TC02823

Appeal number: MAN/2000/0263

VAT-input tax-abuse of rights-whether tax mitigation scheme by partially exempt university using discretionary trust to recover all input tax on refurbishment of building a tax advantage that constituted abuse of rights-no-appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE UNIVERSITY OF HUDDERSFIELD HIGHER EDUCATION CORPORATION **Appellant**

- and -

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

TRIBUNAL: JUDGE DAVID DEMACK

Sitting in public at Manchester on 11 and 12 February 2013

Paul Lasok QC, instructed by KPMG, Manchester, for the Appellant

Raymond Hill of counsel instructed by the general counsel and solicitor for HMRC, for the Respondents

DECISION

1. The appeal of the University of Huddersfield Higher Education Corporation ("the University") originally came before me on 10 July 2002. At the end of a three day hearing I made a reference to the Court of Justice of the European Communities ("the ECJ"), now the Court of Justice of the European Union ("the CJEU"), for a preliminary ruling as to whether, in entering into a tax mitigation scheme devised by KPMG involving a lease and leaseback of a building, the University, a partially exempt trader, was in breach of the Community law principle of abuse of rights. At the time the principle of abuse was not well developed in tax cases since the ECJ had yet to confirm that the principle even applied in a VAT context.

2. Although I expressed a tentative view that there was no abuse of rights in the instant case, as the President of the Tribunals had recently decided to refer questions on the scope of the doctrine of abuse to the ECJ in the case of *Halifax plc and others v Commissioners of Customs and Excise* (Case C-255/02) [2006] ECR I-1609 since a different EU provision was in point in the present case, I too decided to make a reference to the ECJ.

3. The present case was heard by the same panel of judges as heard the *Halifax* case (as well as a third case raising the issue of abuse of rights; *BUPA v Commissioners of Customs and Excise* (Case C-419/02) [2006] ECR I-1685). All three cases were dealt with by Advocate-General Maduro, and although the ECJ gave three separate judgments, all were delivered on the 21 February 2006.

4. In its judgment in the present case, *University of Huddersfield Higher Education Corporation v CCE* (Case C-223/03) [2006] ECR I-1751, the ECJ concluded at [50] that the lease and underlease under consideration were supplies of goods or services and were an economic activity. In relation to abuse of rights, at [52] the court restricted itself to saying:

> "…as is clear from paragraph 85 of the judgment of today's date in Case C-255/02 *Halifax and others*…, the Sixth Directive precludes any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice."

5. The case has now been referred back to me for determination in the light of the ECJ's preliminary ruling, and a number of cases that have been decided in the meantime. The question to be answered remains the same: was an assessment to VAT made on 26 January 2000 in the sum of £612,502 to recover input tax the University had deducted on the supply to it of construction services lawful having regard to the facts as they existed at the time the assessment was made?

6. As at the earlier hearing the University was represented by Dr Paul Lasok QC, but on this occasion the respondent Commissioners ("HMRC") appeared by Mr Raymond Hill of counsel.

The relevant legislation

7. Under what was Article 13(B) of the Sixth VAT Directive (77/388/EEC), and is now Article 135(1)(l) of the Principal VAT Directive (2006/112/EC), Member States are required to exempt from VAT "the leasing or letting of immovable property". Where the exemption applies, a lessor cannot deduct input tax on VAT incurred for the purpose of leasing or letting property.

8. However, under what was Article 13(C)(a) of the Sixth VAT Directive, and is now Article 137(1)(d) and 137(2) of the Principal VAT Directive, "Member States may allow taxpayers a right of option for taxation in cases of … letting and leasing of immovable property … Member States may restrict the scope of this right of option and shall fix the details of its use".

9. Since 1 August 1989, the United Kingdom has provided for such a right of option. It is now to be found in in s.51 of and Schedule 10 to the Value Added Tax Act 1994 ("VATA"). Its effect is to make taxable what would otherwise be exempt supplies of land. Consequently, input tax is recoverable on supplies which have a direct and immediate link with leases on which the option has been exercised.

10. However, since 30 November 1994, the United Kingdom has restricted the right of option. On that date a new para.2 (3A) was inserted into Schedule 10 to VATA by the Value Added Tax (Buildings and Land) Order 1994 ("the 1994 Order"). It provided that the option would not apply to a grant of land made on or after 30 November 1994 "if (a) the person making the grant and the person to whom the grant is made are connected persons; and (b) either of them is not a fully taxable person".

11. The 1994 Order also inserted a new para. 3(8A) into Schedule 10. It provided that "(a) any question whether a person is connected with another shall be determined in accordance with section 839 of the Taxes Act [the Income and Corporation Taxes Act 1988 ("ICTA")]; and (b) a person is a fully taxable person if at the end of the prescribed accounting period of his in which the grant is made he is entitled to credit for input tax on all supplies to, and acquisitions and importations by, him in that period …"

12. Section 839 ICTA deals with "connected persons" in the following terms:

> "For the purposes of, and subject to, the provisions of the Tax Acts which apply to this section, any question whether a person is connected with another shall be determined in accordance with the following provisions of this section (any provision that one person is connected with another being taken to mean that they are connected with one another).
>
> (1) …
>
> (2) A person, in his capacity as trustee of a settlement, is connected with –
>
> (a) …

(b) …

(c) any body corporate which is connected with that settlement.

In this subsection "settlement" and "settlor have the same meaning as in Chapter 1A of Part XV…

(3A) For the purpose of subsection (3) above a body corporate is connected with a settlement if -

(a) it is a close company… and the participators include the trustees of the settlement; or

(b) it is controlled (within the meaning of section 840) by a company falling within paragraph (a) above."

13. Subsections (5) – (7) of s.839 ICTA provide detailed rules as to when a company is connected with another person, including where the same person has control of both companies.

14. "Control" is defined in s. 416(2) ICTA so that "a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs".

15. Paragraphs 2(3A) and 3(8A) of Schedule 10 to VATA were repealed by s.37(1) of the Finance Act 1997 in respect of any supply made after 26 November 1996, and new anti-avoidance measures were subsequently introduced.

Background

16. I take the following summary of the background to the case from Dr Lasok's skeleton argument:

(a) In 1996 the University entered into a lease and leaseback arrangement relating to land and buildings on a site known as East Mill that the University was intending to redevelop for the purposes of its activity as a university ("the East Mill Arrangements"): Decision /37. ["Decision" refers to my earlier decision, and the following number to the relevant paragraph therein].

(b) The arrangements involved a discretionary trust ("the Trust") established the previous year: Decision/21.

(c) The Trust had been established in connexion with similar arrangements, effected in 1995, concerning land and buildings on a site known as West Mill: Decision/12-22.

(d) The University elected to waive the exemption from VAT over East Mill under the terms of paragraph 2(1) of Schedule 10 to VATA and charged VAT on the supplies made under the lease.

(e) The trustees of the Trust, to whom the property was leased, also elected to waive exemption over the property and charged VAT on the supplies made under the terms of the leaseback. The trustees held the property subject to the terms of the Trust.

(f) The East Mill Arrangements were what can colloquially be described as a "cash flow" VAT scheme. They enabled the University to deduct input tax incurred in respect of the redevelopment of East Mill immediately the input tax was incurred but exposed the University to the obligation to account for output tax on the rent payable under the lease: Decision/115.

(g) By letter dated 26 January 2000, the predecessors of the Respondents ("HMRC") issued an assessment in the amount of £612,502, representing the input tax that the University had deducted in respect of the supply to it of standard rated construction services ("the Assessment"): Decision/54.

(h) The University appealed the Assessment: Decision/2.

(i) In the Decision, released on 16 October 2002, the tribunal found the facts in the case and referred to matter to the ECJ.

(j) The leases were surrendered on 18 August 2004. (HMRC were informed that the leases had been surrendered by letter dated 29 July 2005 following an inspection visit).

(k) The ECJ's judgment was delivered on 21 February 2006

(l) In the light of the ECJ's judgment, the University amended its grounds of appeal, and HMRC lodged a response to the amended grounds of appeal.

17. For completeness, since the Decision pre-dated the surrender of the leases (see (j) above), I should record that I find that they were surrendered on 18 August 2004.

The salient facts of the case

18. The salient facts of the case (whether undisputed or found by the tribunal), as in my judgment correctly identified by Dr Lasok, are the following:

(a) All the transactions forming part of the East Mill Arrangements were genuine; they resulted in supplies that were genuinely made, i.e. they were not shams: Decision/53.

(b) "(T)he sole reason for the use of the Trust in relation to East Mill was that of facilitating VAT planning…the sole purpose of the lease by the University to the Trust was also that of facilitating VAT planning… the University contrived to achieve the rent differentials between the lease and the underlease by means of the leaseback being on an internal repairing basis only. And… the sole purpose of the underlease by the Trust to the University of East Mill was to facilitate VAT planning": Decision/49.

