TC03773

Appeal number: TC/2010/06234

VAT – supply of individually negotiated postal services treated by all parties as exempt from VAT – customer seeking to reclaim input VAT on supply from HMRC – whether services standard rated under* Marleasing *or* Becker *– yes – whether VAT was 'due or paid' – no – whether HMRC's exercise of discretion to refuse input tax recovery in absence of invoices flawed – yes but decision would inevitably have been the same if all relevant matters considered – preliminary issue decided against the appellant – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ZIPVIT LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square London on 14 and 15 May 2014

R Thomas QC instructed by DLA Piper UK LLP for the Appellant

S Grodzinski QC and Ms E Mitrophanous, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION in PRINCIPLE

1. The appellant made a claim on 15 September 2009 under Regulation 29 of the VAT Regulations 1995 for input tax which it claimed it had incurred in the period 31 March 2006 to 30 June 2009 in the sum of £383,599. It made a further claim on 8 April 2010 for £31,164 for the next two accounting periods. HMRC rejected the claims on 7 May 2010 and upheld this decision in a review letter dated 2 July 2010. That review decision is now under appeal.

Background

2. The appellant carried on a fully taxable business of supplying vitamins and minerals to its customers by mail order. It used the services of Royal Mail to despatch its mail orders and also to distribute advertisements. It is accepted that Royal Mail and HMRC at the time Royal Mail made these supplies to Zipvit considered that the supplies were exempt from VAT.

3. However, the CJEU ruled in 2009 in the case of *TNT Post UK Ltd* C-357/07 [2009] STC 1438 that the postal exemption was limited. The Court said:

> "[42] …. under [the Directive], the supply of services by the public postal services and supply of goods incidental thereto are exempted from VAT. Only passenger transport and telecommunications services are expressly excluded from the scope of that provision.
>
> [43] However, … it may not be inferred from that provision that all the supplies of services by the public postal services and supplies of goods incidental thereto which are not expressly excluded from the scope of that provision are exempted, regardless of their intrinsic nature.
>
> [44] It follows from the requirements referred to in paragraph 31 of this judgment that the exemption …. must be both strictly interpreted and interpreted consistently with the objectives of that provision, that the supplies of services and of goods incidental thereto must be interpreted as being those that the public postal services carry out as such, that is, by virtue of their status as public postal services.
>
> ….
>
> [46]…it follows…. in particular, from the nature of the objective pursued by Article 13A(1)(a), which is to encourage an activity in the public interest, that the exemption is not to apply to specific services dissociable from the service of public interest, including services which meet special needs of economic operators ….
>
> [47] ….services supplied by the public postal services for which the terms have been individually negotiated cannot be regarded as exempted…. By their very nature, those services meet the special needs of the users concerned.
>
> [48] That interpretation is, moreover, confirmed by recital 15 in the preamble to Directive 97/67, from which it is apparent that the option

> to negotiate contracts with customers individually does not correspond, in principle, with the concept of universal service provision.

4. The ruling at §49 was:

> "Consequently, ….the exemption provided for in Article 13A(1)(a) of the Sixth Directive 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 telecommunications 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." (my emphasis)

5. In brief, the effect of the CJEU's ruling in *TNT* was that postal services provided by the universal postal provider (the Royal Mail in the UK) were not exempt if they were 'individually negotiated'.

Preliminary issue

6. The appellant's claim was made on the basis that Royal Mail had wrongly treated supplies it made to Zipvit as exempt when the services were in law standard rated. There is an outstanding dispute between the parties over the extent of the CJEU's ruling in *TNT* and precisely which services supplied by Royal Mail to Zipvit were 'individually negotiated" and therefore not exempt. This Tribunal is not asked to rule on this dispute as the tax status of the various supplies by Royal Mail is before the High Court in the case of *TNT Post UK Ltd (No 2).*

7. HMRC is agreed, however, that the Royal Mail's 'Mailmedia' supplies were standard rated as a matter of EU law and therefore I am asked to consider Zipvit's claim in principle in so far as it relates to Mailmedia supplies made to it by Royal Mail, leaving issues of quantum if necessary to be agreed by the parties. Zipvit's claim also includes a claim for compound interest, and similarly I am not asked to rule on this.

