arrangements that do not reflect economic reality, such as letter-box companies...

14. Second, the *Kofoed* decision used yet another wording (which seems influenced by the French judicial doctrines of *abus de droit* and *acte anormal de gestion* and closely resembles that used ten years before by the European Court of Justice in the *Leur-Bloem* decision), since it makes reference to the prohibition of improperly or fraudulently taking advantage of European law through abusive practices, namely through abnormal commercial transactions, carried out solely for the purpose of wrongfully obtaining such advantage

15. Theoretically, one may conclude that the European Court of Justice has different concepts of abuse, respectively applicable to VAT (*Halifax*) and direct taxes in the absence (*Cadbury Schweppes* and *Thin Cap GLO*) and in the presence of secondary law (*Kofoed*). However, there is not sufficient evidence to regard this conceptual discrepancy as due to either a difference between direct taxes and VAT, or to the differences in the case law between primary and secondary law".

110. The approach we consider should be adopted in a VAT case[7] and therefore have adopted is that set out in *Part Service* (as the latest ECJ pronouncement in a VAT case). The ECJ says at paragraph 42 "an abusive practice can be held to exist where:

— the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions;

— it is apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage".

It is this we have borne in mind particularly when considering the matters before us.

5 *Origins*

General

110. In trying to understand the doctrine it is helpful to consider its origins.

111. Abuse doctrines in Continental countries have often been concerned with malice or spite. [8] Thus in France it has been said that the owner's
10 right to enjoy his property in the most absolute manner not prohibited by law or regulation is subject to his obligation not to cause damage to the property of anyone else which exceeds the normal incommodities of neighbourhood (JCP 1971. 2. 16781 Case *Epoux Vullion v. Société immobilière Vernet- Christophe).* It had been held before that there was no

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[7] The ECJ said at paragraph 74 in *Halifax* "In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if...." The rest of the paragraph is set out in the main text.

[8] cf the provisions in Quebec, Louisiana etc

right to fence one's property[9] simply in order to harm a neighbour. (*DP 1917. 1. 79 Case Coquerel v. Clément-Bayard*). Until early this century abus de droit in France did not generally apply to tax matters. This is no longer the case (see Article L64 Code des Impots etc).

112. It has been said in one French Legal Dictionary "Littéralement le mot "abus" se réfère à l'usage excessif d'un droit ayant eu pour conséquence l'atteinte aux droits d'autrui. Dans les textes juridiques relatifs aux relations du droit privé et du droit public, on trouve cette acception dans des expressions telles que " abus de droit", "abus de pouvoirs", "abus de position dominante", "abus de biens sociaux" et "clause abusive""[10].

113. The Continental approach has influenced the ECJ here as in other things[11]. However, the ECJ doctrine does not require malice or spite. It seems to be more concerned with outcomes. It is not concerned with motive but with more objective factors as discussed in *Halifax*.

English Law and Abuse – General Matters

114. It is difficult for an English[12] lawyer to approach Abuse in the same way as a civilian lawyer. *Bradford v Pickles* if[13] [1895] AC 587 [14] is often said to be authority for such propositions as that an Englishman may do anything that is not prohibited, his motive is irrelevant and motive does not of itself alter the legality of the exercise of rights in the individual's selfish interest rather than the general good.

115. This may result from a different constitutional approach on the Continent[15] and the view taken of the existence or not of a social contract.

116. Tax avoidance has been the subject to judicial discussion in recent years in the UK. However, it now seems to be dealt with as part of the usual approach to statutory interpretation and realistic fact finding. As Ribeiro P said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35]: "the ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

117. This is still a matter of statutory interpretation rather than of the extent of the right notwithstanding that it may lead to similar results[16]. It is not the *Rochefoucauld* approach discussed below.

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[9] 16 metres high surmounted by metal spikes, an installation which was of no use for the management of the owner's land

[10] "Literally, the word "abuse" refers to the excessive use of a law which resulted in the infringement of the rights of others. In the legal texts for the relations of private law and public law, we find the meaning in expressions such as "abuse", "abuse of power", "abuse of dominant position", "misuse of company assets" and "unfair"". Chairman's unofficial translation

[11] e.g. structures, institutions, acquis communitaire

[12] the Scottish position is more complicated than that se eg *aemulatio vicini*. This

[13] See on this M Taggart, *Private Property and Abuse of Rights in Victorian England* (OUP, Oxford, 2002)

[14] this was not always so see e.g. *Keble v Hickeringill* 1705 11 East 574n *Gloucester Schoolmaster's Case* 1410 YB Hil 11 Hen IV 47 pl 21

[15] eg a constitutional requirement to pay tax

[16] See Lord Hoffmann writing extra judicially ([2005] BTR 197 at 203ff) "The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by the recent decision of the House in *Barclays Mercantile Business Finance Ltd v Mawson.* Indeed it may be said that this case has killed off the *Ramsay* doctrine as a special theory of

