[2016] UKUT 0294 (TCC)
Appeal number UT/2014/0041

VALUE ADDED TAX — Is the appellant entitled to recover VAT input tax in respect of Mailmedia[R] supplies to it from Royal Mail, notwithstanding that Royal Mail did not in fact pay VAT on those supplies, the parties thought the supplies were exempt and the supplies were shown as VAT exempt in the invoices? No

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER
Between:

Appellant

ZIPVIT LIMITED
- and -

THE COMMISSIONERS FOR HER MAJESTY'S

REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: MRS JUSTICE PROUDMAN DBE

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 14, 15 and 16 March 2016

Roger Thomas QC, instructed by Mishcon de Reya LLP solicitors, for the Appellant
Sam Grodzinski QC and Eleni Mitrophanous, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal from the decision of the First-tier Tribunal ("FTT") (Judge Barbara Mosedale) released on 3 July 2014. The appellant made a claim on 15 September 2009 under Regulation 29 of the Value Added Tax ("VAT") Regulations 1995 (1995/2518) ("the Regulations") for input tax which it claimed to have incurred in the period 31 March 2006 to 30 June 2009, and it made a further claim on 8 April 2010 for the next two accounting periods. The respondents ("HMRC") rejected the claims on 7 May 2010, they upheld the decision in a review letter dated 2 July 2010 (written by a Mrs JC Pledger) and the FTT also rejected the claim in its decision.

2. I have had the advantage of representation by Mr Roger Thomas QC for the appellant Zipvit Limited and by Mr Sam Grodzinski QC and Ms Eleni Mitrophanous for HMRC.

3. The appeal is from the FTT's decision on a preliminary issue, namely,

> "Whether a taxable person, who has received supplies of services which were at the material time treated by Royal Mail as exempt under Value Added Tax Act 1994, but which were properly chargeable to VAT under the Sixth VAT Directive or Principle [sic] VAT Directive, is entitled to an input tax credit in respect of those supplies."

Facts

4. The appellant, a company registered for VAT (all its supplies being subject to VAT), carried on the business of supplying vitamins and minerals by mail order. It used the services of Royal Mail to send its mail orders and to distribute advertisements. It used Packetpost^{TM}, Mailmedia^{R} and deliveries by Parcelforce. However it is only the supplies by Mailmedia^{R} which are in issue before me as those supplies are specimen supplies for the purposes of this hearing.

5. Both Royal Mail and HMRC believed that the supplies made by Royal Mail to the appellant were exempt from VAT and Royal Mail did not therefore issue VAT invoices (within the meaning of the Regulations - see below) to the appellant. The contract between the appellant and Royal Mail was silent as to VAT and the invoices indicated (with an "E") that the supplies were exempt.

6. The CJEU ruled on 23 April 2009 in the case of *R (oao TNT Post UK Limited) v. HMRC* C-357/07; [2009] ECR 1-3025; [2009] STC 1438 that the postal exemption was limited. The CJEU decided (at [49]) that,

> "…the exemption provided for in Article 13A 1.(a) of the Sixth Directive [replaced by *The Council Directive of 28 November 2006 on the common system of value added tax* (2006/112/EC) (the Principal VAT Directive or "PVD")] applies to the supply by the public postal services acting as such-

> that is, in their capacity as an operator who undertakes to provide all or part of the universal postal service in a member state- of services other than passenger transport and telecommunication services, and the supply of goods incidental thereto. It does not apply to supplies of services or of goods incidental thereto for which the terms have been individually negotiated."

7. Thus postal services provided by Royal Mail were not exempt if individually negotiated. It is accepted for present purposes that the Mailmedia^{R} services were individually negotiated.

8. The decision of the CJEU resulted in a clutch of claims for input tax by customers so the FTT made an order under Regulation 18 of The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 designating this case as the lead case for the purposes of a claim for input tax. Mr Grodzinski QC says that the total claims amount to something in the region of £1bn.

9. The FTT held that, applying *Marleasing SA v. La Comercila Internacional de Alimentacion SA* ("*Marleasing*") Case C-106/89; [1990] ECR I-4135, item 1 of Group 3 of Schedule 9 to the Value Added Tax Act 1979 ("VATA") must be given a conforming interpretation. It must be read as if Article 132 (1) (a) of PVD contained the same restriction that the CJEU read into the postal exemption in Article 13A 1.(a) of the Sixth Directive 77/388. Thus the FTT concluded (at [37]) that the Mailmedia^{R} services were standard-rated as a matter of UK domestic VAT law as well as a matter of European law and, even if *Marleasing* did not apply, the appellant would still have been entitled to rely on the direct effect of EU law (at [42]).