8. It was agreed that the Tribunal would decide as a preliminary issue:

> "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 1994, but which were properly chargeable to VAT under the Sixth VAT Directive or Principle VAT Directive, is entitled to an input tax credit in respect of those supplies."

The Facts

9. It is agreed by the parties that Royal Mail treated the supplies of 'Mailmedia' to Zipvit as exempt. It did not account to HMRC for VAT on the supplies and it did not issue VAT invoices to Zipvit in respect of these supplies.

10. I was shown the Royal Mail's user guide for Mailmedia services. As it is not in dispute that under *TNT* the Mailmedia service provided by Royal Mail was standard

rated under the VAT Directives, little needs to be said about it. In brief, it was a contract by Royal Mail with its customer to mail out identical advertisements to very large numbers of addressees, and include with each mailing a reply paid envelope. The cost of the service depended on quantity, weight and whether the customer pre-sorted the mailings.

11. There was absolutely nothing in the information provided by Royal Mail about their Mailmedia service which mentioned VAT. A customer wanting the Mailmedia service would complete an online contract application, and Mr Bailey, the principle shareholder and managing director of Zipvit, regularly did so. Similarly, this application did not mention VAT. The Royal Mail's acceptance form also had nothing about VAT in it.

12. Each time Zipvit contracted for the Mailmedia service, Royal Mail provided Zipvit with an invoice for its services. The invoices show that Royal Mail treated the supply of Mailmedia services as exempt from VAT.

13. The appellant's position is that the invoices did not properly reflect the agreement between the parties. Mr Bailey in oral evidence accepted that when first having used the Mailmedia service and received Royal Mail's invoice showing it treated the supply as exempt, he knew that Royal Mail treated the supply as exempt when Zipvit entered into subsequent Mailmedia contracts. He agreed in oral evidence, if not in his witness statement, and I find that at the time of the supplies at issue in this appeal, both Royal Mail and Zipvit considered the Mailmedia services to be exempt from VAT.

14. I also admitted into evidence a recently dated email in which Royal Mail refused to provide a VAT invoice to another customer (not Zipvit) in respect of supplies to that person similar to the supplies made to Zipvit. The facts were that no VAT invoices had been issued by Royal Mail to Zipvit for Mailmedia supplies and Zipvit had not asked for VAT invoices to be issued to it.

The law

Exemption for postal services

15. Article 132 of the Principle VAT Directive 2006/112/EC ("PVD") provided:

> "1. Member States shall exempt the following transactions:
>
> (a) the supply by the public postal services of services other than passenger transport and telecommunications services, and the supply of goods incidental thereto.

16. This provision (and its previous incarnation in the Sixth VAT Directive – "6VD") was given effect by Group 3 of Schedule 9 to the VAT Act 1994 ("VATA") which provided exemption for:

> 1. The conveyance of postal packets by the Post Office company.

> 2. The supply by the Post Office company of any services in connection with the conveyance of postal packets.
>
> NOTES
>
> (1) 'Postal packet' has the same meaning as in the Postal Services Act 2000.
>
> (2) Item 2 does not include the letting on hire of goods.

17. This exemption was substantially amended in UK law following the *TNT* decision but I do not set out the amendments as they post date the supplies at issue in this appeal.

The right to deduct

18. The PVD (as did the 6VD before it) provided:

> 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;
>
> ……

The appellant's case

19. As I have said, it is accepted by HMRC that, as a matter of EU law, Royal Mail's supplies to Zipvit of Mailmedia in the relevant period should have been standard rated. The appellant's position is that Royal Mail's supplies to it of Mailmedia were standard rated as a matter of UK law as well and that therefore it is entitled to recover from HMRC as input tax the output tax which Royal Mail should have accounted to HMRC for on the supplies to the appellant but did not.

20. If it is wrong on that, its position is that it is entitled to rely on the direct effect of the provisions of the PVD which make the supply of Mailmedia services standard rated and that it is therefore entitled to recover from HMRC as input tax the output tax which should have been accounted for to HMRC had the supply been treated as standard rated.