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118. Perhaps the nearest approach to Abuse for an English Lawyer is found in the Maxim of Equity that "Equity will not allow a statute to be used as an engine of fraud" (see e.g. *Rouchefoucauld v Boustead* [1897] 1 Ch. 196). This is not "fraud" in the limited sense of a crime but in the wider sense of unconscionability. Thus, in England, if land is transferred to a person to hold on trust declared orally the transferee cannot claim the land as his and not subject to the trust because the conditions for a validly enforceable trust required by statute have not been met because the trust is not evidenced in writing. The statute would apply on a purposive construction to stop the trust being enforced but Equity would prevent an unconscionable result. This is not a matter of construction of the statute in the usual sense but is a matter of determining the scope of the provision and its application considered after application of the statute properly construed. It is looking to the result or outcome and considering whether it is a result that can be allowed to stand in the context. This seems analogous to the approach of the ECJ in abuse cases.

119. If the purpose of the statute was to ensure that trusts of land were evidenced in writing then even a purposive approach of the statute would have allowed it to be relied on to defeat the trust. However, the result was such that that cannot have been the intended outcome but the absurdity, unconscionability or abuse if such a result were allowed meant that the outcome has to be altered.

Is Abuse a matter of interpretation?

120. Mr. Cordara QC argued that abuse is a matter of interpretation. If so, presumably as the transactions fell within the legislation properly interpreted he says he succeeds.

121. The AG seems to consider Abuse to be a matter of interpretation. Thus he says at [75][17] "...the prohibition of abuse of Community law, seen as a principle of interpretation, does not give rise to derogations from the provisions of the Sixth Directive".

122. The ECJ does not seem to take the same approach whilst reaching the same conclusion. We note that at paragraph 43 in *Part Service* the ECJ set out the test "in the context of interpreting the Sixth Directive." However, this was a case where there was no Advocate General's Opinion. It does not appear to be departing in its "jurisprudence" from *Halifax*. This seems to follow from the questions answered by the ECJ (see paragraph 32).

123. It seems generally accepted that abuse is concerned with the extent to which a person can rely on community law. It cannot be relied on for an abusive purpose. This raises the question as to whether it is principal of interpretation or something else. As noted above the Advocate General in *Halifax* seems to

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revenue law and subsumed it within the general theory of the interpretation of statutes, perhaps the interpretation of utterances of any kind. The references which I have made to the construction of patent specifications are intended to counter the parochialism of tax specialists and show that other people have similar problems. The primacy of the construction of the particular taxing provision and the illegitimacy of rules of general application has been reaffirmed by the recent decision of the House in *Barclays Mercantile Business Finance Ltd v Mawson.* Indeed it may be said that this case has killed off the *Ramsay* doctrine as a special theory of revenue law and subsumed it within the general theory of the interpretation of statutes, perhaps the interpretation of utterances of any kind. The references which I have made to the construction of patent specifications are intended to counter the parochialism of tax specialists and show that other people have similar problems". It seems European Law may be more akin to *Ramsay*. It does not have the same constitutional difficulties.

[17] He also makes frequent reference to interpretation throughout out his Opinion.

regard it as a principle of interpretation. This follows from some of what he said as set out below.

124 The Advocate General in Halifax considered the requirements and said

"65. .... it follows from the previous case law that the Court attempts to strike a cautious balance between leaving it to the national courts to assess the abuse in accordance with their own relevant national rules and ensuring that that assessment does not prejudice the full effect and uniform application of the Community law provisions allegedly relied upon in an abusive manner.[51] As a consequence, the Court has developed the parameter according to which that assessment is to be made at national level. First, the assessment of the abuse must be based on objective evidence. Second, and most importantly, it must be made in conformity with the purpose and objectives of the provision of Community law allegedly relied upon in an abusive way. In this regard, in so far as the determination of such a purpose is a matter of interpretation, the Court has in several cases expressly excluded the existence of an abuse"

125 The Advocate General continued:

"69. I am of the opinion, therefore, that this notion of abuse operates as a *principle governing the interpretation of Community law*, as stated by the Commission in its written observations. What appears to be a decisive factor in affirming the existence of an abuse is the teleological scope of the Community rules invoked, which must be defined in order to establish whether the right claimed is, in effect, conferred by such provisions, to the extent to which it does not manifestly fall outside their scope[18]. This explains why the Court often refers not to abuse of rights, but simply to abuse".