10. HMRC (which argued to the contrary in the FTT) does not, for the purposes of the present appeal, seek to advance the case that the FTT's analysis of this point was wrong. Accordingly, the Mailmedia^{R} supplies were for my purposes standard rated under UK law.

The PVD, VATA and the Regulations

11. The appellant relied on such an interpretation in its attempt to obtain input tax recovery where no output tax was paid by the supplier. Articles 167 and 168 of PVD provide,

> "Article 167
>
> A right of deduction shall arise at the time the deductible tax becomes chargeable.
>
> Article 168
>
> In so far as the goods and services are used for the purposes of taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out

these transactions, to deduct the following from the VAT which he is liable to pay:

(a) The VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person…"

12. However, Article 178 of PVD provides that to exercise the right to deduct the customer must hold an invoice drawn up in accordance with s.3-6 of Chapter 3 of Title XI, although by Article 180 member states may authorise the customer to make a deduction in other circumstances.

13. Paragraph 2A of VATA Schedule 11 (which it is accepted replicates Chapter 3 of Title XI of PVD) provides,

"(1) regulations may require a taxable person supplying goods or services to provide an invoice (a "VAT invoice") to the person supplied.

(2) A VAT invoice must give-

(a) such particulars as may be prescribed of the supply, the supplier and the person supplied;

(b) such an indication as may be prescribed of whether VAT is chargeable on the supply under this Act or the law of another member state;

(c) such particulars of any VAT that is so chargeable as may be prescribed…."

14. Regulations 13 and 14 provide in some detail for invoices and their contents. Regulation 29 provides in relation to claims for input tax,

"(1)…save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax…shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable save that, where he does not at that time hold the document or invoice required by paragraph (2) below, he shall make his claim on the return for the first prescribed accounting period in which he holds that document or invoice…

(2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of-

(a) a supply from another taxable person, hold the document which is required to be provided under regulation 13…

…provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold or provide such other evidence of the charge to VAT as the Commissioners may direct."

15. Thus the UK has chosen in accordance with Article 180 of PVD to authorise the customer to admit "such other evidence as the Commissioners may direct" and make a deduction pursuant to Regulation 29(2).

The issues

16. There are two issues before the Upper Tribunal. First, whether VAT was "due or paid" within the meaning of Article 168(a) PVD, so as to entitle Zipvit to deduct input tax, and secondly, whether the absence of invoices from Royal Mail is fatal to Zipvit's claim in circumstances where HMRC had a discretion to direct otherwise. The FTT decided in favour of HMRC on the first point. The FTT also decided (but see [110] and [148] of the decision) that it would have decided in HMRC's favour on the second point if it had needed to do so.

17. I am satisfied (and the parties agree) that the Upper Tribunal has jurisdiction to consider the exercise of HMRC's discretion if the decision was flawed: see s. 83 and s. 84 (10) VATA, *John Dee Limited v. Customs and Excise Commissioners* [1995] STC 941, *Customs and Excise Commissioners v Arnold* [1996] STC 1271 and *Best Buys Supplies Limited v. HMRC* [2012] STC 885. I therefore propose to deal with the two points in turn.

The meaning of "due or paid"

18. The appellant says that Royal Mail should have paid VAT on its supplies, and after the decision of the CJEU there was no reason for HMRC not to assess Royal Mail. It appears to be accepted by HMRC that it did not, although there was no evidence to that effect before me or the FTT. It is said in the decision (at [175]) to have been assumed by both parties that HMRC had taken a decision not to collect past VAT from Royal Mail and I have some sympathy with this statement. However Mr Thomas QC said that the appellant simply did not know the position. Mr Grodzinski QC now accepts that this was the case, so I proceed on that basis.

19. The appellant says that once HMRC accept that a supply was made and that it was chargeable to tax, they are bound to accept a right to deduct on the ground that it was "due or paid". HMRC on the other hand says that VAT was neither paid nor due and therefore the appellant could not deduct input tax.

20. HMRC's and the appellant's primary position (despite what Mr Thomas QC says in his skeleton argument at [22]-[25]) is that the FTT was wrong in saying that the VAT due or paid in Art 168(a) means the VAT due or paid by the supplier. They both say that it means due or paid by the customer.