21. If it is right on either of the above two submissions, the appellant accepts that it is unable to provide a VAT invoice, which is the normal prerequisite to a valid input tax reclaim, but submits that it nevertheless ought to be entitled to recover the 'input

tax' relying on alternative evidence that the supply of the Mailmedia services to it really did take place.

Submission one – conforming interpretation

22. The appellant's case is that the UK provisions on the postal service exemption are very similar to the EU provisions, save of course that the UK provisions identify the Royal Mail as providing the public postal service in the UK (see §§15-16).

23. As is well known, section 3 European Communities Act 1972 ("ECA") provides:

> **"3. Decisions on, and proof of, Treaties and EU instruments etc.**
>
> (1) For the purposes of all legal proceedings any question as to the meaning or effect of any of the Treaties, or as to the validity, meaning or effect of any EU instrument, shall be treated as a question of law (and, if not referred to the European Court), be for determination as such in accordance with the principles laid down by and any relevant decision of the European Court.
>
> (2) Judicial notice shall be taken of the Treaties, of the Official Journal of the European Union and of any decision of, or expression of opinion by, the European Court on any such question as aforesaid; …."

24. The decision of the European Court in *Marleasing* [1990] EUECJ C-106/89 is also well-known. The facts are irrelevant. In this case the CJEU ruled:

> "[8]…in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, so far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter …."

25. It is therefore the appellant's case that, as it is clear that UK law (the ECA) requires this tribunal to apply the decision of the CJEU in *Marleasing,* I must interpret the postal exemption to achieve the purpose of the PVD, and in doing so take account of the decision of the CJEU in *TNT*. In other words, the UK postal exemption should be given the same interpretation as the CJEU gave the EU postal exemption in the *TNT* case. The UK and EU postal exemptions in practice have virtually the same wording and must be taken to have the same meaning and purpose.

26. The appellant accepts that such a reading of the UK postal exemption, effectively importing restrictions into the exemption which are not there on the face of it, is unlikely to be the reading it would have been given if it was a standalone piece of UK legislation, interpreted under the UK's normal rules of interpretation for domestic legislation. Nevertheless, says the appellant, it is clear from *Prudential Assurance* [2013] EWHC 3249 (Ch) and those cases cited in that case at §101 that different rules of interpretation apply when interpreting legislation intended to implement EU treaty obligations. In particular, such conforming interpretation is not

constrained by conventional domestic rules of interpretation and permits the implication into the legislation of words necessary to comply with Community Law obligations. The only significant limit on this 'broad and far-reaching' obligation to interpret the legislation in a manner compliant with Community law obligations is that the tribunal cannot step over the boundary from interpretation to amendment (so, for instance, the tribunal cannot adopt an interpretation which runs counter to Parliament's intent).

27. The appellant's case is that such a conforming interpretation of item 1 of Group 3 of Schedule 9 (the UK postal exemption) would see words implied into that exemption to limit its application in the same way that the CJEU effectively read into Art 132(1)(a) (the EU postal exemption) words limiting the extent of the exemption, and in particular the reference to 'individually negotiated'. I did not understand HMRC to suggest that such an interpretation went beyond a conforming interpretation and crossed the line from interpretation to amendment. Mr Grodzinsky, as I understood him, accepted that, if a conforming interpretation was given to Group 3, then the effect of that would be to read into the UK exemption the qualification for individually negotiated services read into the EU postal exemption by the CJEU in *TNT*.

28. On the contrary, HMRC's case is that this Tribunal should not adopt a conforming interpretation because, says HMRC, that runs counter to what the CJEU required in *Marleasing* and in particular (in HMRC's opinion) would be contrary to the overall purpose of the Principle VAT Directive. HMRC point out that in *Marleasing* the CJEU only required a conforming interpretation:

> "…in applying national law, whether the provision in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in light of the wording and purpose of the directive in order to achieve the result pursued by the latter." (my emphasis)

29. HMRC's case is that the appellant has not really borne the burden of VAT at all. The supplies of Mailmedia services to Zipvit were was treated as exempt so no VAT was added to the price, and even the appellant accepts that at most the irrecoverable VAT incurred by the Post Office in making the supplies would only have increased the net price by a maximum of 2.5%. The CJEU has said in many cases (such as at §19 of *Rompelman* cited at §95 below) that the purpose of the right to offset input tax was to remove the burden of VAT from taxable persons making taxable supplies: yet if the appellant's appeal is upheld, says HMRC, Zipvit will achieve recovery of VAT which it never paid and which was never in reality a burden on it.

