**[2013] UKUT 0383 (TCC)**

**Case number: TCC-JR/03/2012**

***INCOME TAX — self-assessment — ITA ss 64, 131 — claim for relief to be "carried back" intimated in earlier year return — whether FA 2008 s 130 engaged and HMRC able to set off disputed income tax liability against VAT repayment admitted to be due — TMA ss 8, 9, 9A, 42, Schs 1A, 1B —*** **HMRC v Cotter** ***considered —*** **Cotter** ***binding on this tribunal and determinative in applicant's favour — no debit on account against which set-off could be effected***

***VAT — whether use of FA 2008 s 130 to refuse immediate VAT repayment a proportionate remedy — yes***

**UPPER TRIBUNAL**
**TAX AND CHANCERY CHAMBER**

**THE QUEEN (on the application of KEVIN ROUSE)**

**Applicant**

**- and –**

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

**Defendants**

**Tribunal: Mr Justice Warren, Chamber President**
**Judge Colin Bishopp**

**Sitting in public in London on 16 and 17 May 2013**

**Michael Jones, counsel, instructed by Denison Till, solicitors, for the Applicant**

**Ingrid Simler QC and Scott Redpath, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Defendants**

## DECISION

### Introduction

1. The first of the core issues in this case is whether, and if so in what circumstances, Her Majesty's Revenue and Customs ("HMRC") may refuse to pay to a VAT-registered trader a VAT credit which, as HMRC accept, is due to him, by exercise of the power conferred on them by s 130 of the Finance Act 2008. Section 130 gives HMRC a general power to set off a credit against a debit; the question we must determine is whether it is engaged in this case. The argument advanced by the taxpayer, Mr Kevin Rouse, is that HMRC have created the debit by the purported exercise of a procedure which is not available to them in the circumstances of his case, and there is thus no true debit which may be set off against the credit. The second core issue is whether the set-off which HMRC have effected, or have purported to effect, in the present case under s 130, assuming that section is engaged at all, represents a disproportionate remedy incompatible with European Union ("EU") law.

2. Section 130 is in these terms:

> "(1) This section applies where there is both a credit and a debit in relation to a person.
>
> (2) The Commissioners may set the credit against the debit (subject to section 131 and any obligation of the Commissioners to set the credit against another sum).
>
> (3) The obligations of the Commissioners and the person concerned are discharged to the extent of any set-off under subsection (2).
>
> (4) 'Credit', in relation to a person, means—
>
> (a) a sum that is payable by the Commissioners to the person under or by virtue of an enactment, or
>
> (b) a relevant sum that may be repaid to the person by the Commissioners.
>
> (5) For the purposes of subsection (4), in relation to a person, 'relevant sum' means a sum that was paid in connection with any liability (including any purported or anticipated liability) of that person to make a payment to the Commissioners under or by virtue of an enactment or under a contract settlement.
>
> (6) 'Debit', in relation to a person, means a sum that is payable by the person to the Commissioners under or by virtue of an enactment or under a contract settlement.
>
> (7) In this section references to sums paid, repaid or payable by or to a person (however expressed) include sums that have been or are to be credited by or to a person.
>
> (8) This section has effect without prejudice to any other power of the Commissioners to set off amounts."

3. Section 131 is of no application in this case, and there are no relevant obligations or powers such as are referred to in sub-ss (2) and (8) of s 130. It is apparent from sub-s (1) that there must be both a debit and a credit before the power of set-off is engaged, and from sub-s (2) that HMRC have a discretion whether or not to exercise the power once sub-s (1) is satisfied. There is no statutory avenue of appeal, either against HMRC's determination that sub-s (1) is satisfied, or against their decision to exercise their discretion to effect a set-off. The dispute between the parties reaches us by way of a claim for judicial review. Permission was granted by the Administrative Court, and the application was subsequently transferred to this tribunal in accordance with s 31A of the Senior Courts Act 1981. We are not sure that judicial review is the most appropriate way of dealing with Mr Rouse's claim. It would we think, be open to him to sue to recover the credit and argue that the power to effect set-off did not, on the facts, arise. However, the case having come to us as it has, we propose to deal with it.

## The facts

4. We were provided with various relevant documents, including in particular copies of the self-assessment returns furnished by Mr Rouse for 2007-08 and 2008-09, the two years with which we are concerned, and correspondence between the parties, and with the witness statements of Mr Rouse and of the HMRC officers who had dealt with the matter. There was no material disagreement about the facts, which can be fairly shortly stated.

5. Mr Rouse has carried on business as a self-employed hirer and supplier of plant and machinery since about 1993, and he is registered for VAT in that capacity. He is also a director of a civil engineering company, receiving a salary, and has investment income. He files self-assessment tax returns with the assistance of accountants. In his returns for the years 2007-08 and 2008-09 he disclosed substantial taxable earnings from his employment, self-employment and investments, and some chargeable gains. Disregarding Mr Rouse's claims for relief, to which we come next, the tax and Class 4 national insurance contributions ("NICs") shown to be due from him in the self-assessments which TMA s 9(1) (set out at para 28 below) required him to include with his returns amounted to £1,049,061.05 in 2007-08, and to £998,892.48 in 2008-09.

6. In the year 2008-09 Mr Rouse entered into certain transactions (to use a neutral term) which resulted in a loss of £1,500,000 when shares he had acquired became of negligible value. That loss crystallised in January 2009, shortly before he submitted his 2007-08 return; the due date for its submission was 31 January. Mr Rouse contends that the loss is available by way of relief against his tax liability, and that the relief may be "carried back" so as to be offset against the tax due for 2007-08, in accordance with s 132 of the Income Tax Act 2007 ("ITA"), which is set out at para 18 below. He indicated in his 2007-08 return that he intended to claim relief of £600,000 (representing the then top rate of tax of 40% on the £1.5 million loss) in that manner. We shall refer to that indication as "the first claim". In 2009-10 Mr Rouse entered into a partnership venture, suffering (if his arguments are right) a trading loss estimated in January 2010, and shortly before he submitted his 2008-09 return, at £1,774,260. He indicated in that return that he intended to make a claim for relief of £709,704 (*ie* 40% of £1,774,260)

("the second claim"), again seeking to carry back the relief to the preceding year but on this occasion in accordance with s 64 of ITA, also set out below.

7. HMRC maintain that both of the losses were achieved by the use of tax avoidance schemes which did not achieve their purpose; alternatively, they say, the schemes should be struck down in accordance with the principles expounded by the House of Lords in *W T Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300. Thus the losses, they say, are not available as Mr Rouse claims. We are not concerned in this application with the merits of that contention; it is sufficient to record that there is a dispute.

8. Various adjustments were made to Mr Rouse's account with HMRC, reflecting payments he made, credits for the claimed relief which were made as he submitted his returns, and reversals of those credits as HMRC decided to enquire into or reject the claims. Although the detail of the adjustments is unimportant for present purposes, it is necessary to include some account of them if the chronology is to be understandable. Of immediate importance is the reason why, according to HMRC, Mr Rouse's claims for relief were reflected in his account as soon as they were made and processed, which is to be found in para 4 of Sch 1A to the Taxes Management Act 1970 ("TMA"). At the material time it provided:

> "(1) Subject to sub-paragraphs (1A), (3) and (4) below and to any other provision in the Taxes Acts which otherwise provides, an officer of the Board or the Board shall, as soon as practicable after a claim … is made, or such a claim is amended under paragraph 3 above, give effect to the claim or amendment by discharge or repayment of tax.…
>
> (3) Where any such claim or amendment as is mentioned in sub-paragraph (1) … above is enquired into by an officer of the Board—
>
> (a) that sub-paragraph shall not apply until the day on which, by virtue of paragraph 7(1) below, the enquiry is completed; but
>
> (b) the officer may at any time before that day give effect to the claim or amendment, on a provisional basis, to such extent as he thinks fit."

9. Sub-para (1A) is of no relevance, and no enquiry such as sub-para (3) mentions was made until some time after the return was submitted. Thus effect was given in accordance with sub-para (1) to each of Mr Rouse's claims by making a credit adjustment to his account in the amount claimed, although no repayment was made as the effect of the claim was to reduce his liability rather than to generate an over-payment. It was on 18 September 2009 that HMRC wrote to Mr Rouse to inform him that they were enquiring into the first claim in accordance with para 5(1) of Sch 1A. That provision states that

> "(1) An officer of the Board may enquire into—
>
> (a) a claim made by any person, or
>
> (b) any amendment made by any person of a claim made by him,
>
> if, before the end of the period mentioned in sub-paragraph (2) below, he gives notice in writing of his intention to do so to that person …."