21. They rely on [45] of *PPUH Stehcemp sp. J. Florian Stefanek, Janina Stefanek, Jaroslow Stefanek v. Dyrektor Izby Skarbowej w Łodzi ,* Case C-277/14 ("*Stehcemp*") a case which was decided on 22 October 2015, that is to say, after the FTT gave its ruling.

22. In that case PPUH Stehcemp bought fuel; invoices were issued by a company and PPUH Stehcemp deducted the VAT paid. The tax authorities believed that the transactions were suspicious and that the invoices had been issued by a non-existent trader therefore incapable of supplying goods. The question was whether PPUH Stehcemp could be deprived of its claim to input tax. The CJEU said (at [45]),

> "…the VAT which PPUH Stehcemp actually paid in respect of the fuel supplies at issue…was also "due or paid" within the meaning of Article 17 (2) (a) of the Sixth Directive. It is settled case-law that VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components…Therefore, the question whether or not the supplier of the goods at issue…has paid the VAT due on those transactions to the public purse has no bearing on the right of the taxable person to deduct input VAT (see, to that effect, judgments in *Optigen and Others*, C-354/03, C-355/03 and C-484/03, EU:C:2006:16, paragraph 54, and in *Véleclair*, C-414/10, EU:C:2012:183, paragraph 25)."

23. Mr Grodzinski QC has cited a number of other cases to me in which he said that the Advocate General ("the AG") made it clear that "due or paid" relates to the customer, rather than the supplier: *European Commission v. Kingdom of Spain*, C-189/11 (at [6]), *Finanzamt Sulingen v. Walter Sudhol* [2005] STC 747 (at [6]) and *Schmeink & Cofreth AG & Co v. Finanzamt Borken*, C-454/98 [2000] STC 810 (at [2]). However, the Third Chamber said the same thing in *Bonik EOOD v. Director na Direktsia 'Obsalvane I upravlenie na izpalnenieto'* C-285/11, [2013] STC 773 ("*Bonik*") at [27] and I am told that *Bonik* was cited in the FTT.

24. Both counsel addressed the FTT on the basis that "due or paid" related to the customer not the supplier and the FTT plainly went off on a frolic of its own in deciding otherwise: see [108]-[110] and [114]-[133] of the decision.

25. I do not find that the FTT's reasoning in deciding that "due or paid" means due from or paid by the supplier is convincing, but I follow the decisions of the CJEU in any event and I need not go into the FTT's reasons. I agree with both the appellant and HMRC that the effect of *Stehcemp* is that "due or paid" must mean due or paid by the customer, not the supplier.

26. I should however mention *Véleclair SA v. Ministre du Budget, des Comptes publics et de la réforme de l'État* C-414/10; [2012] STC 1281 ("*Véleclair*") as the FTT placed such reliance on it. That was an import case, where the person seeking the input tax deduction was the same person who had to pay the VAT on import. Nothing in that case supports the FTT's interpretation of "due" and indeed the CJEU in *Stehcemp* (at [45]) cited [25] of *Véleclair* in support of its own decision.

27. HMRC points out that the appellant says that it "is willing to accept that [the FTT] may be correct" as it says the decision accords with the line of cases from *Hostgilt v. Megahart Limited* [1999] STC 141 through *Wynn Realisations Limited v. Vogue Holdings Limited* [1999] STC 524, *Debenhams Retail Plc v. Sun Alliance* [2005] STC 1443 at [12], *Mason v. Boscawen* [2009] STC 624 to *CLP Holding Co Limited v. Singh* [2015] STC 214. I should therefore mention those cases also. I find

that they are irrelevant to the appellant's case, simply supporting the proposition that where supplies are made within a member state, it is the supplier rather than the customer who bears the liability to account for VAT to the tax authority.

28. Alternatively, if "due or paid" does mean due or paid by the supplier, then Royal Mail did not pay any VAT, so the only question is whether tax was "due" within the meaning of Article 168(a) PVD. The FTT concluded that it was not because none of the four situations referred to in [137] of the FTT's decision (no VAT had been declared on its returns, no VAT was declared in a voluntary disclosure, no invoice was issued by Royal Mail showing the VAT as due and there is no evidence to show that HMRC ever assessed Royal Mail to the VAT) arose.