30. That, says HMRC, would fail to achieve the objective of the Directive and indeed run completely counter to it: nowhere does the directive give a taxpayer the right to recover VAT which it has not paid. Doing so is the antithesis of the VAT system of outputs and inputs.

31. But I have difficulties with HMRC's submission. It amounts to saying that any particular provision of the PVD could have a different interpretation depending on the

nature of the case in front of the court. When TNT, a supplier in competition with Royal Mail, the universal postal provider, is in front of the court challenging the seemingly wide-ranging nature of the exemption, the CJEU gave the postal exemption a narrow construction in order to conform to the overall purpose of the directive; yet, says HMRC, when Zipvit, a customer which benefited from the supply being erroneously treated as exempt, is in front of the court, the Tribunal should give the postal exemption a wide interpretation to avoid the overall purpose of the directive being defeated.

32. This cannot be right. I consider that *Marleasing* can only be understood as requiring the court to interpret any particular provision in the light of the wording and purpose of the directive in respect of that particular provision. The particular provision in this case is the exemption for postal services and I must interpret the UK provision which gives effect to it in the light of the wording and purpose of the Directive in respect of the postal exemption as explained by the CJEU in *TNT*. To do otherwise would result in a single provision having differing meanings depending on who was relying on it and for what reason.

33. So I do not accept that HMRC's reading of *Marleasing* is correct. I must apply a conforming interpretation of Group 3 (the UK postal exemption) even where such conforming interpretation is relied on by a taxpayer to achieve input tax recovery where no output tax was paid. I note in passing that the appellant does not accept that it did not pay the output tax and I will return to this point.

34. In conclusion, I agree with the appellant that, applying *Marleasing,* Group 3 must be given a conforming interpretation and in particular it must be read as if it contained the same restriction that the CJEU read into Art 132(1)(a) (the EU postal exemption) and in particular the restriction on 'individually negotiated' services.

35. I am aware that at §19 of the CJEU's decision in *TNT* the Court said:

> "The Value Added Tax Act 1994, as amended by the Postal Services Act, provides that the conveyance by Royal Mail of postal packets, which includes letters, is exempt from VAT, whereas the services provided by TNT Post (which, that company contends, are the same as those provided by Royal Mail) are subject to VAT at the standard rate of 17.5%."

36. However, the CJEU has no authority to interpret UK law and I accept the appellant's point that the CJEU was not purporting to do so: it was merely reciting the then common understanding of UK's postal exemption and not making any finding of law about it. This paragraph from the *TNT* decision does not alter my conclusion that *Marleasing* requires me to adopt a conforming construction of the UK's postal exemption.

37. The parties are agreed that if a conforming construction is adopted, the Mailmedia supplies were standard rated. So I find that the Mailmedia supplies were standard rated as a matter of UK law.

Alternative case – reliance on direct effect

38. I have decided the principle point on the first issue in the appellant's favour and therefore strictly speaking do not need to consider the alternative case. But, in view of the money at stake in the related appeals (I am told £1 billion: see §17 of *288 Group Ltd and others* [2013] UKFTT 659 (TC)), it seems likely that, whatever the outcome, my decision will be appealed on a point of law and it will therefore be useful to set out the parties' arguments on this alternative case as presented to me.

39. The appellant's case here is that if the domestic exemption is not given a conforming interpretation, such that the supplies of Mailmedia were exempt at the relevant time as a matter of UK law, then nevertheless it is clear (with hindsight) that at the relevant time the supplies of Mailmedia were standard rated as a matter of EU law. Under *Becker* C-8/81 the appellant is entitled to rely on the direct effect of EU law:

> "[25]… in the absence of duly adopted implementing measures, individuals may invoke the provisions of a directive which, from the viewpoint of content, are unconditional and sufficiently precise, against all national legislation which does not conform with it. Individuals may also invoke those provisions if they lay down rights which can be enforced against the State."

