Appeal number: FTC/21/2009
[2010] UKUT 360 (TCC)

Redefinition of abusive transaction under Halifax principle– Taxpayer assessed to tax in respect of deductions wrongfully made in relation to the redefined transaction - Whether HMRC must subtract from the assessment the amounts of tax already paid – Whether HMRC may require the taxpayer to reclaim tax already paid as overpaid tax under s.80 VATA 1994

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

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

- and -

MOORBURY LIMITED **Respondent**

TRIBUNAL: Mr Justice Norris

Sitting in public at Royal Courts of Justice on 24 May 2010

Aidan Robertson QC instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Appellant

Andrew Hitchmough and Jonathan Bremner instructed by Ernst & Young LLP for the Respondents

DECISION

TRIBUNAL JUDGE: Mr Justice Norris
RELEASE DATE: 23 September 2010

1. Cumbria College of Art and Design ("the College") decided to develop and to refurbish its campus. If it had directly engaged building contractors to do that work then those contractors would have charged VAT, which would not have been recoverable by the College.

2. To avoid that consequence the College implemented the following scheme:-
   (a) the College agreed to lease part of its campus to XCo (a company wholly owned by the College) on terms which required XCo to develop the land, to provide construction services to the College for £67,287 (plus VAT of £11,775), and then to surrender the lease back to the College;
   (b) XCo then engaged Moorbury Limited (another subsidiary of the College) ("Moorbury") to provide those construction services:
   (c) For the supply of those services Moorbury invoiced XCo in advance on 29 April 1999 in the sum of £3.364 million plus VAT of £588,476;
   (d) Moorbury declared and accounted for the £588,746 of VAT in its return for the period ending June 1999;
   (e) Moorbury then procured the actual supply of the construction services from arms-length contractors over a period beginning in the VAT quarter ending June 1999 and terminating in the VAT quarter ending December 2001;
   (f) The arm's-length contractors charged Moorbury VAT which Moorbury reclaimed as input tax in the relevant VAT accounting periods (including a claim for £41,265 in the VAT quarter ending June 1999);
   (g) When the development was completed XCo surrendered the lease to the College.

3. The effect of this arrangement was hoped to be that the College got its developed and refurbished campus paying only £11,775 in VAT, although the VAT on the construction services actually provided amounted to £588,746.

4. Unfortunately for the College the Commissioners for HM Revenue and Customs ("HMRC") did not see things in that way. In a decision letter dated 26 April 2001 HMRC notified XCo that it had incorrectly claimed repayment of the £588,746 VAT which it had been charged by Moorbury and assessed

XCo in that sum (less the £11,775 accounted for). XCo now accepts this to be correct. In a further decision letter also dated 26 April 2001 (which related to the VAT accounting periods down to December 2000) HMRC explained (as a first ground) that they did not view the supply of construction services by Moorbury as being real "supplies", or alternatively as supplies made in the course or furtherance of a business: the result was that Moorbury had incorrectly charged XCo VAT of £588,766, had incorrectly accounted for that sum as output tax, and had incorrectly treated the VAT charged by the arm's-length contractors as input tax. HMRC considered that in reality the supplies made by the arm's-length contractors were received directly by the College. As a completely alternative second ground HMRC further said that the EC principle of "abuse of rights" applied and had the effect of denying any VAT advantage artificially sought.

5. Because HMRC said that Moorbury had incorrectly treated the arm's-length contractors' VAT as reclaimable input tax, assessments were raised on Moorbury in respect of the tax reclaimed for the periods from June 1999 to December 2000. Because HMRC said that Moorbury had incorrectly charged and accounted for the £588,760 as output tax in its return for the period ending June 1999, Moorbury was invited to make a claim under section 80 VATA 1994 in respect of the tax which (on this analysis) was overpaid. HMRC offered to accept such a section 80 claim even if made on the basis that HMRC's analysis was challenged as incorrect i.e HMRC volunteered not to take a legal point that was open.

6. Section 80 VATA 1994 provides by subsection (1) that where a person has paid an amount of VAT that was not due to HMRC then the Commissioners shall be liable to repay the amount to him. Section 80(2) states that

> "The Commissioners shall only be liable to repay an amount under this section on a claim being made for that purpose."