29. The appellant also addressed the situation where "due or paid" means due or paid by the supplier. Mr Thomas QC argued that the only condition for tax to be "due" is that it is chargeable under Article 62(2). However, Article 168(a) does not refer to whether VAT is chargeable, but only whether VAT is "due" (or paid) on the supply. It is plain from AG Kokott's opinion in *Véleclair* (at [54]-[58], upheld by the full court at [20]) that the two concepts are different. The relevant time for assessing whether VAT is still due for the purposes of deduction is the time when it is finally decided whether the right to deduct exists, that is to say at the time that the appellant made its claims in 2009 and 2010. That is different from chargeability but takes the matter no further as the appellant would not be statute-barred.

30. I find that the question (on the basis that "due or paid" means by the supplier not the customer) is whether the supplier had a legal obligation to pay the VAT. It did not declare liability for VAT and HMRC did not assess it. AG Kokott said at [56],

> "Just as in relation to the State's claim for tax having been extinguished, if that claim is not enforceable, there is no need to relieve the taxable person of a burden which he must no longer bear at all."

31. And the CJEU said at [20] (although the taxable person seeking the input tax deduction was the importer and therefore simultaneously liable to the import VAT),

> "…the term "due" refers to an enforceable tax claim and therefore requires that the taxable person has an obligation to pay the amount of VAT which he seeks deduction of as input VAT."

32. There is an issue whether the FTT (at [147] and [175]-[178] was right that HMRC could not, because of the principle of legitimate expectation, have pursued Royal Mail for past VAT: see *Elmeka v. Ipourgos Ikonomikon* C-181/04-C-183/04 at [32]. Mr Thomas QC says that the FTT was in error as there was no evidence to show that HMRC could not have assessed Royal Mail to VAT. There was no evidence before the FTT that Royal Mail ever entertained such a legitimate expectation or that it relied on it and the burden of proof in an unjust enrichment claim is on HMRC: see s. 80(3) VATA and *Customs and Excise Commissioners v. National Westminster Bank plc* [2003] STC 1072. Nor do I think it is merely a matter of common sense, without HMRC having to adduce any evidence, that Royal Mail did entertain such a legitimate expectation, on the basis that the appellant might have paid a higher price

to Royal Mail which priced its services to include the VAT on inputs which it could not recover. HMRC had published VAT Notice 700/24 in April 2003, stating (at [1.4]) that postal services provided by the Post Office were exempt from VAT, and it is true that the appellant has not explained how or why it would have been lawful to assess Royal Mail to VAT as a matter of public law. However, the burden of proof is on HMRC, as I have said.

33. On the basis that "due or paid" in Article 168 refers to VAT due from or paid by the *customer* to the supplier, the parties' primary submission on which I proceed, the question arises whether the requirement was met.

Paid

34. The appellant's case is simple. Mr Thomas QC relies on s.19(2) of VATA, which by s.19 (1) applies "for the purposes of this Act" and provides,

> "If the supply is for a consideration in money its value shall be taken to be such amount as, with the addition of the VAT chargeable, is equal to the consideration."

35. Thus, submits Mr Thomas QC, as the appellant paid Royal Mail the contract price and the supply was in law standard rated, the price paid to Royal Mail must have comprised VAT. VAT was therefore actually paid within the meaning of the Article. VATA does not suggest that the input tax has to be VAT paid by the customer. The question is whether VAT is "on the supply to him of goods and services". Nor is it necessary for the VAT to have actually been paid to the Commissioners by the supplier. Given that the supplies in question were chargeable to VAT the appellant was entitled, says Mr Thomas, to claim that VAT as input tax.

36. According to the appellant, the terms of the contract are irrelevant to the question of whether VAT was in fact charged. Whether the contract, properly construed, was inclusive or exclusive of VAT, what was actually paid under a standard rated contract must have included an element of VAT because of s.19 (2) VATA.

37. The right of deduction is, as the FTT said (at [79]-[83]), fundamental. That is plain from *Véleclair* and from *Mahagében kft v. Nemzeti Adó- és Vámhival Dél-dunántúli Regionális Adó Főigazgatósága* C-80/11 and C-142/11; [2012] STC 1934 ("*Mahagében*") where the CJEU said (at [40]),

> "The question whether the VAT payable on the prior or subsequent sales of the goods concerned has or has not been paid to the public purse is irrelevant to the right of the taxable person to deduct input VAT. VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components (see order in Case C-395/02 *Transport Service* [2004] ECR I-1991, para 26; judgments in *Optigen Ltd v. Customs and Excise Comrs*; *Fulcrum Electronics Ltd v. Customs and Excise Comrs*; *Bond House Systems Ltd v. Customs and Excise Comrs*

(Joined cases C-354/03, C-355/03 and C-484/03) [2006] STC 419, [2006] ECR I-483, para 54; and *Kittel and Recolta Recycling* (para 49)).”