40. The appellant's case is that this means that as a matter of EU law the supplies to it were standard rated and it is entitled to rely on its right to deduct the input tax on that supply.

41. HMRC accept that the postal exemption is 'unconditional and sufficiently precise' such that it is of direct effect. I agree. That the scope of the exemption was thought to be wider than the CJEU found it to be in *TNT* is irrelevant to the question of whether the obligation to implement the exemption was unconditional and sufficiently precise: all exemptions in Art 132 PVD are clearly compulsory and therefore all of them are of direct effect, even where the precise scope of them is not always clear.

42. I find, therefore, that the appellant can invoke direct effect of the postal exemption against HMRC. As it is HMRC which is refusing the appellant's claim for input tax, I find, therefore, that even if I had not adopted a conforming interpretation, it would not be open to HMRC to defend this appeal on the grounds that Royal Mail's supplies of Mail Media services were exempt under UK law.

43. I mention that the appellant pointed out that it could rely on the direct effect of the postal exemption against not only HMRC but as against Royal Mail. It pointed out that under s 62 of the Postal Services Act 2000, Royal Mail was a wholly owned subsidiary of the government and was under the rules explained by the CJEU in *Foster v British Gas plc* at §§18-20 to be treated as an emanation of the state and therefore a body against whom Zipvit could rely on the direct effect of the postal exemption.

44. HMRC accepted that this is right as a matter of law. However, I do not see how it affects this aspect of the appellant's case as I have already said that HMRC would not able to defend the appeal by relying on the UK law status of the supplies (had I not adopted a conforming interpretation.)

Submission two – was VAT due from or paid by appellant?

45. The appellant therefore succeeds on its first submission that a conforming interpretation must be applied and Royal Mail's Mailmedia supplies were standard rated under UK law at the time they were made. HMRC's next submission is that the appellant is not able to rely on *Marleasing* and any directly effective rights it may have under EU law unless it accepts the full consequences of the Directive. Put colloquially, it must take the rough with the smooth. HMRC says that this means it cannot recover any VAT unless it now pays to the Royal Mail VAT (at the appropriate rate) on the supplies of Mailmedia to it.

46. Article 168 of the PVD cited at §18 above provides only (in so far as inter-UK supplies are concerned) for a right of recovery by the taxpayer of

> "(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services…." (my emphasis)

47. The appellant, as I understand it, agrees that it must accept the full consequences of a conforming interpretation or its choice to rely on its directly effective rights under the Directive, but considers that it has done so. It considers that the sums it paid to Royal Mail for the Mailmedia supplies included VAT at the appropriate rate. Its position is that it was liable to pay and has *paid* the VAT it seeks to recover.

48. But what precisely does 'VAT due or paid' mean?

Is VAT due or paid?

49. The first point to note is that Art 168 requires VAT to be due or paid. It is not enough to owe or pay an amount stated to be VAT if it is not really VAT. This is the ratio of *Genius Holdings BV* C-342/87. In that case the taxpayer paid a sum stated to be VAT on invoices issued to it in circumstances where no VAT was actually due. Under what is now Art 203 of the PVD, the person who issued the invoices had to account for an amount equal to the 'VAT' stated on the invoices, but 'VAT' was not actually due or paid on the supply because the supply was not a taxable supply. In those circumstances, it was held that there was no right to deduct: "VAT" had not been paid.

50. However, in this case, as, firstly, the appellant is entitled to a conforming construction of the exemption and, in any event, can rely on the direct effect of the EU exemption, the supplies made by Royal Mail of Mediamail to Zipvit were standard rated and therefore I find any VAT due or paid was VAT in the sense meant by the CJEU in *Genius Holding.*

51. So what do the words "due or paid" mean? I will consider who must pay, or be due to pay, the VAT. But first of all I deal with the parties' submissions on whether Zipvit had paid or was due to pay the VAT as these were the submissions made at the hearing.

The submissions at the hearing on "due or paid"

52. HMRC deny that VAT was paid. HMRC point out that the appellant's contract for Mailmedia services was silent on VAT. The invoices issued by Royal Mail show that no VAT was charged.