(c) "(I)t was the University's intention in order to obtain an absolute VAT saving by collapsing the VAT arrangements in respect of East Mill after 2 or 3 years… or on the 6th or 10th or 15th anniversary of the commencement of the term of the lease (see the break clause in the lease itself)": Decision/50.

(d) "(T)he transactions into which the University entered were entered into or carried out with the sole intention of obtaining a fiscal advantage: they had no independent business purpose. They amounted to a deferral scheme with a built-in feature that allowed absolute saving at a later date": Decision/136.

(e) "(I)t was the University's, and the Trust's, subjective intention to bring about that result": Decision/137.

19. Dr Lasok made two observations on the contents of [136] of the Decision (see (d) above) which I find helpful to include at this point. First, in deciding that the East Mill Arrangements "amounted to a deferral scheme with a built-in feature that allowed absolute saving at a later date", he noted that the tribunal was opting for the second of three different hypotheses advanced on behalf of HMRC, set out in the Decision/110. The first possible choice was that the East Mill Arrangements were "an absolute VAT saving scheme" – a choice which the tribunal did not make.

20. Secondly, he observed that also at [136] the tribunal held that, "In those circumstances, it is plain to me, and I also find that they [the East Mill Arrangements] amounted to tax avoidance". Dr Lasok commented that that finding could be regarded as a characterisation in law of the facts the tribunal had found, or as an inference of fact drawn from the primary facts found.

21. He made a number of further points on the Decision to which I should also refer. One of the issues before the tribunal in 2002 was whether a cash flow, or tax deferral, scheme was tax avoidance; see Decision/108. It, therefore, appeared to Dr Lasok that at [136] the tribunal was finding that a deferral scheme (with a built-in feature allowing an absolute tax saving at a later date) was to be characterised in law as "tax avoidance". In the context of VAT, the finding that something was "tax avoidance" was, he said, relevant only to the question of the possible application of a national rule laid down pursuant either to, e.g. Article 13(B) of the Sixth VAT Directive, or to a derogation under Article 27(1). It was common ground that no such rule or derogation was applicable in the instant case.

22. He added that the case advanced by HMRC was not based on the concept of "tax avoidance", but rather on the different concept of "abuse of rights". Therefore, the University did not consider that anything presently relevant turned on the finding of "tax avoidance" since what was relevant was what were in law the consequences to be drawn from the primary facts the tribunal had found having regard to the principle of "abuse of rights", not the different concept of "tax avoidance" (see [51] and [52] of the judgment of the ECJ in the *Huddersfield University* case). I agree that nothing turns on my finding of "tax avoidance".

Developments since the decision and their impact on the issues between the parties

23. The *Halifax* case also involved a tax mitigation scheme which HMRC considered abusive. In that case a wholly-owned subsidiary of *Halifax*, a company called Leeds Permanent Development Services Ltd ("Leeds") had made standard rated supplies, but of small value, to *Halifax*, having bought in a large value of standard rated supplies from another wholly-owned subsidiary of *Halifax*, County Wide Property Investments Ltd ("County"). County had in turn bought in a large value of standard rated supplies from independent suppliers for the purpose of making supplies to Leeds. County had then used the supplies it bought in in two ways: to make a small value of standard rated supplies in year 1, and to use the remainder to make a much larger value of exempt supplies in year 2. Because in year 1 Leeds had made only standard rated supplies to *Halifax*, it had reclaimed all the input tax incurred on the supplies made to it by County. The result was an absolute tax saving, which the ECJ referred back to the national court to determine whether *Halifax* had been guilty of an abusive practice.

24. If Leeds had used the supplies received from County in year 1 (or 2) it would have been able to deduct only a small part of the input tax in question. Thus the idea behind the scheme was not simply to create a variety of transactions; crucially different transactions had to take place in different tax years. The tax advantage in that case was an absolute tax saving.

25. As a result of the judgment in *Halifax*, it is now settled law that:

(a) "(T)axpayers may choose to structure their business so as to limit their tax liability": judgment para 73.

(b) "(I)n 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. 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": paras 74-75.

(c) "To allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules": para 80.

26. I should record that "abuse of rights" and an "abusive practice" are concepts of EU law, as is the concept of "a tax advantage the grant of which would be contrary to the purpose" of VAT legislation. Dr Lasok noted that in the Decision the tribunal

considered that the University had not acted in breach of the EU law abuse of rights principle: Decision/144. However, as the Decision had been released before the judgment in *Halifax*, he added that the matter had not been addressed in the same way as it would have been had the *Halifax* judgment been before the tribunal. On the other hand, the tribunal had made findings of fact relevant to the application of the abuse of rights principle.

27. He accepted that the University had structured the East Mill Arrangements in order to limit its tax liability, as it was entitled to do.

28. As to the question whether there was "formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it", there was no dispute between the parties for:

(i) as recorded in the Decision/53, there was no dispute about the genuine nature of the transactions comprising the East Mill Arrangements; and

(ii) if there had not been formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, the East Mill Arrangements would have failed at the outset.

29. Dr Lasok also noted that the tribunal had found the essential aim of the East Mill Arrangements to be to obtain a tax advantage. As it defined those arrangements in the Decision/136, they were "a deferral scheme with a built-in feature that allowed absolute saving at a later date".

30. He thus identified the outstanding questions as:

(a) Whether the tax advantage found by the tribunal was contrary to the purpose of the applicable provisions of the VAT legislation?; and, if so,

(b) What was the consequence (the redefinition question)?

31. Dr Lasok made two observations which were effectively his opening submissions on those questions. First, he maintained that, in order for the assessment under appeal to be lawful, the University must have obtained, or purportedly obtained, a tax advantage contrary to the purpose of the applicable legal provisions *and in the amount assessed by the date of the assessment*, thus justifying the redefinition of the transactions in question *at that time* in order to provide the legal and factual basis for the assessment. (Dr Lasok's emphasis)

32. Secondly, he added, the tax advantage the tribunal had found was inherent in leasing arrangements. As was pointed out in the Decision/51: "I observe that it is in the nature of all leases of land that they may be surrendered at any time so that, in addition to the specific power to collapse contained in each lease, I find that the University also had the opportunity at any time to effect collapse".

33. The CJEU provided guidance on the application of the doctrine of abuse of rights in a VAT context to chains of leasing transactions in its judgment of 22

December 2010 in *HMRC v Weald Leasing Ltd* (Case C-103/09) [2011] STC 596. In that case, a company called Churchill, whose supplies were predominantly those of exempt insurance services, established *Weald* as a wholly owned subsidiary to purchase equipment for its offices and repair centres and then lease them to Suas Ltd ("Suas"), a company which was not part of the Churchill group and was owned by a VAT consultant to the group. Suas then subleased the equipment to members of the Churchill group.

34. The purpose of the lease to Suas was to circumvent para 1(1) of Schedule 6 to VATA, which allows HMRC to direct that the value of a supply should be its open market value in circumstances where a taxable supply is made to a partially exempt trader by a connected person and the value of the supply is lower than its open market value. As Suas was not a member of the Churchill group, HMRC were unable to make a Schedule 6 direction.

35. At [31] of its judgment, the CJEU recorded that the Court of Appeal, as the referring court, stated that the essential aim of the leasing transactions there in issue was "to obtain a tax advantage, namely spreading the payment of the VAT on the purchases in question, so as to defer the Churchill group's VAT liability". It then went on to say, at [32], "However, before it can be concluded that there was an abusive practice, it must also be the case that notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and the national legislation transposing it, that tax advantage is contrary to the purpose of those provisions."

36. At [33] of its judgment, the CJEU pointed out that "leasing transactions come within the scope of the Sixth Directive and that the tax advantage that could arise through recourse to such transactions does not, in itself, constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of that Directive *and* the national legislation transposing it." (Emphasis added by Dr Lasok).

37. The CJEU held that the relevant leasing transactions could be contrary to the purposes of the Sixth Directive, "if the rentals were set at levels which were unusually low or did not reflect any economic reality", or "if the involvement of an intermediate third party company, in this case Suas, in those transactions" was such as to preclude application of the Schedule 6 open market value provision (see the judgment at [40] and [41]). It did so in response to an argument that the arrangements in *Weald* did not give rise to a tax advantage contrary to the purposes of the Sixth Directive because the spreading of the payment of irrecoverable VAT by a partially exempt lessee was in itself simply the inevitable result of entering into a leasing transaction.

38. The CJEU went on to reject an argument by *Weald* that the principle of abuse did not apply because the transactions constituted an attempt to circumvent national law which was not required by the Sixth Directive, but which had been enacted pursuant to a derogation under art.27 of that Directive. At [42] the court held that the principle of abuse could apply because the national provision in question "was adopted on the basis of Article 27 of the Sixth Directive and forms part of the national legislation implementing that directive". In so holding, the court followed the opinion

of Advocate-General Mazak at [24] where he said that "any distinction between national provisions which implement the provisions of the Sixth Directive and those which were adopted in full compliance with a derogation permitted under that directive is, in my view, contrived and tends to undermine the integrity of the national VAT system and indirectly the EU VAT system".

