Easter Term
[2022] UKSC 12
On appeal from: [2018] EWCA Civ 1515

JUDGMENT

Zipvit Ltd (Appellant) *v* Commissioners for Her Majesty's Revenue and Customs (Respondent) (No 2)

before

Lord Hodge
Lady Black
Lord Briggs
Lord Sales
Lord Hamblen

JUDGMENT GIVEN ON
11 May 2022

Heard on 29 and 30 January 2020

Appellant
Roger Thomas QC
(Instructed by Mishcon de Reya LLP (London))

Respondent
Sam Grodzinski QC
Eleni Mitrophanous QC
(Instructed by HMRC Solicitor's Office (Bush House))

LORD BRIGGS AND LORD SALES: (with whom Lord Hodge, Lady Black and Lord Hamblen agree)

Introduction

1. This case is concerned with the right of a trader (in this case, Zipvit) to deduct input VAT due or paid by it on supplies of services to it by a supplier (in this case, Royal Mail), so far as those supplies are used for the trader's own supplies of goods or services to an ultimate consumer. The relevant facts occurred before the United Kingdom's withdrawal from the European Union took effect and the outcome depends on the interpretation of provisions in the EU legislation on VAT.

2. This is the second judgment of the court. In the first judgment ([2020] UKSC 15; [2020] 3 All ER 1017) we set out the background to the dispute and made a reference to the Court of Justice of the European Union. This was the last such reference made by the Supreme Court. On 13 January 2022 the Court of Justice delivered its judgment answering the questions posed in the reference: (Case C-156/20) EU:C:2022:2. That judgment is clear in its effect and enables us to determine the appeal without the need for any further hearing.

3. It will assist the reader of this judgment if we again summarise the principal issues in the case which relate to the interpretation of EU law and then briefly set out the facts.

The principal issues of EU law

4. The general terms and conditions governing the supply contract between the supplier and the trader provided that the trader should pay the commercial price for the supply plus such amount of VAT (if any) as was chargeable in respect of the supply. As determined by a subsequent judgment of the Court of Justice, the supply should in fact have been treated as standard rated for VAT, so that the trader should have been charged VAT assessed at the relevant percentage of the commercial price for the supply. However, at the time of the supply both the supplier and the trader, acting in good faith and on the basis of a common mistake, understood that the supply was exempt from VAT, so the trader was only charged and only paid a sum equal to the commercial price for the supply. The invoices relating to the supplies in question denoted the supplies as exempt and hence indicated that no VAT was due in respect of them.

5. The tax authorities (Her Majesty's Revenue and Customs Commissioners, "HMRC") made the same mistake in good faith. HMRC had inadvertently contributed to the mistake by the parties, by issuing tax guidance containing statements to the same effect.

6. The effect of the mistake has been that the trader has only paid the amounts equivalent to the commercial price for each supply and there is now no prospect that it can be made to pay, or will pay, the additional amount equivalent to the VAT element of the total price (ie the commercial price plus the VAT due in respect of it) which ought to have been charged and paid in respect of such supplies. Likewise, the supplier has not accounted to HMRC for any VAT due or paid in respect of such supplies, and there is no prospect that it can now be made to account, or will account, to HMRC for such VAT.

7. Notwithstanding this, the trader now maintains that under article 168(a) of the Principal VAT Directive (2006/112/EC - "the Directive") it is entitled as against HMRC to make a claim to deduct as input VAT the VAT due in respect of the supplies in question or a VAT element deemed by law to be included in the price charged by the supplier for each supply (and hence deemed by law to be VAT in fact paid in respect of such supply when the trader paid what the parties believed to be the commercial price of the supply). On this appeal it is common ground that the term "due or paid" in article 168(a) means due or paid by the trader to the supplier. However, against the trader's argument HMRC contend that in the circumstances of this case, on the proper interpretation of the Directive: (1) there is no VAT "due or paid" in respect of the supplies in question for the purposes of article 168(a), so no claim can be made to recover input tax in relation to them (we refer to this as the "due or paid" issue), and/or (2) the invoices relating to the supplies in question did not show that VAT was due in respect of the supplies, and since the trader at no stage held invoices which showed that VAT was due and its amount, in compliance with article 226(9) and (10) of the Directive, for this reason also the trader is not entitled to recover input tax in relation to the supplies (we refer to this as the invoice issue). The trader responds on point (1) that VAT must be treated as having been "paid" as part of the price (or as "due") and on point (2) that it is not necessary that it produce VAT invoices since all relevant facts are now known and it can prove by other means the amount of the VAT due or paid on each supply.