10. It is not in dispute that the enquiry was made, if it was validly made, “before the end of the period mentioned in sub-paragraph (2)”. HMRC also said that they intended to suspend the effect of the claim, by applying para 4(3) of the Schedule. They did so by entering a debit of £600,000, plus interest, onto the account, thus cancelling the credit which had been entered following the submission of the 2007-08 return. The cancellation of the credit led to a large debit balance, and on 11 January 2010 HMRC commenced proceedings in the local county court to recover it. Mr Rouse filed a defence to that action, arguing that HMRC had no power to open an enquiry under para 5 of Schedule 1A, or to suspend the effect of his loss relief claim under para 4(3) of that Schedule, because his claim had been notified by inclusion in a return made in accordance with s 8 of TMA, with the consequence that Sch 1A was not engaged. This contention is at the heart of the present dispute between the parties, and we shall deal with it in detail at a later stage.

11. The second claim was treated in a similar way. It led, first, to the entry in Mr Rouse’s account of a credit of £709,704. Although, again, no repayment was made the credit substantially eliminated the previous debit balance, and in consequence HMRC withdrew the county court proceedings they had begun a few weeks earlier.

12. There were no further developments of relevance until 13 October 2010, when HMRC notified Mr Rouse that they were enquiring into his 2008-09 return, in accordance with s 9A of TMA. That section, so far as material to this application, is as follows:

> “(1) An officer of the Board may enquire into a return under section 8 or 8A of this Act if he gives notice of his intention to do so (‘notice of enquiry’)—
>
> (a) to the person whose return it is (‘the taxpayer’),
>
> (b) within the time allowed.…
>
> (4) An enquiry extends to—
>
> (a) anything contained in the return, or required to be contained in the return, including any claim or election included in the return, ….”

13. It is undisputed that the enquiry, if it was a valid enquiry, was in time. The notification added that “your claim to have made a capital loss on the disposal of the shares and to set the resulting loss against your income under s 132 Income Tax Act 2007 [*ie* the first claim] has already been claimed outside of your 2008-09 tax return and is currently under enquiry”. The first claim had been repeated (though not by way of duplication) in the 2008-09 return; its exclusion from the scope of the s 9A enquiry reflected the prohibition in para 5(3) of Sch 1A to TMA on the opening of a second enquiry into a claim already the subject of an enquiry pursuant to para 5(1).

14. On 8 November 2010 (after he had submitted his 2008-09 return but before he submitted his 2009-10 return) HMRC told Mr Rouse that they were opening an enquiry into the second claim pursuant to para 5(1) of Sch 1A, and in consequence suspending the effect of that claim in accordance with para 4(3) by

removing, or cancelling, the credit it had generated. That adjustment led to a further large debit balance, and a second county court action.

15. In February 2011 the second county court action was stayed by consent pending the outcome of the case of *HMRC v Maurice Cotter*. Judgment was given by the High Court in April 2011, but the case proceeded to the Court of Appeal which delivered its judgment in February 2012 (reported as *Revenue and Customs Commissioners v Cotter* at [2011] STC 1646 and [2012] STC 745 respectively) ("*Cotter*"). Since then, permission to appeal to the Supreme Court has been given to HMRC, and that appeal is expected to be heard in the course of this year. Despite the argument by Mr Michael Jones, appearing before us for Mr Rouse, that the judgment of the Court of Appeal in *Cotter* is directly in point and determinative (in his favour) of this application, HMRC have not, as yet, sought a stay of these proceedings until their appeal to the Supreme Court has been concluded; instead they say (by Ms Ingrid Simler QC leading Mr Scott Redpath) that *Cotter* is not in point, and should be distinguished. We shall return to the significance of *Cotter* in due course.

16. Mr Rouse's VAT return for the accounting period 09/11 was a repayment return, that is the claim for input tax credit exceeded the output tax liability by £698,330.90. HMRC accept that the return is correct and that a repayment is due, subject only to their s 130 right of set-off.

**Is section 130 engaged?**

*The applicant's case*

17. The first ground for seeking judicial review rests on the proposition that there was no debit within s 130(1) to set against the credit represented by Mr Rouse's undisputed claim to recover VAT. The first ground is not concerned with whether, assuming contrary to Mr Jones' argument that there was a debit, it was an inappropriate exercise of HMRC's sub-s (2) discretion to invoke the power of set-off in this case. Instead, his arguments about the exercise of the power were advanced in relation to the second ground for seeking judicial review (that the set-off provisions in s 130 are disproportionate and thus incompatible with EU law), to which we come at para 62 below.

18. In order to determine whether sub-s (1) is satisfied it is necessary, Mr Jones said, to examine the manner in which Mr Rouse's claims for relief arose. The first claim stems from ss 131 and 132 of ITA, which, so far as material to this application, provide:

> "**131 Share loss relief**
>
> (1) An individual is eligible for relief under this Chapter ('share loss relief') if—
>
> (a) the individual incurs an allowable loss for capital gains tax purposes on the disposal of any shares in any tax year ('the year of the loss'), and
>
> (b) the shares are qualifying shares.…

**132 Entitlement to claim**

> (1) An individual who is eligible for share loss relief may make a claim for the loss to be deducted in calculating the individual's net income—
>
> (a) for the year of the loss,
>
> (b) for the previous tax year, or
>
> (c) for both tax years."

19. Mr Rouse claimed a deduction for the loss wholly against his income for the previous tax year. The remainder of s 132 and s 133 impose certain conditions (none of which are of any application here) and set out rules for the manner in which the loss is to be treated in various circumstances, particularly where the claim is made in respect of both years. The only rule of present relevance is identified in s 133(1) as Step 1:

> "Deduct the loss in calculating the individual's net income for the specified tax year."

20. The second claim was made in accordance with s 64 of ITA, the material part of which is as follows:

> "**64 Deduction of losses from general income**
>
> (1) A person may make a claim for trade loss relief against general income if the person—
>
> (a) carries on a trade in a tax year, and
>
> (b) makes a loss in the trade in the tax year ('the loss-making year').
>
> (2) The claim is for the loss to be deducted in calculating the person's net income—
>
> (a) for the loss-making year,
>
> (b for the previous tax year, or
>
> (c) for both tax years."

21. Other provisions set out the manner in which the claim is to be calculated. They are similar to those affecting a s 131 claim, and again most are of no present consequence. The exception is ITA s 65(1), which contains a "Step 1" identical to that in s 133(1). In both cases, as Mr Jones pointed out, the making of a valid claim for a year 2 loss "for the previous tax year" leads to a deduction from the year 1 income (as it is calculated for tax purposes) of the amount of the loss. However, as the parties agree, the giving of the relief does not re-open the year 1 self-assessment, but instead merely leads to a calculation of the available relief by reference to the income of year 1. The taxpayer is also given the right to accelerate the relief by crediting it against the amount he must pay in respect of year 1, though his doing so does not affect his self-assessment for that year. We shall return to this point at para 30 below.

22. The provisions set out above deal with the treatment of claims once they have been made, but say nothing about how they are to be made. There are, however, in practical terms only two ways in which a claim can be made: in a

return, or in some other manner; and that is the only distinction which matters for present purposes. Its significance, Mr Jones said, is that Sch 1A, on whose engagement HMRC's actions depend, applies only to claims made otherwise than in a return. So much is apparent from TMA s 42(11):

> "Schedule 1A to this Act shall apply as respects any claim or election which—
>
> (a) is made otherwise than by being included in a return under section 8, 8A, or 12AA of this Act."