39. Dr Lasok submitted that it followed from [33] of the *Weald* judgment that the findings the tribunal had made in the Decision did not, as a matter of law, identify a breach of the EU law principle of abuse of rights at all, as the tribunal had correctly concluded: Decision/144. Further, as a matter of law, my findings did not identify any abusive practice that, *at the time the assessment was made*, could have justified it in law (again the emphasis of Dr Lasok).

40. For reasons which he subsequently developed, and with which I shall shortly deal, Dr Lasok also submitted that the inherent, or normal, features of a lease did not give rise to "a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of [the Sixth] Directive and the national legislation transposing it". In order for a lease to produce such an advantage, he maintained that there must be some abnormal or uncommercial element in it.

The dispute between the parties as it currently stands

41. As appeared from the Decision/78-90 and 99-119 and the Re-amended Statement of Case, HMRC sought to uphold the Assessment on two grounds:

i. The transactions comprising the East Mill Arrangements (the lease and leaseback) were not "supplies" or the conduct of an "economic activity" for VAT purposes; and

ii. The East Mill Arrangements were an "abuse of rights".

42. HMRC did not dispute the commerciality of the terms of the leases involved in the present case, or contend that, by using the Trust, the University was impermissibly circumventing the domestic legislation restricting the right of option to tax in respect of land. Nor did they claim that the interposing of the Trust was an impermissible circumvention of the restrictions on the right to opt to tax.

43. Dr Lasok claimed it was not difficult to identify the reason for HMRC's reluctance to challenge the interposing of the Trust. At the material time, such interposing of a related entity was normal and accepted by them, see *CCE v University of Wales, Cardiff* [1995] STC 611.

44. He also observed that HMRC had failed to obtain from the tribunal a finding that the rental levels concerned were abnormal or uncommercial. The best that they had been unable to achieve was a finding in the Decision/49 that the rent differentials were achieved by means of the leaseback being on an internal repairing basis only; there was no finding that that was artificial or uncommercial.

45. In its judgment in the *Huddersfield University* case, the ECJ found, in favour of the University, that the transactions comprising the East Mill Arrangements were "supplies", and the conduct of an "economic activity" for VAT purposes, but left open the possibility of applying the "abuse of rights" principle established in the *Halifax* case (see [51] and [52] of the judgment).

46. In its grounds of appeal as amended following the ECJ judgment, the University accepted that the findings made in the Decision identified the "essential aim" of the East Mill Arrangements. Shortly stated, the University contended:

(a) The transactions comprising the East Mill Arrangements, including the rent levels, were on commercial terms;

(b) The East Mill Arrangements did not result in a tax advantage that was contrary to the purpose of the Sixth Directive and the national legislation transposing it;

(c) Alternatively, if the East Mill Arrangements did amount to an abuse of rights, the redefinition of those arrangements did not assist HMRC.

47. In their reply to the amended grounds of appeal, HMRC sought to uphold the Assessment on the basis that:

(a) The interposing of the Trust was "capable of constituting an abuse" by preventing HMRC from "applying national rules as to the use of the option to tax in property transactions between connected persons";

(b) The East Mill Arrangements were "contrary to the purpose of the VAT Directive in so far as [they] allowed the University to obtain an absolute tax saving" through the surrender of the leases;

(c) As to redefinition, "in the absence of the transactions concerning the abusive practice (i.e. the insertion of the Trust), either the sale and leaseback should be entirely ignored or a redefinition should be adopted whereby the Trust was regarded as counterparty by a subsidiary of the University so that the national rules on connected parties apply".

48. HMRC did not dispute the commercial nature of the transactions comprising the East Mill Arrangements, or the commerciality of the rents that were payable.

SUBMISSIONS ON THE ABUSE OF RIGHTS POINT

Submissions for HMRC

49. Mr Hill introduced HMRC's case by explaining that the tax advantage they considered the University intended to obtain through the insertion of the Trust into the East Mill Arrangements was the ability to deduct input tax; that enabled it to spread the payment of VAT on the purchases in question, and to defer its burden of irrecoverable input VAT. He claimed that the mechanism the University used to obtain that advantage was circumvention of the national anti-avoidance rules as to the option to tax supplies of interests in land, those rules being found in paras 2(3A) and 3(8A) of Schedule 10 to VATA and s.839 ICTA. The point of the scheme entered into

was to enable the University to recover the whole of the VAT charged on the refurbishment works at East Mill as input tax. If the scheme had not been entered into, and the University had simply contracted for the refurbishment work, it would have been able to recover only that proportion of the VAT charged which corresponded to its partial exemption recovery rate.

50. If the University had used a wholly owned subsidiary company as a vehicle to purchase the head lease on East Mill, and the subsidiary had then sublet the building to the University, prior to 30 November 1994 the subsidiary company would have been able to opt to tax. The subsidiary would have charged the University output tax on the rent, but been able to deduct input tax on all of the refurbishment costs of the building. However, the 1994 Order prevented the University from entering into such an arrangement after 30 November 1994: a subsidiary company controlled by the University would have been a 'connected person'. Since the University was not wholly taxable, the option to tax would have been withdrawn.

51. Mr Hill maintained that the purpose of inserting the Trust into the East (and West) Mill schemes was to ensure that the Trust was not connected to the University under s.839 ICTA. The effect was that the University could deduct the whole cost of refurbishing East Mill "upfront", with irrecoverable input tax being suffered over a period, thereby giving it a timing benefit (with the added possibility of obtaining an absolute tax benefit if the leases were collapsed). In the Decision/49 the tribunal found the sole reason for the use of the Trust to be that of facilitating VAT planning, as was that for the lease and the sub-lease.

52. Mr Hill opened his submissions on the question of abuse of rights by reference to Advocate-General Maduro's opinion in *Halifax.* The Advocate-General, in summarising the doctrine of abuse generally, said at [63] that one of the contexts in which abuse was invoked was "when Community law provisions are abusively relied upon in order to gain advantage in a manner that conflicts with the purposes and aims of those same provisions". Mr Hill claimed the Advocate-General there to be using the word 'advantage' very broadly - "simply to cover any benefit to the person seeking to obtain it". He added that, at [96], the Advocate-General indicated that it would be for the national courts to determine whether the activities at issue could be seen as having "an autonomous economic justification unconnected with the mere purposes of avoiding or deferring the payment of VAT". On that basis, Mr Hill submitted that a 'tax advantage' was simply a benefit or the deferring of the payment of VAT. It was, therefore, capable of including the deduction of input tax, since a taxpayer who could deduct input tax upfront avoided bearing the burden of irrecoverable input tax.

53. Consequently, Mr Hill maintained that use of the Trust enabled the University to gain a tax advantage of upfront deduction of input tax even where the resultant benefit was merely the deferral of irrecoverable input tax. He invited me to distinguish the decision in *Weald* from the present case because in the latter the leasing transactions were exempt from VAT, subject to an option to tax which Member States were entitled to grant and to protect using anti-avoidance provisions, whereas in the former they were standard-rated.

54. He contended that the approach to the concept of 'tax advantage' he had described was supported by the tribunal decision in *Lime Avenue Sales: Benenden School Trust v HMRC* (2007) Decision No. 20140. There the tribunal took an approach which identified as abuse steps taken falling outside a taxpayer's normal commercial operations, holding that the trust, an educational establishment making largely exempt supplies, had obtained a tax advantage in recovering otherwise irrecoverable input tax on construction costs of a new study centre.

55. Since, in the present case, the University could obtain the tax advantage of deducting input tax only by opting its interest in East Mill, Mr Hill submitted that the effect of so opting was directly contrary to the purpose of the Sixth Directive and the relevant national rules. Provided a trader's activities were subject in principle to VAT, he contended that the input tax deduction system provided by the Sixth Directive was designed to relieve him entirely of the burden of VAT paid or payable (*Halifax* at [78]). Conversely, to allow input tax deduction where no transactions conforming to the deduction rules of the Sixth Directive, or the national legislation transposing it, would be contrary to the principle of fiscal neutrality, and thus contrary to the purpose of those rules (*Halifax* at [80]).

56. Mr Hill added that, since the University's supplies were largely those of education and thus exempt, it could not deduct most of its input tax. The same would apply to its supplies of land, unless it had opted to tax them – a possibility, but a restricted one.

57. The national anti-avoidance rules of which the University sought to take advantage were, in Mr Hill's further submission, designed to prevent recovery of input tax by exempt or partially exempt traders making supplies of interests in land to 'connected persons'. He accepted that, since the Trust was not "technically" a 'connected person' within the definition in s.839 ICTA, HMRC could not withdraw the option to tax. However, he maintained that that could not preclude their reliance on the doctrine of abuse of rights since it only came into play "notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and in the national legislation transposing it" (*Weald* at [29]).

58. Mr Hill contended that the Trust fell within the relevant national rules. The 1994 Order adopted the definition of 'connected persons' in s.839 ICTA. In part that depended on s.416(2) ICTA, which defines control of companies. He submitted that s.839 was clearly intended to cover a broad set of circumstances in which persons might be in such a relationship as would enable one to influence the other, including family ties, trust relationships, etc. He added that 'control', as defined in s.416, was also very broad.