38. The appellant relied on two cases, *Corina-Hrisi Tulică v. Agenția Națională de Administrare Fiscală- Direct Generală de Soluționare a Contestațiilor* (C-249/12); [2013] All ER (D) 121 (“*Tulică*”) and *Simpson & Marwick v. HMRC* [2013] STC 2275 (“*Simpson*”).

39. In *Tulică*, the appellants, who were suppliers, entered into contracts for sale of land which made no provision for VAT. The question for the CJEU was whether the contract price had to be treated as inclusive or exclusive of VAT. It held that, provided the appellants had no means of recouping the VAT from their customers, then the contract price included VAT. The CJEU said (at [43]),

> “…the VAT Directive, in particular Articles 73 and 78 thereof, must be interpreted as meaning that, when the price of a good has been established by the parties without any reference to VAT and the supplier of that good is the taxable person for the VAT owing on the taxed transaction, in a case where the supplier is not able to recover from the purchaser the VAT claimed by the tax authorities, the price agreed must be regarded as already including the VAT.”

40. In *Simpson*, a firm of Scottish solicitors was a supplier of legal services to clients who were VAT registered and who had insurance against the costs of legal advice. They issued VAT invoices for the VAT element of their fees alone to the clients, as the insurers would not pay the VAT. The firm made a bad debt relief claim for the full amount of the VAT (notwithstanding that their net fees had been paid) which was discovered on a VAT inspection and HMRC assessed the firm. The Inner House of the Court of Session said (at [26]),

> “…The refund to which the taxpayer is entitled is stipulated in s.36(2) as the “amount of VAT chargeable by reference to the outstanding amount” The words “outstanding amount” are defined in sub-s (3) by the amount of the “consideration”, or the extent to which the “consideration” has been written off. But as s.19 VATA makes plain, the “consideration is an amount inclusive of VAT. There is nothing in the text which gives any warrant for an exercise of seeking to identify the extent to which the amount is “demonstrably all VAT”.”

41. Both these cases looked at the position of the supplier and are not any authority either on recovery of input tax by a customer or what “VAT due or paid” means in Article 168, which were irrelevant to the issues being argued. However they are authority for the general proposition that, where the contract is silent on the issue, VAT, if paid, is a component of the price as far as the supplier is concerned, not an addition to it.

42. Mr Grodzinski QC says that s.19(2) merely calculates the VAT which the supplier owes to HMRC (“Determination of value…of supply of goods or services”) but does not determine whether the amount paid by the customer to the supplier

includes VAT, which can only be determined by the agreement between the parties. The appellant must show that what it paid Royal Mail expressly included an element of VAT. Whether the amount paid by the customer to the supplier includes VAT is to be determined only by the contract between the parties. He says that the appellant cannot now claim that VAT was paid, having never contested the invoices which indicated exemption.

43. I do not agree with this construction of s.19 (2) VATA. S.19 (2) is general in its application and does not refer solely to calculation of VAT as far as the supplier is concerned. It refers to "the supply" and that must relate to the supply to the customer as well as the supply by the supplier.

44. Mr Grodzinski QC relies for his propositions that the contract is determinative (and that the customer has to bear the economic burden- see below) on *Minister Finansów v. MDDP sp z oo Akademia Biznesu, sp komandytowa* C-319/12; [2014] STC ("*MDDP*"), *T-Mobile v. Austria* [2008] STC 184 and *Finanzamt Osnabruck-Land v. Bernhardt Langhorst* [1997] STC 1357 at [25]-[29]. I deal with *MDDP* below. As for *Langhorst*, I agree with the FTT (at [93]-[94]) that this seems to be a straightforward application of an anti-abuse measure and that it is difficult to see how the case supports HMRC's proposition that the terms of a contract affect the customer's right to input tax recovery.

45. I therefore turn to *T-Mobile.* In that case, the Austrian government granted bandwidth licences to customers who then claimed that the supply was taxable so that they were entitled to treat the consideration as VAT inclusive and recover the VAT as input tax. However the CJEU decided that the supplies were not an economic activity by the government so that no VAT was payable and there was accordingly no VAT to recover as input tax. AG Kokott did however address the question, although she pointed out that there was no need to do so as the allocation of frequencies was not a transaction subject to VAT. She said (at [145]),

> "…Whether or not a payment includes VAT all depends on what the parties actually agreed. If this should not be clear the content of their agreement has to be ascertained according to the rules of interpretation applicable under national law…"

Thus, taken at face value, this extract certainly seems to support Mr Grodzinski QC's submission that as Royal Mail and the appellant assumed that the supplies were exempt, and despite s. 19 (2) of VATA, no VAT was payable by the appellant to Royal Mail.

