[2018] UKUT 0382 (TCC)

Appeal number: UT/2017/0099

VAT – standard rated supplies by subcontractor incorrectly treated as zero-rated – main contractor in liquidation and unable to recover VAT Act 1994 – whether assessment of subcontractor for VAT would unjustly enrich HMRC contrary to principle of fiscal neutrality – whether assessment made to best judgement - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

J & B HOPKINS LIMITED

Appellants

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Mr Justice Snowden
Judge Greg Sinfield

Sitting in public in London on 10 May 2018

Timothy Brown, counsel, instructed by Freestone Jacobs Limited for the Appellant

Brendan McGurk, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. In 2014, the Respondents ('HMRC') assessed the Appellant ('JBHL') for VAT at the standard rate on supplies made by JBHL to Rok Building Limited ('Rok') which JBHL and Rok had mistakenly treated as zero-rated. Rok had correctly zero-rated its onward supplies to its customer, a charity. The contract between JBHL and Rok provided that the contract sum was exclusive of VAT. As Rok's supplies to the charity were zero-rated, Rok should have been able to recover any VAT charged to it by JBHL.

2. After the mistake had been discovered, JBHL did not issue a VAT only invoice to Rok for the unpaid VAT chargeable in addition to the contract price because Rok had gone into liquidation and JBHL took the view that Rok would have been unable to pay any amount to JBHL.

3. JBHL appealed HMRC's assessments to the First-tier Tribunal ('FTT'). JBHL accepted that its supplies to Rok were not zero-rated but contended that the assessments were contrary to EU law because HMRC would be unjustly enriched by the amount of VAT as Rok could no longer recover it. JBHL also submitted that the assessments were not valid because they had not been made to HMRC's best judgment. In a decision released on 5 May 2017, with neutral citation [2017] UKFTT 410 (TC), the FTT dismissed JBHL's appeal. JBHL now appeals, with permission of the FTT, against the FTT's decision on two grounds, namely that the FTT erred in law in:

> (1) finding that HMRC would not be unjustly enriched and/or that there was no breach of the principle of fiscal neutrality; and
>
> (2) concluding that it had no jurisdiction to hear the Appellant's ground of appeal in respect of HMRC's discretionary decision to assess.

4. For the reasons set out below, we have decided that JBHL's appeal must be dismissed.

5. Save as otherwise indicated, paragraph references in square brackets in this decision are to paragraphs in the FTT's decision.

Factual background

6. There was no dispute about the facts before the FTT which are set out at [2] - [12]. The material facts can be summarised as follows.

7. JBHL is a mechanical and electrical services installation company. In 2009, JBHL entered into a construction contract with Rok to install mechanical and electrical equipment in a new place of worship for a charity. Rok had contracted with the charity to build the place of worship. Rok was thus the main contractor and JBHL was a sub-contractor. The contract between Rok and JBHL provided that the contract sum was exclusive of VAT.

8. The charity provided Rok with a certificate, complying with Note (12)(b) to Group 5 of Schedule 8 to the Value Added Tax Act 1994 ('VATA94') stating that the building was intended for use solely for a relevant charitable purpose and the work was thus zero-rated. Rok provided the zero-rated certificate to JBHL. However, contrary to the understanding of Rok and JBHL, that did not mean that JBHL's supplies to Rok were

zero-rated for two reasons. First, the certificate was not addressed to JBHL. Secondly, Note (12)(a) to Group 5 provides that a supply relating to a building intended for use solely for a relevant charitable purpose cannot be zero-rated unless the supply is made to the person who intends to use the building for the relevant purpose, i.e. the charity. Accordingly, where supplies are made by a main contractor and a sub-contractor, only supplies by the main contractor to the charity can be zero-rated. Neither Rok nor JBHL appear to have appreciated that zero-rating was restricted to supplies made by Rok to the charity.