Section 80(4) then provides that the Commissioners are not liable to repay any amount paid to them more than three years before the making of the claim. Section 80 concludes with the words

> "Except as provided in this section the Commissioners shall not be liable to repay an amount paid to them by way of VAT by virtue of the fact that it was not VAT due to them".

On this appeal it is agreed that this section provides an exhaustive regime concerning the making of the claims by taxpayers for recovery of overpaid VAT and that the time limits imposed by the section are (in the general run of cases) compatible with overriding Community law principles of effectiveness and equivalence.

7. Moorbury appealed this decision of HMRC. During the pendency of the appeal three relevant events occurred. First, the period specified in section 80(2) VATA 1994 expired without Moorbury having made any repayment claim for the £588,766 tax overpaid in the VAT quarter ending June 1999. Second, in October 2005 HMRC issued a further decision letter and further assessments in respect of the VAT quarters ending March 2001 and June 2001. If these new assessments gave rise to claims for overpayment of tax as a result of the redefinition of the transactions (upon which redefinition the new assessments were based) it was too late for Moorbury to make any claim, because the 3-year period had already elapsed. Third, in February 2006 the European Court of Justice handed down its judgment in the Halifax case (Case C-255/02 reported at [2006] STC 919).

8. The Halifax case concerned a scheme bearing some similarities with that upon which the College embarked. The decision established:-

   (a) That a transaction constituted a "supply" of services if, on an objective assessment, it was such, notwithstanding that the sole aim and intention of the transaction was to obtain a tax advantage and that it had no other economic object (which holding rendered HMRC's first alternative ground for assessing tax on Moorbury incapable of further argument):
   (b) That the Sixth Directive 77/388 had to be construed as precluding the conferring of any right to deduct input VAT where the underlying transaction amounted to an abusive practice:
   (c) That an abusive transaction was one which (although formally complying with the relevant provisions) on an objective assessment of its real substance disclosed the essential aim of securing a tax advantage which would be contrary to the purpose of the relevant provisions of the Sixth Directive:
   (d) That where an abusive practice was found to exist then the transaction itself had to be redefined so as to re-establish the situation that would have prevailed absent the entry of the abusive transaction.

9. Paragraphs 95 and 96 of the judgment in Halifax then set out the consequence of that redefinition in these terms:-

> "95. In that regard, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been exercised abusively….
> 96. However, they must also subtract therefrom any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess…."

10. Giving effect to the "abuse of rights" principle did not depend on the terms of substantive or procedural domestic law nor did it require domestic legislation to be enacted in order to give substantive effect to the principle. It operated as a principle of construction of the law as it stood. Advocate General Maduro had explained how this worked in his Opinion:-

> "79. … the prohibition of abuse of Community law, seen as a principle of interpretation, does not give rise to derogations from the provisions of the Sixth Directive. The result of its application is that the legal provision *interpreted* cannot be regarded as conferring the right at issue because the right claimed is manifestly beyond the aims and objectives pursued by the provision abusively relied on … An interpretation of the Sixth Directive according to this principle cannot but have the most obvious consequence to be expected in the context of legal interpretation: that the right is not in fact conferred, contrary to the literal meaning of the legal provision. If this interpretation entails any kind of derogation, it will be only from the text of the rule, not from the rule itself, which comprises more than its literal element". (Original emphasis).

11. The question that arises on this appeal is: does the redefinition of the transactions in which Moorbury participated (so as to re-establish the situation that would have prevailed absent the entry of those transactions) require Moorbury to make a claim under section 80 VATA 1994 if it is to receive back its overpaid tax? Or does the principle that enables HMRC to redefine the transactions so as to restore neutrality require HMRC to reimburse any overpaid VAT without a claim under section 80?

12. After initial resistance HMRC now accept that in relation to the VAT quarter ending June 1999 they cannot claim payment of £41,265 and ignore the actual payment of £588,760: the overpayment can be used to satisfy the claim arising on the redefinition of the transactions without the need for a claim by Moorbury under section 80. HMRC automatically "net-off" what (on redefinition) have become the new liability and the new overpayment. But HMRC argue that in relation to claims arising subsequent to the June 1999 accounting period it *is* necessary for Moorbury make a section 80 claim (and that there is no automatic "netting-off") and that Moorbury has now lost that right. Accordingly HMRC argue that they can claim payment of a further £547,481 from Moorbury (in addition to assessing XCo for the same amount of wrongly recovered input tax) and ignore the fact that Moorbury has already paid £547,481.

