[2020] UKUT 0042 (TCC)

Appeal number: UT/2019/0044

VAT – whether the margin scheme for the sale of second-hand vehicles applies to sales of vehicles made by a financier following the recovery of possession of the vehicles on the termination of hire purchase transactions- Articles 14 and 312 to 315 Principal VAT Directive

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

VOLKSWAGEN FINANCIAL SERVICES (UK) LIMITED

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: The Hon. Mr Justice Zacaroli
Chamber President
Judge Timothy Herrington

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 21 and 22 January 2020

Amanda Brown, of KPMG LLP, for the Appellant

Peter Mantle, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2020

DECISION

Introduction

1. The appellant ("VWFS") appeals against a decision by the First-tier Tribunal ("FTT") (Judge Harriet Morgan) released on 9 November 2018 (the "Decision"). The FTT dismissed VWFS's appeal against the decision of the respondents ("HMRC") to reject its claims for a refund of over £24 million of output tax which it considered it had overpaid on sales of vehicles to third parties (typically at auction) which were either voluntarily returned to it or repossessed on early termination of finance agreements entered into by VWFS with members of the public for the purchase of motor vehicles. The claims were made under s 80 of the Value Added Tax Act 1994 ("VATA") in relation to such sales made by VWFS in the period from 1 July 2010 to 30 June 2014 (the "resales").

2. The FTT was asked to determine whether in principle VWFS was entitled to a refund. Before the FTT the Appellant contended that the resales should be taxed by reference to the provisions of Article 8 of the Value Added Tax (Cars) Order 1992 (the "Cars Order") which implemented Articles 313 to 315 of the Principal VAT Directive ("PVD"). Those provisions implement a margin scheme (the "Margin Scheme") for dealers in second-hand goods whereby in essence VAT is charged only on the difference between the price paid by the dealer and the price received on the resale thereby taking account of the VAT suffered by the customer in respect of the capital price paid by him for the vehicle when it was new.

3. In the alternative, VWFS contended that the sale at auction should be treated as neither a supply of goods nor a supply of services pursuant to Article 4(1)(a) of the Cars Order (with the result that it need not account for output tax on the sale) on the basis that, unless interpreted as to allow taxation by reference to the margin scheme, the provisions of Article 4(1AA) of the Cars Order (which prevents a disposal of a used motor car by person who repossessed it under the terms of a finance agreement from being neither a supply of goods nor supply of services) were unenforceable.

4. By the Decision, the FTT determined: (1) the margin scheme does not apply to the resales and (2) the provisions of Article 4(1AA) of the Cars Order were not unenforceable with the result that the appeal was dismissed.

5. VWFS appeals against the Decision with the permission of Judge Richards, granted in the Upper Tribunal on 2 April 2019. It now only pursues its contention that the relevant supplies should be taxed by reference to the Margin Scheme.

6. Consequently, the sole issue on this appeal is whether the sale by VWFS of a second-hand motor vehicle which it has repossessed from (or had returned to it by) a customer following the termination of a finance agreement under which that customer originally took possession of the car falls within the Margin Scheme.

7. Articles 312 to 315 of the PVD make provision for the Margin Scheme. Paragraph 51 of the preamble to the PVD states that it is appropriate to adopt a scheme to be applied to second-hand goods with a view to preventing double taxation and the distortion of competition as between taxable persons.

5 8. Article 313 requires Member States to apply a special scheme for taxing the profit margin made by taxable dealers on the supply, inter-alia, of second-hand goods. Article 314 provides:

> "The margin scheme shall apply to the supply by taxable dealer of second-hand goods… where those goods have been supplied to him within the
> 10 Community by one of a list of specified persons:
>
> (a) a non-taxable person;
>
> (b) another taxable person, in so far as the supply of goods by that other taxable person is exempt pursuant to Article 136;
>
> (c) another taxable person in so far as the supply of goods
> 15 by that other taxable person is covered by the exemption for small enterprises provided for in Articles 282 to 292 and involves capital goods;
>
> (d) another taxable dealer, in so far as VAT has been applied to the supply of goods by that other taxable dealer in
> 20 accordance with this margin scheme."

9. Article 315 provides:

> "The taxable amount in respect of the supply of goods as referred to in Article 314 shall be the profit margin made by the taxable dealer, less the amount of VAT relating to the profit margin.
>
> 25 The profit margin of the taxable dealer shall be equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price."

10. The Margin Scheme has been implemented in domestic law in relation to motor cars by Article 8 of the Cars Order which, so far as relevant, provides:

> 30 "(1) Subject to complying with [certain conditions], and subject to paragraph (3) below, where a person supplies a used motor car which he took possession of in any of the circumstances set out in paragraph (2) below, he may opt to account for the VAT chargeable on the supply on the profit margin on the supply instead of by reference to its value.
>
> 35
>
> (2) The circumstances referred to in paragraph (1) are that the taxable person took possession of the motor car pursuant to –
>
> (a) a supply in respect of which no VAT was chargeable under the
> 40 Act…
>
> …

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

(a) the price at which the motor car was obtained shall be calculated as follows:-

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

…"

10

11. It is common ground that for the Margin Scheme to apply it is necessary to find that the return of the vehicle to VWFS constitutes (1) a supply of goods, (2) for consideration. It is also common ground that for this purpose "supply of goods" is defined by Article 14 of the PVD.

15 12. Article 14(1) provides as follows:

> "(1) 'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner.
>
> (2) In addition to the transaction referred to in paragraph 1, each of the following shall be regarded as a supply of goods:
>
> 20 (a) the transfer, by order made by or in the name of a public authority or in pursuance of law, of the ownership of property against payment of compensation;
>
> (b) the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, 25 which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment;
>
> (c) the transfer of goods pursuant to a contract under which commission is payable on purchase or sale.".

13. The requirement for consideration results from the terms of Article 2 of the 30 PVD. Article 2, so far as relevant, provides:

> "1. The following transactions shall be subject to VAT:
>
> (a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such;
>
> …"

35 It was common ground before the FTT that when VWFS enters into a finance agreement with a customer, it correctly accounts for VAT on the basis that it makes a supply of goods to the customer for consideration equal to the full amount of capital payments due from the customer under the finance agreement.

The Facts

14. The FTT made findings of fact at [21] to [37] of the Decision and further findings as to the terms of the relevant finance agreements at [202] of the Decision. So far as is relevant to this appeal, we summarise those findings as follows.

15. Where a customer wishes to purchase a vehicle on credit the vehicle will be purchased by VWFS from the dealer. That sale will be subject to VAT which the dealer will charge on the sale and which VWFS can recover as input tax in the usual way. VWFS then enters into a finance agreement with the customer in respect of the vehicle which is regulated under the terms of the Consumer Credit Act 1974, as amended ("CCA").

16. There are two basic types of finance agreement used by VWFS. The first is a hire purchase agreement ("HP agreement") under which the customer is entitled to the possession use and enjoyment of the vehicle for the specified term of the agreement with an option to purchase the vehicle at the end of the term once all the instalments due under the finance agreement have been paid. The second is a personal contract plan agreement ("PCP agreement") which differs from a HP agreement in that instead of equal monthly instalments the customer is liable to make smaller equal monthly payments during the majority of the term and a large "balloon" payment at the end of the term. The FTT gave further detail of the terms of the finance agreements at [23] as follows:

> (1) The instalments payable under the finance agreements are calculated (a) to repay over the stated term the capital cost of the car to VWFS plus an amount representing the VAT which VWFS is required to account for on the capital amount and (b) to include its financing charge for the credit or loan VWFS in effect provides. The first monthly instalment also includes an acceptance fee charged by VWFS.
>
> (2) The balloon payment under a PCP agreement is set by VWFS at the start of the contract by reference to the expected residual realisable value of the car at the end of the term on the assumption that the customer complies with the terms of the PCP agreement relating to the mileage expected to be undertaken and the condition of the car. The balloon payment typically represents around 40% of the total price.
>
> (4) Legal title to the vehicle is transferred to the customer if the customer exercises the option to purchase the vehicle on paying a small option to purchase fee (of around £60) and provided all instalments are paid, including, in the case of a PCP agreement, the balloon payment. The option fee has to be paid when the final instalment is due. The customer is required to sign a declaration in the finance agreement that "you…. understand that the Vehicle will not become your property until you have made all the payments and exercised the option to purchase."
>
> (5) Under a PCP agreement the customer can choose to "hand back" the car shortly before the balloon payment is due, in which case it can ask VWFS to act

as its agent for the sale of the vehicle at auction. Cases where customers have elected to do so are not the subject of the VAT reclaims made by VWFS which are the subject of its appeal.

(6) A customer can terminate a finance agreement voluntarily without the customer incurring a cost (subject to any excess mileage and damage charges) once he or she has paid or, on paying, at least half the total amount payable under the agreement (a "voluntary termination"). This reflects a customer's statutory right to terminate in these circumstances under ss 99 and 100 CCA.

(7) If, when the customer wishes to terminate the agreement, he or she has not already paid 50% of the total amount due, the customer must proceed to do so. Voluntary terminations occur most commonly where the customer chooses to hand back the car after having already paid 50% or more of the monthly instalments. The finance agreement makes it clear, consistent with the customer's rights under the CCA, that on a voluntary termination once he has paid at least 50% of the total amount due and has taken reasonable care of the goods he has no obligation to pay any more.