23. That provision is reflected in the title of Sch 1A, which is "Claims etc not included in returns". However, said Mr Jones, Mr Rouse's claims plainly were included in returns, in his case returns made under s 8. Thus Sch 1A did not apply to them and the enquiries purportedly opened pursuant to para 5 were not valid enquiries. For the same reason, the power to suspend the effect of the claims conferred by para 4(3) was also not engaged. Claims included in returns made under s 8 could be investigated by the opening of an enquiry in accordance with s 9A of TMA, but no enquiry in accordance with that section had been opened into Mr Rouse's 2007-08 return, and the time limit for opening such an enquiry had now expired. Accordingly, his return for that year could not now be amended. There had been a timely s 9A enquiry into the 2008-09 return, but it could take effect only when it is closed and an amendment to the return is made. As that has not yet happened, the return stands good at present. There is no provision, in s 9A or elsewhere, and similar to that in para 4(3) of Sch 1A, which enables HMRC to suspend the effect of a claim made in a return until a s 9A enquiry is closed, or to take any other steps with the same or a similar result (a proposition which Ms Simler did not dispute). Section 9C allows for what might be termed an emergency assessment when, in the course of an enquiry under s 9A, an officer "forms the opinion … that unless the [self-]assessment is immediately amended there is likely to be a loss of tax to the Crown", but that power has not been invoked. It follows that, save for £4,000 which Mr Rouse accepts is due for other, unrelated, reasons, there is no debit, meaning tax owed by Mr Rouse to HMRC, and s 130 cannot apply.

24. HMRC's case that the claims were not included in a return is unsustainable, Mr Jones said, both as a matter of fact and because it was rejected by the Court of Appeal in *Cotter*.

25. Mr Rouse made his returns because he was required to do so in accordance with TMA s 8(1):

> "(1) For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a notice given to him by an officer of the Board—
>
> (a) to make and deliver to the officer … a return containing such information as may reasonably be required in pursuance of the notice …."

26. Returns must be made in the form prescribed by the Board: see TMA s 113(1). The returns which Mr Rouse was required to furnish made provision for claims such as he made. In his 2007-08 return Mr Rouse entered, in a box headed

"Any other information", "Capital loss arising in tax year 2008-09 of £1,500,000 is claimed against 2007-08 under section 131 ICTA 2007" [ICTA being a mistake for ITA]. Included with the return were pages for the provision of "Additional information", on which it is printed that the pages "are for less common types of income, deductions and tax reliefs" and that they were to be "sent back with your Tax Return". In a space headed "Relief now for 2008-09 trading, or certain capital, losses" Mr Rouse entered £1,500,000, and in a second space headed "tax year for which you are claiming relief" identified 2007-08. In the Tax Calculation Summary pages Mr Rouse was invited to identify "Any 2008-09 repayment you are claiming now" and included the figure of £600,000 representing 40% of the loss. The self-assessment for the year 2007-08 sent with the return did not take account of the relief, but in the tax computation (that is, the calculation of the amount Mr Rouse was due to pay) prepared by his accountants, also sent with the return, the £600,000 was included as "Next year's tax claiming now", with a cross-reference to the entries in the return.

27. In his return for 2008-09 Mr Rouse included the loss of £1,500,000 on the page headed "Capital gains summary", providing an explanation of the circumstances in which the loss had occurred in a box headed "Any other information" on the next page of the return. In that explanation he made it clear that he wished to carry the loss back to 2007-08 in accordance with ITA s 132. In the same return, in a section provided for the identification of "Income tax losses" and, more specifically, "Trading losses", and under the heading "Relief now for 2009-10 trading, or certain capital, losses", he entered the estimated amount of the second claim, £1,774,260. On the following page, in a box headed "Additional information", he gave a brief explanation of the loss and added "Full details will be reported on my tax return for the year ending 5 April", omitting to add, as it is agreed he intended, "2010". The amount of the relief, in this case £709,704, was treated in the same way as the relief arising from the first claim had been treated in the previous return, in particular in the self-assessment and tax computation the accountants prepared. We did not see Mr Rouse's return for 2009-10.

28. The self-assessments were produced, Mr Jones added, in order to satisfy the requirements of 9(1) of TMA which, so far as material, is in these terms:

> "… every return under section 8 … of this Act shall include a self-assessment, that is to say—
>
> (a) an assessment of the amounts in which, on the basis of the information contained in the return and taking into account any relief or allowance a claim for which is included in the return, the person making the return is chargeable to income tax and capital gains tax for the year of assessment; and
>
> (b) an assessment of the amount payable by him by way of income tax, that is to say, the difference between the amount in which he is assessed to income tax under paragraph (a) above and the aggregate amount of any income tax deducted at source and any tax credits to which section 397(1) or 397A(1) of ITTOIA 2005 applies…"

29. It is unremarkable that the claims were made as they were, since it is a requirement that claims which can be made in a return must be so made. Section 42(1) to (2) of TMA provides that:

> "(1) Where any provision of the Taxes Acts provides for relief to be given, or any other thing to be done, on the making of a claim, this section shall, unless otherwise provided, have effect in relation to the claim.
>
> (1A) … a claim for relief, an allowance or a repayment of tax shall be for an amount which is quantified at the time the claim is made.
>
> (2) … where notice has been given under section 8 … of this Act, a claim shall not at any time be made otherwise than by being included in a return under that section if it could, at that or any subsequent time, be made by being so included."

30. We interpose, in order that what follows may be understood, that the requirement has an exception which is relevant in this case. By TMA s 42(11A), "Schedule 1B to this Act shall have effect as respects certain claims for relief involving two or more years of assessment". Paragraph 2 of that Schedule provides as follows:

> "(1) This paragraph applies where a person makes a claim requiring relief for a loss incurred or treated as incurred, or a payment made, in one year of assessment ('the later year') to be given in an earlier year of assessment ('the earlier year').
>
> (2) Section 42(2) of this Act shall not apply in relation to the claim.
>
> (3) The claim shall relate to the later year.
>
> (4) Subject to sub-paragraph (5) below, the claim shall be for an amount equal to the difference between—
>
> (a) the amount in which the person is chargeable to tax for the earlier year ('amount A'); and
>
> (b) the amount in which he would be so chargeable on the assumption that effect could be and were, given to the claim in relation to that year ('amount B').
>
> (5) Where effect has been given to one or more associated claims, amounts A and B above shall each be determined on the assumption that effect could have been, and had been, given to the associated claim or claims in relation to the earlier year.
>
> (6) Effect shall be given to the claim in relation to the later year, whether by repayment or set-off, or by an increase in the aggregate amount given by section 59B(1)(b) of this Act [which provides for refunds of payments on account], or otherwise."

31. Those provisions make it clear that the making of a claim for relief against year 1 income in respect of a loss incurred in year 2 does not re-open the year 1 assessment, as we mentioned at para 21 above. Instead, as Carnwath LJ put it in *Blackburn v Keeling* [2003] STC 1162 at [16],

> "This elaborate deeming provision has the effect (so far as it applies) that, where under s 380(1)(b) [now ITA s 64(2)] loss relief is claimed on income in the preceding year, the claim none the less 'relates' to the later year (para

> 2(3)). The amount of the claim is computed using the formula in para 2(4), based on the income in the previous year; but it does not affect the tax position in the earlier year (para 2(3)). It gives rise to a 'free-standing credit' (in the Revenue's language) which can be used in any of the ways set out in para 2(6)."

32. *Cotter* differs a little from this case in its facts. At some time in 2008, Mr Cotter submitted his 2007-08 return, disclosing significant income and gains. In December 2008 HMRC produced a calculation of his tax liability (which for the reasons we give at para 39 below was treated as his TMA s 9 self-assessment) of about £212,000. Mr Cotter then entered into what HMRC say was a tax avoidance scheme, leading to a loss which crystallised in January 2009. In the same month his accountants submitted an amendment to the return, in order to claim relief for the loss and to carry the relief back to 2007-08; the loss had, of course, been incurred in 2008-09. The manner in which the claim was entered on the amended return was materially the same as the manner in which Mr Rouse completed his returns. Some of what Mr Cotter included amounted, as the Court of Appeal said, to an effective invitation to HMRC to open an enquiry. The accountants also stated that, after taking the loss relief into account, Mr Cotter owed no more tax for 2007-08. He intended, like Mr Rouse, to bring forward the benefit of a 2008-09 claim for relief in order to eliminate, or substantially reduce, the payment he was required to make on 31 January 2009. In March 2009 HMRC made a further calculation of his liability, disregarding the relief claim, and arrived at the same figure as they had calculated in the previous December. They also opened an enquiry in accordance with para 5(1) of Sch 1A, but no s 9A enquiry. It is not clear from either report of the case whether HMRC refused to give provisional effect to the claim or did so, subsequently invoking para 4(3) of Sch 1A, but whatever the route adopted it is plain that they did not agree with Mr Cotter's accountants that no further tax was due and, as in Mr Rouse's case, they began county court proceedings to recover the tax they thought to be due. Mr Cotter served a defence challenging the county court's jurisdiction. The question of jurisdiction was then transferred to the High Court. Thus the dispute reached the High Court (David Richards J) and subsequently the Court of Appeal by a different route from that by which this case has reached us.