13. The argument is in essence that whilst it is for EU law to determine substantive rights it leaves questions of procedure to domestic law; that the procedure for reclaiming overpayments of tax is to be found in s.80 VATA which is an exhaustive and exclusive regime; that the inclusion within that regime of a limitation period on claims which is itself non-discriminatory and which does not make it virtually impossible or excessively difficult to exercise

EU law rights is entirely permissible; that when HMRC made its re-assessments in 2001 s.80 VATA satisfied those requirements (because there was still one year of the three allowed by Parliament left to run); and that accordingly s.80 VATA should simply be allowed to take its course and the failure to make a "without prejudice" claim for repayment pending the determination of the validity of the re-assessments means that Moorbury has lost its chance.

14. In the First Tier Tribunal Judge Colin Bishopp held that HMRC's argument failed. I agree with his decision.

15. First, he noted that in paragraph 92 of Halifax the Court had held that

> "..the measures which the Member States may adopt [for the correct collection of the tax and for the prevention of evasion] in order to ensure the correct the levying and collection of tax must not go further than is necessary to obtain such objectives… They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT [which is a fundamental principle of the common system of VAT].."

I agree that this is a salutary starting point for the application of any principle of construction which Halifax may lay down. Whilst it is, as a rule, for Member States to specify the conditions under which tax authorities may recover tax after the event the measures governing the collection of VAT may not be used (and should not be read) in such a way as to have the effect of systematically undermining the neutrality of the tax.

16. Second the tribunal judge noted the force of HMRC's argument that in general EU law requires no more than the provision by domestic law of an accessible remedy (because it is in general content to leave procedural rules to Member States): and that section 80 in general provided a procedure that afforded an accessible remedy for over payment of VAT. But he held that the Halifax principle was something apart from the general.

17. I too acknowledge the force of this submission. But as I understand the decision in Halifax it does not concern the creation of substantive rights or entail the provision of remedies: it lays down a principle of construction. Even if a transaction is formally correct in every respect it does not have the consequence that a literal application of the relevant legal rule would suggest if that consequence is contrary to the purpose of the rule and if the essential aim of the transaction was to obtain a tax advantage. The result of interpreting the deduction rule in that way is to secure that the correct tax is collected: and the interpretative principle itself tells us what that correct tax is, namely the tax that would have been paid and collected if the abusive transaction had not been entered.

18. HMRC argued that to fail to acknowledge that section 80 was the remedy that domestic law provided for the overpayment of tax was to elide questions of substantive law with questions of procedural law. I do not agree. The Halifax principle is, as I see it, a self contained principle of construction which, if engaged, may require the Court to adopt an approach different from that adopted in the general run of cases. This I believe was the view taken by the Court in WHA v HMRC [2007] EWCA Civ 728. In that case Counsel for the taxpayer argued that it was inappropriate to consider a scheme as a whole because questions relating to VAT were to be determined by reference to individual transactions. Lord Neuberger (with whom the other members of the Court agreed) held:-

> "While I accept the soundness of the approach in classic VAT cases….I do not consider that it can possibly be appropriate when considering whether a scheme infringes the purpose of the Sixth Directive.."

Application of the Halifax principle may require a departure from the approach adopted in classic VAT cases. A distinction between substantive and procedural law (if material) may not be correctly made when what is under consideration is a principle of construction and the consequences of its application.

19. Further, adopting this approach does not involve holding (as HMRC argued) that there is no limitation period on a repayment claim under s.80; nor does it involve challenging the consistent jurisprudence of the ECJ that national limitation periods are compatible with the EU law general principle of legal certainty. I accept without cavil the approach set out in Ecotrade (Cases C-95/07 and C-96/07) at paragraph [46] and Marks & Spencer v CCE (Case C-62/00) that limitation periods which prevent the deduction of input tax are not incompatible with the Sixth Directive provided that they comply with the principles of equivalence and effectiveness. Nor would I wish to depart in any way from the conclusions of Henderson J in Chalke [2009] EWHC 952 (which are, as I have indicated, accepted by both sides on this appeal). But the question in the present case is whether (applying the Halifax interpretative approach) it is necessary to make a claim (to which a limitation period might apply) at all.