(8) VWFS is entitled to terminate the contract and repossess the car where the customer defaults on his or her obligations under the agreement (a "forced termination"). Where this occurs before the customer has paid one third of the total price, VWFS can simply repossess the car. Where the consumer has paid one third or more of the total price, VWFS is required either to obtain the consumer's consent to the repossession or to get a court order before repossessing the car to avoid the customer being able to reclaim all monies paid under the agreement (pursuant to s 90 and s 91 CCA). The finance agreement provides, consistent with the customer's rights under the CCA, that on a forced termination the customer must pay any arrears which were accrued and remained unpaid under the agreement as at the date of termination as well as, by way of agreed damages, the total amount payable under the agreement, less the aggregate of the amounts of repayments already made, subject to a rebate calculated in line with regulations made under the CCA, the net proceeds of sale of the repossessed vehicle and any refunded part of a Valid Road Fund Licence.

17. Following a voluntary or forced termination, VWFS sells the car usually at auction. Depending on the type of the car, its condition and mileage the sale price of the car may exceed, be equal to or be less than the amount which is outstanding under the finance agreement at the time the car is handed back and the agreement is terminated.

18. Under a HP agreement the right to terminate voluntarily crystallises at the half way point in the agreed term. Under a PCP agreement, as the balloon payment typically represents around 40% of the total price, the right to terminate typically arises around two to three months before that payment is due.

19. The customer is subject to a number of restrictions and responsibilities as regards the use and care of the vehicle. Those matters include keeping the vehicle

under the customer's possession and control and not selling, hiring it out or otherwise disposing of it or using it as security for a loan or other obligation. The customer is obliged to keep the vehicle insured (for the benefit of VWFS), pay all relevant taxes and keep the vehicle in good repair.

5 **VAT position in relation to the transactions which are the subject of this appeal**

VAT position at the outset of the finance transaction

20. As recorded by the FTT at [42] of the Decision, when VWFS acquires the vehicle which is to be the subject of a finance agreement from the dealer, it claims credit for the VAT it is charged on the purchase of the vehicle as input tax in the usual 10 way (on the basis that it relates to its onward taxable supply of the vehicle to the customer). It also accounts for output tax on the supply of the vehicle to the customer on the full amount of the capital payments due under the finance agreement, notwithstanding that it will only receive the full amount from the customer over the life of the finance agreement.

15 21. At [43] and [44] of the Decision the FTT set out the VAT implications of a simple example of these transactions as follows:

> "43. For the purposes of illustration it is assumed that VWFS pays £120 for the vehicle it acquires from the dealer which includes £20 of VAT and charges the customer a capital sum of £120 which includes in total £20 of VAT. The 20 capital sum of £120 is payable by the customer in 10 instalments of £12 which includes £2 of VAT in respect of each instalment. The same figures and assumptions are used in illustrations throughout this decision.
>
> 44. As VWFS emphasised, as it has to account for the £20 of output tax at the outset, it suffers a cash flow cost. It has to fund the payment of £20 of VAT 25 charged by the dealer but only collects the output tax it accounts for in respect of the supply [of the vehicle under the finance agreement] in instalments when the capital repayments are made (in the sum of £2 when each of the 10 instalments is paid)."

VAT position on termination of the finance agreement

30 22. As the FTT recorded at [45] of the Decision, when a finance agreement is terminated early and the vehicle repossessed, VWFS has collected from the customer only part of the output tax which it was required to account for initially on the supply of the vehicle.

23. Where there is a voluntary termination, with the result that the customer has no 35 further liability to make the outstanding payments arising under the finance agreement, there is in effect a decrease in the consideration for the supply of the vehicle.

24. Article 90 of the PVD is relevant where there is an adjustment to the consideration for a supply after the supply has taken place and provides as follows:

> "1. In the case of "cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.
>
> 2. In the case of total or partial non-payment, Member States may derogate from paragraph 1."

25. Article 90 of the PVD has been implemented in domestic law by Regulation 38 of the Value Added Tax Regulations 1995 (the "Regulations") and by the provisions for relief for bad debts set out in s 36 VATA and Part XIX of the Regulations.

26. Regulation 38 of the Regulations ("Regulation 38") provides, so far as relevant, that where there is a decrease in the consideration for a supply, which includes an amount of VAT, which occurs after the end of the prescribed accounting period in which the original supply took place, the supplier is required to adjust his VAT account by making a negative entry in the VAT payable portion of his VAT account. The entry is required to be made by reference to the prescribed accounting period in which the decrease is given effect in the supplier's business accounts.

27. Therefore, where there is a voluntary termination VWFS can claim a downward adjustment to its VAT account in respect of the supply of the vehicle under Regulation 38, thus giving VWFS a credit for the VAT element of the capital sum payable for the vehicle which will no longer be paid by the customer.

28. As we have noted, where there is a hostile termination VWFS sells the vehicle and the net amount of the sale proceeds will be set off against the amounts still owed by the customer. Those sale proceeds will result in a decrease in the consideration for the supply of the vehicle to the customer and VWFS can accordingly claim a downward adjustment to its VAT account under Regulation 38. Where there are still sums outstanding for which the customer remains liable but which he does not pay, VWFS can recover the VAT element on the outstanding debt by way of bad debt relief pursuant to Article 90 of the PVD, as implemented by s 36 VATA and Part XIX of the VAT Regulations 1995.

29. Developing the simple example given at [21] above, the FTT illustrated the VAT position on early termination at [50] and [51] of the Decision as follows:

> "50. Following the above, example, if the customer terminates voluntarily half way through the term of the finance agreement, at that point the customer has paid to VWFS £50 of capital instalments plus £10 representing VAT on those instalments. VWFS makes a VAT adjustment under regulation 38 reflecting that it will not receive the further £50 due but for termination. The effect of such an adjustment is that VWFS obtains a credit for or repayment of VAT of £10 for which it is no longer liable and will no longer receive from the customer.
>
> 51. If the termination occurs on the customer's default and VWFS sells the vehicle for £30, VWFS makes a VAT adjustment under regulation 38 reflecting an amount equal to the sales proceeds of £30 as a reduction in the consideration

for the HP supply. VWFS may be able to claim bad debt relief in respect of the remaining amount owed of £20."

VAT on the resales

30. The VAT analysis set out at [20] to [29] above is common ground between the parties. The dispute between the parties centres only on the basis on which VAT is accounted for in respect of the resale of the vehicle following either a voluntary or hostile termination.

31. In that regard, the essential question to be answered, in order for the resales to be taxed under the Margin Scheme, is whether there was a "supply" by the customer to VWFS of the vehicle. If so, the provisions of Article 8 of the Cars Order would result in VWFS needing to account for output tax on the resale calculated only by reference to the profit margin on the resale.

32. In order for there to be a "supply" there must be a supply of goods by the customer for consideration when the vehicle is repossessed.

33. Article 4 (1) of the Cars Order makes special provision for disposals of repossessed vehicles. So far as relevant, this provision (the "de-supply provision") states:

> "Subject to paragraphs (1A) to (2) below, each of the following descriptions of transactions shall be treated as neither a supply of goods nor a supply of services –
>
> > (a) the disposal of a used motor car by a person who repossessed it under the terms of a finance agreement, where the motor car is in the same condition as it was when it was repossessed;
> >
> > …"

34. The de-supply provision is subject to an exclusion introduced in 2006 and which is to be found as Article 4 (1AA) of the Cars Order in the following terms:

> "Paragraph (1) (a) above shall not apply where adjustment, whether or not made under regulation 38 of the Value Added Regulations 1995, has taken account, or may later take account, of VAT on the initial supply under the finance agreement as a result of repossession and the motor car delivered under that agreement was delivered on or after 1 September 2006."

35. This exclusion applies because VWFS's VAT account will have been adjusted pursuant to Regulation 38, as described at [27] and [28] above.

36. As the FTT recorded at [54] of the Decision, VWFS initially accounted for output tax on the total consideration received in respect of the resales (that is on the assumption that the Margin Scheme did not apply) and on the basis that the de-supply provision does not apply due to the 2006 exclusion. It subsequently claimed repayment of the relevant sums which HMRC rejected, resulting in the proceedings which are the subject of this appeal.

No input tax recovery by customers and purchasers of the vehicles

37. As recorded by the FTT at [55] of the Decision, it was common ground that each customer and each purchaser of a repossessed vehicle is not entitled to deduct as input tax the VAT on the supply of the vehicle and the resale respectively because they are the final "retail" consumers. VWFS contends that if the Margin Scheme does not apply there will be double taxation because of an element of irrecoverable VAT paid by the customer before the repossession of the vehicle.

The Decision

Double Taxation

38. As recorded at [59] of the Decision, VWFS's stance centres on its view that, under the principles underpinning the EU VAT regime, VWFS is entitled to relief from charging VAT on the full price received on the resales to avoid double taxation. As mentioned above, before the FTT that position was pursued through two alternative arguments, one of which was that the exclusion to the de-supply provision was incompatible with EU law because it gave rise to double taxation when VAT was charged on the resales.