9. JBHL commenced work under the contract. Between 6 November 2009 and 5 November 2010, JBHL issued 11 invoices to Rok for part of the contract sum without charging any amount in respect of VAT on the basis that such supplies were zero-rated. Rok paid the invoices. On 8 November 2010, Rok was placed into administration. On 6 November 2012, Rok went into liquidation.

10. Following a compliance visit to JBHL in 2013, HMRC concluded that the supplies shown on the invoices issued by JBHL to Rok between 6 November 2009 and 5 November 2010 were chargeable to VAT at the standard rate because JBHL had made its supplies to ROK and not to the charity.

11. HMRC originally assessed JBHL for VAT on the full contract sum. However, HMRC subsequently accepted that Rok would never pay any part of JBHL's claim for the unpaid VAT due on the contract sum because, by the time that the assessments were made, Rok's assets had been realised and distributed to its creditors. The amounts originally assessed were then reduced on the basis that the amounts actually paid by Rok to JBHL should be treated as having been inclusive of VAT. By the time that the appeal came before the FTT, the amount of VAT in issue was approximately £221,000.

The FTT's decision

12. JBHL has never disputed that its supplies to Rok were chargeable to VAT at the standard-rate. However, Mr Brown, who appeared for JBHL, made two submissions in the FTT which, with some refinement and elaboration, he maintained before us.

13. The first submission was that if JBHL had charged VAT on the contract sum, as it ought to have done, then Rok would have been entitled to recover an equivalent amount from HMRC because it was directly attributable to Rok's zero-rated supply to the charity. In such a case, HMRC would have collected the VAT (output tax) charged by JBHL and paid or credited Rok with the VAT (input tax) paid by Rok to JBHL, leaving HMRC in a net nil VAT position. However, Rok had never been provided with a VAT invoice by JBHL and so had never recovered any such VAT and (so Mr Brown submitted) was not in any position to do so now. Accordingly, Mr Brown contended that if the assessment was maintained and JBHL were required to account for VAT to HMRC, HMRC would receive a windfall and be unjustly enriched because they would hold the VAT collected from JBHL but not be under any corresponding duty to pay or credit an equivalent amount of VAT to Rok.

14. Mr Brown submitted that such a situation would be contrary to the principle which he said could be found in Case C-317/9*4 Elida Gibbs Ltd v CCE* [1996] STC 1387 ('*Elida Gibbs*'), that the taxable amount, on which VAT is calculated and payable to the tax authorities, cannot exceed the amount actually paid by the final consumer. Mr Brown contended that since the charity was the final consumer and it had properly paid no VAT

because Rok's supply to it was zero-rated, HMRC should not be entitled to retain any VAT at all and, accordingly, the assessment should be discharged.

15. Mr Brown further argued that Case C-35/05 *Reemtsma Cigarettenfabriken GmbH v Ministero delle Finanze* [2008] STC 3448 ('*Reemtsma'*) and later cases that followed it such as Case C-427/10 *Banca Antoniana Popolare Veneta SpA* ('*Banca Antoniana*') should be applied by analogy. He submitted that *Reemtsma* showed that the principles of fiscal neutrality and effectiveness required a tax authority to reimburse the recipient of a supply who had paid an amount as VAT when no VAT was in fact due and where it was virtually impossible or excessively difficult for the recipient of the supply to recover the wrongly paid VAT from the supplier. Mr Brown contended that the same approach should apply for JBHL's benefit where it was impossible for the recipient, Rok, to recover the VAT that it should have been charged.

16. Mr Brown's second submission was that the FTT should hold that the assessment had not been made to HMRC's best judgement, as required by section 73 VATA94, because it was made without considering the effect of Rok's insolvency and the resulting windfall for HMRC.