33. HMRC were successful in the High Court, but in the Court of Appeal Arden LJ, with whom Richards and Patten LJJ agreed, said at [18]:

> "The argument for the Revenue is a very simple one. Mr Scott Redpath, for the Revenue, submits that by virtue of s 128(7) of the ITA [which applies para 2 of Sch 1B to claims such as that made by Mr Cotter] and para 2 of Sch 1B to the TMA the appellant was not entitled to make a claim in his 2007–08 tax return for loss relief arising out of the income loss incurred in 2008–09. Space is provided in the prescribed form of self-assessment tax return for details of a loss relief claim to be made, but this is simply for the convenience of the taxpayer and to avoid the need for him to make a separate claim. As the information provided by the appellant in this case did not 'relate' to the period for which the tax return was prepared, it was not properly to be treated as part of it. The appellant should have made the claim either in his 2008–09 return or have made a separate 'stand alone' claim. On that basis, the Revenue, on Mr Redpath's submission, correctly took the

> view that it was the procedure in Sch 1A to the TMA that should be followed to challenge a claim in the circumstances of this case. A 'return', properly so called, on Mr Redpath's submission, is limited to the information which is properly capable of being assessed in the tax year to which the return relates."

34. She then recorded that David Richards J had accepted that argument, before herself rejecting it:

> "[22] In my judgment, the point is a short point of statutory construction of s 9A of the TMA. Section 9A(4) makes it clear that the Revenue's enquiry may extend to 'anything contained in the return, or required to be contained in the return'. The material words are 'contained in'. Those words cannot mean 'required to be contained in' because that would make the alternative words redundant, contrary to well-established canons of construction. The latter words are clearly used in order notionally to bring into the return information which the taxpayer has wrongly omitted.
>
> [23] The words 'contained in' may, in some contexts, mean 'permitted to be contained in' a document. The words may in other cases mean 'actually contained in'. In my judgment, the latter meaning is too wide in the present context. It is inconsistent with the requirement in s 8 that the taxpayer must file a return 'containing such information as may reasonably be required in pursuance of the notice'. That means that the taxpayer is not free to insert absolutely anything that he wants in a return. The notice will require him to complete a return in a particular form, and that form will indicate the required information.
>
> [24] The relevant boxes in the present case permitted the appellant to make a loss relief claim if he chose to do so. It also required him, if he did so, to give the information sought by the boxes, including the year in which he sought to take the relief. The Revenue does not contend that the form of the return did not entitle the appellant to complete the boxes as he did.
>
> [25] The Revenue's argument amounts to saying that, despite apparently being permitted to insert the information which he inserted in his return, the appellant was in fact not to be treated as having done so because the relevant statutory provisions did not permit him to claim relief for a loss incurred in one year against a liability to tax for an earlier year. On this argument, the form was wrong to give him this opportunity.…
>
> [27] … the purpose of the self-assessment regime is to simplify and bring early finality to liability to tax. The Revenue's interpretation of s 9A of the TMA is inconsistent with this underlying purpose. It creates a need for the taxpayer and the Revenue to investigate whether a matter stated in a return ought under tax law to be there. This complicates the completion of the return and the challenge by the Revenue to its content. The Revenue's interpretation is likely to lead to satellite litigation to determine whether the s 9A procedure applies. That litigation would have to be resolved before the substance of the claim could be determined. Parliament cannot have intended that result, with the inevitable delays in tax collection that would ensue.
>
> [28] The Revenue's interpretation is also inconsistent with s 9(3). When an assessment is made by the Revenue under that provision, it has to be done 'on the basis of the information contained in the return'. Where a word is used more than once in the same set of statutory provisions, it bears the same

> meaning unless it is clear it cannot do so. The Revenue's interpretation would enable the procedure for enquiries and appeals laid down in ss 9A, 28A and 31 to be short-circuited by treating claims for relief made in a return as not so made."

35. Although Arden LJ did not put it in this way, it follows from her reasoning, on the applicant's case, that the fact that para 2(2) of Sch 1B disapplies s 42(2) does not mean that a claim for relief against year 1 income for a year 2 loss cannot be made in a return, but instead implies no more than that the taxpayer is not obliged to make it in that way. But, following Arden LJ's reasoning, Mr Rouse's claims were "contained in" (within the meaning of s 9A) his returns: the first claim was contained in the 2007-08 return and the second claim was contained in the 2008-09 return. It also follows that the claims were "included in" his return within the meaning of s 42(11), which provides that

> "Schedule 1A to this Act shall apply as respects any claim … which—
>
> (a) is made otherwise than by being included in a return under section 8 …"..

36. That, said Mr Jones, is enough to preclude the application of Sch 1A and, with it, HMRC's ability to create a debit by invocation of para 4(3) of that Schedule. Since there is no other mechanism by which they can create one, there was no debit available to be set off against the VAT credit. On that basis, the amount of that credit, less the undisputed £4000, should be paid forthwith to Mr Rouse.

*The defendants' case*

37. For HMRC, Ms Simler emphasised the annual nature of income tax, a point derived from ITA s 4, and in particular sub-s (5): "Every assessment to income tax must be made for a tax year." The annual nature of the tax is reflected in s 23, which prescribes the means by which a person's income tax liability for a tax year is calculated:

> "*Step 1* Identify the amounts of income on which the taxpayer is charged to income tax for the tax year.
>
> The sum of those amounts is the 'total income'.
>
> Each of those amounts is a 'component' of total income.
>
> *Step 2* Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year."

38. The following steps then detail the arithmetical calculations to be made, and are not material for present purposes. What is apparent from the section is that each tax year is self-contained: the income and reliefs to be brought into the calculation are those arising in the tax year, and not some other year. The reliefs to which Mr Rouse claimed to be entitled were included in the s 24 list to which Step 2 refers. It is important to bear in mind, Ms Simler added, that the relief is one "to which the taxpayer is entitled for the tax year". The reliefs for the losses claimed by Mr Rouse were therefore proper to the tax year in which they arose, as para 2(3) of Sch 1B to TMA makes clear: notwithstanding an election to carry the

relief back, "[t]he claim shall relate to the later year". Schedule 1B was applied to the claims by TMA s 42(11A) (see para 30 above), and again, in respect of the second claim, by ITA s 60(2). Thus despite the inclusion in each case of the year 1 income in the calculation, the relief was nevertheless given as part of the assessment for year 2. The fact that the taxpayer could accelerate the benefit of the relief, by offsetting the credit to which it led against the amount he had to pay in respect of his year 1 liability, did not alter the fact that the relief remained a year 2 relief. That was precisely what Carnwath LJ said in *Blackburn v Keeling*, and it exactly reflects not only para 2(3), but also para 2(6) of Sch 1B: "Effect shall be given to the claim in relation to the later year". There is no impact on the tax position in the earlier year. There is accordingly no occasion to re-open a year 1 assessment; all that is required is an arithmetical calculation which adopts the year 1 income as one of its components.

39. The self-assessment process requires the taxpayer to deliver a tax return by a fixed date, 31 January following the end of the tax year to which the return relates. That is the latest date; when a taxpayer files a return on or before 31 October, HMRC carry out the calculation of the tax due on behalf of the taxpayer by working out the net tax due and notifying him of the result (which he may challenge). However it remains and is treated as the taxpayer's own self-assessment. When a taxpayer files the return between 31 October and 31 January, the self-assessment must contain the taxpayer's own calculation of the tax although, if the return is filed electronically, HMRC will usually still calculate the tax automatically for the taxpayer. In this case, as we have said, Mr Rouse's returns were accompanied by his, or his accountants', self-assessment and tax computation, only the latter bringing into account the effect of the accelerated relief. The returns were processed on receipt, in accordance with HMRC's usual practice, on the initial assumption that they and the calculations included within them were complete and correct, but on the footing that HMRC might subsequently enquire into the accuracy of the return or the validity of a claim included in it. HMRC refer to this procedure, Ms Simler said, as "process now, check later". It was that procedure which had led to the various adjustments to Mr Rouse's account and the opening of the enquiries to which we referred above.