20. Third, the tribunal judge held that it was not necessary to make a claim because the exercise which Halifax required to be undertaken enabled HMRC only to claim the tax correctly due on the redefined transaction taken as a whole, not an excessive amount of tax in respect of which Moorbury had to make a claim for repayment. The way in which he put it was thus:-

> "…. … it follows from the Court's observations in Halifax that if the Commissioners determine to redefine abusive arrangements, they must

> redefine them in their entirety, making all of the adjustments which the redefinition entails. Taken together, as it is clear from their own terms they must be, paragraphs 95 and 96 of the judgment can only lead to the conclusion that as a condition of demanding tax which has been underpaid the taxing authority must, unprompted, subtract any tax which has been overpaid…."

I agree. The power to redefine and re-assess is confined to re-establishing the situation that would have prevailed in the absence of the transactions which constitute the abusive practice. This may involve reassessment: it may also involve reimbursement. The interpretative principle (and the mechanism of redefinition) applies equally to both. There would be a most curious asymmetry in the Halifax principle (not apparent from the language in which it is expressed by the Court) if for the purpose of collecting tax the taxing authority was permitted to depart from the literal meaning of the charging and deduction rules but for the purpose of permitting re-imbursement was entitled to insist upon the literal terms of the rule and strict adherence by the taxpayer.

21. HMRC argued before the lower tribunal and before me that this approach overlooked the periodic nature of the VAT liability. Whilst HMRC would now concede that the assessment in the sum of £41,265 for the period ending June 1999 was wrong, there was no overpayment in any other period of account against which the new assessments had to be balanced. Judge Colin Bishopp rejected this argument holding (fourthly) that redefinition, if properly implemented, required the return for each period to be adjusted so as to re-establish the situation that would have prevailed in the absence of the abusive transaction. That would result in payment returns for some periods and repayment returns for others; but there was nothing inconsistent with domestic law in collecting (or repaying) the overall net amount due.

22. I agree. Indeed, I consider that the Halifax principle proceeds on the footing that one does not examine a transaction in its discrete parts period by period. As Lord Neuberger put it in WHA (*supra*) at paragraph 22:-

> "The whole point of the principle is that, although each step of the scheme in question works, the overall effect of the scheme is unacceptable".

If, in order to see whether the principle may be invoked, one is required to look at the overall effect, I cannot see why (in applying the principle when invoked) one should be required to ignore the overall effect. Whatever may be the position in (say) the quarter ending December 2000, overall Moorbury has paid the VAT of £547,481 for which HMRC now says it is liable: and no process of redefinition (if required) should ignore that. (Indeed, I could not see the point in raising assessments and then inviting an "overpayment claim" to cancel them out. Redefinition to eliminate the abusive transaction obviously

affected the liability of XCo. But in the original transaction Moorbury's position was actually VAT neutral (it had accounted for and had deducted VAT); and in the redefined transaction Moorbury's position should on HMRC's analysis also have been VAT neutral (it was being assessed for but could reclaim overpaid VAT). Since on the net overall position the tax result appears to be correct I am not clear why redefinition was necessary at all: see WHA (*supra*) at paragraph [57]. But there may be some subtlety I have missed).

23. The tribunal judge held (fifthly) that any approach other than requiring HMRC automatically to give credit for tax already paid before raising assessments upon the redefinition of a transaction "risks injustice to a taxpayer". That was because the challenge to a transaction as abusive would always lie with HMRC, and the challenge and consequential redefinition may occur after any right to claim re-payment had become time barred. Such was, in fact the case, in relation to the 2005 assessments.

24. Now in my judgment the tribunal was right to address this as a serious concern. Ecotrade (*supra*) concerned the reassessment and recovery procedures of the Italian tax authorities in relation accounting irregularities in the operation of what was called the "reverse charge procedure". The re-assessment practice penalised procedural non-compliance by denying the right to deduct tax otherwise deductible. The ECJ held at paragraph [68] :-

> "That practice goes further than is necessary for the correct collection of the tax and for the prevention of evasion within the meaning of Article 22(8) of the Sixth Directive, since it may even lead to the loss of the right to deduct if the re-assessment of the tax return by the authorities is made after the expiry of the limitation period available to the taxable person in which to make the deduction…."