126 In approaching abuse the Advocate General considered that:

"71. In my view it is not therefore a search for the elusive subjective intentions of the parties that ought to determine the existence of the subjective element mentioned in *Emsland*. Instead, the intentions of the parties to improperly obtain an advantage from Community law are merely inferable from the artificial character of the situation to be assessed in the light of a set of objective circumstances. Provided that those objective circumstances are found to exist one must conclude that a person who relies upon the literal meaning of a Community law provision to claim a right that runs counter to its purposes does not deserve to have that right upheld. In such circumstances, the legal provision at issue must be interpreted, contrary to its literal meaning, as actually not conferring the right. It is consideration of the objective purpose of the Community rules and of the activities carried out, and not the subjective intentions of individuals, which, in my view, lies at the heart of the Community law doctrine of abuse. I am of the view, therefore, that the use of the term 'abuse of rights' to describe what is, according to the case law of the Court, in essence a principle of interpretation of Community law may actually be misleading. I prefer therefore to use the term 'prohibition of abuse of Community law' and will speak of 'abuse of rights' only where simplicity so".

127The Advocate General's approach is not necessarily concerned with evasion and avoidance. It is concerned with the extent to which EU law can be relied on. The question is then whether this is more than a purposive interpretation.

128 The Advocate General considered (at paragraph 86) that "... the scope of the Community law interpretative principle prohibiting abuse of the VAT rules

[18] We have sought to use the term abuse in most circumstances in this Decision

must be defined in such a way as not to affect legitimate trade. Such potential negative impact is, however, prevented if the prohibition of abuse is construed as meaning that the right claimed by a taxable person is excluded only when the relevant economic activity carried out has no other objective explanation than to create that claim against the tax authorities and recognition of the right would conflict with the purposes and results envisaged by the relevant provisions of the common system of VAT. Economic activity of that kind, even if not unlawful, deserves no protection from the Community law principles of legal certainty and protection of legitimate expectations because its only likely purpose is that of subverting the aims of the legal system itself.

129 It was also consider that there were limits to the doctrine. Thus it was said by the Advocate General:

"89. The prohibition of abuse, as a principle of interpretation, is no longer relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages against tax authorities. In such circumstances, to interpret a legal provision as not conferring such an advantage on the basis of an unwritten general principle would grant an excessively broad discretion to tax authorities in deciding which of the purposes of a given transaction ought to be considered predominant. It would introduce a high degree of uncertainty regarding legitimate choices made by economic operators and would affect economic activities which clearly deserve protection, provided that they are, at least to some extent, accounted for by ordinary business aims.

90. There can be little doubt that the possibility must be recognised that also in such cases, where activities are accounted for by a mixture of tax and non-tax considerations, further restrictions could be introduced for claims arising from activities which, to varying extents, predominantly seek to achieve tax advantages. This, however, will require the adoption of appropriate national legislative measures. Mere interpretation will not suffice. Such measures might include more general anti-abuse provisions of the kind adopted in some Member States, that are applicable inter alia to VAT, which may differ, either in their scope, modus operandi or effects, from the operation in the field of VAT of the interpretative Community law principle of the prohibition of abuse.[83] In any case, such legislation must comply with the art 27 procedure and the limits laid down in that regard by the Court.[84]

ECJ Approach in Halifax

126 The ECJ in *Halifax* do not seem to approach matters in quite the same way as the Advocate General. They do not seem to regard it as a matter of interpretation but rather as going to the extent that European Law can be relied on[19]. It is almost looking from the other end of the telescope.

127 At paragraph 43 the ECJ in setting out the questions in *Halifax* made it clear that it was concerned with transactions:

(i) effected by each participator with the intention solely of obtaining a tax advantage; and

(ii) which have no independent business purpose;

128 The ECJ said at paragraph 68. "... it must be borne in mind that, according to settled case law, Community law cannot be relied on for abusive or fraudulent ends (see, in particular *Kefalas v Greece and OAE* (Case C-367/96) [1998] ECR

[19] We have noted above the reference to interpreting the Sixth Directive in *Part Service* above.

I-2843, para 20; *Diamantis v Greece* (Case C-373/97) [2000] ECR I-1705, para 33; and *I/S Fini H v Skatteministeriet* (Case C-32/03) [2005] STC 903, [2005] ECR I-1599, para 32)".

129 The problem then becomes what is meant by "abusive". "Fraudulent" tends to be more obvious in the particular context. No question of fraud has been raised in this case.

130 Some guidance may be drawn from paragraph 69 where it is said:

"The application of Community legislation cannot be extended to cover abusive practices by economic operators, that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for by Community law (see, to that effect, *Firma Peter Cremer v Bundesanstalt für Landwirtschaftliche Marktordnung* (Case 125/76) [1977] ECR 1593, para 21; *General Milk Products GmbH v Hauptzollamt Hamburg-Jonas* (Case C-8/92) [1993] ECR I-779, para 21; and *Emsland-Stärke* (C-110/99), para 51). The ECJ was clear that the principle of prohibiting abusive practices also applies to the sphere of VAT noting that preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see *Gemeente Leusden and Holin Groep BV v Staatssecretaris van Financiën* (Joined cases C-487/01 and C-7/02) [2004] ECR I-5337, para 76)."