40. The starting point for self-assessment is TMA s 8(1) (set out at para 25 above). That subsection, consistently with the annual nature of the tax, requires the taxpayer to furnish a return designed to establish the extent to which he is chargeable "for a year of assessment". That approach is carried forward into s 9, which requires the taxpayer to include with his return "a self-assessment … of the amounts in which … taking into account any relief … a claim for which is included in the return, the person making the return is chargeable … for the year of assessment". The self-assessment cannot include anything proper to another year. The same applies, with necessary variations, in respect of the second claim.

41. In *Cotter*, the Court of Appeal recognised at [23] that there must be some limit to what the taxpayer can include in a return, and that a taxpayer is not free to insert absolutely anything he wishes to insert. And at [31] Arden LJ said that to be "contained in" a return, a matter must be both actually contained in the return and "reasonably included in it in response to the particulars which the return seeks".

42. The fact that a taxpayer could not make a claim for year 2 relief to be available to be offset against his year 1 liability in his year 1 return did not prejudice him, since Schs 1A and 1B provide the machinery for the claim to be made. The mechanism was explained by the Help Sheet which was provided to taxpayers completing their returns. That produced for the year 2008-09, for example, in a section headed “Claims not made in a Tax Return”, included the passage:

> “Not all claims to loss relief must be made in a tax return or amended tax return. Some claims may be made in advance of the tax return for the year of loss … Any repayment due as a result of a claim for relief by reference to earlier years’ income, profit or capital gains relates to the year of loss, even though the relief is calculated by reference to your income, profit or capital gains and circumstances of the earlier years.”

43. The taxpayer is therefore given the choice between making the claim in the return for year 2, in accordance with s 42(2), and making an immediate claim, what HMRC describe as a “stand-alone claim”, in year 1, by (for example) sending a letter or, as in this case, by using the boxes provided in the year 1 return for the purpose and in either case thereby invoking the Sch 1A procedure. But what he cannot do is treat the claim as proper to year 1, as Carnwath LJ made clear in *Blackburn v Keeling,* and accordingly the inclusion in the year 1 return of a statement that the taxpayer intends to carry back a year 2 loss must represent the invocation of the Sch 1A procedure, because a s 42(2) claim can be made only in the return for the year to which the claim relates, the year 2 return. A notice served in accordance with TMA s 8(1) requiring a taxpayer to submit a return is validly made only if it relates to “a year of assessment”, meaning a single tax year. Anything included in the return which relates to a different tax year is therefore not submitted in answer to the notice and does not form part of the return, even if for the taxpayer’s convenience HMRC make it possible for him to include it on the return form. There is no rule which precludes HMRC from prescribing a form, such as a s 8 return, for a primary purpose, as well as one or more subsidiary purposes. Thus the prescribed form may serve the principal purpose of requiring the taxpayer to provide information in accordance with TMA ss 8 and 9, but it may also allow information to be provided for other purposes, including the making of stand-alone claims for loss relief to be applied in accordance with TMA Sch 1B. The argument that the provision in the prescribed form of the facility to enter information relevant to other years has the consequence that information so entered becomes part of the return elevates form above substance, and TMA s 113 (dealing with prescribed forms) does not have the effect of enabling HMRC to allow taxpayers to make claims otherwise than in respect of the year to which they relate.

44. Section 42(11) applies to any claim which “is made otherwise than being included in a return under section 8”, and not merely “otherwise than in a return”. If it is correct that a return under s 8 encompasses only information relating to income and losses for the year in respect of which the return is made, a claim proper to year 2, even if mentioned in the year 1 return, is not included in a return “under section 8”, and it necessarily engages the Sch 1A machinery.

45. It is clear from Mr Rouse's 2007-08 return, submitted in accordance with TMA s 8 in order to establish the amounts in which he was chargeable to income and capital gains tax for that tax year, and from the self-assessment he made of his liabilities, that the total amount of tax and NICs due (disregarding any payments on account for that tax year) amounted to £1,049,061.05. The "Tax Calculation Summary" page of the return shows this total, as does the self-assessment accompanying the return. Similarly, his return for 2008-09 includes a self-assessment of the total amount of tax and NICs due from him amounting to £998,892.48. Mr Rouse declared a liability to make, and did make, payments on account for 2008-09 and 2009-10 which reflected his income tax liability for 2007-08 and 2008-09, disregarding the reduction to which the first claim and the second claim were respectively intended to lead. He was correct to do so: TMA s 59A, which provides for the making of payments on account, does not allow any such reduction, for the very reason that a taxpayer's liability for an earlier year is not affected by a credit related to a later year.

46. The fact that Mr Rouse made a claim to carry back relief for losses he said arose in 2008-09 in various places on his return for 2007-08, whether in empty spaces on the return or in response to the invitation to include "relief now for 2008-09 trading, or certain capital, losses", is immaterial. The invitation enabled him to make an accelerated 2008-09 claim, and as a matter of fact that is what he did. In doing so he was himself asking for Sch 1A to be applied to the claim, since it was only by that mechanism that the accelerated effect which he required could be given to his claim. He could instead have waited to make the claim until he submitted his 2008-09 return, but in that case he would not have been able to set the relief against his outstanding liability in January 2009. The same was true of *Cotter*; the taxpayer could secure accelerated relief only by making a claim which brought the Sch 1A machinery into action.

47. The self-assessment for 2007-08 which Mr Rouse furnished did not take account of the first claim, and that was the correct approach. Instead he confined himself, also correctly, to taking credit for the first claim against liability to make payment on 31 January 2009 in accordance with his 2007-08 return. It follows that although the claim was mentioned in the spaces provided for the purpose and to that extent made, it was not made *in* the return since the scope of the return was confined to Mr Rouse's 2007-08 liability; and if it had been made in the return (assuming that was possible) the s 9(1) self-assessment should have taken it into account. That it did not was a further recognition that this was a claim which triggered the application of Sch 1A. The position in the following year's return was the same. In each case, the year 2 claim specified by Mr Rouse had no effect on the self-assessed tax liability he declared for year 1. It follows that the argument that HMRC were required to open an enquiry into his tax returns in order to investigate the claims for accelerated relief in accordance with s 9A is wrong: when he made the claims, they formed no part of his self-assessed tax liabilities declared due in each of those tax years. Mr Rouse submitted correct self-assessments for those years, and HMRC found no need to enquire into them. As there was no occasion for HMRC to open s 9A enquiries into the self-assessment for 2007-08, the enquiry into the first claim was properly made either in accordance with Sch 1A, on the footing that it was a stand-alone claim, or as a s

9A enquiry into the 2008-09 return, that being the year to which the claim related. What HMRC could not do (contrary to the view of the Court of Appeal) was open a s 9A enquiry into the 2007-08 return in order to examine the first claim.

48. HMRC's position is that the Court of Appeal was wrong to decide in *Cotter* that the claim for relief was "contained in" Mr Cotter's year 1 return so that an enquiry had to be opened in accordance with s 9A, and that is the thrust of their appeal to the Supreme Court.

49. However, even if, contrary to HMRC's proposed arguments in the Supreme Court, the Court of Appeal was correct to hold in *Cotter* that, where a taxpayer notifies a claim to carry back relief from year 2 in his year 1 return, HMRC are required to open an enquiry under s 9A, it is difficult to see how that can avail the taxpayer in this case since there was no reason to enquire into his self-assessment for 2007-08 or, save in respect of the first claim, into his self-assessment for 2008-09. Instead, HMRC dealt with the claims, as they were obliged to do, in accordance with Sch 1A. And once Sch 1A is engaged it is open to HMRC to do as they have done, that is suspend the effect of a claim which they believe is bound to fail.