59. As the tribunal found at Decision/32, "the Trust was effectively controlled by the University by its having power to appoint and remove the trustees". The control which the University had over the Trust was, in Mr Hill's further submission, materially the same as it would have had over a wholly-owned subsidiary company. As the 1994 Order prevented use of a subsidiary company to achieve tax savings, the University was advised to use the Trust instead.

60. He maintained that the whole point of interposing the Trust into the East Mill Arrangements was to defeat the relevant anti-avoidance provisions and thereby to secure the option to tax, allowing the University to deduct all of the input tax on refurbishment of East Mill. As the tribunal found at Decision/136, "the transactions into which the University entered were entered into or carried out with the sole intention of obtaining a fiscal advantage". In Mr Hill's yet further submission, the use of a gap or loophole in the national anti-avoidance rules to defeat them was clearly contrary to purpose.

61. In response to a claim by Dr Lasok that HMRC had failed to identify a tax advantage arising from the interposing of the Trust into the East Mill Arrangements, Mr Hill repeated that the tax advantage identified was that of the University having the ability to deduct input tax, thereby spreading payment of the VAT due on the related purchases. He maintained that the University's assertion that the cash flow benefits were not themselves a tax advantage, and thus entry into a leasing transaction without an additional feature was not in itself capable of being abusive, was a wrong analysis.

62. In his analysis, Mr Hill observed that, in *Weald*, the taxpayer did not have to opt to tax in order to deduct input tax on the relevant goods and services. If it chose to lease them, it had a right to deduct input tax pursuant to the deduction rules, subject to any issue as to the open market value of the goods and services. *Weald* obtained a tax advantage through entering into a transaction for the leasing of goods which allowed it to spread the payment of the VAT on the purchases in question, but that was not contrary to the purpose of the VAT legislation "provided that the VAT on that leasing transaction is duly and fully paid" (judgment at [34]).

63. The University did not have a right to tax the supply of interests in land (including leases), or to deduct input tax in relation to them unless the UK had allowed taxpayers the right of option, and the right was exercised within the conditions laid down by the state. The University had obtained a tax advantage through leasing land to and from the Trust by obtaining upfront input tax recovery on the refurbishment costs of the relevant buildings and thereby obtaining the benefit of deferral of the burden of irrecoverable input tax. Mr Hill contended that that advantage was contrary to the purpose of the relevant national legislation because it was a leasing transaction in which the Trust was used to preclude the application of the relevant national anti-avoidance rules.

64. Putting it another way, Mr Hill observed that at [88] of his opinion in *Halifax* Advocate-General Maduro explained that what is now the first *Halifax* principle – the assessment of whether the accrual of the tax advantage is contrary to the purpose of the Sixth Directive and national implementing legislation – "is important, not only because it provides the standard upon which the purpose and results of the activity in question are to be assessed. It also provides a safeguard for those instances where the sole purpose of the activity might be to diminish tax liability but where that purpose is actually a result of a choice between different tax regimes that the Community legislature intended to leave open".

65. Mr Hill maintained that whilst the Community legislature intended all traders to have the possibility of leasing equipment, rather than buying it outright, it also intended Member States to have the power to impose limits on recovery of input tax on leases of land. He submitted that the UK legislature specifically intended to restrict recovery of input tax on leases of land where one of the parties was partially exempt or exempt, and one of the parties had influence over the other. Therefore, the diminution in tax liability which resulted from the University's scheme was not a choice for traders which the Community and UK legislatures intended to leave open.

66. He dismissed a further claim by Dr Lasok, that HMRC did not assert that the relevant national rules were a justified or proportionate response to some phenomenon relevant to the abuse of rights principle, as a further mischaracterisation of the scope of the doctrine of abuse of rights. Mr Hill maintained that the doctrine of abuse applied to attempts to obtain a tax advantage contrary to the purpose of provisions of national law which either implemented the VAT Directives or which were adopted in compliance with derogations permitted under the Directive (see *Weald* at [42] of the judgment and [24] of the Advocate-General's opinion).

67. At [66] of its judgment in joined cases *Gemeente Leusden and Holin Groep* (C-487/01 and C-7/02) [2004] ECR I-5337, the ECJ held that "Article 13(C) of the Sixth Directive allows the Member States to grant their taxable persons the right to opt for taxation of lettings of immovable property but also allows them to restrict the scope of that right or withdraw it", and gave "wide powers to the Member States" in that regard. Mr Hill observed that the conditions which Member States could apply to the option to tax could include conditions aimed at preventing possible tax evasion, avoidance and abuse (*Gemeente Leusden* cited in *Halifax*). He maintained that the imposition of conditions on the option to tax by the UK was therefore justified, and those imposed were not disproportionate.

68. Mr Hill also dismissed a claim by Dr Lasok that HMRC's argument was misconceived for there was no evidence that had the lease arrangements been entered into by different, unconnected parties the terms would have been different in any material respect, submitting that that was not a necessary condition for a finding of abuse.

69. A further feature that in Mr Hill's submission compounded the abusive nature of the East Mill Arrangements was the possibility which they gave the University of obtaining an absolute tax saving – a possibility, indeed an intention on the part of the University, recognised in the Decision/136 where the tribunal concluded that the East Mill Arrangements were a deferral scheme "with a built-in feature that allowed absolute saving at a later date".

70. Mr Hill also submitted that the whole of the University's argument that abuse occurred only where the transactions in question resulted in the accrual of a tax advantage was predicated on a mischaracterisation of the tax advantage the University gained through the East Mill Arrangements. He again contended that the tax advantage was nothing more or less than the ability to deduct its input tax in full on

the costs of refurbishing East Mill, and the advantage accrued immediately the scheme was implemented.

71. The consequences of the University gaining that advantage were twofold. If the University let the scheme run, it would obtain a timing benefit, but that benefit would gradually be eroded by the tax disadvantage of being charged VAT by the Trust on the sublease, which was largely irrecoverable as input tax. Mr Hill maintained that the possibility of collapsing the scheme at a future date simply meant that the University's initial tax advantage on input tax recovery could be protected from that erosion, thereby allowing the University to obtain an absolute tax saving.

72. He claimed the University's argument in that regard to be inconsistent with the judgment of the ECJ in the present case. The court recorded that the scheme gave rise to the possibility of obtaining an absolute tax saving ([22] and [31] of the judgment). It then noted at [52] that the Sixth Directive precluded any right of a taxable person to deduct input VAT where the transactions from which that right derived constituted an abusive practice. If, as the University contended, there was no possibility of the transactions being regarded as contrary to the purpose of the Directives and constituting an abusive practice, the ECJ would have said so. Instead, Mr Hill submitted, it expressly envisaged that they could be regarded as abusive, and contemplated that such abuse would be an abuse of the right to deduct.

73. In the *Lime Avenue* case, the tribunal did not accept the suggestion that an abuse of rights could not be established until all the transactions involved in a scheme were completed. There the tribunal rejected an argument by the appellant that the *Halifax* principles applied only to actual transactions, so that an input tax repayment claim under an original scheme was refused by HMRC before the company making the claim made any supplies of the building in question. Actual supplies were only made following the introduction of a modified scheme, and the appellant argued that the initial arrangements should be ignored in determining the application of the *Halifax* principle.

74. In the present case, Mr Hill submitted that it was the validity of the initial deduction of input tax by the University which was in issue. It was unnecessary to await the collapse of the scheme to determine whether that deduction was contrary to the principle of abuse, and it should be disallowed. He maintained that it followed that the tribunal's findings of fact in the present case remained relevant to the University's right to deduct: the essential aim of the scheme was to make an absolute saving.

75. He claimed that if HMRC were unable to refuse input tax deduction until the final transactions under the scheme were completed, the University could simply have awaited the expiry of the three (now four) year time limit under s.77 VATA for the making of assessments before collapsing the scheme. The University's argument amounted to an acceptance that collapsing the scheme to gain an absolute saving would be a tax advantage contrary to the purposes of the VAT system. But if the scheme had been collapsed after 3 (or 4) years, HMRC would have been acting prematurely to assess before collapse, the time limit to assess would have expired, and therefore no assessment would ever have been possible.

76. In response to the question: what was the amount of tax that could properly be claimed in the Assessment, Mr Hill submitted that it was the amount of the input tax deduction, which was the tax advantage sought.

77. As for the *Rompelman v Minister van Financien* (Case C-268/83) [1985] ECR 655, on which Dr Lasok placed some reliance, Mr Hill maintained that that case established that a Member State had to allow input tax deduction where a taxpayer incurred VAT which it intended to use for the purpose of making taxable output transactions. In the present case, Mr Hill submitted that the tax advantage accrued when the scheme was implemented and deduction of input tax was claimed. The essential aim of the East Mill Arrangements was to obtain that advantage, and the obtaining of the advantage of the scheme was contrary to the purpose of the relevant national provisions. The East Mill Arrangements ceased to be consistent with the UK's implementation of the VAT system, when the University opted to tax contrary to the purpose of the relevant national legislation.