53. The appellant presented its case on the basis that all it needed to show was that the sum that the appellant had paid to Royal Mail included an amount of VAT. It relied on s 19(2) VATA. That provision says:

> "(2) 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."

54. I find that this does set out the formula which calculates how much VAT is payable, and logically therefore how much is recoverable by the supplier's customer *if* that customer is able to deduct VAT.

55. It is certainly clear that so far as the *supplier* is concerned, s 19(2) means that whether the contract price is paid in whole or in part, the supplier cannot avoid entirely liability to account for VAT on the basis that the customer has only paid the net amount of the price (for instance, see *Simpson & Marwick* below on the operation of bad debt relief ('BDR')).

56. The appellant's case is simple. They paid Royal Mail the contract price. The supply was standard rated (albeit no one knew it at the time). Therefore, says Mr Thomas, an appropriate percentage of the price paid to Royal Mail comprises VAT. And Zipvit has paid that because it paid the whole contract price.

57. Even if the contract was exclusive of VAT, says the appellant, it is wrong to see the unpaid element as exclusively representing VAT. In the appellant's view the terms of the contract are irrelevant to the question of whether VAT was paid. Whether inclusive or exclusive of VAT, what was actually paid included an element of VAT because the contract was standard rated.

58. The appellant relies on two cases for this proposition.

Corina-Hrisi Tulica [2013] EUECJ C-249/12

59. In this case, the appellants entered into contracts for the sale of land which were silent on VAT. The appellants were then assessed to VAT on the basis that the land sales were standard rated. It was not made clear to the CJEU whether or not the appellants would be able to recover the VAT from their customers (see §28).

60. The question for the CJEU was whether the contract price had to be treated as inclusive or exclusive of the due VAT. Its ruling was that, if the taxpayers had no means of recouping the VAT from their customers, than the total contract price *included* the VAT. This is reflected in the provisions in VATA and in particular s 19(2). The Court said:

> [43] …[the Directive] 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."

61. As Mr Thomas said, there was nothing in the CJEU's consideration in this case about who bore the economic burden. It seems clear that the purchasers did not have economic burden as the supply was presumed exempt. Nevertheless, the supplier was still liable to pay the VAT to the tax authorities.

62. One distinction with *Tulica* and this appeal is that national authorities did assess the taxpayer who had mistakenly treated standard rated supplies as exempt. Here, HMRC has clearly decided not to assess the Royal Mail. That exercise of discretion by HMRC, and whether or not it was the right decision as a matter of public law, cannot affect the answer to the question of whether the customers actually paid the VAT as a matter of the PVD. So while it is a distinction with this case, it cannot be a material distinction.

63. But the relevant distinction with this case is that in *Tulica,* the court was concerned with the *supplier's* VAT liability whereas this appeal is concerned with the *customer's* VAT entitlement. The CJEU gave no consideration in *Tulica* to the customers' position. The case is only authority for saying that, assuming, as the parties do, that the Mailmedia contract requires no further sums to be paid, then Royal Mail's liability to VAT (had HMRC chosen to assess it) would have been on the basis that what Zipvit had paid *included* VAT. The case is not authority on the customers' input tax recovery position.

64. The case is not authority on what "VAT due or paid" means in Art 168, which was irrelevant to the legal issue in that case and was not considered by the CJEU.

Simpson and Marwick [2013] STC 2275

65. In this second case relied on by the appellant, a firm of solicitors, Simpson & Marwick, provided legal services to clients who were VAT registered and who had the benefit of insurance against the costs of legal advice. Misunderstanding advice from the Law Society, the firm issued invoices for their net fees to the insurer and invoices for the VAT element of their fees to their VAT-registered client. (They should, of course, have issued normal VAT invoices to the clients, and merely sent a copy to the insurer.)

66. The insurers would, under the terms of their contract of insurance, pay their client's net legal bill. They did not reimburse the VAT element as the client was entitled to recover this from HMRC. Occasionally, the client became insolvent before paying the VAT element of the fees to Simpson & Marwick. Simpson & Marwick were therefore out of pocket by an amount equivalent to the VAT element on their legal fees. However, they made a bad debt relief claim for the full amount of the VAT.