*Discussion*

50. It is, we think, appropriate to begin by examining what underlies the various provisions—here ITA ss 64 and 131, in *Cotter* ITA s 128—which gave rise to the claims for relief. They provide for a taxpayer who has an erratic, or fluctuating, pattern of income and gains a measure of protection by allowing him to secure relief for a loss suffered in a year in which he may have little or no income or gains against which relief might otherwise be available, by setting the loss against his income or gains for another year, although in these cases only the immediately prior year may be used for the purpose. Nevertheless, the prior year's income is used only as a means of calculating the scale of the relief; as Carnwath LJ explained in *Blackburn v Keeling* (see para 31 above) the claim, and the relief which it generates, remain "related" to the later year. That relation is made clear by TMA Sch 1B paras 2(3) and 2(6).

51. Paragraph 2 of that Schedule is triggered when a claim is made for relief "to be given in an earlier year of assessment", but it does not itself provide any mechanism by which the relief can be brought forward, and it does not direct the reader to one. Indeed, sub-para (3), "The claim shall relate to the later year" and sub-para (6), "Effect shall be given to the claim in relation to the later year" suggest that the relief becomes available, by way of reduction of the amount payable by the taxpayer or by refund, only when his later year's liability falls for determination. There is no provision here which expressly allows him to set the relief against the payments he must make in respect of the earlier year, nor is there any provision which permits him to bring forward the determination of his later year's liability in order to achieve much the same result.

52. Pausing there, the position is that Mr Rouse included in his 2007-08 return a claim (if that is the correct term—a point to which we return below) for immediate relief in respect of a 2008-09 loss (for simplicity we deal only with the 2007-08 return but the same applies, with suitable modifications, to the later

year), but did not bring the relief into the self-assessment, required by TMA s 9(1), which accompanied that return since the loss related to 2008-09 and effect could be given to it only in that year, by virtue of Sch 1B para 2(6). He could not, and did not, adjust his 2007-08 self-assessment in order to reduce the amount of tax he was required to pay on 31 January 2009. His 2008-09 self-assessment could not be submitted at that time, because the tax year had not ended; but even if he could have submitted it, his doing so would not alter the dates on which payments were to be made prescribed by TMA ss 59A and 59B, and in particular the date on which final payment or repayment was required by s 59B(4).

53. The only manner in which he could secure the immediate reduction he required was to accelerate the effect of the relief by making an early claim in such a manner as to invoke the mechanism of Sch 1A para 4(1), which requires HMRC to give effect to a claim "as soon as practicable" after it is made. In that respect we agree with Ms Simler's submissions, though were are bound to say that the legislative intention would be much clearer if there were a pointer in Sch 1B to Sch 1A. However, Mr Jones did not suggest any other route by which Mr Rouse might have secured the benefit of accelerated relief, and did not challenge Ms Simler's argument that Mr Rouse had necessarily relied on para 4(1) of Sch 1A. As we have already explained, by virtue of TMA s 42(11), Sch 1A can apply only to a claim "made otherwise than by being included in a return under section 8 …". It necessarily follows that if Mr Rouse wished to secure the benefit of early relief, he had to make a claim which was not "included in a return under section 8", but made in some other way, a matter to which we shall also return shortly. What is of immediate importance is that once Sch 1A, and particularly para 4(1), is engaged, so too is para 4(3), since the former is expressly made subject to the latter. In other words, if this analysis of the statutory machinery is correct, Mr Rouse cannot seek the benefit of accelerated relief, available only by the invocation of para 4(1), without exposing himself to action of the kind for which para 4(3) provides. It accordingly follows that if para 4(3) was properly engaged, HMRC were entitled to suspend the effect of the claim and that there was a valid debit on Mr Rouse's account when HMRC took such action.

54. Arden LJ said that the fact that, in *Cotter*, the claim was made by amendment rather than in the original return was of no consequence, and we respectfully agree; Ms Simler did not argue otherwise. It likewise makes no difference that Mr Cotter's claim for relief arose in a different manner from those Mr Rouse has made; in each case the same provisions of TMA with which we are concerned were engaged. Thus there is a factual parity between *Cotter* and this case, and we agree with Mr Jones that it is not open to us to distinguish it. The question before the court in *Cotter* was whether the enquiry which HMRC had opened in accordance with para 5(1) of Sch 1A was a valid enquiry. As the extracts from the judgment of Arden LJ which we have set out show, the court's conclusion in *Cotter* that the enquiry was not valid derived from the wording of TMA s 9A. It provides that an officer may enquire into "a return under section 8", but sub-s (4) extends the enquiry so made to "anything contained in the return … including any claim or election included in the return". The enquiry is not, or is apparently not, confined by the statutory wording to matters pertinent only to the year of assessment to which the return relates, nor to claims made in respect of

that year. That is not the issue before us, though as we shall explain it impacts upon the question we must decide.

55. We confess to having encountered some difficulty with additional comments Arden LJ made when expressly declining to decide whether or not what Mr Cotter entered in the relevant boxes on his return amounted to a valid claim. She gave her reasons for so declining at [33] and [34]:

> "[33] The judge went on to consider the further issue whether under the relevant provisions the taxpayer was entitled to make a claim in his tax return for 2007–08 for an income loss that was incurred in 2008–09. The essential difference between the parties on this issue is whether loss relief can be set off in this way, or whether it has to be claimed in the subsequent year, *ie* the year in which the loss was incurred, by way of a claim for a credit against tax paid in the previous year. Mr Redpath [for HMRC] submits that the claim could not be made in the 2007–08 return. Mr Gordon [for the taxpayer] submits, in essence, that under s 42(2) of the TMA a claim is required to be made in a tax return if it could be so made. Although this section is substituted by Sch 1B to the TMA where a claim involves more than one year, that schedule merely gives the taxpayer, on the [taxpayer's] case, the right to elect to make a separate claim. There was nothing to require him to take this option if he could, in fact, make the claim in a return.
>
> [34] The judge accepted the arguments of the Revenue on this second issue. However, it follows from my conclusion that the Revenue should have followed the s 9A procedure in this case that the appellant should have had a right to appeal to the First-tier Tribunal. In those circumstances, in my judgment, the right course is to leave this further issue open. It was a matter for the First-tier Tribunal. Neither the county court nor the High Court had any jurisdiction to determine it."

56. Ms Simler did not advance quite the same argument before us; she accepted that what Mr Rouse entered on his returns was a claim, albeit not a claim made in a "return under s 8". There are, as it seems to us, three possibilities: that what Mr Rouse entered was a claim contained in a return under s 8; that it was a claim, but not one made in a return under s 8 (Ms Simler's argument); or that it was not a claim at all. We deal with the third of those possibilities first.

57. If what Mr Rouse entered in his 2007-08 return did not amount to a "claim" within the statutory meaning of that term, then it follows that he did not make the first claim until his 2008-09 return was submitted (and, *mutatis mutandis*, the same applies to the second claim). In that case Sch 1A, and in particular the requirement imposed on HMRC by para 4(1) to give prompt effect to what was entered in the relevant boxes, was not engaged when his 2007-08 return was received. If that is so, it may be that HMRC were right to withdraw the benefit of the relief, but if they were it was not because of para 4(3), but because they should not have given effect to what did not amount to a claim within the purview of para 4(1). That is not an argument either party advanced before us, and it is moreover an unattractive argument in that it would, absurdly, oblige a taxpayer wishing to secure relief in year 1 in respect of a year 2 loss to decline the invitation to make a claim by the convenient (to him and to HMRC) expedient of including it in his year 1 return, and instead write a letter.

58. We have hesitated before doing so, since we are dealing with an application for judicial review rather than a statutory appeal, but as it seems to us to be necessary for our decision we have decided that we should reach a conclusion on the question whether what Mr Rouse entered on his year 1 returns amounted to a claim. In doing so we take into account the fact that he did not write a letter but instead made what he plainly considered to be, and was expressed as, a claim for relief in each of the two returns We take into account, too, the manner in which a return is laid out as we have described it at para 26 above, and the terms of para 2(3) of Sch 1A, "A claim shall be made in such form as the Board may determine", albeit that provision applies of necessity only to claims made otherwise than in a return under s 8.

59. It is not necessary for present purposes for us to decide whether Mr Rouse made a claim in "a return under section 8" or, to use HMRC's own term, a "stand-alone claim". This is the point left open by Arden LJ and which she considered was for the First-tier Tribunal to decide. But we have concluded that it would be very strange if, against the background we have described of an invitation to make a claim accepted by a taxpayer intending to do just that, it should be determined nevertheless that what he did could not amount to the making of a claim. Moreover, if what Mr Rouse entered on the return form did not amount to a claim, it is difficult to see what other description might be attached to it. We conclude, therefore, that in each case Mr Rouse did make a claim for year 2 relief in his year 1 return.