Submissions for the University

78. Having emphasised that the tribunal was no longer required to consider the question of tax avoidance, but rather to address the EU concept of abuse of rights, Dr Lasok submitted that in the latter context the distinction between deferral and absolute tax saving was very important; it was particularly relevant in looking at the Assessment as it could not be justified on the ground that if there was an abuse of rights it lay in an absolute tax saving. The Assessment was based on setting aside the lease and leaseback arrangements as inserted steps which led logically, in HMRC's view, to the denial of the University's deduction claim made in the relevant period in 1997. To Dr Lasok, the only way in which HMRC's case on the obtaining of a tax advantage could be understood was by reference to the *pre-Weald* approach of comparing a taxpayer's normal operation with that actually carried out: "the taxpayer avoided bearing the burden of irrecoverable input tax" (see [27] of *Lime Avenue*).

79. Of Mr Hill's reliance on [62] and [63] of the Advocate-General's opinion in the *Halifax* case, Dr Lasok observed that those paragraphs were concerned with the concept of abuse of rights as it had emerged in cases in types of EU legislation other than VAT. He submitted that those paragraphs were irrelevant for, at [74] of its judgment in the *Halifax* case, the ECJ had adopted a finely defined definition of abusive practice: consideration of non-fiscal abusive practices was irrelevant in the light of the specific approach adopted. Dr Lasok similarly rejected Mr Hill's reliance on the *Lime Avenue* decision, observing that it had been made on the basis of "normal commercial operations some two years before *Halifax* was decided – a basis "exploded" by the ECJ in *Weald*.

80. The University had not made an absolute tax saving in the relevant period in 1997. There had been no factual enquiry as to whether there had been an absolute tax saving and, if so, how much was that saving. Hence, Dr Lasok submitted, the Assessment stood or fell on HMRC's contention that obtaining an immediate

deduction of input tax, i.e. an upfront deduction, was an abuse of rights, even if the price paid by the University to obtain an upfront tax deduction was an obligation to account for output tax. It was for HMRC to establish that there had been an abuse of EU and domestic legislation.

81. Dr Lasok maintained that in the present case there were two issues:

i) whether the transactions resulted in the accrual of a tax advantage the grant of which was contrary to the purposes of the legislation;

ii) the "redefinition question".

82. In his submission, only the first of those issues was relevant in determining whether, in the light of the tribunal's earlier findings of fact, there was an abuse of rights. He asked: what was the tax advantage to the University that was contrary to the purposes of the legislation? At [78] of its judgment in *Halifax*, the ECJ said "…, 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…".

83. Dr Lasok interpreted that passage as saying that the deduction system was intended to relieve a trader of VAT provided he was making taxed, or some other, outputs that generated the right to recover input tax. HMRC's difficulty was that they had to say that the tax advantage was the upfront deduction of input tax. But that was a fundamental feature of the VAT system. If output transactions were non-existent for VAT purposes because they were not economic activities there was no transaction subject to VAT to counterbalance input transactions generating input VAT.

84. Dr Lasok noted that in the *Huddersfield University* case, the ECJ had held the transactions entered into by the University to be genuine and to be economic activities, and claimed that the judgment was delivered on the basis that the University had made standard rated outputs.

85. He also claimed that there was nothing in the *Halifax* decision to support the idea that the upfront deduction of input tax was a tax advantage contrary to the purposes of the legislation. In fact, upfront deduction was simply a fundamental and integral feature of the VAT regime. In so far as the *Weald* case was concerned, Dr Lasok noted that the CJEU had said at [14], "The aim of those transactions [the transactions in point] was to divide and spread the payment of that amount in order to defer the Churchill Group's VAT liability".

86. The ECJ also observed at [27] of *Weald* that "…taxpayers may choose to structure their business so as to limit their tax liability…" And at [38] and [39] the court held that:

> "38. … [to] resort to a leasing transaction in respect of an asset does not automatically mean that the amount of VAT on that transaction will be less than would have been paid if the asset had been purchased.
>
> 39. That being so, the national court will have to determine, first, whether the contractual terms of the leasing transactions at issue in the main proceedings are contrary to the Sixth Directive and of the national legislation transposing it. That would particularly be the case if the rentals were set at levels which were unusually low or did not reflect any economic reality."

87. At that point in dealing with the *Weald* judgment, Dr Lasok interposed the following observations from [20] and [21] of Advocate-General Mazak's opinion in the same case. The Advocate-General said:

> "20. … the fact that an exempt trader chooses to enter into a leasing arrangement in respect of assets/equipment rather than purchase them outright in order to benefit from a more favourable treatment under VAT legislation, by deferring its VAT burden is not, in itself, sufficient to support the finding that an abuse of that legislation has occurred… while there may be cash-flow advantages for the trader, there is no inherent VAT saving in leasing rather than purchasing equipment.
>
> 21. I consider that the setting-up and use of a wholly owned or 'captive' subsidiary, …, with the sole purpose of obtaining a VAT advantage in the form of a deferral of VAT is not *per se* abusive, as such an advantage could be obtained by entering into an arm's length leasing arrangement with an unrelated third party…Where, however, the rental payments under the leasing arrangements are set at artificially low levels, which do not reflect open market conditions, thereby in turn artificially reducing the amount of VAT payable, that part of the transaction relating to the level of payments rather than the lease itself would, in my view, be contrary to the purpose of the Sixth Directive and the national legislation transposing it."

88. Reverting to the *Weald* judgment, Dr Lasok noted that, at [40], the CJEU said: "… the national court will also have to determine whether the involvement of an intermediate third party company… in those transactions is such as to preclude the application of those provisions."

89. In *Weald*, the CJEU concluded that it was irrelevant whether a company entered into leasing transactions involving an intermediate third party company even though it did not engage in leasing transactions in the course of its normal commercial operations In the light of the CJEU's judgment, HMRC's reliance on the *pre-Weald* approach on whether the transactions were entered into in the course of normal commercial operations was, in Dr Lasok's submission, misplaced.

90. He further contended that the *Weald* judgment showed that, in the context of upfront input tax deduction using leases and leasebacks, the question was whether there was an absolute tax saving: deferral of tax was not itself relevant and was not

contrary to the tax regime. He added that the national rule in point in *Weald* was directed at preventing a tax advantage contrary to the purposes of the VAT regime. It addressed the point of undervaluing rentals regarded by the CJEU as important. In *Weald*, the inclusion of Suas appeared entirely consistent with the claim that there was no abuse of rights.

91. If in the present case HMRC wanted to rely on [40] to [42] of *Weald*, Dr Lasok maintained that they would have to show that the national rules on which they relied were consistent with the principles of EU VAT law.

The application of Halifax and Weald in the present case

92. Dr Lasok accepted that the obtaining of an absolute tax saving in the present case was contrary to the purposes of the VAT regime. Hence, he agreed that, if the other *Halifax* conditions were satisfied, use of the leases to obtain an absolute tax saving because the rentals were too low or because the leases were surrendered would have constituted an abuse of rights: they would have been advantages contrary to the VAT regime.

93. However, for a number of reasons Dr Lasok submitted that that acceptance did not help HMRC. First, he maintained that their contention that the East Mill Arrangements allowed the University to obtain an absolute tax saving through the surrender of the leases was not a valid ground supporting the Assessment. That, he claimed, could not possibly be the event that triggered the tax advantage since surrender had not occurred when the Assessment was made.

94. The Commissioners' alternative case, that the possibility of obtaining an absolute tax saving through collapse of the leases was contrary to the purpose of the VAT Directives, was not, in Dr Lasok's submission, supported by the authority relied on – para 33 of *Wollny v Finanzamt Landshut* (Case C-72/05) [2006] ECR I-8297. There the ECJ noted that "the aim is to ensure, in accordance with the underlying system introduced by the Sixth Directive (…) a correspondence between deduction of input VAT and charging of output VAT (…).

95. In the *Halifax* case, the ECJ clearly stated that an abusive practice arose only where the transactions in question resulted in the accrual of a tax advantage ([74] of the judgment), and that the accrual of a tax advantage was a necessary feature [86]. The requirement that the transactions concerned "must result in the accrual of a tax advantage" was repeated at [29] of *Weald*. The future possibility of obtaining an absolute tax saving was not, therefore, a tax advantage for the purposes of the abuse of rights principle: it was the actual accrual of the absolute tax saving that was the tax advantage.

96. In Dr Lasok's submission, HMRC's contention could be tested by asking: if the East Mill Arrangements produced a tax advantage in the form of an absolute tax saving, what was the amount of tax that could properly be claimed in an assessment? He maintained that the obvious answer was the amount of the absolute tax saving and, in the present case, not the amount assessed. Here, the absolute tax saving could not

be determined until the leases were collapsed and the saving obtained. Accordingly, it was not the East Mill Arrangements themselves that gave rise to the tax advantage, but rather the premature collapsing of the leases.