17. As we address the same arguments below, it is not necessary to set out the FTT's reasoning in detail. The essence of the FTT's decision was that although JBHL took the view that it had been paid the agreed contract price and had not been paid any VAT, that was incorrect in law. The FTT held that, in law, the consideration actually paid by Rok to JBHL is deemed to have included a proportionate amount of VAT, for which JBHL was properly liable to HMRC. The FTT therefore concluded that to the extent that HMRC might be regarded as enriched, this would only be because Rok did not reclaim the VAT which it had paid. Hence, the FTT concluded, any such enrichment would be at the expense of Rok and not at the expense of JBHL. The FTT explained, at [51]:

> "What the appellant is really asking to do is to be let off its assessment for VAT which it actually received because HMRC has had a windfall at the expense of Rok, on the basis that Rok owes the appellant a different sum (i.e. the unpaid purchase price)."

18. The FTT held that although the principle in *Reemtsma* could apply to an underpayment of VAT, it only applies where the tax authorities would enjoy a windfall at the expense of the appellant, and hence on the analysis of the transaction outlined above, the principle did not assist JBHL because any windfall was at the expense of Rok or its creditors.

19. The FTT went on to hold that it did not have jurisdiction to review, in the public law sense, the question of whether it was proper for HMRC to exercise its discretion to issue the assessment to JBHL, but that if it did have such jurisdiction it would not have interfered with HMRC's decision.

Issues in the appeal

20. There are accordingly two issues or groups of issues in this appeal. The first is whether the effect of the assessments is that HMRC would be unjustly enriched and/or whether the assessments would be contrary to the principles of fiscal neutrality or effectiveness. The second is whether the FTT has jurisdiction to consider HMRC's decision to assess and, if so, whether HMRC were wrong not to exercise their discretion not to assess JBHL for VAT in the circumstances.

The correct VAT treatment

21. Given JBHL's reliance on *Elida Gibbs*, we start by considering the basic principles which apply to the role and obligations of taxable persons such as JBHL in the VAT system, and by analysing how VAT should have been charged and accounted for on the transactions in issue in this case under that system.

22. *Elida Gibbs* concerned the operation of money-back coupon schemes by a manufacturer of toiletries. Depending on the scheme, either the retailer who had accepted a coupon from the consumer was entitled to reclaim monies from Elida Gibbs, or the consumer herself was able to send the coupon with proof of purchase directly to Elida Gibbs and to apply for a refund. Elida Gibbs contended that the amount of VAT which it had paid to HMRC should be reduced because the reimbursement of the coupons represented a retroactive discount given by it.

23. At the start of its judgment, the ECJ explained the basic principles behind the VAT system as follows,

> "18. Before replying to these questions, it is appropriate to describe briefly the basic principle of the VAT system and how it operates.
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> 19. The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him.
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> …
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> 21. That basic principle clarifies the role and obligations of taxable persons within the machinery established for the collection of VAT.
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> 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.
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> 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 … 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.
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> 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."

24. Having set out this principle, the ECJ held, at [28]-[29],

> "28. In circumstances such as those in the main proceedings, the manufacturer, who has refunded the value of the money-off coupon to the retailer or the value of the cash-back coupon to the final consumer, receives, on completion of the

> transaction, a sum corresponding to the sale price paid by the wholesalers or retailers for his goods, less the value of those coupons. It would not therefore be in conformity with the Directive for the taxable amount used to calculate the VAT chargeable to the manufacturer, as a taxable person, to exceed the sum finally received by him. Were that the case, the principle of neutrality of VAT vis-à-vis taxable persons, of whom the manufacturer is one, would not be complied with.
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> 29. Consequently, the taxable amount attributable to the manufacturer as a taxable person must be the amount corresponding to the price at which he sold the goods to the wholesalers or retailers, less the value of those coupons."

25. The application of these principles can be seen in an analysis of how the VAT system should have worked in this case. For simplicity we assume that the contract sum agreed between JBHL and Rok and between Rok and the charity was, in each case, £100 exclusive of VAT.