The factual background

8. Royal Mail is the public postal service in the United Kingdom. Article 132(1)(a) of the Directive (and equivalent provisions which preceded it) provides that member states shall exempt "the supply by the public postal services of services other than

passenger transport and telecommunications services, and the supply of goods incidental thereto". In implementing this provision, Parliament and HMRC interpreted it as covering all postal services supplied by Royal Mail. The implementing national legislation, the Value Added Tax Act 1994 ("VATA"), contained a provision to this effect (Schedule 9, Group 3, paragraph 1) and HMRC issued guidance notes to the same effect.

9. Zipvit carries on the business of supplying vitamins and minerals by mail order and used the services of Royal Mail. During the period 1 January 2006 to 31 March 2010, Royal Mail supplied Zipvit with a number of business postal services under contracts which had been individually negotiated with Zipvit. The present proceedings concern supplies of one such service, Royal Mail's "Mailmedia®" service ("the services").

10. The contract under which Royal Mail supplied the services incorporated Royal Mail's relevant general terms of business which provided that all postage charges specified as payable by the customer (ie Zipvit) were exclusive of VAT, that the customer "shall pay any VAT due on Postage and other charges at the appropriate rate", and that "VAT shall be calculated and paid on [the commercial price of the services]". Accordingly, insofar as VAT was due in respect of the supply of the services, the total price payable by Zipvit for such supply under the contract was the commercial price plus the VAT element.

11. However, on the basis of the domestic legislation and guidance and the common mistaken view that the services were exempt from VAT, the invoices issued by Royal Mail to Zipvit in relation to the services were marked "E" for exempt, showed no sum attributable to VAT to be due, and charged Zipvit only the commercial price of the services. Zipvit duly paid to Royal Mail the sums set out in the invoices. Zipvit did not at the time of the supplies make any claim to recover input VAT in respect of them.

12. Since Royal Mail understood the services to be exempt, and since it had set out no charge for VAT in its invoices, it did not account to HMRC for any sum relating to VAT in respect of the supply of the services. HMRC likewise believed the services to be exempt and did not expect or require Royal Mail to account to them for any such sum.

13. Things proceeded in this way for several years, until the judgment of the Court of Justice of 23 April 2009 in *R (TNT Post UK Ltd) v Revenue and Customs Comrs* (Case C-357/07) EU:C:2009:248; [2009] ECR I-3025. The Court of Justice held that the postal services exemption applied only to supplies made by the public postal services acting

as such, and did not apply to supplies of services for which the terms had been individually negotiated.

14. On the basis of this interpretation of the Directive and its predecessor by the Court of Justice, in the relevant period the services in the present proceedings should have been treated as standard rated. Royal Mail should have charged Zipvit a total price for the supply of the services equal to the commercial price plus VAT at the relevant rate, and Royal Mail should have accounted to HMRC for that VAT element. As it was, however, Zipvit was not charged and did not pay that VAT element, and Royal Mail did not account to HMRC for any sum representing VAT in respect of the services.

15. In the light of the *TNT Post* judgment, Zipvit made two claims against HMRC for deduction of input VAT in respect of the services by a procedure called "voluntary disclosure": (i) on 15 September 2009 in the amount of £382,599 plus interest, in respect of "input tax paid from the quarter ended 31 March 2006 (due after 1 April 2006) to the quarter ended 30 June 2009", and (ii) on 8 April 2010 in the amount of £33,147, relating to the periods to December 2009 and to March 2010. These claims were calculated on the basis that the prices actually paid for the supplies must be treated as having included a VAT element.

16. In the meantime, HMRC were making inquiries with Royal Mail to establish precisely which of its services were affected by the *TNT Post* judgment.

17. HMRC rejected Zipvit's claims by letter dated 12 May 2010. This was on the basis that Zipvit had been contractually obliged to pay VAT in relation to the commercial price for the services, but it had not been charged VAT in the relevant invoices and had not paid that VAT element. After review, HMRC upheld that decision by letter dated 2 July 2010.

18. At this time, the national limitation period of six years under section 5 of the Limitation Act 1980 for a contract claim by Royal Mail to claim the balance of the total price due to it in respect of the supply of the services (ie a sum equal to the amount of the VAT due in respect of such supply, calculated by reference to the commercial price of the services) had not expired. But issuing claims against all Royal Mail's relevant customers affected by the *TNT Post* judgment, including Zipvit, would have been costly and administratively burdensome for Royal Mail and it had no commercial interest in doing this, and so did not pursue such claims.