39. The FTT dealt with the question as to whether there was double taxation in its discussion as to whether the exclusion to the de-supply provision was incompatible with EU law. Although that argument is not pursued by VWFS in these proceedings, it still forms the underlying rationale for its arguments in relation to the applicability of the Margin Scheme so the FTT's analysis as regards the question of double taxation is relevant to this appeal.

40. At [60] the FTT recorded VWFS's contention that there is an "embedded" irrecoverable VAT cost in the vehicles as a result of the HP supplies to the customers who, as non-taxable persons, cannot recover the VAT charged by VWFS. It recorded VWFS's submission that under the principles underpinning the EU VAT regime, that VAT cost must be relieved when the vehicles are "reintroduced" into the commercial supply chain when VWFS takes back possession of the vehicles on early termination of the finance agreements and the vehicles are re-sold at auction. It is important to emphasise that the "embedded" irrecoverable VAT referred to is the VAT element paid by the customer on the instalments under the finance agreement paid by him before the termination of the finance agreement, in respect of his use of the vehicle during the time that the finance agreement was in place.

41. At [135] the FTT noted the fundamental principle that VAT is a tax charged on each transaction in the production and distribution process on a proportional basis after deduction of the amount of VAT borne directly by the various costs components. It also noted, correctly, that it would be contrary to that principle for a dealer to charge VAT on the full price received on the sale of goods which the dealer acquired from a person who has suffered irrecoverable VAT on the price that person paid for the goods, where the dealer cannot obtain relief for that VAT cost.

42. At [136] the FTT observed that where a dealer acquires goods from a non-taxable person there is an irrecoverable VAT cost "embedded" in the goods which cannot be relieved in the hands of the dealer under the general VAT regime because there is no claim for input tax that can be made against the output tax due on sale of the goods by the dealer. The FTT went on to explain that under the Margin Scheme, that position is alleviated so that the dealer is required to account for VAT only on its profit margin in recognition that, in effect, an irrecoverable VAT cost for which relief cannot be obtained has already been suffered on the price the dealer pays for the vehicle.

43. However, at [140] the FTT said it would be contrary to the proportional basis of the VAT charge, as reflected in the aims of the Margin Scheme, for VWFS to obtain relief for the irrecoverable VAT suffered by the customer under the HP supply on the subsequent resale. It said:

> "In this case, whilst it is indisputable that the customer suffers an irrecoverable VAT cost under the HP supply, that simply does not represent a cost which needs to be relieved in the hands of VWFS…."

44. The FTT's reasoning for that conclusion was set out at [145] to [151] as follows:

> "145. The key point is that the cost of the vehicle to VWFS is a direct cost component of both the HP supply and the separate (albeit related) supply on resale at auction. VWFS consumes or uses the supply of the vehicle to it to realise value from the vehicle under a HP transaction and, when that transaction terminates early, to realise, on sale at auction, whatever value remains following the period of use of the vehicle under the HP transaction. On the basis that VWFS is required to charge VAT on the price paid by the customer and the purchaser at auction, each suffers a definitive VAT charge, in effect, on the proportion of the value realised by VWFS from its total use of the vehicle which VWFS realises from each of them respectively. The vehicle can be said to enter "final consumption" under the HP supply, therefore, only partially by reference to the value received by VWFS for that supply. It enters final consumption partially also under the supplies made on the repossession sales by reference to the remaining value which VWFS then realises.
>
> 146. The margin scheme operates on the basis that a proportion of the cost component incurred by the consumer in making the supply of the vehicle to the dealer, on which the definitive charge to VAT is suffered, is in effect passed on to the dealer in the price charged for that supply. VWFS argument involves in effect that the consumer's cost under the HP supply, on which it suffers an undisputed definitive VAT charge, is passed on to VWFS on the basis that the customer supplies the vehicle back to VWFS on repossession or the handing back of the vehicle.
>
> 147. Even if it could be said there is a supply of that nature (and, as set out below, I do not consider that is the case) in economic and commercial terms there is no real passing of the customer's cost under the HP supply to VWFS in these circumstances. On VWFS' own analysis that cost is passed on to VWFS on the basis that it incurs, as consideration for the asserted supply, an amount

equal to the sums which, as at the termination date, the customer no longer has to pay or which the customer is deemed no longer to be liable for (to the extent that the net sales proceeds are set off against the sums due). The fact is that VWFS receives full relief for the VAT otherwise due on those amounts by way of reduction to the consideration received under the HP supply under the adjustment provisions. If the margin scheme or the de-supply provision were to apply VWFS would obtain relief for those amounts a second time on the basis that VWFS has somehow incurred a further entirely notional cost.

….

149. From whichever perspective this is viewed, it can be nothing other than double counting for VWFS to receive relief for the irrecoverable VAT cost incurred by its customer in respect of the part of the value of the vehicle which VWFS realises under the HP supply against the VAT due on the remaining value it realises from the vehicle on the resale. As HMRC submitted, if the margin scheme or the de-supply provision applies, VWFS recovers all of its input tax on the purchase of the vehicle but ultimately only accounts for part of the overall consideration it receives through its use of the vehicle under the HP supply and the subsequent sale. In effect, enabling VWFS to account for output tax on a lower amount than it actually receives on the supplies it makes through the cost component incurred in making those supplies (the purchase price it paid or the vehicle) enables VWFS to obtain relief for a proportion of the VAT it bears on that cost component twice over.

150. VWFS objected to HMRC's analysis on the basis that it ignores that the input tax incurred on the supply of the vehicle to VWFS from the dealer, is in effect consumed in making the HP supply to the customer. VWFS argued that such a supply, as a supply into final consumption, has precisely the same chain breaking effect as an exempt supply. It is impermissible to look through a supply into final consumption and indirectly attribute the input tax as HMRC seek to do. This breaches the principle that……each step in the chain is to be considered separately for VAT purposes.

151. I note that there is no direct correlation between the amount of input tax which can be recovered and the amount of output tax charged. A business can recover input tax incurred on the basis that it is attributable to the making of onward taxable supplies whatever the value of those onward supplies. However, I do not consider that this detracts from how the proportionality principle underpinning the VAT regime is to be applied in this case. The vehicle can only be said to enter partial final consumption under the HP supply in the manner explained above. There is no authority (and no reason as a matter of principle) that this partial final consumption should be regarded as "breaking the chain" to give a result which is clearly contrary to the intended effects of the EU VAT regime."

Application of the Margin Scheme

45. As already noted, it is common ground that for VWFS to succeed it must establish that the return of the vehicle to it upon termination of the finance agreement constitutes a "supply of goods" within Article 14(1) or Article 14(2)(b) of the PVD.

46. At [157] the FTT identified the dispute between the parties as being whether the requirements of the Margin Scheme were satisfied on the basis that VWFS' customers, as non-taxable persons, make supplies of goods to VWFS on the handing back or repossession of the vehicles, whether that occurs pursuant to a voluntary or forced termination. In order to answer that question, the FTT carried out an analysis of the application and effect of Article 14 of the PVD, by reference to the case law of the Court of Justice of the European Union ("CJEU")[1]. These authorities do not focus, however, on the issues arising on this appeal.

47. At [210] the FTT concluded that the transfer of possession of the vehicle *to the customer* under the finance agreements at issue in this case is to be regarded as a "supply of goods" pursuant to Article 14(2)(b), but that it did not constitute the transfer of the right to dispose of the vehicle as owner, and thus did not fall also within Article 14(1). On this appeal, it is common ground that the transfer of possession of the vehicle to the customer constituted a supply of goods within Article 14(2)(b). VWFS, having contended before the FTT that it also fell within Article 14(1), did not pursue that argument before us.

48. At [211] the FTT took as its starting point in deciding whether there was a supply of goods by the customer when the vehicle was repossessed by VWFS an examination of the effect of the contractual arrangements between the parties. On that approach, the FTT held that the customer does not make a supply of goods to VWFS in return for consideration on the handing back or taking back of the vehicle on termination of the finance agreements. Its core reasoning was set out at [212] to [217] as follows:

> "212. As HMRC submitted, as a matter of contractual interpretation and in accordance with the commercial and economic reality, on termination, VWFS merely exercises its pre-existing right to have delivered to it or re-take possession of its own asset in recognition that the contractual relationship is at an end. The effect of the ending of the relationship is that (1) VWFS is entitled to ownership of the vehicle unencumbered by any further obligations or rights of the customer under the finance agreement (save for those expressly relating to the termination and re-possession); and (2) the customer no longer has any contractual right to the possession or use and enjoyment of the vehicle or to purchase it.
>
> 213. In other words the recovery of possession of the vehicle simply puts VWFS in the position necessary to recognise and give effect to the intended position on termination of the contractual relationship between it and the customer, as provided for from the outset in the contractual terms, by restoring its physical possession and control of the vehicle. Of necessity, as the vehicle is in the possession of the customer, the customer must either deliver it up or VWFS must arrange collection of it from the customer in order to give effect to these pre-existing contractual rights.

---

[1] We use the term "CJEU" to include the European Court of Justice where the context requires.