26. Had VAT been charged and accounted for correctly, JBHL would have invoiced Rok for £100 plus £20 VAT for a standard rated supply of construction services. Rok would have paid JBHL £120. JBHL would have accounted for £20 VAT (output tax) to HMRC. Rok would have invoiced the charity for £100 for a zero-rated supply of construction services. The charity would have paid Rok £100. Rok would then claim a repayment from HMRC of £20 VAT (input tax), which it had paid to JBHL. The end result would have been that:

(1) JBHL retained £100 for work done;

(2) Rok would be in a neutral position, having made neither a profit nor a loss, because its receipts of £100 from the charity and £20 from HMRC would be exactly matched by its payment of £120 to JBHL;

(3) HMRC would also be in a neutral position as they would have received £20 from JBHL and refunded the same amount to Rok; and

(4) the charity would have paid £100 without any VAT for the work done because the supply by Rok was zero-rated.

27. Accordingly, the effect of the zero-rating, correctly applied, in this case would be that any VAT charged in the chain of supplies that led to the supply to the final consumer, i.e. the charity, is recovered throughout the chain until the final supply to the charity which is not subject to VAT (or, at least, not at a positive rate).

28. What actually happened in this case is that JBHL did not invoice Rok for any VAT or account to HMRC for VAT on the supply of construction services to Rok. In the ordinary course of events, a supplier in such a situation could, subject to time limits, correct such an error by issuing a new invoice showing the VAT which should have been charged. The customer would then pay the extra amount due to the supplier and reclaim it, subject to the usual rules, from HMRC. As we have indicated, that did not happen in this case because Rok had gone into liquidation before JBHL's failure to charge VAT had been discovered and (the parties accepted) Rok was in practical terms unable to pay any further sums to JBHL.

29. If, however, JBHL had issued a new invoice to Rok which Rok did not pay then JBHL would, subject to conditions, have been able to claim bad debt relief under section 36 VATA94 and Part XIX of the VAT Regulations 1995. Although a new invoice of this type is often referred to as a "VAT only" invoice, it is important to appreciate that this

does not mean that JBHL would have been able to claim bad debt relief for VAT purposes for the whole of the extra £20. Any bad debt relief for VAT purposes would be calculated on the basis that Rok had paid £100 (i.e. 5/6th) of the total consideration of £120 due under the contract, and the amount of the bad debt relief would be restricted to the amount of VAT included in the proportion of the total consideration for the supply which remained unpaid. This would have been 1/6th of £20, i.e. £3.33, and not the full £20: see *Simpson & Marwick v HMRC* [2013] CSIH 29, [2013] STC 2275.

30. As indicated above, HMRC initially assessed JBHL for VAT of what, in our simplified example, would have been £20. Having considered the matter further, HMRC reduced the assessment to £16.67. Mr McGurk, who appeared for HMRC, stated in his skeleton that the reduced assessment was to reflect the fact that debt relief was due. Although, for reasons we have explained, that result would be consistent with the amount of bad debt relief to which JBHL might have been entitled, on the facts we do not see how that could be a valid explanation for HMRC's revised assessment. Section 36 VATA94 provides that bad debt relief is only due where, among other conditions, a person has accounted for and paid an amount of VAT on an amount of consideration that has been written off in his accounts as a bad debt and, secondly, that person has made a claim to HMRC for bad debt relief. JBHL had not met either of these conditions so we do not see how any question of bad debt relief could arise.

31. The alternative basis for HMRC's revised assessment would be section 19(2) VATA94 which 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."

32. The treatment of such supplies as VAT inclusive under equivalent provisions to section 19(2) VATA94 in the Principal VAT Directive was considered by the CJEU in Joined Cases C-249/12 and C-250/12 *Corina-Hrisi Tulica v Agentia Nationala de Administrare Fiscala* ('*Tulica*'). These were cases where both the supplier and purchaser wrongly thought that supplies of land were exempt from VAT when they were, in fact, taxable. The contracts made no provision for VAT. The issue was whether the sellers were liable to account for VAT in addition to the prices agreed by the parties or on the basis that the prices paid were inclusive of VAT. The CJEU held, at [33] – [37], that, where a contract has been concluded without reference to VAT and the supplier is unable, as a matter of national law, to charge VAT in addition to the agreed price for the supply and recover it from the purchaser, the agreed price for the supplies must be regarded as including VAT.