67. This was discovered on a VAT inspection and Simpson & Marwick (not surprisingly) were assessed to VAT on the basis that they had over-claimed BDR to the extent that their charges for their services had actually been paid.

68. Simpson & Marwick appealed the assessment on the basis that the entirety of the VAT element of their invoice had been written off in their books, although the net debt had been paid. The VAT Tribunal dismissed the appeal. The Upper Tribunal allowed the appeal but the Tribunal's decision was then restored by the Court of Session.

69. The law here is entirely clear. The question was how much output VAT a supplier was liable to account for to HMRC. The firm of solicitors had made supplies of services and was liable to account for and had accounted for VAT on them. But it had only been part-paid for its services and that meant it was entitled to recover (as BDR) some of the VAT which it had accounted for to HMRC. And it was entitled to recover in proportion to the amount which was unpaid:

> "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 reference to 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'…"

70. What relevance does this case have to this appeal? *Simpson & Marwick* looked at a *taxpayer's* liability to account for output tax; this appeal is about a taxable *customer's* right to recover input tax. Put another way, like *Tulica, Simpson & Marwick* looked at the position of the supplier; this case is about the position of the supplier's customer.

71. *Tulica* and *Simpson & Marwick* do not contain the answer to the question of the customers' input tax recovery entitlement as that was not considered, although I note that even on HMRC's case the customer in *Simpson & Marwick* would be entitled to recover VAT (but only in proportion to how much of the contract price had actually been paid) as the contract obviously did provide for VAT to be paid.

72. But neither case is any authority whatsoever on the crucial question of the meaning of the words "VAT due or paid" in Art 168, which govern the appellant's entitlement to deduct.

Does the right to deduct depend on the contractual terms?

73. HMRC's case is that "VAT due or paid" means that the appellant must show that what it paid to the supplier expressly included an element of VAT. HMRC's case is that s 19(2) merely calculates the VAT which the supplier owes to HMRC. But whether the amount 'paid' by the customer to the supplier includes a payment of VAT is not, say HMRC, determined by s 19(2). It is, says HMRC, determined by the contract between the parties.

74. The appellant does not agree. Mr Thomas gave an illuminating example of a special offer where the seller advertises his product for sale on the basis it is "VAT free" or "the seller will pay the VAT". If the item before the offer was made would have been sold for £100 plus VAT, everyone understands that this means the (gross) price is now £100. But as a matter of law (whatever or not the unsophisticated customer understands it) the sale was not VAT free: the vendor will have to account to HMRC for the VAT element contained within the £100 purchase price. And putting aside the rules on simplified invoices, the vendor would have to issue a VAT invoice to the customer, and the customer, says Mr Thomas, if fully taxable and registered, would have the right to recover the VAT shown on the invoice even though one term of the contract was that the supplier would pay the customer's VAT.

75. If, on the other hand, HMRC is right, the VAT registered fully taxable customer would have no right of VAT recovery because the contract stated that no VAT would be charged (albeit an invoice would then be issued showing that VAT was charged).

76. HMRC countered with an example of a contract for a supply of something for £120 which was stated to be VAT inclusive. This says HMRC would give the supplier a liability to pay £20 to HMRC and its fully taxable customer a right to recover £20 from HMRC. Yet, says HMRC a contract for £120 which was silent on VAT, while it would give the supplier a liability to pay £20 to HMRC would not give the full taxable customer a right to recover the £20 from HMRC.

77. HMRC's case, it seems to me, has to be seen as based on the premise that the terms of the contract between supplier and customer can affect the customer's right to recover VAT from HMRC. So HMRC say, because Royal Mail and Zipvit effectively agreed that the contract was free of VAT, when Zipvit paid the contract price, what they paid did not amount of payment of VAT.

78. This cannot be right. There is no express requirement in the PVD or its predecessors that the right to deduct is limited in cases involving intra-Member State supplies to cases where the contract expressly provides for VAT.