97. Nor was the fact that a tax advantage might be obtained at some time in the future a valid reason to cause the arrangements themselves to cease to be consistent with the VAT system. Any problem arose with the subsequent decision or event that brought about an unacceptable tax advantage. Dr Lasok contended that the Assessment was therefore wrong in law.

98. The Assessment was not based on the rent levels or any other term of the leases being abnormal, nor did it relate to any absolute tax saving, hypothetical or actual. Had HMRC been targeting an absolute tax saving, they would have waited until the University prematurely surrendered the leases. If the conditions for abuse of rights were then present, they would have calculated the absolute tax saving made, and assessed accordingly. Dr Lasok rejected HMRC's claim that they could not so assess as they would have been out of time to do so as "weird and requiring explanation".

99. The Assessment was justifiable only on the hypothesis that the upfront deduction of input tax was a tax advantage contrary to the purposes of the legislation, even if there was a direct and immediate link between the input tax transaction and the standard rated output transaction, the consideration for which was at a normal commercial level. In Dr Lasok's submission, HMRC formulated the supposed tax advantage in various ways, but failed to deal with the fact that the deferral advantage in the present case did not at the time of the Assessment generate an absolute tax saving because the input tax was balanced by the liability to account for output tax.

Deferral

100. Dr Lasok observed that the option to tax was expressly provided for in art.13C of the Sixth Directive. Taxation was the general principle; exemptions were a diversion from the normal rules. The power for Member States to allow the option to tax property was a reversion to the general rule of taxation. Therefore HMRC could not contend that the taxation of immovable property was contrary to the purposes of the Sixth Directive. Not only was it a general principle that economic activities should be taxed, but many exemptions did not permit diversion from them. However as art 13C permitted taxation, the taxation of the leases in the present case was entirely consistent with the purposes of the Directive.

101. If the exercise of the option to tax property amounted to the obtaining of a tax advantage, Dr Lasok contended that it was one entirely consistent with domestic legislation. It was common ground that none of the limitations on exercising the option in domestic law applied in the present case. He maintained that the *Weald* case was clear authority for the proposition that using a lease/leaseback arrangement to obtain an upfront tax advantage could not be contrary to the purposes of the VAT

legislation; it might be a tax advantage, but to amount to an abuse of rights it had to be contrary to the purposes of the legislation.

102. Dr Lasok submitted that a claim by Mr Hill that the use of a gap or loophole to defeat the national anti-avoidance rules was clearly contrary to their purpose could not be supported. If there was a loophole, he maintained it must have been left for a reason. HMRC's claim raised questions on the national rule on which they relied for:

i) A prescriptive anti-avoidance rule declared its purpose in the words used. It was a point of domestic law as to how one identified the purposes of a legal provision.

ii) If a gap or loophole was used, it was still necessary to satisfy all the *Halifax* principles before use of the gap or loophole amounted to an abusive practice.

iii) HMRC could not say that defeating a national anti-avoidance rule was an abusive practice under EU law unless the national rule was consistent with EU law.

103. In relation to (i) above, Dr Lasok observed that the present case dealt with an exemption from VAT, but in a situation where domestic legal provisions allowed use of the option to tax. The UK thought that the "box" ought to be filled with tax, but then progressively limited the option to tax. However, Parliament carefully decided how far it was going to narrow the option; it decided to go so far but no further. He submitted that when Parliament carefully defined how to remove the option there was no scope for a purposive construction of the legislation that overrode Parliament's choice. When Parliament narrowed the option it was derogating from the principle of a general option. Each derogation would have had a policy justification behind it, but restrictions of the option were all cutting away at the underlying principle that taxable persons should have the right to opt for taxation.

104. He submitted that in adopting the s.839 ICTA definition of 'connected persons', Parliament was using very prescriptive language, and clearly did not intend to withhold the option where the persons connected were a university and a trust. However, here, Dr Lasok accepted that if the University and the Trust had attempted to obtain an absolute saving, since that was not consistent with the legislation it would have been abusive.

105. In the present case, unlike that of *Weald*, Dr Lasok contended that the anti-avoidance rules in point did not precisely identify the mischief to be dealt with, or indicate at what they were targeted. Consequently, he contended that it was impossible to say whether the University was circumventing whatever the rules were designed to deal with. Further, from reading the words used in the anti-avoidance rules themselves, it could not be said what illegitimate tax advantage the University obtained by entering into the East Mill Arrangements.

106. Section 839 ICTA was detailed, clear and specific in so far as it dealt with the question of whether a body corporate was a connected person vis-à-vis a person who was a trustee of a settlement and, in Dr Lasok's submission, there was no room to go

beyond the words used by Parliament. Had Parliament used words such as "control as a matter of fact", it would have been a different matter. As Lord Hoffmann, speaking extra-judicially, said in an article entitled "Tax Avoidance" at [2005] BTR 197 in commenting on the difficulties of distinguishing between acceptable and unacceptable tax avoidance (at 205):

> "…Parliament may not be content to describe the economic event which should attract tax…Instead, it enacts a mass of detailed rules which it is hoped will tie up the taxpayer in a net from which he cannot escape. But sometimes there are holes in the net and the courts find that they cannot plug them by appealing to the economic event which, at a higher level of generality, it appears that Parliament wished to tax. It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there."

107. Dr Lasok explained that he was not submitting that all tax avoidance schemes must be successful, but maintained that when Parliament adopted the approach it did adopt for VAT by engaging s. 839 ICTA it was adopting specific language and a specific approach to the term 'connected persons'. It was deciding to limit the scope of opting to tax to the 'connected persons' mentioned in s.839, and not as defined in some other way. He submitted that the only conclusion the tribunal could draw was that at the material time a policy decision had been made not to withdraw the option when a trust was involved, unless the relationship between the trustee and the body corporate was that defined in s.839(3A).

108. In relation to (ii) at [102] above, Dr Lasok claimed that if a taxpayer had taken advantage of a gap or loophole it was still necessary to consider the two parts of the principle laid down in *Halifax* before deciding that use of the gap or loophole was abusive practice. On the assumption that HMRC's interpretation of the legislation was correct, it did not prevent a taxpayer successfully taking advantage of a gap or loophole: it was still necessary to identify the tax advantage contrary to the VAT legislation.

109. In the present case it was necessary to look at the legislation in the round, and identify its purpose. He submitted that that purpose was not to deprive persons of input tax deduction where their outputs were standard rated. If by exploiting a loophole a taxable person deducted input tax but had to account for output tax, there was no end result contrary to either domestic or EU legislation.

110. And in relation to (iii) at [102], Dr Lasok submitted that HMRC could not say that defeating an anti-avoidance rule was an abusive practice under EU rules unless the national rule was consistent with EU law. (In *Weald*, the national condition was compliant with EU law, and addressed the form of abuse in the form of abnormally low payments. The fact of compliance was commented on by both the Advocate-General and the CJEU itself). The function of the EU abuse of rights principle was to ensure a result consistent with EU law. In the present case, HMRC could rely on the abuse of rights principle only if they could show that the domestic rule they relied on

was consistent with EU law. Here HMRC were invoking the abuse of rights principle in connection with UK anti-avoidance legislation. To test its compatibility with EU law, it was necessary to identify the precise purpose of the anti-avoidance rules, and determine whether they were proportionate.

111. In Dr Lasok's submission, an exception to an exemption caused transactions to fall back into tax and, since the EU preference was for taxation rather than exemption, HMRC's reliance on anti-avoidance was put into a peculiar light: here the exercise of the option to tax did not produce tax avoidance, but just the opposite – the reversion to the basic principle of taxation of economic activities.

112. Dr Lasok observed that HMRC claimed paras 2(3A) and 3(8A) of Schedule 10 to VATA and s.839 ICTA to be anti-avoidance rules designed to prevent recovery of input tax by exempt or partially exempt traders making supplies of interests to 'connected persons'. To Dr Lasok the exclusion of certain types of 'connected persons' by reference to s.839 ICTA suggested that the mischief aimed at was the possibility of connected persons agreeing to the terms of a contract being uncommercial. But if the purpose of the rule was to deal with uncommercial terms, the transactions in the present case were not contrary to the anti-avoidance rules because the terms were commercial. Further, it was settled law that when Member States acted within the scope of EU law they must act within its general principles, including that of proportionality - to Dr Lasok an anodyne and trite proposition.

113. As was said at [92] of *Halifax*, the measures which Member States may adopt under art.22(8) of the Sixth Directive in order to ensure the correct levying and collection of tax and for the prevention of fraud must go no further than necessary to obtain such objectives. Dr Lasok questioned whether those principles had been accepted by the UK in its anti-avoidance rules. If the mischief targeted lay in the possibility of an agreement on uncommercial terms, more targeted anti-avoidance rules would have been required. In the present case had there been an undervaluation of rents, the valuation rule could have been applied. If HMRC wished to rely on domestic legislation, they needed to be more specific about its purpose and justification. On the face of it, Dr Lasok maintained that the anti-avoidance rules were inconsistent with EU law.