33. The decision in *Tulica* was followed and applied by the Court of Appeal in *Zipvit Limited v HMRC* [2018] EWCA Civ 1515 ('*Zipvit*'), the judgment in which was issued after the hearing of the appeal in the instant case. The decision of the Upper Tribunal in that case had been mentioned in a footnote in HMRC's skeleton argument in this appeal and both parties made written submissions to us on the Court of Appeal's judgment. In *Zipvit*, Royal Mail supplied services to Zipvit, a company which supplied vitamins and minerals by mail order. At the time they were supplied, everyone (i.e. HMRC, Royal Mail and Zipvit) believed that the services were exempt and treated them accordingly. Subsequently, a decision of the CJEU in Case C-357/07 *R (oao TNT Post UK Limited) v HMRC* [2009] ECR I-3025, [2009] STC 1438 held that such services were not exempt but standard rated. Following that case, Zipvit made several claims to recover the input

tax that it said it must be treated as having paid on the supplies made to it by Royal Mail. In other words, assuming that Zipvit had paid £100 on the understanding that the supplies were exempt from VAT, the question for the Court of Appeal was whether Zipvit was entitled to be regarded as having paid £83.33 plus £16.67 of input tax, assuming a standard rate of VAT of 20%, and to recover £16.67 from HMRC.

34. The Court of Appeal considered the position where the parties to a contract agreed a price that was exclusive of VAT. The Court of Appeal held, at [59], that in such a case:

> "… it will be a matter of construction of the agreement between the parties to determine whether the customer is contractually liable to pay an amount equal to the VAT, if and when it turns out to be properly chargeable. Assuming that to be the correct construction, and if it emerges that VAT is chargeable on the supply, the supplier will probably then send a VAT-only invoice to the customer (which would be for £24, if the agreed VAT-exclusive price were £120)."

35. Applying what the CJEU had said in *Tulica*, the Court of Appeal held, at [69], that:

> "It is only if [the VAT that should have been added to the original price] cannot be recovered by the supplier from the purchaser that it becomes necessary to treat the original price as VAT-inclusive, in order to preserve the principle that the VAT on a transaction cannot exceed the amount actually paid by or due from the end customer."

36. The Court of Appeal in *Zipvit* noted, at [70], that *Tulica* recognised the "need for a retrospective dissection of the price paid for a supply which subsequently turns out to be taxable, but only in a situation where the supplier is unable to recover the tax from the customer as a matter of national law."

37. In the instant case, HMRC appears to have assumed that Rok's insolvency and the fact that it had distributed all of its assets, meant that JBHL could not recover the amount of the VAT that should have been added to the contract price from Rok as a matter of English law. Although it might well be said that the only thing preventing JBHL from recovering such amount was not English law but the fact that JBHL delayed in doing so until Rok had become insolvent, since HMRC's revision of the assessment was favourable to JBHL, we do not think we need to express any view on this point.

Unjust enrichment, fiscal neutrality and effectiveness

38. Against that explanation of how the VAT system should have worked in this case, we turn to the first issue in this appeal, namely whether HMRC were right to assess JBHL for VAT where the charity, as final consumer, had not borne any VAT and the intermediate customer/supplier (Rok) is no longer in a position to reclaim any VAT. If so, the end result will be that HMRC will collect £16.67 VAT and will retain that sum, which they would not have been entitled to do if JBHL had correctly charged and invoiced VAT to Rok, which had then recovered it.

39. The first point to make is that we agree with the FTT at [87] that the correct analysis of the position is that, to the extent that HMRC would be enriched, such enrichment is not at the expense of JBHL but is at the expense of Rok which has not made a claim to recover the VAT.