214. The key point is that, the outcome and effect of a voluntary termination or forced termination is provided for as part of the bundle of rights and obligations governing the parties' contractual relationship. At the point of termination, VWFS' right to re-gain possession of the vehicle is automatic in the sense that it does not depend on any additional agreement, consent or thing done or to be done by the customer in contractual terms in return for any consideration other than that provided for in the finance agreement from the outset subject to the provision for adjustment on termination. It follows that there is nothing which can be regarded as a supply which is separate from the HP supply which is made in return for consideration. In effect the consideration expressed to be due under the finance agreement is due in relation to the entirety of the rights and obligations arising under the agreement as adjusted in the event of early termination.

215. I note that, on a voluntary termination, the customer's obligation to pay the remaining part of the sums otherwise due following termination falls away as stated in the finance agreement and moreover, by law, by virtue of the statutory provisions in CCA. As the customer is entitled by law to terminate a finance agreement on paying 50% of the price due; when the customer elects to do so, VWFS has no legal right to collect the rest of the sums which otherwise would have fallen due. VWFS can hardly be said in any real sense to give up or release a right to future sums which by law it no longer has.

216. Nor can the customer be said to receive something of value in return for VWFS recovering possession of the vehicle. The fact that it no longer has to pay any further sums, which would have been due, had the finance agreement remained in place, is entirely commensurate with the fact that, at the customer's own election, the customer no longer has any entitlement to the possession and use and enjoyment of the asset. The customer has paid for what he or she has received; the hire of the asset for the period of time prior to termination.

217. As regards a forced termination, under the finance agreement VWFS can require possession of the vehicle so that it can sell it to use the proceeds to off-set the sums for which the customer would otherwise be liable. The situation is akin to that where a lender enforces its security under a loan, when the borrower is in default. Again the customer no longer has the right to possession, use and enjoyment of the vehicle due to its default and subsequent termination, as is clearly stated to be the outcome of default in the contractual terms. VWFS cannot be said to be providing value to the customer in protecting its position by exercising its pre-existing right to take possession of its own asset to realise the value in satisfaction or partial satisfaction of the amounts otherwise remaining due."

49. The FTT supplemented this reasoning by analysing the combined effect of Articles 14 and 90 at [231] to [234] as follows:

"231. As the courts have applied article 14, in combination with article 90, in this context, those rules provide a comprehensive scheme for taxing the entirety of a HP transaction as a supply of goods. In effect the full bundle of rights and obligations comprised within the HP transaction is taxed as a supply of goods. Accordingly, the change in those rights and obligations on an early termination is catered for by the application of article 90. It is clearly established that article 90

applies to recognise the resulting change to the payments due as a reduction for the consideration for the supply of goods taking place under the HP transaction. As VWFS itself recognised, at that point the supply of goods made in respect of the HP transaction is complete in the sense that its full value for VAT purposes has been determined.

232. VWFS' position that, on recovery of the vehicle by VWFS, there is a separate customer supply of the goods is entirely out of kilter with this approach. In effect VWFS' argument requires the unpicking of the bundle of the rights and obligations comprising the HP transaction which article 14, in combination with article 90, taxes in its entirety as a supply of goods. It cannot be the case that the amounts which are taken into account as a reduction in the consideration for the HP supply on termination also serve as consideration for a separate supply by the customer to VWFS.

233. As noted, VWFS said that this criticism of its approach ignores the need for each separate transaction to be taxed separately for VAT purposes. However, VWFS has not provided any substantive foundation for the view that there is such a separate supply. I cannot see that there is any reason why it must follow from the fact that a HP transaction is taxed as a supply of goods that, in order for the underlying assets to be the subject of any further supply of goods, the customer/hirer who receives the HP supply must make an onward supply. Nor can I see that to hold that there is no customer supply on VWFS recovering possession of the vehicle somehow results in the HP transaction being improperly re-categorised retrospectively as a supply of services.

234. The effect of article 14 in this context, as VWFS fully accepts, is to tax the HP transaction itself definitively, once and for all, as a supply of goods. That treatment is not compromised or affected in any way by the fact that there is no supply of goods by the customer on VWFS recovering possession of the vehicle. Article 14 simply does not go beyond its stated remit according to its own terms of reference; it does nothing more than provide the means of taxing the HP transaction. Its function is fulfilled once, in combination with article 90, the taxable amount of the HP supply is determined. The fact that there are other provisions in the VAT regime which in a sense apply a fiscal fiction, such as the VAT group and TOGC provisions, adds nothing to the debate. The application of those rules in a wholly different context says nothing about how article 14 is to be interpreted."

50. Finally, although in the light of its conclusion that there was no supply by the customer to VWFS on termination of the finance agreement it was not necessary to do so, the FTT briefly considered at [238] to [242] what the profit margin would be were the Margin Scheme to have applied as follows:

"238. VWFS submitted that in this case there are a number of possibilities which the tribunal could adopt. These include taking as the price the monetary value of the sums collection of which is foregone on termination or using a wholly imputed price calculated as a fixed percentage of the sales price or a proportionate calculation reflecting how far through the contract the customer is at termination. VWFS said, however, that such valuations do not fully reflect the embedded VAT and, therefore, using such a value would not meet the objective of the margin scheme of avoiding double taxation. For that reason, in its view,

the best approach is to take as consideration for the supply the price the customer has actually paid under the finance agreement.

239. VWFS considered that there is support for this approach in the decision in *Empire Stores Ltd.* In that case the CJEU held, at [16], that there was a direct link between the supply of articles for no extra charge to existing and potential customers and the provision of an introductory service by the customers in agreeing themselves to purchase goods offered in the Empire stores' sales catalogue for the first time or for introducing others who did so. If the service was not provided no article was due from or supplied without extra charge by Empire Stores. The value of that supply of introductory services was equal to the price paid by *Empire Stores* for the goods. VWFS submitted that the court made clear, at [19], that it is the value placed on the consideration by the recipient of the consideration which drives the taxable amount. In effect in that case the supply was valued through the lens of the supplier by reference to the sum spent.

240. However, if, contrary to my view, the scheme does apply, I can see no reason why the purchase price should not be taken to be an amount equal to the sums which VWFS said is provided as consideration by VWFS in return for the supply of goods it argued is made by the customer to it (on the basis of which it said the scheme applies). I agree with HMRC's criticisms of VWFS' alternative approach.

241. HMRC said that VWFS's approach to valuation of the supply is contrived and unrealistic. The approach in *Empire Stores* is only permissible if no monetary value has been agreed between the parties; that is not the case if VWFS's analysis of the nature of the consideration is right, namely, that it is the release from sums otherwise due which constitutes consideration. If that is not consideration expressed in money, it is clearly closely analogous to monetary consideration; it is to be valued as the amount foregone by VWFS.

242. It is important, as the CJEU emphasised in *Empire Stores*, that the taxable amount of a supply is the consideration actually received and not a value estimated according to objective criteria. It is wholly unrealistic to regard the subjective value attached by either VWFS or the customer to the vehicle when VWFS recovers possession as equivalent to the amount paid by the customer under the finance agreement."

Grounds of Appeal and issues to be determined

51. VWFS asserted three grounds of appeal:

(1) The FTT failed to appreciate the consequence of their conclusion that the supply to the customer decisively gave rise to irrecoverable VAT in the hands of the customer;

(2) The FTT, having agreed with HMRC that the supply of the vehicle to the customer under the Finance agreement was taxed as a supply of goods pursuant to Article 14(2)(b) of the PVD, refused to acknowledge that such tax treatment necessitated the repossession of those goods (or

their voluntary return) as having given rise to a supply of goods for consideration[2] by the customer back to VWFS;

(3) As a consequence of the errors identified in the first two grounds, the FTT incorrectly concluded that the Margin Scheme cannot apply to the supplies of repossessed cars.

52. It was accepted before us that the essential question on this appeal is the second ground because unless the repossession of the vehicle constituted a supply of goods for consideration the Margin Scheme cannot apply. So far as the first ground of appeal is concerned, Mrs Brown, who appeared for VWFS, did not suggest that the fact (as VWFS contended) that the FTT's conclusion gave rise to irrecoverable VAT was a separate reason for finding that the Margin Scheme applied, but she submitted that it was part of the background against which the provisions of the PVD fell to be construed.

53. As we have noted, before us, so far as the supply of the vehicle *to* the customer at the outset of the finance agreement is concerned: (1) HMRC accepted that it constitutes a supply of goods within Article 14(2)(b); and (2) VWFS does not contend that it constitutes a supply of goods within Article 14(1).

54. So far as the return of the vehicle by the customer to VWFS following termination of the finance agreement is concerned, VWFS contends that it constituted a supply of goods within either Article 14(1) or Article 14(2). We will address this contention first by reference to the language of Article 14 before considering to what extent, if any, the interpretation of Article 14 is affected by the existence of irrecoverable VAT.

Discussion

Is the return of the vehicle a supply of goods within Article 14(1)?

55. The principal hurdle in the way of the argument that the return of the vehicle, following termination of the finance agreement, is a supply of goods within Article 14(1) is that the customer under a finance agreement never acquires the right to dispose of the vehicle as owner unless and until it exercises the option to purchase. By definition, therefore, wherever a finance agreement is terminated prematurely the customer has never acquired the right to dispose of the vehicle as owner in the first place. If it never obtains the right to dispose of the car as owner, we do not see how there could be any transfer of that right from it to VWFS.