114. Dr Lasok brought his submissions on abuse of rights to an end by dealing with a number of points made by Mr Hill that had not featured in the former's opening of the University's case.

115. He contended that HMRC's case fell foul of the point made in *Paul Newey t/a Ocean Finance v HMRC* [2010]UKFTT 183, at [91], that it was invalid to compare one structure of transactions with another structure that might possibly have been adopted, i.e. it was the tax advantage that must be contrary to the purposes of the legislation, not the structure used.

116. He also claimed HMRC's case to be misconceived as being based on a false premise: they appeared to say that had the University's transactions been entered into by different, unconnected parties, the terms would have been different in material

respects. In the absence of any evidence as to what those different terms might have been, he asked what it was in those circumstances that justified the conclusion that there was a tax advantage?

117. If HMRC had no case based on the terms of the leases, what was left? The inbuilt possibility of absolute tax advantage – identified by the tribunal as a commonplace feature of leases. The only candidate for tax advantage was the actual obtaining of an absolute tax saving that could not have been obtained had the parties been completely at arm's length. That state of affairs was not in existence when the Assessment was made, nor was it in existence when the case came before the tribunal in 2002. Whether it had later come into existence had never been investigated.

118. Dr Lasok dealt with Mr Hill's claim that the University's upfront deduction of input tax notwithstanding that it had to account for output tax to be contrary to the VAT legislation by submitting that it was not supported by any authority, and no case had been cited for the proposition. He added that the second part of the *Halifax* abuse of rights principle – that the essential aim of transactions was to obtain an illegitimate tax advantage – led nowhere unless the transactions led to the accrual of a tax advantage contrary to the purposes of the legislation.

119. Dr Lasok questioned why, when someone paid input tax to his supplier and then used the inputs for the purpose of making supplies, since there was, by definition, no irrecoverable input tax, was there a tax advantage at all? He admitted that there was one in that under the VAT system deduction could be effected of all input tax at one time, even though outputs using those inputs might be spread over a period. That reflected the structure and purpose of the VAT system and "real life" where, e.g. builders supplying construction services for use over a period of time expected to be paid for their services when they were completed, even if the person to whom the services were supplied expected to be paid over a period of time.

120. Why was it that HMRC claimed the context of the University's transactions to alter the true nature of input tax deduction, and transform it into something contrary to the purposes of the VAT legislation? Dr Lasok claimed that issue to be something HMRC were unwilling to confront: the principle of fiscal neutrality. In the present case, they maintained that similar transactions had to be given a different analysis and VAT treatment, not by reference to the nature of the transactions concerned, but simply by their context. To Dr Lasok, that claim was very troubling because the normal VAT approach was to treat similar transactions in a similar way. He submitted that Mr Hill had approached the question in two ways. First, he had criticised what he said was the University's approach of splitting transactions into steps and viewing each step individually, citing [22] of the decision in *WHA Ltd v HMRC* [2003] STC 648 that the whole transaction must be considered. Dr Lasok submitted that the University's case did not involve looking at each step individually. He added that at [16] and [17] of *WHA* as reported in 2003 the same argument appeared to have succeeded as in *Lime Avenue*, but it was rejected by the ECJ (see [2008] STC 1695).

121. Dr Lasok attributed HMRC's reasoning for their arguments to one of three things:

(1) A repeat of the original argument rejected by the ECJ;

(2) The "normal commercial operations" argument in *Lime Avenue* and *WHA* which could not survive the decision in *Weald*; and

(3) What he described as the "boot strapping/begging the question" argument which he claimed involved saying that in order to justify disregarding the leases it was necessary to disregard the leases; a circular argument that led nowhere.

122. In summary Dr Lasok accepted that the University had made an upfront deduction of input tax, but maintained that it had a corresponding liability to account for output tax. As there was a net liability to HMRC under the transactions, the overall outcome of the transactions entered into was favourable to them. It would have been unfavourable only had the leases been surrendered at a point in time that gave the University an absolute tax saving. Dr Lasok submitted that the overall result achieved was consistent with the purposes of the VAT legislation, unless there was an intervening collapse of the leases.

123. Finally, he noted that HMRC had persisted in maintaining that the leases should be ignored. The cases of *Rompelman* and *Halifax* recognised that input tax deduction was consistent with a situation where the output tax was accounted for in accordance with taxed transactions, i.e. the transactions in the present case. Consequently, Dr Lasok submitted that there was nothing in the context of the transactions to establish the existence of the accrual of a tax advantage contrary to the purposes of the legislation.

SUBMISSIONS ON THE REDEFINITION POINT

Submissions for HMRC

124. Mr Hill observed that at [94] and [98] of its judgment in *Halifax*, the ECJ held that transactions involved in abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice. Once the two *Halifax* conditions were satisfied, redefinition was mandatory – per Lord Neuberger in *WHA Ltd v HMRC* [2007] STC 1695. Mr Hill submitted that the University's claim that redefinition took HMRC nowhere was simply wrong: assuming the transactions involved abusive elements which enabled the University to gain an improper tax advantage, the transactions had to be redefined to remove those advantages.

125. Having observed that at [95] of its judgment in *Halifax*, the ECJ held that the tax authorities were entitled, with retroactive effect, to repayment of amounts deducted as input tax where the right to deduction had been exercised abusively, Mr Hill noted that at [48] and [50] of its judgment in *Weald*, the ECJ confirmed what it had earlier held at [94] and [98] of its judgment in *Halifax*. And, in relation to the specific facts in *Weald*, stated at [51] that, if the national court concluded that *Weald's* transactions were abusive, it would have to redefine those transactions either by disregarding the existence of Suas, or by varying or diapplying the contractual terms concerned. Mr Hill added that were I to conclude that the first *Halifax* condition was

satisfied on the basis of either or both of the transactions identified by HMRC, then the University would have abused the right to deduct.

126. Mr Hill explained HMRC's analysis on redefinition as that the sale and leaseback transactions should be entirely ignored. If I were to accept that analysis, the University would be treated as having used the refurbishment works for the purposes of its partially exempt supplies of education, and would be entitled to deduct input tax at its relevant partial exemption recovery rate. As the tribunal noted in the Decision/1, if the scheme were found to be abusive the "lease and leaseback should be disregarded as inserted steps" and the University should be entitled to input tax recovery only at its partial exemption recovery rate.

127. The fact that redefinition might involve more than redefining particular contractual terms was not, in Mr Hill's submission, an obstacle to redefinition, as he believed the University claimed.

128. He invited me to act on the tribunal's definition of redefinition in the decision of the tribunal in *Paul Newey* which took the following form:

> '105 . . . redefinition is simply the process by which the abusive elements of the transactions can be disregarded for tax purposes and the tax effects absent those abusive transactions can be restored . . . Thus it is not the process of redefinition that is important, it is the neutralisation of the abusive scheme. The neutralisation flows not from the redefinition itself, but as an inevitable consequence of the finding that a scheme is abusive. The nature of the abuse dictates what is required to be neutralised. It is not the redefinition that determines how (or if) the abuse is to be neutralised; it is the neutralisation that dictates the redefinition . . . the net effect of that redefinition must be to put both the taxpayer and the revenue authority in the same net position that they would each have been in absent the abusive practice, no more and no less. That is the essence of neutralisation. We do not ourselves consider that an abusive practice can be left un-neutralised because a redefinition would have to create a hypothesis that exists outside the real world and disregards contracts or circumstances that then exist including those involving third parties. Redefinition is simply a means to an end, and the means adopted by way of redefinition must be such as to achieve that end, namely the cancellation of the abuse, irrespective of real world constraints. The creation of such a hypothesis, to our minds, is the essence of redefniniton.'"

129. On that basis, Mr Hill invited me to uphold the assessment and to dismiss the appeal.

Submissions for the University

130. Dr Lasok first submitted that HMRC's contentions as to redefinition paid no attention to the case law on the subject. He maintained that it followed from [48] to

[53] of the judgment in *Weald* that redefinition involved identifying the precise aspect of the arrangements in point that constituted the abuse, and then redefining the transactions in question so as to establish the situation that would have prevailed in the absence of the particular element(s) constituting the abuse. It was clear from *Weald* that where the problem lay in a particular provision of an agreement, the redefinition requirement applied in relation to that provision. Consequently, if a tax advantage was obtained by reference to a particular provision, redefinition was to be carried out in accordance therewith. In that way, the correct result was to be obtained.

131. In the present case, Dr Lasok maintained that the rental terms were commercial, and that the interposing of the Trust was not an element constituting abuse for it did not itself produce any impermissible tax advantage. The only conceivable tax advantage could be the premature collapse of the leases.

132. Dr Lasok claimed that addressing the problem posed by the possibility of a premature collapse of the leases, and performing some appropriate redefinition of the transactions in point, was incapable of justifying the Assessment. In any event, the Assessment was not directed at any absolute tax saving. Further, the commerciality of the leases had never been disputed and, he maintained, on the evidence was unassailable.