46. However it seems that the AG (and it was only the AG, as I have said) was answering the question posed at [143] and that question alone. The FTT (at [88]-[91]) decided that while the question whether or not the customer was liable to pay an additional amount in VAT depended upon the terms of the contract, the AG did not consider whether, the contract price having been paid, the contractual terms would make any difference to the right to recover input tax. Although logically the contract must determine both issues, including the question of whether or not VAT is included in the purchase price, the contract itself was silent about the whole issue of VAT, although the invoices admittedly showed that the parties believed the transactions to be exempt.

47. Mr Grodzinski QC also submitted that a core requirement of the VAT invoice is to show that the customer has borne the economic burden of VAT. He submitted that the principle of fiscal neutrality requires that the right to deduct input tax be based on the customer having borne the economic burden of the VAT. It would, he said, be contrary to the principles of fiscal neutrality and the prevention of distortion of competition for the appellant to be permitted to deduct VAT that was not chargeable under the domestic legislation at the time and which was not in fact charged. The logic of the PVD is that the economic burden of VAT should be borne by the final consumer, which explains why a taxable person may both account for VAT on its supplies but recover VAT on its purchases.

48. However I note that in *Véleclair* it was ruled that (pursuant to Article 17 (2)(b) of the Sixth Directive) the Sixth Directive was not to be interpreted as allowing a member state to make the right to deduct VAT on importation conditional upon actual prior payment of VAT by a taxable person where the taxable person was also the holder of the right to deduct input tax. If the EU legislature had wished to make the right to deduct VAT on importation conditional upon the actual prior payment of that VAT, it could have done so explicitly, for example by removing the word "due" from art.17.

49. Mr Grodzinski QC relies on the recent (17 February 2016) opinion of AG Bot in *Senatex GmbH v. Finanzamt Hannover Nord*, C-508/14 at [43],

> "That said, I do not dispute the importance of the invoice in the common system of VAT. It is a form of proof which permits the collection and deduction of VAT. Thus a trader who invoices the sale of goods or the supply of a service issues an invoice with VAT and collects that VAT on behalf of the State. Similarly, that invoice will enable a taxable person who has paid VAT to provide proof of this and thus to deduct VAT."

50. Mr Grodzinski QC says that this shows that the purpose of the invoice is to show that VAT has actually been paid under the terms of the contract. However the case has been taken out of context. The statement of the AG is undoubtedly true but again takes the matter no further. The case was concerned with the issue of invoices without a tax or VAT identification number, in other words, with errors in the drawing up of the invoices. The words "that said" refer back to the AG's conclusion in [42].

51. Mr Grodzinski QC also relied on the Third Chamber's decision in *MDDP* at [40] and [45], which says that,

> "...art 168 of that directive [the PVD] does not permit a taxable person both to benefit from that exemption [supply of educational services] and to exercise the right to deduct tax."

52. I agree with the FTT (in [103]-[105]) that this quotation is again taken out of the context which the CJEU was considering. If the taxpayer wished to rely on (wrongful) national treatment his supply would be exempt and he would be unable to recover input tax, but if he elected for EU treatment his supply would be taxable and he would have to pay output tax. In the present case the appellant has only benefited

in the sense that Royal Mail did not charge it VAT. I do not see why that would affect the appellant's right of recovery of input tax as the right of deduction is fundamental to the VAT system.