56. VWFS seeks to overcome this by contending that, while the customer did not at the commencement of the hire period *actually* obtain the right to dispose of the vehicle as owner, it is to be treated for all fiscal purposes as if it did.

---

[2] Although the second ground refers solely to the repossession constituting a "supply of goods" it was common ground that in order to constitute a supply of goods for the purposes of VATA it was necessary to show that the supply was for consideration.

57. The starting point for this argument is the fact (as is common ground) that transfer of possession of the vehicle at the commencement of the hire period under the finance agreement is to be regarded as a supply of goods pursuant to Article 14(2)(b). VWFS contends that, because Article 14(1) states that "supply of goods" *means* "the transfer of the right to dispose of tangible property as owner", then Article 14(2)(b) is to be read as treating a transaction that falls within it *as* a transfer of the right to dispose of tangible property as owner. In other words, VWFS contends that Article 14(1) has the effect of requiring the phrase "supply of goods", wherever it appears in the PVD, to be replaced with the words "the transfer of the right to dispose of tangible property as owner". On this basis, Article 14(2) is to be read as: "In addition to the transaction referred to in paragraph 1, each of the following shall be regarded as a *transfer of the right to dispose of tangible property as owner*".

58. Mrs Brown further submitted (by analogy with the mathematical conclusion that where A = C and B = C it follows that A = B) that since the right to dispose of tangible property as owner is to be equated with "supply of goods" (under Article 14(1)) and the actual handing over of goods under a finance agreement is to be equated with "supply of goods" (under Article 14(2)(b)) it follows that the actual handing over of goods under a finance agreement is to be equated with the transfer of the right to dispose of tangible property as owner.

59. We cannot accept this argument, which misinterprets the purpose and effect of Article 14(1). The concept "supply of goods" is used throughout the PVD. The purpose of Article 14 is to define the type of transaction that will constitute a "supply of goods". Article 14(1) identifies *one* of the transactions that will constitute a supply of goods. Article 14(2) provides three other transactions that also constitute a supply of goods.

60. The position is made clear by the opening words of Article 14(2): "In addition to the transaction referred to in paragraph 1". The transaction referred to in paragraph 1 is "the transfer of the right to dispose of tangible property as owner". Article 14(2), therefore, is identifying three further transactions which, though they are *not* "the transfer of the right to dispose of tangible property as owner" are nevertheless to be regarded as a "supply of goods."

61. This is supported by the decision of the CJEU in *Minister Finansow v Gmina Wroclaw* C-665/16 ("*Wroclaw*"). The case concerned the compulsory purchase of land by and from departments in the same local authority. The question was whether it fell within Article 14(2)(a). The Advocate General (at [44]-[47]) rejected an argument that for a transaction to fall within Article 14(2)(a) it must also fall within Article 14(1). He described Article 14(2) as constituting "*lex specialis*" to the general definition of supply of goods contained in Article 14(1). At [48] to [50] he said:

> "48. Article 14(1) and Article 14(2) of the VAT Directive are separate instances of a 'supply of goods' which must receive an independent interpretation. Article 14(1) contains the general criteria for the determination of a supply of goods. Article 14(2) contains a list of transactions which 'in addition' to those falling within the general definition of Article 14(1) shall also be regarded as a 'supply of goods'. The structure of Article 14 is

> therefore decisive: Article 14(1) establishes the general requirements for a supply of goods to be given. Conversely, Article 14(2) refers to specific transactions which are assimilated to a supply of goods.
>
> 49. Article 14(2)(a) of the VAT Directive employs different terms when compared with Article 14(1). Article 14(2)(a) does not refer to the 'right to dispose of tangible property as owner', but clearly chooses a different formulation: 'the transfer, by order … of the ownership of the property'.
>
> 50. As a result, in the specific context of mandatory transfers of ownership as opposed to freely assumed contractual relations, Article 14(2)(a) effectively supplants all the relevant elements of Article 14(1). The different logic and purpose outlined above thus entails different notions."

62. At [52], the Advocate General addressed specifically Article 14(2)(b), as follows:

> "Moreover, it might be added by internal analogy that Article 14(2)(b), which constitutes another of the 'additional' transactions assimilated to a supply of goods, refers to the 'actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment'. As the Court has held, the wording of that provision makes it clear that, unlike the transactions covered by Article 14(1), those covered by Article 14(2)(b) do not refer to the transfer of the power to dispose of property as an owner."

63. The CJEU, at [34] to [36] of its judgment, agreed with the Advocate General, concluding that the conditions for the application of Article 14(2) (which constituted a *lex specialis*) are "independent of those in [Article 14(1)]".

64. VWFS contends that it is clear from *Wroclaw* that a supply under a finance agreement is "for all purposes and for all time taxed as a supply of goods with all the same consequences flowing as if the supply had been one under Art 14(1)". That is a *non sequitur* and we reject it. On the contrary, the passages from *Wroclaw* which we have identified above, support the conclusion that Articles 14(1) and 14(2) are dealing with different transactions. Where the Advocate General referred to the transactions in Article 14(2) being "assimilated to a supply of goods", he was saying no more than that the transactions in Article 14(2) are to be treated in the same way as a supply falling within Article 14(1) as a supply of goods for VAT purposes. We find nothing in the *Wroclaw* decision to support the contention that a transaction in Article 14(2) is to be regarded as a transfer of the right to dispose of tangible property as owner.

65. Even if we are wrong so far, and the actual handing over of goods at the commencement of a finance agreement is to be regarded as the transfer of the right to dispose of tangible property, we nevertheless reject VWFS's contention that once that fiscal fiction is established, its consequences must be followed through to their natural conclusion, which is that when the customer returns the car to VWFS it is to be

regarded as transferring back the right to dispose of the vehicle as owner. We address this in detail below at [70] to [85].

66. VWFS further contended that in circumstances where – during the currency of the finance agreement – neither VWFS nor the customer is entitled to dispose of the vehicle as owner, the transfer of possession of the vehicle back to VWFS upon termination of the finance agreement is to be equated with the transfer of the right to dispose of the vehicle as owner. Even if this is properly analysed as VWFS *acquiring* the right to dispose of the vehicle as owner, it is impossible to construe it as having acquired that right by way of *transfer* to it from the customer. The more appropriate analysis is that notwithstanding that ownership of the vehicle remains with VWFS, it is disabled during the currency of the finance agreement, by reason of contractual restrictions, from exercising certain rights, in particular the right to dispose of it to third parties. Upon termination of the finance agreement, that contractual disability falls away and VWFS resumes the right to exercise all rights as owner, including to dispose of the vehicle to third parties. That analysis is consistent with the FTT's findings as to the terms of the finance agreements: see the summary set out at [16] to [19] above.

Is the return of the vehicle a supply of goods within Article 14(2)(b)?

67. Alternatively, VWFS contends that the return of the vehicle is a supply of goods within Article 14(2)(b), on the basis that the handing back of the vehicle occurs pursuant to a contract which fits the description set out in the sub-paragraph, in that it is a contract for the hire of goods for a certain period which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment.

68. We do not accept this construction of Article 14(2)(b). We consider that the language of the provision indicates that it is intended to refer only to the transfer of possession of the goods to the customer at the outset of the finance agreement. Such a transfer of possession is accurately described as occurring "pursuant to" the finance agreement. In contrast, it would require a strained construction to describe the repossession of the car as either an "actual handing over" of the goods, or being "pursuant to" the finance agreement, certainly where this is a result of forced termination. Even in the case of a voluntary termination, the customer has a statutory right to hand the vehicle back so that while this might accurately described as an "actual handing over" of the vehicle, it is not to be regarded as "pursuant to" the finance agreement, even if the terms of the finance agreement reflect the statutory right.

69. This is, moreover, consistent with the purpose of the provision, as we have identified it at [59] and [60] above, namely to treat the transfer of possession as a supply of goods (when it would otherwise be regarded as a supply of services) in order to accelerate the payment of VAT on the whole capital value of the vehicle. In contrast, the return of the car pursuant to a finance agreement would not otherwise be regarded as a supply at all (whether of goods or services), and the purpose of Article 14(2)(b) is thus not engaged.

The consequences of the deeming provision in Article 14(2)(b)

70. VWFS supported its contention that the return of the vehicle should be seen as a "supply of goods" – whether within Article 14(1) or Article 14(2)(b) – on the following basis: since the transfer of possession of the vehicle *to* the customer is deemed for VAT purposes (pursuant to Article 14(2)(b)) to be a supply of goods, the return of the vehicle *from* the customer is also to be regarded for VAT purposes as a supply of goods.

71. VWFS criticises the FTT for having analysed the nature and consequences of the repossession or voluntary return of the car by reference to the contractual provisions, viewed in the light of economic and commercial realities. The FTT adopted a conventional approach to the construction of terms of the finance agreements: see [211] to [213] of the Decision referred to at [48] above and [231] to [234] of the Decision as referred to at [49] above.

72. VWFS contends that the "fiscal fiction" created by Article 14(2)(b) must be followed through to its natural conclusion.