131 The ECJ like the Advocate General emphasised the requirements of certainty and foreseeable application at paragraph 72. This reads:

"However, as the Court has held on numerous occasions, Community legislation must be certain and its application foreseeable by those subject to it (see, in particular, *Netherlands v EC Council* (Case C-301/97) [2001] ECR I-8853, para 43). That requirement of legal certainty must be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which they impose on them (*Netherlands v EC Commission* (Case 326/85) [1987] ECR 5091, para 24, and *Finanzamt Sulingen v Sudholz* (Case C-17/01) [2005] STC 747, [2004] ECR I-4243, para 34)".

132 The requirements of legal certainty is therefore something we are required to keep firmly in mind and we have sought to do so as with the fundamental principles of European Union law in considering this case.

133 It seems to us that "Purpose" for abuse purposes is not necessarily the same purpose as the purpose when construing a particular piece of legislation. Again *Rouchefoucauld* illustrates this in an English context.

134 This is the only way we have found of reconciling abuse and purposive construction. One looks at the legislation purposively to construe it. One then has to consider the outcome to see whether that defeats the purposes of the imposition of VAT etc such that it cannot be allowed to stand bearing in mind that the taxpayer can choose the way it carries on business provided it is not abusive.

Is tax planning permitted?

135 Mr. Cordara QC emphasised that the ECJ in *Halifax* allowed a taxpayer to choose how it carries on business on the basis of tax considerations. We agree on the basis set out below that the trader has a choice but this is always subject to abuse where European rights are involved. Subject to abuse the trader may structure of its business so as to their tax liability.

136 The ECJ (agreeing with the Advocate General) said:

"73. Moreover, it is clear from the case law that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system (see, in particular, *BLP Group* [1995] STC 424, [1996] 1 WLR 174, para 26, and *Customs and Excise Comrs v Cantor Fitzgerald International* (Case C-108/99) [2001] STC 1453, [2002] QB 546, para 33). Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the highest amount of VAT. On the contrary, as the Advocate General observed in para 85[20] of his opinion, taxpayers may choose to structure their business so as to their tax liability".

137 It is clear from this that taxpayers are not required to order their affairs so as to pay the maximum VAT. However, the taxpayer may not take advantage of an EU law provision it is not entitled to by creating a situation in an abusive way which appears to fulfil the European Union law requirements but leads to a result that is absurd or unintended by the directive (cf *Rouchefoucauld*).

138 In the Advocate General's view it follows that a taxpayer can arrange its affairs in the most advantageous way provided the arrangement falls within the EU provision properly interpreted and does not lead to a result not falling within the purposes of the provision. This is part of the difficulty of the question as to whether abuse is merely a doctrine of interpretation.

139 We have borne this in mind in considering this matter.

What is the Test?

140 The ECJ in *Halifax* set out the fundamental test at paragraph 74 and 75 of its judgement. This is central to what we are concerned with. This is the test to be applied in the VAT cases. The paragraphs read as follows:

"74. In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

75. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in para 89 of his opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages".

[20] "85. Furthermore, the Court has consistently held, in consonance with the position generally accepted by Member States in the tax domain, that taxpayers may choose to structure their business so as to limit their tax liability. In *BLP Group plc v Customs and Excise Comrs* (Case C-4/94) [1995] STC 424, [1996] 1 WLR 174, the Court ruled that 'a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system'.[81] There is no legal obligation to run a business in such a way as to maximise tax revenue for the State. The basic principle is that of the freedom to opt for the least taxed route to conduct business in order to minimise costs.[82] On the other hand, such freedom of choice exists only within the scope of the legal possibilities provided for by the VAT regime. The normative goal of the principle of prohibition of abuse within the VAT system is precisely that of defining the realm of choices that the common VAT rules have left open to taxable persons. Such a definition must take into account the principles of legal certainty and of the protection of taxpayers' legitimate expectations".

141 This was summarised in *Part Service* as:

"in the context of interpreting the Sixth Directive, an abusive practice can be held to exist where:

— the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions;

— it is apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage".

This makes it clear that abuse is not limited to the situation where the sole purpose is the obtaining of a tax advantage. It is sufficient if it is essential aim.

142 We also have the helpful questions in WHA to apply in deciding this issue.

143 We also note that The ECJ has said that:

(a) It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT (see para 93).

(b) It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

Who is to decide what?