40. Mr Brown submitted that the natural conclusion on the facts was that JBHL was the only party to be "out of pocket" and hence HMRC must have been enriched at JBHL's

expense. He said that JBHL had a net income of £83.33 for the services which it provided, as opposed to the £100 for which it had bargained, while HMRC would retain the difference of £16.67 as a windfall. Although JBHL might think of itself as not having been paid any VAT by Rok, and that therefore it should not have to pay any VAT to HMRC, for the reasons we have already set out, we do not accept that this is the correct way to analyse the position.

41. There is no dispute that supplies made by JBHL were chargeable to VAT at the standard rate, and on proper analysis, JBHL has received a partial payment of £83.33 of the contract price together with £16.67 VAT. It is now being required to account for that VAT to HMRC. The only sense in which JBHL is "out of pocket" is because Rok has not paid it the full price. But that situation has come about entirely because of JBHL's own error. As Mr McGurk submitted, JBHL is in effect trying to use principles of fiscal neutrality (*Elida Gibbs*) and effectiveness (*Reemtsma*) to fill the void that exists because it made an error which it did not discover until it was too late to pursue a contractual remedy against Rok for the balance of the price.

Elida Gibbs

42. In our opinion, there is also no inconsistency between the decision in *Elida Gibbs* and what happened in the instant case. *Elida Gibbs* concerned a question of how the VAT system should operate to ensure that the taxpayer who collects tax and accounts for it to HMRC is not assessed to VAT on a greater amount than is paid by the final consumer. *Elida Gibbs* was also a case involving a simple supply chain of manufactured goods which were identically rated for VAT at each stage of the chain.

43. Mr Brown rightly accepted that *Elida Gibbs* was not authority for saying that VAT was not due from a supplier simply because someone else in the chain had failed to claim an equivalent sum of VAT as input tax. That would obviously be the case where an intermediate party in a chain made an onward supply to its customer that is taxable at the standard rate. There could be no question of the principle of fiscal neutrality being infringed by the intermediate party failing to claim input tax in such a case.

44. But the position cannot be any different if, as in the instant case, the supply to the ultimate consumer is chargeable to VAT at the zero-rate. The zero-rate, also known as an exemption with refund, is an exception to general rule that tax is charged at all stages of the chain of supply including the supply to the final consumer. To that extent, zero-rating is also an exception to the principle of fiscal neutrality. As the Court of Appeal stated in *Zipvit* at [47],

> "47 … where a trader makes exempt supplies, he is in respect of those supplies in the same position as a final consumer, and must therefore bear the burden of input tax attributable to those supplies. This burden of irrecoverable input tax is an exception to the general principle of fiscal neutrality in the field of VAT …"

45. It is also readily apparent that *Elida Gibbs* was not a case in which the VAT system had been operated incorrectly. The ECJ was plainly considering the case on the assumption that the rules had been followed. That is, we apprehend, what the ECJ was referring to when it held, at [24],

> "It follows that, <u>having regard in each case to the machinery of the VAT system, its operation and the role of the intermediaries</u>, the tax authorities may not in any

> circumstances charge an amount exceeding the tax paid by the final consumer." (our emphasis)

46. In the instant case, for the reasons that we have already given, the design of the VAT system is such that, if operated properly, fiscal neutrality would have been achieved for all parties in the supply chain. The problem in this case has arisen because JBHL failed to operate "the machinery of the VAT system" correctly.

47. Moreover, and self-evidently, *Elida Gibbs* was not a case which considered in any way whether HMRC is under a general obligation to modify its treatment of a taxpayer on account of the insolvency of another entity involved in the transaction. Such a situation was, however, considered in *Reemtsma*.

Reemtsma

48. In *Reemtsma*, an Italian firm provided advertising and marketing services to Reemtsma and charged Italian VAT. Reemtsma was a company with its principal place of business in Germany and without a permanent establishment in Italy, and should not have been charged VAT. The supplier had gone out of business and so Reemtsma sought a refund of the VAT directly from the Italian tax authority. The refund was refused on the basis of an Italian law which provided, in effect, that only the Italian supplier could apply for a refund of VAT from the tax authority, so that the recipient of services had to pursue a claim for recovery under the civil law. Reemtsma challenged that decision.