73. The first way in which VWFS put this argument is that if it is accepted that the transfer of possession at the outset is to be regarded as "the transfer of the right to dispose of tangible property as owner" then the fiction that has to be carried through is that the customer has the right to dispose of the goods as owner. We have rejected the essential premise for that argument at [55] to [66] above. We understood, however, VWFS to advance the broader argument that once the fiscal fiction that there has been a supply of goods to the customer at the outset of the finance agreement has been established, it is necessary when considering the VAT consequences of the return of the vehicle to start from the premise that the customer has had the vehicle supplied to it, so that the return of the vehicle must be regarded as a supply of goods back to VWFS.

74. The approach to construction of a deeming provision in the tax context was set out by Peter Gibson J in *Marshall (Inspector of Taxes) v Kerr* [1993] STC 360, at 366 (cited with approval by Lord Walker in *DCC Holdings (UK) Ltd v Revenue and Customs Comrs* [2010] UKSC 58, at [38]):

> "For my part I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so."

75. VWFS relies on two cases in which this approach to a deeming provision has been applied.

76. The first is *R (On the application of Northumbria Healthcare NHS Foundation Trust) v Revenue and Customs Commissioners* [2019] UKUT 170 (TCC) ("*Northumbria*"), a decision of the Upper Tribunal (Henry Carr J and Judge Sinfield). This case concerned a salary sacrifice scheme pursuant to which an NHS Trust offered car leasing to its (and other NHS Trusts') employees. The Trust contended that it was entitled to a refund of the VAT incurred by it in relation to the car leasing activity. This entitlement arose under s.41(3) of the Value Added Tax Act 1994 and a Contracted Out Services Direction made pursuant to that section. In essence, the claim to a refund depended on whether the supply of the services was not for the purpose of any business carried on by the Trust.

77. It was common ground that "any business carried on" had the same meaning as "economic activity" in Article 9(1) of the PVD. Article 9(1) of the PVD defines economic activity as the activity of persons "supplying services".

78. Having quoted the passage from the judgment of Peter Gibson J referred to above, the Upper Tribunal concluded, at [33]-[34], that the requirements of s.41(3) were deemed to have been satisfied. The starting point was that the provision of cars by the Trust under the salary sacrifice scheme could not be regarded as a supply of services because, by the Value Added Tax (Treatment of Transactions) Order 1992, Article 2, it "shall be treated as neither a supply of goods nor a supply of services…". It followed that the leasing of cars cannot be an economic activity because that required a supply of services:

> "33. We take the view that provision of the cars by the Trust to the employees under the salary sacrifice scheme cannot be regarded as a supply of services because it has been de-supplied by the De-Supply Order. It follows that the leasing of the cars by the Trust cannot be an economic activity because that requires a supply of services. Since the effect of the De-Supply Order is that any "business" or "economic activity" relating to the Car Scheme is ignored for VAT purposes, the Trust is deemed to be, or reverts to being, a purely non-business operation. In those circumstances, the terms of section 41(3)(a) VATA94 are deemed to be satisfied pursuant to the De-Supply order.
>
> 34. This, in our view, is clear from the ordinary and natural meaning of Article 9(1) of the PVD which states that "any activity of … persons supplying services shall be regarded as 'economic activity'" (emphasis added). There is nothing in Article 9 to suggest that a person who does not supply any services (whether as a matter of fact or by operation of a deeming provision) should or could be regarded as carrying on an economic activity. If the Trust's only activity were the provision of cars to employees under the salary sacrifice arrangements, there would be no economic activity as a result of the De-Supply Order. Accordingly,

> the supplies of the leased and maintained cars to the Trust for the purpose of providing those cars to employees cannot have been for the purpose of any business carried on by the Trust. That is also the position if the Trust's wider activities are taken into account. That is because those other activities of the Trust are not business activities and do not constitute an economic activity."

79. In our view, the circumstances in *Northumbria* are so far removed from the circumstances of this case as to be of no assistance. On the basis of the analysis adopted by the Upper Tribunal, in *Northumbria* there was a direct connection between the deeming provision (Article 2 of the Value Added Tax (Treatment of Transactions) Order 1992, which treated the provision of cars as neither a supply of goods nor a supply of services) and the issue to be determined (whether the Trust was carrying on an economic activity pursuant to Article 9 of the PVD), because Article 9 defined "economic activity" as activity of persons "*supplying services*". Leaving aside any other activity of the Trust (which for different reasons did not constitute economic activity) the only basis upon which the Trust could be said to be carrying on an economic activity was by reference to the "supply" of cars pursuant to the salary sacrifice scheme. Since these were deemed to be neither a supply of goods nor services, they could not be relied upon to establish economic activity. It is true (as VWFS point out) that the question at issue was the Trust's entitlement to a refund of VAT charged in relation to a different transaction to that which was deemed to be de-supplied, namely the acquisition of the car which was then leased to employees. Nevertheless, since the entitlement to a refund of that VAT expressly depended upon the relevant transaction being for the purpose of carrying on a business, and that in turn (being equated with "economic activity" in Article 9 of the PVD) required the Trust to be undertaking activity consisting of supplying services, it could properly be said (in the words of Peter Gibson J in *Marshall v Kerr*) that to treat the Trust as not carrying on an economic activity was an inevitable consequence of deeming there to be no supply.

80. In contrast, in the present case, there is no, let alone a direct, connection between the deeming provision (which relates to the transaction between VWFS and the customer) and the issue to be determined, namely whether a subsequent sale of the same vehicle by VWFS in the second-hand market, following repossession from the customer, falls within the Margin Scheme. The two transactions are different. The only connection between them is that the subject matter of each is the same vehicle.

81. Moreover, there is nothing in the legislative purpose of Article 14(2)(b) that provides any imperative to deem the repossession of the vehicle as a supply of goods. Absent Article 14(2)(b), the transfer of possession of the vehicle to the customer would be part of a supply of services. Article 14(2)(b) deems what would otherwise be a supply of services to be a supply of goods. The purpose is to accelerate the payment of VAT based on the full capital value of the vehicle. That purpose is achieved when VWFS accounts for VAT on the full capital value of the vehicle upon inception of the Finance agreement. If the contract is performed in the way expressly anticipated in Article 14(2)(b) (that is, in the "normal course of events" ownership transfers to the customer at the latest upon payment of the final instalment) then no

further issue arises. If the contract is terminated early, then the issue arises that VWFS has accounted to HMRC for VAT on the full capital value of the vehicle but has received only a portion of that value from the customer. That is the very issue, however, which is addressed by Article 90 of the PVD and the bad debt relief provisions which, in combination, ensure that VWFS accounts only for VAT on such part of the capital value of the vehicle that it ultimately receives from the customer.

82. In substance, this reverses the effect of the deeming provision in Article 14(2)(b). Once it is established that the normal course of events envisaged by Article 14(2)(b) (that ownership would transfer to the customer at the latest upon payment of the final instalment) cannot now occur, the fiction that it is a supply of goods comes to an end. VWFS is required to account (taking into account the adjustments permitted by Article 90 and the bad debt relief provisions) only for the amount of the instalments actually received from the customer during the period of hire. Although it has suffered the cash-flow detriment of accounting for this VAT upfront, it is ultimately required to account for same amount of VAT if the transaction had been treated as a supply of services, namely the provision of a vehicle on hire for the period during which it was in the possession of the customer.

83. In other words, the VAT consequences arising from the return of the vehicle to VWFS are sufficiently addressed by Article 90 of the PVD and the bad debt relief provisions such that it cannot be said that it necessarily follows from the deeming provision in Article 14(2)(b) that the return of the car must be treated either (on VWFS's broader argument) as a supply of goods or (on VWFS's more narrow argument) as a transfer of the right to dispose of the goods as owner and thus a supply of goods.

84. The second case relied on by VWFS is *Skandia America Corp (USA), filial Sverige v Skatteverket* (C-7/13) [2015] STC 1163. In this case S, an entity established in the US, carried out activities through a branch, V, in Sweden. V was a member of a Swedish VAT group. Article 11 of the PVD provides that each member state could regard as a single taxable person any persons established in the territory of that member state who, while legally independent, were closely bound to one another by financial, economic and organisational links. The CJEU concluded that, while V did not operate independently and was not a taxable person in its own right, for VAT purposes the services supplied by S to V were deemed to be supplied, not to V itself, but to the VAT group of which V formed part. Unlike the present case, there was in *Skandia* a direct connection between the deeming provision (which treated V as part of a VAT group which constituted a single entity for tax purposes) and the VAT treatment of a supply made to V, and the deeming provision had a broad purpose, namely that for VAT purposes generally V was to be regarded as part of a group that formed a single entity. Accordingly, we find this case, too, to be of little assistance.

85. For the above reasons, while we accept the premise that it is necessary to treat as real "the consequences and incidents inevitably flowing from" the deemed state of affairs, we disagree that in the circumstances of this case that means that it is necessary, when considering the VAT consequences for the purposes of the operation of the Margin Scheme of the return of the vehicle, to deem that the return also

constitutes a supply of goods (whether generally, or on the basis that it is deemed to be the transfer by the customer to VWFS of the right to dispose of the vehicle as owner).

Consideration

5

86. The FTT concluded that, even if there was a supply of goods within Article 14 on the return of the car to VWFS, there was in any event no consideration for that supply: see [215] to [217] of the Decision, as referred to at [48] above.