144 The Court said at 76. "It is for the national court to verify in accordance with the rules of evidence of national law, provided that the effectiveness of Community law is not undermined, whether action constituting such an abusive practice has taken place in the case before it (see *Eichsfelder Schalchtbetrieb* (Case C-515/03) [2005] All ER (D) 306 (Jul), para 40)".

145 It continued at 78 "In that connection, it must be borne in mind that the deduction system under the Sixth Directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (see, in particular, *Abbey National plc v Customs and Excise Comrs* (Case C-408/98) [2001] STC 297, [2001] 1 WLR 769, para 24, and *Ziti Modes* [2005] STC 1059, [2003] ECR I-14393, para 38)".

146 The Tribunal therefore has decide in accordance with English rules whether an abusive practice has taken place. This we have attempted to do.

147 We remind ourselves that the ECJ said at paragraph 81:

"As regards the second element, whereby the transactions concerned must essentially seek to obtain a tax advantage, it must be borne in mind that it is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden (see, to that effect, *Emsland Stärke* [2000] ECR I-11569, para 58)".

148 The ECJ summarised the position at paragraph 86 in a slightly different form of words. For it to be found that an abusive practice exists, it is necessary,

first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

149 *Part Service* unlike *Halifax* which dealt with "sole aim" considered whether transactions, the essential aim of which is to obtain a tax advantage could be abusive and concluded that it could apply if the attaining of a tax advantage was the principal aim (see paragraph 45 of the ECJ judgement).

150 The court considered that there was abuse in the case before it. It described the characteristics of the transactions which led it to that view at paragraph 57. This reads:

"In the present case, the transactions at issue in the main proceedings, as described by the referring court, have the following characteristics:

the two companies taking part in the leasing transaction are part of the same group;

the service supplied by the leasing company (IFIM) is subject to a division, the financing element is entrusted to another company (Italservice) to be split into a credit service, an insurance service and a brokerage service;

the service of the leasing company is therefore reduced to a service for renting a vehicle;

the lease payments made by the customer are of an amount which is only slightly higher than the purchase cost of the vehicle;

that service, considered in isolation, therefore seems to be economically unprofitable, so that the viability of the business cannot be ensured solely by means of contracts concluded with the customers;

the leasing company receives the consideration of the leasing transaction only through the cumulative lease payments made by the customer and the amounts transferred from the other company of the same group".

The reference the lease being economically unprofitable clearly informed the Court's thinking where seemingly a business was split on a basis which meant that one was dependent on the other economically so in reality there was only one business.

151 We do not consider that the characteristics of the transactions before us resemble those in *Part Service* and we so find.

Does Abuse of law require a provision to be identified that is abused?

152 The ECJ talks about abuse of provisions of the Sixth Directive. In *WHA* Lord Neuberger talks of matters "'contrary to the purpose of' the provisions of the Sixth Directive". This suggests that it is not necessary always to identify the specific provision that is abused. However, it will generally be easier to show abuse if a particular provision can be identified and how it is abused shown. It is a matter of context, circumstance and degree in each case in our view and this is how we have approached this case.

153 In our view this is something that depends on the particular circumstances of the case. This is linked to the matters discussed in the next section. However, we are of the view that abuse does not necessarily require the identification of a specific provision that is abused but that it may be harder, in practice, to show abuse if a specific provision is not identified.

Can the doctrine apply to the abuse of the system?

154 It seems to us that fraud is an example of abuse of the system rather than any particular provision. Fraud is included within abuse (see eg *Kofoed* improperly or fraudulently taking advantage of European law through abusive practices). Thus MTIC fraud in the VAT sphere could be regarded as an abuse of the system rather than just the provisions on Input Tax.

155 It is a matter of context, circumstance and degree in each case. We consider that the doctrine can apply to abuse of the system in appropriate cases.

Abuse and English Law – Specific Matters

Introduction

156 Lord Neuberger of Abbotsbury (with whom Latham LJ and Waller LJ agreed) said in *WHA Ltd and another v Revenue and Customs Commissioners* [2007] EWCA Civ 728:

"[12] The abuse issue can usefully be considered by answering four questions, which appear to emerge from the passages I have quoted from the judgment in *Halifax*. First, does the Scheme, or an aspect of the Scheme, result in the accrual of a tax advantage which, as HMRC assert, is 'contrary to the purpose of' the provisions of the Sixth Directive? Secondly, if so, was it, as HMRC contend, the 'essential aim' of the Scheme, or of the relevant aspect, that a tax advantage be obtained? Thirdly, if so, are there any special features of the Scheme itself, or of the law relating to it, which should nonetheless prevent the abuse argument succeeding? Fourthly, if not, can (and must) the Scheme, or the relevant part, be 'redefined'?