49. The question posed by the Italian court and the scope of the arguments were described by the CJEU at [34]-[36],

> "34. … the national court asks the Court whether the common system of VAT and the principles of neutrality, effectiveness and non-discrimination preclude national legislation such as that at issue in the main proceedings, which does not entitle the recipient of services to reimbursement of VAT by the tax authorities where that tax was not due, but was nevertheless paid by that recipient to the tax authorities of the Member State where the services were supplied.
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> 35. Reemtsma considers that the principle of effectiveness implies that the national legislation should not constitute an obstacle to the exercise of the right to reimbursement of sums paid as VAT in contravention of the applicable rules. That principle might otherwise be infringed as a result of the insolvency of the supplier or possible conflicting judgments of the civil and tax courts.
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> 36. The Commission considers, by contrast, that a tax system such as the one in force in Italy, in which only the supplier is entitled, in principle, to seek reimbursement of VAT from the tax authorities and the recipient of the services may demand the amount unduly paid from the supplier in accordance with civil law is acceptable. In that regard, the Member States are free to choose the procedure which they judge appropriate for guaranteeing that reimbursement, provided that the principle of effectiveness is respected. The implementation of that principle could thus require that the recipient be able to bring an action directly against those authorities if reimbursement were to turn out to be virtually impossible or excessively difficult."

50. At paragraph [37] of its judgment, the CJEU pointed out that in the absence of Community rules, it was for each member state to prescribe conditions for repayment of taxes, subject to the principle of effectiveness, which the CJEU described as requiring that provisions of the domestic law of a member state must not be "framed so as to render virtually impossible the exercise of rights conferred by the Community legal order".

51. On that basis, in paragraph [40] of its judgment, the CJEU accepted the view of the Commission and ruled that a national law which only allowed the supplier to seek reimbursement of overpaid VAT from the tax authority but permitted the recipient of the supply to bring a civil action against the supplier for recovery of the amount mistakenly paid as VAT did not infringe the principle of effectiveness. However, the CJEU went on to state, at [41],

> "41. In that regard, as rightly submitted by the Commission, if reimbursement of the VAT becomes impossible or excessively difficult, in particular in the case of the insolvency of the supplier, those principles may require that the recipient of the services to be able to address his application for reimbursement to the tax authorities directly. Thus, the Member States must provide for the instruments and the detailed procedural rules necessary to enable the recipient of the services to recover the unduly invoiced tax in order to respect the principle of effectiveness."

Banca Antoniana

52. In *Banca Antoniana*, the bank sought to recover VAT charged and accounted for on supplies which the Italian tax authority eventually accepted were exempt. Under Italian law, the bank's claim against the tax authority for overpaid tax was subject to a two-year time limit starting on the date the VAT was paid. Unfortunately, by the time the Italian tax authority had changed its view about the tax liability of the relevant supplies, the bank's claims were largely out of time. The difficulty faced by the bank was that the limitation periods for claims by its customers to recover VAT overpaid to the bank were more generous and their claims were largely in time.

53. The CJEU referred to *Reemtsma* and then observed at [29] - [30]:

> "29. Those same considerations must prevail where the fact that it is impossible or excessively difficult to obtain reimbursement of the VAT paid but not due affects, not the recipient of the services, but the provider.
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> 30. It also follows from the case-law that the principle of effectiveness would be infringed if the taxable person had neither the right to obtain reimbursement of the tax concerned during the period allowed for bringing a claim against the tax authority, nor - after an action for recovery of sums paid but not due has been brought against him by his clients subsequent to the expiry of that period - the possibility of bringing proceedings against the tax authority, with the result that the consequences of the VAT payments made but not due, attributable to the State, would be borne by the taxable person alone …"

54. The CJEU went on to hold that the bank had acted prudently and had collected and paid tax in accordance with the practice of the tax authority at the relevant time. The situation in which the bank found itself was therefore not of its own making: see paragraphs [36]-[40].