133. An inbuilt future tax advantage did not indicate that redefinition was appropriate because:

(a) Such an advantage was not abusive;

(b) The redefinition of such transactions was disproportionate since one only needed to address the event or term that generated the tax saving, e.g. if the tax advantage was available only as a result of the premature surrender of the leases, it was only when that occurred that HMRC could assess, and then only if the surrender was abusive.

134. Dr Lasok submitted that, in the circumstances, redefinition would not have produced e.g. leases that lacked break clauses or, as HMRC contended, the replacement of the Trust by a subsidiary company of the University. Redefinition could, therefore, not have produced any benefit satisfactory to HMRC. Thus the appeal should be allowed.

CONCLUSION

135. I have set out the submissions of the parties *in extenso* in order properly to deal with the technical arguments presented to me. As a result of my having done so, I find myself able to explain how I reach my conclusion quite shortly.

136. A number of matters come to mind as important in reaching my conclusion in the present case, and I find it helpful to record them at this point.

137. At Decision/136 I found that "…[The transactions into which the University entered] amounted to a deferral scheme with a built-in feature that allowed absolute

saving at a later date." And, as Dr Lasok observed, in so finding I made that choice from options including "an absolute saving scheme".

138. In opening his submissions, Dr Lasok claimed, correctly in my judgment, that in the context of the EU concept of abuse of rights it is important to distinguish between the deferral of payment of tax and absolute tax saving.

139. Dr Lasok also invited me to note that in its judgment in the *Huddersfield University* case, the ECJ held the transactions entered into by the University to be genuine and to be economic activities. I accept as correct his submission based thereon that the judgment was delivered on the basis that the University made standard-rated supplies.

140. Another important point he made, with which I agree, was that, in the *Halifax* case, the ECJ stated at [74] of its judgment that an abusive practice arises only where the transactions in question result in the accrual of a tax advantage, and that such accrual is a necessary feature of abuse [86]. The requirement that the transactions concerned "must result in the accrual of a tax advantage" was repeated at [29] of the judgment in *Weald*.

141. When the ECJ dealt with the University's case, as Mr Hill observed, it did envisage that the East Mill Arrangements could be regarded as abusive, and contemplated that such abuse would be an abuse of the right to deduct, but it was left to the tribunal to make the decision in that behalf. It follows that unless I find the East Mill Arrangements to have been abusive, the court's comments avail HMRC nothing.

142. It will be recalled that Mr Hill submitted that in using the word 'advantage' at [63] of his opinion in *Halifax*, Advocate-General Maduro was doing so "very broadly - simply to cover any benefit to the person seeking to obtain it". And in doing so, he claimed the Advocate-General to be extending its meaning to cover the deferring of payment of VAT. It was in reliance on that claim that he went on to maintain that a tax advantage was capable of including the deduction of input tax upfront since a taxpayer who could so deduct input tax "avoided bearing the burden of irrecoverable input tax". Dr Lasok observed that the expression "avoided bearing the burden of irrecoverable input tax" first appeared at [27] of the tribunal decision in *Lime Avenue* - a decision he described as "exploded" by the CJEU in the *Weald* case. I agree with that description, and with a submission by Dr Lasok that the contents of [63] Advocate-General Maduro's opinion in *Halifax* are irrelevant in the present context since they relate to the concept of abuse of rights in an EU non-fiscal context.

143. Mr Hill continued his submissions by inviting me to distinguish the present case from that of *Weald* on the basis that that case involved standard-rated supplies as opposed to the exempt supplies that would have been made in the present case had the University not opted to standard-rate its supplies of land. I am not prepared so to distinguish the present case; I can find no justification for doing so.

144. Next, Mr Hill submitted that, notwithstanding that HMRC could not withdraw the option to tax from the University since the Trust was not "technically" a

'connected person' within the definition of s.839 ICTA, it could not preclude their reliance on the doctrine of abuse since it came into play notwithstanding the application of, in the present case, the provisions of the national legislation transposing the Sixth Directive. Nevertheless, he contended that s. 839 was intended to cover a broad set of circumstances, including those in point in the present case. In my judgment, s.839, by stating that "any question whether a person is connected with another *shall be determined* in accordance with the following provisions of this section" (my emphasis), as Dr Lasok correctly submitted, Parliament was deciding to limit the scope of opting to tax to the connected persons mentioned in s.839. I further agree with Dr Lasok that the section is detailed, clear and specific; there is no room to go beyond the words used by Parliament. The fact that the University had materially the same control over the Trust as it would have had over a subsidiary company is irrelevant.

145. I then turn to deal with Mr Hill's submission that the University's use of a gap or loophole in the national anti-avoidance rules, identified as the interposing of the Trust into the East Mill Arrangements, was contrary to purpose, and thus abusive; and the leasing transactions in which the Trust was used to preclude the application of the anti-avoidance provisions in Schedule 10 to VATA and s.839 ICTA were those contrary to purpose. He claimed that the UK legislature intended to restrict recovery of input tax on leases of land where one of the parties was exempt/partially exempt, and one of them had influence over the other; the East Mill Arrangements were not a choice which the legislature intended to leave open. Having said that I accept that the exercise of the option to tax amounted to the obtaining of a tax advantage, I agree with Dr Lasok that it was an advantage entirely consistent with the domestic legislation in point. I also agree with Dr Lasok that the *Weald* case is authority for a lease/leaseback arrangement to be used by an exempt/partially exempt trader to obtain an upfront tax advantage. It follows that, in my judgment, the East Mill Arrangements were not contrary to the purposes of the legislation; they were thus not abusive.

146. Of Mr Hill's contention that the absolute tax saving available to the University as a result of its entering into East Mill Arrangements compounded their abusive nature, I need say little. As I pointed out at [51] of the Decision, "…it is the nature of all leases of land that they may be surrendered at any time so that, in addition to the specific power to collapse contained in each lease, I find that the University also had the opportunity at any time to effect collapse." Against that background, from HMRC's point of view, any such lease/leaseback arrangement would appear to be contrary to purpose, and thus abusive. I am unable to accept that proposition.

147. I entirely agree with Dr Lasok's submission that it is the actual accrual of an absolute tax saving that is an abusive tax advantage, and in the present case that did not occur until the University collapsed the leases in 2004. Consequently, again in my judgment, it was not until then that HMRC were in a position to assess, and only in whatever redefined sum they calculated taking into account the tax the University had by then paid.

148. I also accept that from the outset it was the University's intention to make an absolute tax saving, but as I have found that did not occur until 2004. Only then did it

obtain a tax advantage contrary to the VAT regime. By paying the irrecoverable input tax (and the rent) on the sublease by the Trust, the University was paying the tax for which it would have been liable on the refurbishment costs of East Mill had it carried out the works itself.

149. I am as puzzled as Dr Lasok by HMRC's claim that they would have been out of time to assess for tax had they waited until 2004 when the University collapsed the leases. In my judgment, they could then have calculated the absolute tax saving made, and assessed accordingly. It follows that again I do not accept that the amount that HMRC could properly claim was the amount of the University's input tax deduction in 1997.

150. There are a number of points made in closing by Dr Lasok with which I must also deal. Leading on from the contents of the last preceding paragraph, Dr Lasok correctly observed that the Assessment was not based on the rent levels or any other term of the leases being abnormal, nor did it relate to any absolute tax saving. Thus he maintained, again correctly in my judgment, the terms of the leases were not abusive.

151. And as Dr Lasok further observed, the Assessment was justifiable only on the hypothesis that the University's upfront deduction of input tax was a tax advantage contrary to the purposes of the legislation, rejecting a submission by Mr Hill that such deduction was abusive notwithstanding the University's liability to account for output tax. In my judgment, the tax advantage obtained was not abusive for it was not absolute and, furthermore, it was balanced by the liability to account for output tax. And, as Dr Lasok correctly added, Mr Hill's submission was not supported by any authority.

152. As I agree entirely with the contents of [101] and [102] of this decision, they dealing with Dr Lasok's submissions on the option to tax in both an EU and domestic context, I need not elaborate on them.

153. At [103] of this decision I set out three points made by Dr Lasok raising questions on the national rules on which HMRC rely. He proceeded to elaborate on those points. Yet again, I agree with all the submissions that arose from his elaboration, so that I need not deal with them further.

154. On the parties submissions on redefinition, I agree with Dr Lasok's submission that it follows from [48] to [53] of the judgment in *Weald* that redefinition involves identifying the precise aspect of the arrangements in point that constitute the abuse, and then redefining the transactions in question so as to establish the situation that would have prevailed in the absence of the particular element(s) constituting the abuse. And, where the problem lies in a particular provision of an agreement, the redefinition requirements apply in relation to that provision.

155. I allow the appeal. However, for completeness I should say that I accept the case for the University presented by Dr Lasok and, to the extent that my conclusion does not specifically deal with matters the subject of his submissions, I do so unreservedly.

156. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DAVID DEMACK
TRIBUNAL JUDGE

RELEASE DATE: 29 April 2013