60. As we have said, his purpose in doing so was to secure the accelerated relief which was available to him only by the invocation of para 4(1) of Sch 1A, and in compliance with that provision HMRC gave him the relief he claimed. Their subsequent withdrawal of the relief, in exercise of the para 4(3) power, followed upon their opening of an enquiry in accordance with para 5(1) of Sch 1A. But in *Cotter* the Court of Appeal decided that only a s 9A enquiry could be opened into a claim contained in a return. At [30] in *Cotter* Arden LJ referred to the possibility of opening protective enquiries, but it is implicit in her reasoning that once a s 9A enquiry has been opened otherwise than as a protective measure, there cannot, at the same time, also be an enquiry under para 5. Thus, notwithstanding the fact that (on Mr Rouse's own case) Sch 1A was engaged, the enquiry mechanism of para 5(1) of that same Schedule was not, with the consequence that the enquiry HMRC purported to open was invalid and the condition on which the para 4(3) power might be exercised was not satisfied. There was, therefore, no valid exercise of the power, and correspondingly no debit on Mr Rouse's account against which the VAT credit due to him might be set off.

61. We consider that to be a surprising result, but we are compelled to agree with Mr Jones that *Cotter* is in point, and it is plainly binding on us. The first ground on which Mr Rouse seeks judicial review must succeed.

**Does the set-off under section 130 of a sum due to a taxpayer against a disputed debt owed by the taxpayer represent a disproportionate remedy?**

62. It may be that we do not, strictly, need to deal with this issue in view of our conclusion about the application of s 130, but we heard full argument on it and it is, we think, appropriate to express our views, particularly since there is a pending

appeal (in *Cotter*) which may be relevant to the application of Sch 1A and, consequently, s 130. We do so on the basis that we are wrong on our conclusion on the first ground and that the enquiry mechanism of Schedule 1A is in fact engaged.

*The applicant's case*

63. Mr Rouse's starting point is that he has the right, conferred by s 25(3) of the Value Added Tax Act 1994 ("VATA"), to immediate payment of the VAT credit. That provision correctly implements, as is common ground, art 183 of Council Directive 2006/112/EC, the Principal VAT Directive, and it is in mandatory terms:

> "If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, subject to subsections (4) and (5) below, the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a 'VAT credit'".

64. Subsection (4) provides for the holding over of a VAT credit in certain circumstances which are not relevant here, and sub-s (5) for the withholding of a credit from a person who has failed to file his returns, which is not this case.

65. The right to repayment for which art 183 (formerly art 18(4) of the Sixth VAT Directive) provides is directly effective, as the Advocate General (Fennelly) explained in *Garage Molenheide BVBA and Others v Belgium* (Joined cases C-286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126 ("*Garage Molenheide*") at para 35, and any measures taken by member states which interfere with that right must be proportionate if they are to be compatible with EU law. In *Garage Molenheide*, the question was whether a Belgian law which permitted the tax authority to retain VAT credits as a precautionary measure in certain circumstances offended the European concept of proportionality. In its judgment the Court said:

> "46. … in accordance with the principle of proportionality, the member states must employ means which, whilst enabling them effectively to attain the objective pursued by their domestic laws, are the least detrimental to the objectives and the principles laid down by the relevant Community legislation.
>
> 47. Accordingly, whilst it is legitimate for the measures adopted by the member states to seek to preserve the rights of the treasury as effectively as possible, they must not go further than is necessary for that purpose. They may not therefore be used in such a way that they would have the effect of systematically undermining the right to deduct VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation.
>
> 48. The answer to be given in that regard must therefore be that the principle of proportionality is applicable to national measures which, like those at issue in the main proceedings, are adopted by a member state in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the

> principles of the common system of VAT and in particular the rules governing deductions which constitute an essential component of that system."

66. The Court went on to say that it is for the national courts of the member states to determine whether or not the measures in question are proportionate and compatible with EU law. It then added, at para 57,

> "… provisions of laws or regulations which would make it impossible for the court adjudicating on the substance of the case to lift in whole or in part the retention of the refundable VAT balance before the decision on the substance of the case becomes definitive would be disproportionate."

67. That observation, said Mr Jones, was of importance in this case since the First-tier Tribunal, which would be required in due course to adjudicate on the substance of the case—that is, whether the claims for relief were properly made—had no power to lift, or even rule on, the retention of the VAT credit by application of s 130. This tribunal, too, could override the exercise of the s 130 power only by way of judicial review since it has no statutory jurisdiction to do so and, in addition, neither the First-tier Tribunal nor this tribunal has the power to direct the adoption of a less onerous method of protecting the Treasury, such as a bond or guarantee. The course to be adopted in such circumstances was identified by the Court at para 64:

> "… if the national provisions or a particular construction of them would constitute a bar to effective judicial review, in particular review of the urgency and necessity of retaining the refundable VAT balance, and would prevent the taxable person from applying to a court for replacement of the retention by another guarantee sufficient to protect the interests of the treasury but less onerous for the taxable person, or would prevent an order from being made, at any stage of the procedure, for the total or partial lifting of the retention, the national court should disapply those provisions or refrain from placing such a construction on them."

68. The same point was put succinctly and even more plainly by Lord Walker of Gestingthorpe in *Fleming (trading as Bodycraft) v Revenue and Customs Commissioners* [2008] STC 324 at [24]:

> "… it is a fundamental principle of the law of the European Union (EU), recognised in s 2(1) of the European Communities Act 1972, that if national legislation infringes directly enforceable Community rights, the national court is obliged to disapply the offending provision."

69. The provisions in issue in *Garage Molenheide* provided only for the protective and conditional retention of the input tax credit, whereas s 130 provides for a set-off of the credit for as long as HMRC's enquiry lasts, and only when it is concluded does the taxpayer secure a right of appeal to the tribunal to dispute any amendment to his self-assessment which HMRC might make.

70. For those reasons, said Mr Jones, the setting off of a repayment in the form of a VAT credit indisputably due to a taxpayer against a supposed debit which was very much disputed, with no right of appeal and with no possibility of a less onerous course of action, went further than was necessary, and was correspondingly disproportionate. We should, therefore, follow what Lord Walker

had said in *Fleming* and disapply s 130 in this case by directing HMRC to pay the input tax credit, less the undisputed £4,000, to Mr Rouse. Alternatively, and for the same reasons, we should conclude that HMRC's application of s 130 to the circumstances of Mr Rouse's case was disproportionate and should be overturned.

*The defendants' case*

71. Ms Simler made the point that there is no challenge in principle to HMRC's having opened enquiries into the claims, even if the manner in which they had been opened might be disputed. Their perception is that the losses which are the subject of the claims were generated by marketed tax avoidance schemes, the sole purpose of which was to create artificial losses for the purpose of reducing a participant's tax liability, and that the schemes were contrived and of dubious validity. Many similar claims have been made, with the aim (as HMRC see the matter) of obtaining an early tax benefit. It is necessary in order to avoid the risk of large tax losses to take action of the kind for which s 130 provides, and the policy applied consistently by HMRC in such cases of this kind has been to withhold repayments where lawfully possible. In this case, HMRC are of the view that it is extremely doubtful that any relief will in fact be due to Mr Rouse in respect of either of his claims, and that it is correspondingly not appropriate to give any provisional effect to them. It follows, said Ms Simler, that the discretion was exercised rationally, and within the limits of the power conferred by para 4(3) of Sch 1A.

72. HMRC do not dispute the need to observe the principle of proportionality, as it was described in *Garage Molenheide*, though Ms Simler referred also to the description of the relevant principles provided by Lord Hoffmann in *C R Smith Glaziers (Dunfermline) Ltd v Customs and Excise Commissioners* [2003] STC 419, in the course of a judgment in which he analysed the European jurisprudence, including *Garage Molenheide*. At [25] he said:

> "… the principle of proportionality in its broad sense … is divided into three sub-principles: first, a measure must be suitable for the purpose for which the power has been conferred; secondly, it must be necessary in the sense that the purpose could not have been achieved by some other means less burdensome to the persons affected; and thirdly, it must be proportionate in the narrow sense, that is, the burdens imposed by the exercise of the power must not be disproportionate to the object to be achieved."