It would therefore seem unlikely that in Halifax the ECJ would formulate a principle that *might* lead to the loss of the taxpayer's right to subtract from any assessment tax charged on an output transaction for which he was artificially liable.

25. HMRC submitted to me that the tribunal judge had misunderstood the position for which they contended. There was no risk of injustice to the taxpayer because HMRC would not rely on the section 80 limitation period if to do so would make it virtually impossible or excessively difficult for a taxpayer to exercise its EU law rights. If the limitation period had already expired then HMRC would, in exercise of their general administrative discretion, offer a period of 90 days within which an overpayment claim might be made (the period of 90 days being one which HMRC consider makes possible and not excessively difficult an exercise by the taxpayer of its EU law rights). If the limitation period had not already expired but in the judgment of HMRC the remaining period did make it virtually impossible or excessively difficult for a

taxpayer to exercise his EU law rights then in exercise of their general administrative discretion HMRC would offer a further period of 90 days. In each case HMRC would be open to a request for an extension which they might in the exercise of that same discretion consider granting. If the taxpayer considered that HMRC's offer still inhibited the exercise of the EU law right then HMRC's decision was judicially reviewable.

26. In my judgment this proposal does not answer Judge Colin Bishopp's objection relating to the risk of injustice. HMRC say that the correct application of the Halifax principle may have unfair results but they can be mitigated by the exercise of administrative discretions. I cannot think that those who formulated the principle intended that consequence, for they had stated in paragraph [72] of their judgment:-

> "…Community legislation must be certain and its application foreseeable by those subject to it…. That requirement of legal certainty must be observed all the more strictly in the case of rules liable to entail financial consequences in order that those concerned may know precisely the extent of the obligations which they impose on them…."

Legal certainty cannot be achieved by the exercise of administrative discretions in individual cases. It can be achieved if the Halifax principle is analysed as conferring on the taxing authority a right to demand with retroactive effect repayments of wrongfully deducted VAT but subject to the obligation upon the taxing authority to subtract from any such demand any tax paid but for which the taxable person was not liable on the redefined transaction.

27. I therefore dismiss the appeal. I hold

(a) Section 80 VATA 1994 constitutes an exclusive and exhaustive regime for the recovery of overpaid VAT where the circumstances are such as to fall within the scope of the section;

(b) The Halifax principle is a rule of construction which (once an abusive transaction is identified) requires the literal text of the relevant provisions to be construed in a way that prevents the right of deduction being used artificially;

(c) The consequence of applying the principle is that the transaction may be redefined to secure that the correct tax is paid by the correct person;

(d) In that connection HMRC may assess the taxpayer in the sums correctly due (that is to repayment of the sums abusively deducted, but having subtracted therefrom any output tax for which the taxable person is not liable on the redefinition);

(e) That the outcome specified by the ECJ to result from the application of the Halifax principle does not authorise HMRC to raise an assessment in respect of which tax has already been paid

and then permit a taxpayer to reclaim the tax paid as an overpayment, but (in order to avoid the risk of injustice which may arise from a late invocation of the Halifax principle) requires HMRC only to demand payment of that which is correctly due and outstanding in relation to the transaction (irrespective of the number of separate accounting periods covered by the transaction which was regarded as abusive and is now redefined);

(f) Because Moorbury was not required to make a claim for recovery of overpaid VAT section 80 VATA is not engaged and Moorbury has not "lost" its right to have the tax it has in fact paid set against the tax now demanded from it.

(g) HMRC is only entitled to collect the correct amount of tax from XCo.

28. HMRC submitted that whatever the outcome of the appeal they should have their costs because Moorbury never explained why it did not make a "without prejudice" claim for repayment of the overpaid tax. In my judgment this cannot be determinative of the costs order to be made on the appeal. I have held that they did not need to. The discretion as to costs would normally be exercised in favour of a successful respondent: having considered the nature and conduct of the appeal I see no relevant factors that would justify a departure from the general rule. I accordingly direct that the appellants shall pay the costs of the respondent which (in the absence of agreement) are to be assessed on the standard basis.

16 September 2010.

Mr Justice Norris……*Alastair Norris*

Release Date: 23 September 2010