53. The basic principle of VAT and its operation are set out in *Elida Gibbs Limited v. Customs and Excise Commissioners*, C-317/94; [1996] STC 1387 ("*Elida Gibbs*"), namely that it is intended to tax only the final consumer. The ECJ said,

> "22. It is not, in fact, the taxable persons who themselves bear the burden of VAT. The sole requirement imposed on them, when they take part in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved, is that, at each stage of the process, they collect the tax on behalf of the tax authorities and account for it to them.
>
> 23. In order to guarantee complete neutrality of the machinery as far as taxable persons are concerned, the Sixth Directive provides, in Title XI, for a system of deductions designed to ensure that the taxable person is not improperly charged VAT. As the court held in its judgment in *Gaston Schue Douane Expediteur BV v. Inspecteur der Invoerrechten en Accijnzen, Roosendaa* (Case 15/81) [1982] ECR 1409 at 1426, para 10, a basic feature of the VAT system is that VAT is chargeable on each transaction only after deduction of the amount of VAT borne directly by the cost of the various price components of the goods and services. The procedure for deduction is so arranged that only taxable persons are authorised to deduct from the VAT for which they are liable the VAT which the goods and services have already borne.
>
> 24. It follows that, having regard in each case to the machinery of the VAT system, its operation and the role of the intermediaries, the tax authorities may not in any circumstances charge an amount exceeding the tax paid by the final consumer."

See also *Rompelman v. Minister van Financiën* C-268/83; [1985] 3 CMLR 202 at [19].

54. But does it follow from *Elida Gibbs* or indeed *Rompelman* that VAT must be paid under the terms of the contract? I do not think so because the right to deduct input tax is fundamental to the system.

Due

55. Mr Thomas QC submitted (if his previous arguments failed) that as by Article 167 the right of deduction arises at the time the tax becomes chargeable, the VAT became due (although not assessed on Royal Mail) within Article 168. This conflates "due" with "chargeable", but "due" means due at the date when the claim is made. Nevertheless "due" refers to an enforceable tax claim and I am back to the proposition

that there was no evidence about legitimate expectation and that the burden of proof was on HMRC to adduce it.

56. None of the cases deals with the situation where the supplier has not actually paid VAT to the tax authority. On the contrary, all the cases assume that VAT is paid down the chain so that only the final consumer is taxed. Thus although I accept the attractive and simple submission of Mr Thomas QC, the question arises whether Mr Grodzinski QC is right that the contract determines whether or not VAT is included in the price and whether a person who has not borne the economic burden is entitled to be regarded as "due or paid" within the meaning of Article 168 (a) PVD. On the present state of the authorities I do not think that Mr Grodzinski QC is right, but because of the view I have taken of the VAT invoice question, the matter is academic only.

VAT Invoices

57. If input tax is to be deducted, the PVD and VATA require, as I have said, the supplier to issue a VAT invoice to the customer with all the sale particulars including the amount of VAT charged. In *Petroma Transport SA v. Belgium* C-271/12; [2013] STC 773 a failure to hold valid invoices at the date the tax authority made its decision to disallow the tax deduction was fatal to the claim (at [34]-[35]).

58. It is common ground that the appellant holds no VAT invoices. Accordingly, it has no right to input tax deduction under Article 178 PVD (see *Terra Baubedorf-Handel GmbH v. Finanzamt Osterholz- Scharmbeck* C-152/02 [2005] STC 525), but it says that HMRC should nevertheless have authorised input tax deduction in the exercise of their discretion to admit "such other evidence of the charge to VAT" under Article 180 PVD and the proviso to Regulation 29(2).

59. The appellant apparently relies on the Statement of Practice of March 20 07 *VAT Strategy: Input Tax deduction without a valid VAT invoice*, effective from 16 April 2003. I say "apparently" because I note from [171] and [173] of the FTT's decision, emphasised in [32] of the skeleton argument of Mr Grodzinski QC and Ms Mitrophanous that,

> "Mr Thomas specifically denied that he was making out a case that HMRC's decision was flawed for failure to comply with this Statement of Practice."

60. Thus I do not see how an appeal can lie on this basis. However, for completeness sake I go on to consider the Statement of Practice, which says at [17] and [19],

> "**How will HMRC apply their discretion?**
>
> 17. For supplies of goods not listed at Appendix 3 [and these were not], claimants will need to be able to answer most of the questions at

> Appendix 2 satisfactorily. In most cases, this will be little more than providing alternative evidence to show that the supply of goods or services has been made (this has always been HMRC's policy)…
>
> 19. As long as the claimant can provide satisfactory answers to the questions at Appendix 2 and to any additional questions that may be asked, input tax deduction will be permitted. "