19. At this time, HMRC were within the time limits set out in section 73(6) and section 77(1) of VATA to issue assessments against Royal Mail for VAT in respect of at least some of the supplies of the services. However, HMRC considered that they should not issue such assessments because national law in the form of VATA had provided at the relevant time that the supply of the services was exempt and, moreover, Royal Mail had not in fact received from Zipvit the VAT due in respect of the supplies. Furthermore, HMRC considered that they had created an enforceable legitimate expectation on the part of Royal Mail that it was not required to collect and account for VAT in respect of the services, so that Royal Mail would have a good defence to any attempt to issue assessments against it to account for VAT in respect of the services.

20. The sums claimed by Zipvit as input VAT on the relevant supplies amount to £415,746 plus interest. The present proceedings are a test case in respect of supplies of services by Royal Mail where the same mistake was made. The court has been provided with estimates of between about £500m and £1 billion as the total value of the claims against HMRC.

21. Zipvit appealed against HMRC's review decision to the First-tier Tribunal (Tax Chamber). By the time of the hearing the limitation period for a contract claim by Royal Mail against Zipvit for the payment of the balance of the total price due for the supply of the services had expired in relation to the greater part of the supplies which had been made. HMRC were also out of time to issue an assessment against Royal Mail.

22. The First-tier Tribunal dismissed Zipvit's appeal. It dismissed Zipvit's argument under article 168(a) on the "due or paid" issue, which was sufficient to determine the appeal in favour of HMRC. But its reasoning on that issue was disapproved later and HMRC does not seek to support it. However, the Tribunal also ruled that since Zipvit did not hold valid tax invoices in respect of the supply of the services, showing a charge to VAT, it had no right to claim deduction of such VAT as input tax. Also, although HMRC have a discretion under national law to accept alternative evidence of payment of VAT in place of a tax invoice (under regulation 29(2) of the Value Added Tax Regulations 1995 (SI 1995/2518) - "regulation 29(2)"), which they had omitted to consider in their decisions, the Tribunal found that had they considered whether to exercise this discretion HMRC would inevitably and rightly have decided not to accept Zipvit's claim for a deduction of input VAT in respect of the services (we refer to this as the discretion issue). This is because repayment of notional input VAT to Zipvit in respect of the services would constitute an unmerited windfall for Zipvit. Zipvit had in fact paid only the commercial price for the services, exclusive of any element of VAT, so repayment to it of a notional element of VAT in respect of the supply of those services would mean that in economic terms it would have received the services for

considerably less than their true commercial value. There was no good reason why HMRC should in their discretion dedicate large sums of public money to achieve such an unmeritorious benefit for Zipvit.

23. Zipvit appealed. The Upper Tribunal (Tax Chamber) (Proudman J) dismissed the appeal. She upheld the First-tier Tribunal's decision on the invoice issue and on the discretion issue under regulation 29(2). In the light of those rulings, Proudman J regarded Zipvit's argument on the "due or paid" issue as academic, although it seems she would have been disposed to accept it.

24. The Court of Appeal dismissed Zipvit's appeal. For the first time in the Court of Appeal there was a thorough examination of the contractual arrangements between Zipvit and Royal Mail. The Court of Appeal considered that, in the light of its analysis of those arrangements, a reference to the Court of Justice would be required to resolve the "due or paid" issue. However, it dismissed Zipvit's appeal on the basis of the invoice issue and the discretion issue. It held that it was a necessary precondition for Zipvit to be able to exercise any right of deduction of input VAT in respect of the services that it should be able to produce VAT invoices which showed that VAT had been charged in respect of the supplies of the services or supplementary evidence showing payment of the relevant tax by Royal Mail to HMRC, which Zipvit could not do. It agreed with the Tribunals below on the discretion issue.

25. Zipvit has appealed to this court. Zipvit contends that it should succeed on both the "due or paid" issue and the invoice issue, including so far as necessary on the discretion issue under regulation 29(2). At the first hearing of the appeal the court found that neither the "due or paid" issue nor the invoice issue could be regarded as *acte clair* and decided that a reference should be made to the Court of Justice.

26. In the light of the judgment of the Court of Justice it is possible to determine Zipvit's appeal shortly. We address the three issues in turn.

(1) The "due or paid" issue

27. Article 168(a) of the Directive provides that a trader who is a taxable person has an entitlement to deduct from VAT which he is liable to pay "the VAT due or paid … in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person".