[13] Whilst one can analyse the issue in this case by breaking it down into these four questions, it is right to acknowledge that the answers may overlap to some extent, and that it may be a matter of opinion as to which question a particular argument or point goes. Nonetheless, I propose to consider the four questions in turn, as that makes it less difficult to achieve a structured and tolerably clear approach to what is, to my mind at least, a potentially confusing problem".

157 We gratefully adopt this approach and the helpful guidance from the Court of Appeal and seek to apply it. We turn now to consider these four questions. The first two questions essentially restate the tests in *Halifax.*

Is the Scheme or part of it contrary to the purpose of the Sixth Directive?

158 Lord Neuberger reminded us at paragraph [14] that the European Court drew a distinction between transactions entered into 'in the context of normal commercial operations' and those entered into 'solely for the purpose of wrongfully obtaining advantages provided for by Community law'. The latter type of transaction is capable of constituting an abuse, provided it satisfies the two tests identified the application of the abuse doctrine. Such a transaction or scheme will not satisfy the first test unless it is 'contrary to the purpose' of the principles governing the payment of VAT, which include the 'provisions of the Sixth Directive' (see para 74), as well as 'the principle of fiscal neutrality' (see para 80). He also said that the purposes of the VAT provisions is, to be found primarily by reference to the provisions of the Sixth Directive, EC Council Directive 77/388[21].

[21] although the law has subsequently been consolidated into the VAT Directive, EC Council Directive 2006/112—'the 2006 VAT Directive'. It is not thought that this should change the underlying policy.

159 We have discussed Article 26a and its policy and rationale (see 18 above). We concluded it does not reveal a clear underlying policy but does want gradual adaptation of the legislation in specific areas. It does not refer to "trapped VAT" nor require "Input VAT" to have been paid. It does make it clear that a uniform basis (presumably a margin scheme) should apply to used goods works of art, antiques and collectors' items.

160 In the light of the requirement of certainty that the ECJ has emphasized it would require in our view a clearer policy, rationale or purpose to be able to say that in this context the Sixth Directive was being abused by virtue of the transactions. Bearing in mind those Second-Hand goods i.e. used cars are being sold it is not obvious that this is against its purpose.

161 We conclude that the transactions are not against the purposes of the Sixth Directive. If we are wrong on this then as we consider the essential aim to be finance and not the obtaining a tax advantage of it should not make a difference to the outcome.

Was the essential aim of the Scheme to obtain a tax advantage?

162 Lord Neuberger reminds us that the question of purpose was to be judged objectively and not subjectively, i.e. by reference to the terms of the scheme concerned and the commercial realities, not by reference to what the parties concerned say their intention was (or what their subjective intention is found to have been). Thus in paras 75 and 86, the court made reference to the necessity of basing one's conclusion as to the intention on 'objective factors'. The point was more fully made in para 87 of the Advocate General's opinion[22]. He said in particular "In fact, when applying it, the national authorities must determine whether the activity at issue has some autonomous basis which, if tax considerations are left aside, is capable of endowing it with some economic justification in the circumstances of the case".

163 We have been careful in considering Mr Forsyth's evidence to look to the commercial realities objectively as to the position of Pendragon and to consider the terms of the transactions.

164 We consider (even ignoring Mr Forsyth's evidence) that the obtaining of finance provided some autonomous basis which if tax considerations are left endows some economic justification in the circumstances of this case and we so find.

165 This is so not because Mr Forsyth said that the company needed finance but from the position of the officious bystander it was clear that the company in this business would need considerable finance available to it. A company in Pendragon's position as regards headroom and gearing in particular would clearly need finance and on the finest terms available.

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[22] He said "87. I am of the view therefore that the Community law notion of abuse, applicable to the VAT system, operates on the basis of a test comprising two elements. Both elements must be present in order to establish the existence of an abuse of Community law in this area. The first corresponds to the subjective element mentioned by the Court in *Emsland* [2000] ECR I-11569, but it is subjective only in so far as it aims at ascertaining the purpose of the activities in question. That purpose—which must not be confused with the subjective intention of the participants in those activities—is to be objectively determined on the basis of the absence of any other economic justification for the activity than that of creating a tax advantage. Accordingly, this element can be regarded as an *element of autonomy*. In fact, when applying it, the national authorities must determine whether the activity at issue has some autonomous basis which, if tax considerations are left aside, is capable of endowing it with some economic justification in the circumstances of the case".

166 It is permitted to arrange affairs to take advantage of the relevant tax provisions provided it is not abusive. Here we find that the financing was necessary but was done in a tax efficient but non-abusive way. The ECJ has not prevented this. It specifically says that one may choose the more tax efficient way of carrying out a transaction. We consider that this was what Pendragon did and we find this as a primary fact. The obtaining of finance provided a sufficient autonomous basis and economic justification.