Appendix 2 provides,

> "**Questions* to determine whether there is a right to deduct in the absence of a valid VAT invoice**
>
> 1. Do you have alternative documentary evidence other than an invoice (e.g. a supplier statement)?
>
> 2. Do you have evidence of receipt of a taxable supply on which VAT has been charged?
>
> 3. Do you have evidence of payment?
>
> 4. Do you have evidence of how the goods/services have been consumed within your business or their onward supply?
>
> 5. How did you know that the supplier existed?
>
> 6. How was your relationship with the supplier established? For example:
>
> - How was contact made?
> - Do you know where the supplier operates from (have you been there)?
> - How do you contact them?
> - How do you know they can supply the goods or services?
> - If goods, how do you know the goods are not stolen?
> - How do you return faulty supplies?
>
> *This list is not exhaustive and additional questions may be asked in individual circumstances"

61. Thus, says the appellant, all the questions asked are plainly directed to true alternative evidence to avoid fraud which is not of course in issue in these proceedings (contrast *Kohanzad v. Customs and Excise Commissioners* [1994] STC 967 and *Mahagében*) and the appellant has all the alternative evidence required. Indeed the officer who made the review decision considered that alternative evidence could be proffered and that the supplies had taken place. The appellant argues that the asterisk at the end does not apply in these circumstances; no other questions were

asked and thus HMRC could not reasonably reject the appellant's claim to recover input tax.

62. I agree with Mr Thomas QC that if the Upper Tribunal finds that HMRC's decision was flawed, it has three options open to it, as follows,

- If the decision maker reached a decision that no reasonable decision maker could have reached, the appeal should be allowed and the appellant's claim for input tax should be upheld;

- But if HMRC's decision would inevitably have been the same had it been properly undertaken, then the appeal should be dismissed;

- In any other case HMRC should be required to reconsider their decision, taking into account such matters as they should take into account and leaving out of account those matters which they ought not to have taken into account.

63. However, I agree with the FTT as follows. The reviewing officer did not consider all the relevant matters, set out in [192] of the FTT's decision, in particular that the supply was standard rated, despite being treated as exempt.

64. The FTT concluded that in the context of entitlement to recover input tax, economic burden was irrelevant. However I agree with the FTT that this does not mean that such considerations are irrelevant when considering whether or not to exercise HMRC's discretion to permit recovery of VAT in circumstances where no VAT was paid to the benefit of the public purse: see *Terra* at [35],

> "The exercise of that right [the right to deduct input tax] assumes that, in principle, they have received an invoice, or another document which may be considered to serve as an invoice, and that the VAT cannot be regarded as being chargeable on a given transaction before it has been paid".

65. I find, as did the FTT (at [173]) that the Statement of Practice does not constitute a clear representation that HMRC would repay VAT on a supply which was treated as exempt. I note that one of the questions asked in Appendix 2 to the Statement of Practice is, "3. Do you have evidence of payment?", suggesting that deduction is only permitted where the public purse has benefited from the payment of VAT.

66. The appellant did not bear the economic burden of VAT, yet claims it must be treated in effect as if it had paid VAT. Royal Mail priced its services to include the VAT on inputs which it could not recover as its services were exempt. Thus the appellant has not borne the economic burden of VAT because the supply was assumed to be exempt and priced without VAT. It must not be forgotten either that the invoices described the supplies as exempt.

67. Where HMRC is exercising their discretion whether to allow input tax recovery in circumstances where no VAT invoice is held, it must be correct, as the FTT concluded (at [193]), to consider the reason why a VAT invoice was not held. This is

that the supply was treated as exempt and the appellant did not pay any amount representing VAT. The CJEU has said (see for example *Rompelman* at [19]) that the purpose of the right to offset input tax is to remove the burden of VAT "totally" from the undertaking. As the FTT said (at [195]),

> "Why should HMRC pay a refund out of public funds where it is not legally obliged to do so and such repayment would represent a windfall for the appellant rather than compensation for real loss?"

68. Mr Thomas QC argues that the appellant suffered from the benefit to HMRC as irrecoverable VAT may have increased the price of the supply to the appellant. However, the appellant's claim (and it would be a claim, and the appellant would have to show causation: see [183] of the FTT's decision) was no more than 2.5% and no officer would reasonably think that a 2.5% increase in price would justify a repayment of 15-17.5% of the price. Therefore even if the reviewing officer had taken the correct matters into account I consider, with the FTT (at [198]), that she would have reached the same conclusion. Thus I also agree that her decision not to accept other evidence in lieu of a VAT invoice cannot be impugned.

69. Even if I am wrong about the meaning of "due or paid" in Article 168(a), therefore, it seems to me that HMRC was not obliged to consider "other evidence" of the charge to VAT. I therefore dismiss the appeal.

THE HON MRS JUSTICE PROUDMAN DBE

RELEASE DATE: 27 June 2016