87. In its submissions supporting its grounds of appeal, the only point taken by
10 VWFS in relation to consideration was that the FTT had implicitly accepted, if the return of the vehicle was seen as a transaction independent of the supply to the customer, that "consideration for that supply is the value foregone on the remainder of the contract." In fact, the FTT concluded (at [215] to [217]) that no consideration was provided to the customer upon repossession of the vehicle because: (1) on a voluntary
15 termination, VWFS has no legal right to collect the remainder of the sums which would otherwise have fallen due, so VWFS cannot be said to have given up, or released, a right to future sums which by law it no longer has; and (2) on a forced termination, VWFS cannot be said to be providing value to the customer in protecting its position by exercising its pre-existing right to take possession of its own asset. In
20 the passage from the FTT's decision upon which VWFS places reliance in its grounds of appeal ([241]), the FTT was considering the position on the assumption that it was wrong that the Margin Scheme did not apply. On that assumption, it concluded that the best approach for the purposes of valuing the supply was that the release from sums otherwise due by the customer constituted consideration. In other words, the
25 FTT was merely identifying what would qualify for consideration, if there was any consideration at all (contrary to its conclusion that there was not).

88. In its skeleton argument for the appeal, however, VWFS contended, by reference to the decision in *Astra Zeneca UK Limited v Revenue and Customs Commissioners* (C-40/09) [2010] STC 2298, that the agreement to forego an
30 entitlement to receive sums otherwise due constitutes valuable consideration. This was, at least, an implicit attack on the finding of the FTT that there was no consideration. VWFS also took issue with the FTT's conclusion that, if the Margin Scheme applied at all, then the best approach was that it was the release of sums otherwise due that constituted consideration. It contended, instead, that the principles
35 in *Empire Stores Ltd v Customs and Excise Commissioners (C-33/93)* [1994] STC 623 ("*Empire Stores*") apply, such that consideration for the supply of the car to VWFS on repossession is calculated by reference to the cost to the customer in relinquishing possession, which is in turn "determined by reference to the payments made but adjusted to take account of the benefit of use over the period of possession
40 prior to termination."

89. Mr Mantle, who appeared for HMRC, pointed out that these arguments advanced in VWFS's skeleton, and developed orally at the hearing, were not foreshadowed in the grounds of appeal. He was, nevertheless, in a position to deal with the substance of the arguments. We agree that these arguments were not

foreshadowed in the grounds of appeal but, like Mr Mantle, will proceed to deal with their substance in light of the fact that HMRC had sufficient advance notice of the arguments contained in VWFS's skeleton and was able to address them at the hearing.

90. We nevertheless reject VWFS's contention that the FTT erred in its conclusion that no consideration is paid by VWFS for the return of the car. We consider that the FTT was correct to find that, whether on a voluntary or forced termination, the financial consequences – as between VWFS and the customer – of the repossession of the vehicle are pre-ordained by the terms of the finance agreement and do not constitute separate consideration for the return of the car.

91. VWFS's principal objection is, in essence, that the FTT erred in having regard to the contractual and economic realities, as opposed to the fiscal fiction. We have addressed this point in dealing with the question whether the return of the car constituted a supply within Article 14 of the PVD. In short, for the same reasons there set out, we consider that even if the return of the vehicle is considered to be a supply, the question whether consideration was provided for that supply is to be determined on the basis of the conventional approach set out, for example, in *Secret Hotels2 Ltd (formerly Med Hotels Ltd) v Revenue and Customs Commissioners* [2014] UKSC 16, [2014] STC 937 and *Airtours Holidays Transport Ltd v Revenue and Customs Commissioners* [2016] UKSC 21, [2016] STC 1509 – that is, as a matter of contractual interpretation in accordance with commercial and economic reality.

92. Separately, however, VWFS contends that even having regard to the terms of the finance agreement and commercial and economic realities, there was consideration for the return of the car in the same way as the CJEU determined there was consideration on the facts of *Astra Zeneca*. That case concerned a voucher scheme for employees, under which employees could choose to accept part of their remuneration in the form of vouchers, which they could use to redeem for goods at specified high street retailers. The first question raised for determination was whether the provision of vouchers constituted a supply of services for consideration.

93. The Advocate General, at [51] of his opinion, noted that employees could choose not to receive any part of their remuneration in vouchers and instead to be paid wholly in cash and said "[t]he provision of vouchers to employees can therefore be interpreted as a transaction entered into by the employees in exchange for payment of a given sum of money (that part of their remuneration which, if they did not receive vouchers, they would obtain in money.)" On this basis, he concluded, at [52], that all the conditions identified in the court's case law for establishing the existence of a supply for consideration were met including, in particular, consideration, expressed in money terms and a direct link between the service provided and the consideration received. The court reached the same conclusion, at [27] to [31].

94. In our judgment, the *Astra Zeneca* decision is distinguishable from the circumstances in this case. In the case of voluntary termination of a finance agreement, it is true that the customer exercises a choice and in this sense there is a parallel with *Astra Zeneca*. The difference, however, is (as the FTT pointed out) that as a consequence of that unilateral choice VWFS has no legal right to collect the rest

of the sums which would otherwise have fallen due. The proper analysis, having regard to the contractual and economic realities, is that the customer, having agreed to hire the vehicle for the duration of the finance agreement, with an option to purchase on payment of the last instalment, may choose to bring the hire period to a premature end (thus precluding it from ever exercising the option to purchase), and thus incurs no liability for the remainder of the term of the hire period. As the FTT put it, at [216] of the Decision, the customer does not receive anything of value in return for VWFS recovering possession. Rather, the fact that it incurs no further liability is a reflection of the fact that it no longer has the use of the vehicle.

95. In the case of forced termination, the position is even further removed from that in *Astra Zeneca*. Here, the customer exercises no choice at all. Upon default, VWFS has the right, pursuant to the original contract, to repossess the vehicle and sell it in order to satisfy the amounts due under the finance agreement from the customer. As the FTT concluded at [217], this cannot properly be characterised as VWFS providing value to the customer. Accordingly, it does not constitute consideration for the return of the car.

96. In these circumstances, it is unnecessary for us to address the question of how the consideration (if there were any) is to be valued. Had we needed to do so, however, we would have concluded that the consideration consists of the portion of the price of which the customer is relieved (either because it is satisfied out of the proceeds of sale of the vehicle on a forced termination or because the customer is relieved of paying it by statute under a voluntary termination). We would have rejected VWFS's alternative calculation, based on the cost to the customer in relinquishing possession. VWFS's argument in this respect was based on the decision in *Empire Stores*. That case concerned the taxable amount to be ascribed to articles provided by a company operating a retail mail-order business to an "introducer" in return for the services provided by the introducer. The CJEU concluded that the taxable amount corresponded to the price paid by the company for the relevant article. This best represented the expense which the company was prepared to incur in order to obtain the services. At [18] to [19], the court said:

> "[18] As for the determination of that value, which is the substance of the second question, the Court held in Naturally Yours Cosmetics (cited above), at paragraph [16], that the consideration taken as the taxable amount in respect of a supply of goods is a subjective value, since the taxable amount is the consideration actually received and not a value estimated according to objective criteria.
>
> [19] Where that value is not a sum of money agreed between the parties, it must, in order to be subjective, be the value which the recipient of the services constituting the consideration for the supply of goods attributes to the services which he is seeking to obtain and must correspond to the amount which he is prepared to spend for that purpose. Where, as here, the supply of goods is involved, that value can only be the price which the supplier has paid for the article which

he is supplying without extra charge in consideration of the services in question."

97. If VWFS is correct that there was consideration for the return of the car, then the valuation by reference to that attributed to the services by the person who obtains them envisaged by [19] of the judgment in *Empire Stores* does not arise, since this would be a case where the parties had agreed on a sum of money, namely the amount of the instalments from which the customer was released. That was the basis of calculating the consideration in the *Astra Zeneca* decision, at [29], where the consideration was "the part of the cash remuneration which the employees must give up."

98. Moreover, the exercise in this case would be to calculate the "purchase price" paid by VWFS for the supply of the vehicle to it, in order to arrive at the profit margin for the purposes of the Margin Scheme. It is difficult to see how that could sensibly be calculated by reference to the cost to the customer of giving up possession of the vehicle. The *Empire Stores* decision is easily distinguished, being concerned with the different question of calculating the value of services *received by* the company.

Irrecoverable VAT

99. As we have noted, VWFS relied, in support of its contention that the return of the vehicle is to be construed as a supply for the purposes of the Margin Scheme, on the proposition that there is otherwise irrecoverable VAT (and thus double-taxation if VAT is charged on the re-sale of the vehicle in the second-hand market). This, it contends, is a powerful factor in favour of construing Article 14 of the PVD in a manner which enables the Margin Scheme to apply.

100. Mrs Brown submitted that double taxation arises wherever there is a second charge to VAT on the value of goods in respect of which the VAT by any previous owner remains unrelieved. She submitted that is inevitably the case, here, to the extent of the payments made by the customer under the finance agreement. This is best illustrated by a simple example. The capital value of a vehicle is £10,000. Possession is transferred to a customer pursuant to a finance agreement under which the customer is obliged to pay ten equal monthly instalments of £1,200 (being £1,000 plus VAT). By virtue of Article 14(2)(b) on the transfer of possession of the vehicle to the customer at the outset of the finance agreement, VWFS is required to account to HMRC for VAT on that transaction in the sum of £2,000. After six months the customer, having paid 50% of the instalments due under the finance agreement, exercises the option to hand the vehicle back. The customer has thus paid £6,000 which comprises £5,000 payments referable to the capital value of the vehicle and £1,000 VAT. Mrs Brown submits that this leads to unrelieved VAT of £1,000 being "embedded" in the vehicle.