167 This case is distinguishable from *Part Service* where economic interdependence meant that the business splitting could not be regarded as genuine. Consequently, it was abusive even though it fulfilled the technical requirements of such treatment. It did not represent "normal commercial operations' but was entered into 'solely for the purpose of wrongfully obtaining advantages provided for by Community law'.

168 We find that Pendragon was fully aware of the VAT position. It would be surprising if they were not. They had a significant in-house tax team and had taken advice from leading accountants and practitioners on the matter. The fact that they took advice does not make the transactions abusive.

169 In reaching this conclusion we have borne in mind what Lord Neuberger said at paragraph [29] in WHA that "Of course, in one sense at any rate, the purpose of the Scheme was to enable NIG's liabilities under the MBIs to be performed and to be reinsured. So, it may be contended, tax avoidance cannot be said to be the sole, even arguably the main, purpose of the Scheme, viewed as a whole. However, as I see it, when considering the purpose of the Scheme for present purposes, one must primarily address the aspects of the Scheme which are artificial". He also reminded us that the national court/ tribunal must 'determine the real substance and significance of the transactions concerned.' This plainly seems to envisage that a scheme may be abusive while having a genuine underlying commercial purpose. The transfer of the business as a going concern from outside the Pendragon group does not in our view amount to an abusive artificial transaction. Any lender would be likely to require security and where chattels were concerned would be highly likely to want ownership of the goods as well as a right to the income stream. Given the need for finance from a third-party who would require such security we find this to be part of the normal commercial operations in these particular circumstances and not transactions 'solely for the purpose of wrongfully obtaining advantages provided for by Community law'.

170 We also note that His Lordship says that a scheme may be abusive while having a genuine underlying commercial purpose. We have already found that there is a genuine commercial purpose here. We do not consider that the use of the hybrid hire purchase agreements and/or the transfer of the business as a going concern are themselves are abusive. They have a commercial purpose in connection with the financing - the sale and leaseback could not otherwise have been obtained. Pendragon on advice chose "… to structure their business so as to limit their tax liability (see *Halifax* paragraph 73). This was not abusive.

171 Mr Forsyth's position, although similar to that of Mr Ross-Roberts as regards his own personal views as to the subjective reasons for the transactions are not the basis on which we have reached our conclusions. We have adopted an objective approach and so Lord Neuberger's warning does not apply.

172 As regards the point that a taxpayer who has alternative courses open to him is entitled to choose that which minimises his liability to VAT Lord Neuberger does not consider that there was anything in that point in *WHA*. He said "there may be cases where it is difficult to decide whether a particular arrangement is one which includes a step or steps which amount to an abuse or whether it is a course which is properly open to the taxpayer as a way of minimising his liability to VAT. However, this is not such a case". He considered the insertion of the company was an ingenious, but wholly artificial, step included purely to enable the input tax paid by WHA to be reclaimed.

173 This is factually not the case here. Given that outside financiers would require security over both the vehicles and the income flow it is not an artificial step to carry out a transfer of the business as a going concern. Given that there was to be a hire of the vehicles drafting an HP contract in such a way as to give the taxpayer the choice of carrying out the normal commercial operation in a tax efficient way cannot be said to be abusive in the current circumstances. It was not something inserted as a purely artificial step which could be disregarded. The cars were to be sold and leased back such that title to the goods i.e. the cars and the income (i.e. the rentals) would be in a third-party bank. The vehicles had to be got back and the short-term finance repaid. In the circumstances of this case there was no artificial insertion of steps or the creation of a wholly artificial set of transactions rather the necessary financing was carried out in a tax efficient way. This seems to be contemplated by the ECJ when discussing how taxpayer can structure his or her business.

174 We note that the Court of Appeal rejected intentions that the abuse principle can only be invoked in relation to EU legislation and not domestic law and if different that the doctrine of abuse should not be invoked to put right an oversight in the drafting of national legislature. We do not consider those arguments further.

175 From the evidence which we have seen and heard we find as a fact considering matters objectively and not subjectively that in the particular circumstances of this case the essential aim of the transactions was to obtain finance and not to obtain a tax advantage. The real substance and significance of the transactions was the obtaining of finance. This puts it in Mr Pleming QC's non-abusive box and we so find[23]

How is the Scheme to be redefined?

176 We find this a very hard question to answer. The obvious recharacterisation would be as a loan transaction. However given the involvement of a third-party bank and the transfer of vehicles this seems a hard matter to achieve. The alternative is to treat it as a short term leasing transaction. However, in those circumstances one would expect the VAT treatment to be similar to that claimed by the Appellants. If we have to recharacterise the transactions we would recharacterise them a short term leasing transactions.

177 The difficulty of recharacterising the transactions as other than finance transactions reinforces our view that they were not abusive transactions and we so find.