28. Zipvit's contention is that in the circumstances of this case, on each occasion when (although contractually liable for VAT in addition) it only paid the commercial price charged to it in Royal Mail's invoice it (Zipvit) must be treated as having paid an element of VAT to be regarded as embedded in the sum paid. The sum charged by Royal Mail and paid by Zipvit should be treated as a total price comprising a (lesser) taxable amount and the VAT at standard rate on that taxable amount. Thus, if Royal Mail charged Zipvit £120 in an invoice for the services, that being the commercial price for the services, and Zipvit only paid that amount, then even though the invoice purported to say that the services were exempt from VAT, the taxable amount (within the meaning of articles 73 and 78 of the Directive) should (after the elapse of six months under article 90 of the Directive and section 26A of VATA) be treated as having been only £100 and the additional £20 (assuming a 20% rate of VAT) should be treated as VAT, which Zipvit is now entitled to claim as input VAT relating to supplies made by it to its customers. This embedded VAT element of each payment constitutes VAT which has been "paid", in the requisite sense, and thus falls within article 168(a). Alternatively, even if the embedded element of VAT on which Zipvit relies is not to be regarded as having been "paid" for the purposes of article 168(a), VAT should be regarded as being "due" for the purposes of that provision, so that Zipvit is entitled to claim to deduct it as input VAT on that basis.

29. According to the judgment of the Court of Justice (para 31), "given that VAT is a tax which must be charged, at each stage, only on the added value and must ultimately be borne by the final consumer …, a taxable person such as Zipvit cannot claim to deduct an amount of VAT for which it has not been charged and which it has therefore not passed on to the final consumer". Therefore, in the circumstances of this case, the Court of Justice has ruled (para 33) that "VAT cannot be regarded as being included in the price paid by the recipient of the services [ie Zipvit]" and (para 35) that VAT cannot be regarded as having been "paid" by Zipvit within the meaning of article 168(a) of the Directive.

30. Nor, in the circumstances of the case, could VAT be regarded as being "due" within the meaning of article 168(a), since no request for payment of that tax was sent to the recipient of the relevant supply (ie Zipvit): paras 36-40.

31. The Court of Justice summarised its conclusion at para 41, saying that article 168(a) must be interpreted as meaning that VAT cannot be regarded as being "due or paid" within the meaning of that provision where the trader and the supplier have mistakenly assumed, on the basis of an incorrect interpretation of EU law by the national authorities, that the supplies at issue were exempt from VAT, with the result that the relevant invoices did not refer to it, in a situation where the contract between the trader and the supplier provides that, if such tax were due, the recipient trader

should bear the cost of it, and where no step to recover the VAT was taken in good time, with the result that any action by the supplier and the tax authorities (HMRC) to recover the unpaid VAT is time-barred.

(2) The invoice issue

32. In view of its definitive ruling on the "due or paid" issue, the Court of Justice did not find it necessary to answer the question referred to it in relation to the invoice issue: paras 42-43.

33. The invoice issue is concerned with the question whether, if Zipvit had a substantive right under article 168(a) of the Directive to claim to recover as input VAT the notional embedded input VAT which it asserted it had paid or was due to pay, there is an additional condition to be fulfilled before it could make such a claim, namely that it holds VAT invoices which evidence and support its claim to have paid such input VAT. Since the Court of Justice has ruled that, as a matter of substance, a trader in the position of Zipvit has no right to claim to recover under article 168(a) of the Directive in respect of that notional element of VAT, and Zipvit's appeal to this court based on EU law must fail for that reason, it is likewise not necessary for this court to determine whether Zipvit's appeal should fail for an additional reason based on the invoice issue. Nor do we think it is appropriate that we should rule on the invoice issue. It is academic and turns on a point of EU law which is not clear and has not been the subject of a definitive ruling by the Court of Justice. There may have to be debate on another occasion whether the judgment of the Court of Justice in this case has any bearing on the reasoning of the Tribunals and the Court of Appeal in relation to this issue.

(3) The discretion issue

34. That leaves the discretion issue. This is a matter of domestic law, but it relates to how the discretion under regulation 29(2) would or should have been exercised by HMRC against the background of a proper understanding of the operation of the Directive. It may perhaps be doubted whether a payment to Zipvit of a sum on account of notional VAT pursuant to regulation 29(2) would have been lawful or appropriate if, under EU law and Issue (2), the production of a VAT invoice would have been required to justify such a payment. However, again, it is not necessary to decide that question in order to give an answer under Issue (3). We assume that, in line with the reasoning of the Tribunals, a valid discretion existed in domestic law in the form of regulation 29(2) to make such a payment.

35. In the circumstances of the case, as set out above, Zipvit had no right under the Directive to recover from HMRC any element of input VAT. Moreover, in commercial terms, as the Tribunals and the Court of Appeal correctly pointed out, any payment to Zipvit would have been an unmerited windfall.

36. We therefore agree with their conclusion that, had HMRC considered the exercise of their discretion under regulation 29(2), they would have been bound to have concluded that no payment should be made to Zipvit. There was no sound basis on which it would have been appropriate to use public monies to make any such payment.

Conclusion

37. For the reasons given above, Zipvit's appeal is dismissed.