101. Mrs Brown relies primarily on the judgment of the CJEU in *Staatssecretaris Van Financien v Gaston Schule Douane-Expediteur BV* (C-47/84) (arising from the earlier related case C-15/81) ("*Gaston*") in support of her submissions. Mrs Brown also referred us to a number of other authorities in support of her argument, but we do

not consider it necessary to refer to them as those authorities were all concerned with different legislative provisions and factual circumstances far removed from the circumstances of this appeal.

102. *Gaston* was the first case to be considered by the CJEU in connection with the VAT treatment of sales of second-hand goods. The case concerned the interaction of Article 95 of the EEC Treaty[3] and Article 2 of the Sixth Directive, the predecessor of the PVD, in the context of the importation of a second-hand boat from France to the Netherlands. Gaston was a customs forwarding agent importing on behalf of a private individual who had bought the boat from another private individual in France. The Dutch authorities assessed VAT on the importation. In the first referral, reference C-15/81, the Court determined that in order to be compatible with Article 95 of the Treaty the VAT payable on importation into the Netherlands must be reduced by reference to the residual part of the VAT of the member state of exportation which was still contained in the value of the product when imported. Following such determination however, there remained in dispute the question as to whether the residual part of the French VAT by which the boat was still burdened was to be taken into account solely in the calculation of the VAT payable on importation or also in determining the taxable amount. The Netherlands court also questioned how the residual amount was to be calculated.

103. On the second reference the Advocate General emphasised that to charge VAT on the full price of goods in respect of which there had been an irrecoverable VAT charge breached the neutrality of internal taxation. Therefore, in order to avoid the double charge to tax the irrecoverable VAT, by reference to which the goods were burdened, had to be deducted prior to any charge to tax being calculated. At [21] the Court confirmed, in answer to the first question, that the residual VAT may not form part of the taxable amount when calculating the charge to import VAT under Article 11 of the Sixth Directive. As regards the second question and the calculation of the residual VAT by reference to which the goods remained burdened, the Court determined at [32] that a simple proportionate calculation be undertaken by reference to the diminution in value of the goods in question. Where the value of goods had appreciated the residual value of VAT would equate to the VAT actually paid.

104. Mrs Brown submits that there is, in principle, no difference between the present scenario and that identified in *Gaston*. She submits that in both cases double taxation needs to be avoided by removing from the taxable amount, on which the second charge to tax arises, the residual VAT borne by the goods when those goods previously entered into final consumption.

105. We accept, as the FTT did at [136] of the Decision, as referred to at [42] above, that where a dealer acquires goods from a non-taxable person there is irrecoverable

[3] Article 95 prohibits Member States from imposing VAT on the importation of products from other Member States supplied by private person where no such tax is levied on the supply of similar products by a private person within the territory of the Member State of importation, to the extent to which the residual part of the VAT paid in the Member State of exportation and still contained in the value of the product when it is imported is not taken into account.

VAT cost "embedded" in the goods which cannot be relieved in the hands of the dealer under the general VAT regime because there is no claim for input tax that can be made against the output tax due on sale of the goods by the dealer, a position which is, in the case of the sale of a second-car alleviated through the Margin Scheme.

106. However, in full agreement with the FTT and the submissions of Mr Mantle, on behalf of HMRC, we do not accept the premise that it is necessary for the irrecoverable VAT embedded in the vehicle to be relieved in the hands of VWFS on the subsequent resale following repossession of a vehicle pursuant to the terms of a finance agreement.

107. The contention that there is irrecoverable VAT is premised on the assumption that the payments made by the customer under the finance agreement are to be regarded as payments *for the vehicle* such that to the extent that it has paid VAT that is regarded as "embedded" in the vehicle. For reasons which reflect those we have set out at [82] and [83] above, when rejecting the contention that the consequences of the fiscal fiction in Article 14(2)(b) should be followed through to the return of the vehicle, we consider that the substantive effect of Regulation 38 and the bad debt relief provisions, as applied on the repossession or return of the vehicle, is that VWFS is ultimately obliged to account for VAT on the payments it has actually received from the customer in return for the taxable supply he has actually received under the finance agreement. In other words, for VAT purposes the now terminated finance agreement is treated in the same way – so far as the calculation of VAT for which VWFS is required to account to HMRC (albeit not curing the cash-flow burden imposed on VWFS at the outset) – as if the transaction was a supply of services not goods. On that analysis, the customer has paid under the finance agreement for the use of the car for the period of hire and it has not acquired an ownership right in the car in which could be embedded such irrecoverable VAT as it had paid.

108. As Mr Mantle submitted, Regulation 38 and the bad debt provisions flush out of the system any VAT already paid so that there is no double taxation on the resale. The correct amount of VAT has been recovered in respect of the consideration paid by the customer in respect of the period for which he had possession of the vehicle, and the correct amount of VAT will be recovered on the subsequent resale of the vehicle for a consideration which reflects the value of the vehicle at that point. As Mr Mantle also submitted, the question of double taxation could only arise if there were a chain of supply including a supply for consideration by a non-taxable person to a taxable dealer. In other words, the contention that there is double taxation depends upon establishing the very argument (i.e. that the return of the vehicle is a supply) which VWFS seeks to prove.

109. We consider that the position is no different to the position where instead of being supplied under a finance agreement, the vehicle had simply been supplied under a hire agreement. Upon termination of that agreement, the customer would have paid VAT of an amount calculated by reference to the hire charge for the period during which he had possession of the car and VWFS would charge VAT in respect of the

consideration received by it on the sale of the second-hand vehicle following its return.

110. Even if that is wrong, we do not accept that we would be required to reach any different conclusion to that set out above, as to the interpretation of Article 14(1) or Article 14(2)(b).

111. The draftsman of the Cars Order recognised a potential mischief in connection with the resale of vehicles repossessed under finance agreements. The mischief was a variant of that on which VWFS relies in this case, namely that where a finance company has accounted for VAT on the full capital value of a vehicle supplied to a customer under an finance agreement, there would be an element of double recovery of VAT by HMRC if VAT was charged on the resale of that same car in the second-hand market, following its repossession. Article 4(1)(a) of the Cars Order thus provides that the disposal of a second-hand car repossessed under a finance agreement is treated neither as a supply of goods nor supply of services.

112. It was appreciated, however, as a result of the judgment in *Revenue and Customs Commissioners v General Motors Acceptance Corporation (UK) plc* [2004] STC 577, that a finance company could obtain the benefit of both a downward VAT adjustment under Regulation 38 in respect of the initial supply under the finance agreement and of the de-supply provision on the subsequent resale, if the customer returns the car and/or does not pay, which would result in *under* taxation. Accordingly, as we have referred to at [34] and [35] above, by Article 4(1AA) of the Cars Order (introduced in 2006), the de-supply provision does not apply where adjustment of the amount of the VAT on the initial supply under the finance agreement as a result of repossession has taken place.

113. It seems to us that the legislative purpose in the disapplication of the de-supply provision (which inevitably occurs upon the early termination of a finance agreement between VWFS and a customer) militates against VWFS's contention that the Margin Scheme should apply to re-sales of repossessed vehicles.

114. VWFS itself recognised that if the "consideration" for the supply to VWFS of the returned vehicle was to be equated with the sum of the instalments from which the customer was released, then it would likely lead to under-taxation. That is because of the practical unlikelihood (in view of the significant depreciation in the value of vehicles from their purchase price when new within a relatively short period of time) of the vehicle being resold for an amount greater than the unsatisfied portion of the original sale price. VWFS's solution to this problem is to regard, as the consideration for the supply of the returned vehicle, not the sum of the instalments from which the customer is released, but the cost to the customer of returning the vehicle early. For reasons we have set out above, we have rejected that contention. Accordingly, as the FTT recognised at [105] the under-taxation (or windfall to VWFS as it is put by the FTT) would arise if the Margin Scheme applied in much the same way as if the de-supply provision applied in conjunction with Article 90.

115. In the example referred to above, if (which is not an unrealistic assumption) VWFS were to re-sell the car at half its original value, then it will have received the full capital value of the vehicle from a combination of (1) the customer and (2) the buyer of the second-hand car on the resale. Unless, however, it is obliged to charge VAT (and to account to HMRC in respect of VAT received) on the resale, it will have accounted to HMRC for VAT on only one-half of the full capital value of the vehicle.

116. In short, for the above reasons, even if there were an element of embedded irrecoverable VAT in the vehicle at the point it is repossessed, that would be insufficient reason to apply what we consider would be a strained construction to Article 14 of the PVD.

Disposition

117. The appeal is dismissed.

MR JUSTICE ZACAROLI **JUDGE TIMOTHY HERRINGTON**

UPPER TRIBUNAL JUDGES

RELEASE DATE: 27 February 2020