55. The CJEU therefore decided that there was a breach of the principle of effectiveness because the Italian system meant that the bank was liable to repay the tax to its customers but had no effective remedy against the tax authority for the same period. The CJEU concluded, at [41],

> "41. In such a situation, the tax authority must take account of the particular situations of the economic operators and, where appropriate, provide for

> adjustments to the way in which its new legal assessments of those transactions are applied."

56. In our view, these authorities establish that in the case of a mistake as to whether VAT is payable, national law should provide for a means of recovery of overpaid VAT directly from the tax authorities either (i) by an innocent customer who cannot recover it from the supplier (*Reemstma*), or (ii) by an innocent supplier who would be required to repay it to the customer (*Banca Antoniana).* But in each case, there had been an overpayment of VAT which was not due and the person claiming the repayment was not at fault. In *Reemstma*, the overpayment was caused by the supplier wrongly invoicing the customer for VAT, and in *Banca Antoniana* the incorrect VAT treatment of the supplies was attributable to the State and that the situation was not the fault of the bank which the CJEU described as "a prudent and alert economic operator" that "correctly applied VAT to the transactions".

57. That is not the case here. What happened in this case is that JBHL made the error in its invoicing and there has been no overpayment of VAT by anyone. JBHL must be treated as having received £16.67 VAT from Rok which it must pay over to HMRC, and the consequence of JBHL's error and subsequent insolvency of Rok is that JBHL will not be able to recover the full contract price. In asking for the assessment for £16.67 to be quashed, JBHL is not seeking a repayment of VAT to restore fiscal neutrality (as was the case in both *Reemtsma* and *Banca Antoniana*) but is trying to withhold payment to put it into the position it would have been in if it had followed the VAT rules correctly. There is nothing in the principles of fiscal neutrality or effectiveness that require the tax authorities of a member state to insulate a taxpayer from the consequences of the insolvency of its counterparty where it has made a mistake in applying the relevant VAT rules.

58. We have considered whether we should refer any questions to the CJEU for a preliminary ruling. Mr Brown submitted that, given the lack of authority on the issue, this would be a suitable case to be referred to the CJEU. However, we consider that the matter is 'acte clair' as a matter of EU law in light of the CJEU's decisions referred to above.

59. For those reasons, we dismiss JBHL's appeal on the ground of unjust enrichment, fiscal neutrality or effectiveness.

Best judgment

60. Before the FTT, Mr Brown submitted that section 73(1) VATA94 gave HMRC a discretion whether or not to assess in cases such as this. He contended that HMRC had not considered whether or not to assess in circumstances where there would be a windfall to HMRC, and, accordingly, the assessment was not to best judgment as required by section 73(1) VATA94. The FTT rejected that submission and held that it did not have any jurisdiction to consider HMRC's exercise or failure to exercise a discretion to assess.

61. Even if the FTT did have jurisdiction, Mr Brown accepted that in order to succeed JBHL would have to show that HMRC's assessment was made wholly unreasonably: see *Rahman v Customs and Excise Commissioners* [1998] STC 826 at 835 per Carnwath J. In our view, however, for the reasons set out above, it cannot be said that the assessment in this case was wholly unreasonable. There are no grounds such as unjust enrichment at

the expense of JBHL or any EU principles upon which HMRC might properly have decided that they should not collect output tax due from JBHL.

62. Accordingly, we do not think that it is necessary for us to express a view about section 73(1) VATA94 and the FTT's jurisdiction in this case. We would prefer to leave that issue for another appeal in which it might be determinative.

Disposition

63. For the reasons given above, JBHL's appeal against the FTT's decision is dismissed.

Costs

64. Any application for costs in relation to this appeal must be made in writing within one month after the date of release of this decision and be accompanied by a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

The Hon Mr Justice Snowden

Upper Tribunal Judge Greg Sinfield

Release date: 23 November 2018