73. The guidance given in *Garage Molenheide* was also considered by the Court of Appeal in *R (Teleos plc and others) v Customs and Excise Commissioners* [2005] STC 1471 ("*Teleos*"), in which the set-off provisions of s 81(3) of VATA, which are similar to those of s 130 of the Finance Act 2008, were in issue. The taxpayer challenged a decision by HMRC that a supply of mobile phones made by the taxpayer did not meet the conditions for zero-rating, and were accordingly chargeable to VAT at the standard rate. An assessment followed, part of which HMRC enforced by setting it off against input tax credits due to the taxpayer, in accordance with s 81(3). The judge decided to refer certain questions relating to the underlying dispute to the CJEU (as it now is). As there was likely to be some delay before the reference was determined, and HMRC had refused to make an interim payment, the taxpayer applied to the domestic court for interim relief in

the form of a payment of 50% of the total set off by HMRC plus certain other sums. The judge refused the application, applying only domestic law. The taxpayer appealed, relying on *Garage Molenheide*. After an extensive examination of that case Dyson LJ, giving the judgment of the court, said this:

> "[23] I accept that, if there were no mechanism whereby a taxpayer in a position such as that facing Teleos in the present case could ever obtain an interim payment of the VAT withheld by the Commissioners, then that would involve an infringement of the principle of proportionality as explained in *Garage Molenheide*. I did not understand [counsel for the taxpayer] to dispute the fact that, as the judge said, in the exercise of their care and management powers (para 1 of Sch 11 to the 1994 Act), the Commissioners have a discretion to make interim payments in appropriate cases. The discretion must not be exercised unreasonably in the *Wednesbury* sense (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223) nor disproportionately. Thus, in refusing to make interim payments, the Commissioners must not go further than is necessary to attain the objective of maintaining the common principles of VAT and, in particular, the principle of effective recovery of VAT and the right in the taxpayer to make authorised deductions from the amount of tax due. There is no doubt that the exercise of this discretion is susceptible to judicial review.…
>
> [29] Since there is no appeal from the decision by Moses J to reject a public law challenge against the decision not to make an interim payment, it is not necessary to say more about the circumstances in which such a challenge may successfully be made on public law grounds, and the role of proportionality. The critical point is that the courts of this country do provide a mechanism for ensuring that proportionate decisions are made by the Commissioners in relation to interim payments, and if they are not, the court can intervene. That is sufficient to meet the requirements of the ECJ as articulated in *Garage Molenheide*, and obviates any need to give a strained interpretation to CPR 25.1 or CPR 25.7. Our system is to be distinguished from the Belgian system where, as was made clear in *Garage Molenheide*, the national court had no power to interfere with a decision not to make an interim payment of VAT in any circumstances."

74. Although there is no statutory right of appeal against the exercise of the discretionary powers conferred by s 130 to set off, and by para 4(3) of Sch 1A not to give provisional effect to a claim for relief, it is nevertheless clear that the courts and this tribunal do provide a mechanism for challenging decisions made by HMRC in the exercise of those powers, and this case is an example of such a challenge. That being so, it is irrelevant that the tribunal which will eventually adjudicate on the validity of the relief claims, if HMRC should amend or disallow them, is unable to interfere with the decision to set off: a taxpayer in Mr Rouse's position has an effective remedy, and that is all EU law requires.

*Discussion*

75. As in *Teleos* and unlike in *Garage Molenheide*, the taxpayer in the position of Mr Rouse is not faced with the impossibility of obtaining some interim relief, but may apply to the court, even if not the tribunal which will ultimately determine the validity of his claim, for judicial review of HMRC's exercise of

their discretion. We agree with Ms Simler, and follow Dyson LJ in concluding, that the availability of that remedy is sufficient, and that the CJEU was not seeking to lay down the principle that the court (here, the First-tier Tribunal) which is to determine the merits of the claim must also be able to suspend the effect of, in this case, s 130. We recognise that it is not open to us, exercising a judicial review jurisdiction, to direct HMRC to accept something less than retention of the repayment which is due, such as a bond or guarantee, but respectfully agree with Dyson LJ that the lack of an alternative does not undermine the conclusion that the ability of the High Court or this tribunal to intervene, by overturning HMRC's decision if it is appropriate to do so, affords sufficient protection to a taxpayer adversely affected by the exercise of that discretion. The right to repayment of a VAT credit is to be protected, as the European and domestic law both show, but not in a manner which overrides any other consideration, including the obligation imposed on HMRC to ensure the effective collection of taxes.

76. On the facts of the present case, and on the assumption that Sch 1A is engaged, effect is not normally to be given to a claim whilst an enquiry is under way: see para 4(3)(a) of Sch 1A. But HMRC had the power, under para 4(3)(b), to give effect to the first claim and the second claim on a provisional basis to such extent as the relevant officer of HMRC thought fit. This is a matter of discretion the exercise of which has not been challenged. That is unsurprising; indeed, our view is that the exercise of the discretion in that way was rational and proportional. That left Mr Rouse with the benefit of a credit for VAT but he remained liable for the amount owing under his self-assessments without any deduction in relation to the first claim or the second claim. The suspension of the loss relief claims (resulting in the full amount of the assessed tax being due) had nothing to do with the state of Mr Rouse's account with HMRC in relation to VAT.

77. In those circumstances, we do not consider that the decision to effect set-off under section 130 of the VAT credit and the assessed tax was open to challenge on the footing that it involved a breach of EU law. Where a taxpayer has a right to a VAT refund but has also has an unchallenged and unchallengeable liability to HMRC for tax, it is unarguable, we think, that set-off under s 130 would breach EU law on the basis that the taxpayer would be deprived of his VAT refund. In commercial and economic terms he most certainly would not be deprived of it but would receive it in one way (by discharge or reduction of his own debt) rather than in another (by actual payment). The position is no different in the present case, where Mr Rouse was liable to tax pursuant to his self-assessments even though he had loss relief claims subject to suspension under para 4(3)(a). Given that the loss relief claims did not reduce the amounts due under the self-assessments but would, if valid, be given effect to under para 2(6) of Sch 1B (in relation to the earlier year rather than the year of assessment in each case, and principally by repayment or set-off), Mr Rouse would have no defence to an action to recover the excess of the assessed tax over the claimed VAT refund. The most he could have hoped to achieve was a stay of proceedings pending the completion of the enquiry. Where no question of stay arises—because HMRC have asserted their rights by effecting set-off under s 130—there is, it seems to us,

no material distinction between the cases where there is, and is not, a claim for loss relief which is subject to an enquiry under Sch 1A. This is not a case, as Mr Jones puts it, of an undisputed claim being defeated by a set-off in respect of a disputed debt. Rather, it is a set-off of one undisputed claim against another, with the first claim and the second claim, if eventually allowed, giving rise to a right to repayment of overpaid tax (not overpaid VAT) or set-off if Mr Rouse then has any outstanding amounts due under the self-assessments. We see nothing incompatible with EU law in a structure which precludes Mr Rouse from preventing set-off of amounts due to HMRC in reliance on his contingent claims against them (*ie* the first claim and the second claim).

78. Accordingly, we would refuse the second ground for judicial review if it arose for decision on the basis, contrary to our actual decision, that Sch 1A is engaged.

**Disposition**

79. The claim for judicial review of HMRC's decision to invoke the mechanism of TMA Sch 1A in order to open enquiries into the applicant's claims succeeds. The power under para 4(3) of Sch 1A to withhold the benefit of those claims pending determination of those enquiries does not arise. If Sch 1A is not engaged, then there is no other subsisting power by which HMRC may delay giving effect to the first claim or the second claim, not least because there is no s 9A enquiry into the 2007-08 return and there has as yet been no closure of the s 9A enquiry into the 2008-09 return. Accordingly, save in respect of the admitted sum of £4000, the power of set-off for which the Finance Act 2008, s 130, provides is not engaged. However, were it engaged, it would not represent a disproportionate remedy.

80. We will hear further submissions about the precise form of relief which follows from these conclusions if the parties cannot agree it.

**Mr Justice Warren**
**Chamber President**

**Colin Bishopp**
**Upper Tribunal Judge**

**Release date: 07 August 2013**