Conclusion

178 We have found that:

[23] See paragraph 100(d) above)

a. The scheme is not contrary to the purposes of the Sixth Directive. What was done was done in a tax efficient manner but that does not make the essential aim of the scheme to obtain a tax advantage nor was any part of it;
b. The essential aim of the scheme was to obtain finance not an abusive VAT advantage;
c. We do not need to consider Lord Neuberger's third question as the abuse argument has not succeeded. A special feature here would be that the taxpayer has chosen its business structure in such a way as to minimize its VAT liability which is not abusive. The other feature is that Second-Hand goods are being sold so the margin scheme is supposed to apply. No evidence was led us to competition etc so we can express no view on that; and
d. Recharacterisation is difficult in the circumstances of this case. However if one were needed it would be as a short term leasing transaction.

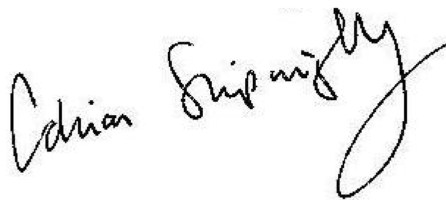
179 On that basis there would be no abuse. We test that conclusion by considering whether such a result is:

(a) Absurd;
(b) Unintended;
(c) Disproportionate;
(d) Inappropriate;
(e) Fraudulent;
(f) Unconscionable; or
(g) Wrongfully allowing advantages provided for by community law to be obtained;

And conclude that it is not such a result. It is the result that conforms to legal certainty and proportionality and has not been shown to be distortive of competition. It is the result we have reached following the guidance of the Court of Appeal's four questions in *WHA*.

180. Accordingly we find that the transactions were not abusive.

181. Consequently the appeal is allowed with costs.



ADRIAN SHIPWRIGHT
TRIBUNAL JUDGE
RELEASE DATE: 31 July 2009

APPENDIX

Pendragon appeals

Pendragon Company Car Finance Limited

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Misdeclaration penalties	11-Jan-02	£538,610	MAN/2002/0132	08-Feb-02
Assessment & return amendment	8-Jan-02	£3,117,820 and £472,926.14	MAN/2002/0138	08-Feb-02
Return amendment	19-Apr-02	£253,296.57	MAN/2002/0368	30-Apr-02
Misdeclaration penalty	19-Apr-02	£37,994	MAN/2002/0377	30-Apr-02

Pendragon Demonstrator Finance Limited

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Return amendments	8-Jan-02	£2,183,318.24	MAN/2002/0135	08-Feb-02
Misdeclaration penalty	11-Jan-02	£327,497	MAN/2002/0134	08-Feb-02

Pendragon Demonstrator Finance November Limited

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Return amendments	8-Jan-02	£1,787,055.33	MAN/2002/0137	08-Feb-02
Misdeclaration penalty	11-Jan-02	£268,056	MAN/2002/0131	08-Feb-02
Return amendment	19-Apr-02	£291,901.97	MAN/2002/0369	30-Apr-02
Misdeclaration penalty	19-Apr-02	£43,785	MAN/2002/0376	30-Apr-02

Pendragon Demonstrator Sales Limited

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Return amendment	4-Jul-02	£50,880.91		18-Jul-02
Civil penalty	9-Jul-02	£7,632	MAN/2002/0715	09-Aug-02
Return amendment	15-Oct-02	£58,156.66	MAN/2002/0717	28-Oct-02
Civil penalty	16-Jan-03	£5,870		21-Jan-03

Return amendment	15-Jan-03	£39,139.38		21-Jan-03
Civil penalty	5-Mar-03	£1,949		11-04-03
Return amendment	5-Mar-03	£12,998.42		25-Apr-03

Pendragon Plc

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Misdeclaration penalty	11-Jan-02	£166,215	MAN/2002/0136	08-Feb-02
Assessment	21-Jan-02	£1,704,844	MAN/2002/0133	08-Feb-02
Assessment	19-Jun-02	£259,773		26-Jun-02
Assessment	15-Jul-02	£1,592,095	MAN/2002/0673	18-Jul-02
Civil penalty	9-Jul-02	£238,814		09-Aug-02
Civil penalty	4-Sept-02	£157,861		18-Sep-02
Assessment	16-Sept-02	£1,052,410		18-Sep-02
Assessment	23-Dec-02	£404,473	MAN/2003/0079	02-Jan-03
Assessment	5-Mar-03	£152,883		07-Mar-03
Assessment	16-May-03	£82,765		27-May-03

Stripestar Limited

Notice	Date of notice	Amount due	Appeal reference	Date appeal lodged
Decision letter	22-Oct-01	-	MAN/2001/0972	07-Dec-01
Assessment	21-Jan-02	£236,084	MAN/2002/0120	08-Feb-02
Assessment	24-Jun-02	£14,669	MAN/2002/0474	04-Jun-02

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