Right of deduction is fundamental

79. Art 167 provides:

> "a right of deduction shall arise at the time the deductible tax becomes chargeable"

80. There is nothing in this provision which suggests that contractual terms could alter or take away a right of deduction. It implies on the contrary that the right of deduction of the VAT for the customer arises immediately that its supplier becomes liable to pay the VAT. Obviously there are restrictions on recovery of input tax expressly set out in the Directive where the taxpayer is partly exempt or the input tax blocked, but nowhere is there any restriction explicitly arising out of the terms of the contract. Nor do I see any reason why one should be implied. The logic of the PVD is that a supplier's liability to account for VAT is matched by a corresponding right to deduct by a fully taxable customer.

81. A fundamental principle of the PVD and its forerunners is the system of payment and deduction of tax. For instance, the Advocate General in *Danfoss A/S* (C-371/07) [2009] STC 701 said the right to deduct is 'fundamental and general' and exceptions to it are narrowly interpreted:

> "Any departure from that basic system of taxation and deduction must, as a derogation from a general principle, be interpreted strictly."

82. It seems to me that if such a limit on the right to deduct, as HMRC contend was intended, it would have been expressly provided for. It wasn't. And the CJEU would not 'read' one in because that would constitute a departure from the basic system of taxation and deduction.

83. HMRC, needless to say, do not agree and refer me to the Advocate General's opinion in the 3G case.

T-Mobile Austria GmbH and others C-248/04

84. In this case, the Austrian government granted '3G' bandwith licences for consideration. The 'customers' then claimed that the supply was taxable and they were entitled to treat the consideration as VAT inclusive and recover the VAT as input tax. In that sense the case has many parallels to this one.

85. In the event, however, the CJEU ruled that the 'supplies' were not an economic activity by the Government and the CJEU did not have to address the question of the customers' entitlement to input tax recovery. There was no VAT to recover.

86. The Advocate General did address it. She said:

> "[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, which it is for the courts of the member states alone to determine."

87. HMRC rely on this for their case that, as the Royal Mail and Zipvit agreed that the supplies were exempt, therefore no VAT was paid by Zipvit to Royal Mail.

88. However, I consider that HMRC take this quotation from the Advocate General out of context. She was answering the question set at [143] which was:

> "…whether the agreed payments already include the value added tax or are payments to which value added tax may still be added"

89. That this was the question she was answering is made even clearer from the heading to that section:

> "…is the frequency use payment to be considered a net or gross figure?"

90. In other words, she was saying that whether the customer was liable to pay an additional amount in VAT to the other contractual party depended on the terms of the contract. This is obviously right and explains why she dealt with it so briefly. What she was not considering was whether, where the contract price had been paid, the contractual terms would make any difference to a fully taxable customer's right to recover input tax on a taxable supply.

91. In other words, she was (as the court was in *Tulica)* dealing with the question of quantification of the amount of VAT and not with the customer's right of deduction. The Opinion in the 3G case is of no relevance to the question in this appeal.

Bernhard Langhorst C-141/29 [1997] STC 1357

92. HMRC also rely on the case of *Langhorst.* In this case, the taxpayer, a farmer who had elected to use a special VAT scheme with a lower rate of VAT, had self-billing customers. They 'self-billed' him at the normal VAT rate unaware of his election to use the special scheme. He did not correct this. The CJEU ruled that the farmer was liable to pay the amount shown as VAT in the invoices under the provision that is now Art 203 PVD which requires any amount shown as VAT in an invoice to be paid even if it is more than the amount of VAT which would otherwise be due.

93. This seems to be a straightforward application of an anti-abuse measure (Art 203) which requires anyone who issues what purports to be a VAT invoice, to account for the VAT stated in that invoice, even if no taxable supply took place, or, as in this case the supply did take place but at a lower rate of VAT than stated. However, applying *Genius Holdings,* the farmer's self-billing customers would nevertheless only have been entitled to recover as input tax the VAT at the correct rate despite the higher amount stated on the invoices and paid by them.

94. It is difficult to see how this case supports HMRC's proposition that the terms of the contract can affect the customer's right to input tax recovery.

Economic burden

95. HMRC says that where the contract does not provide for VAT to be paid, the customer has not borne the economic burden of the VAT, so why should he recover it? The logic of the PVD is that the economic burden of VAT should be borne by the final consumer: that explains why a taxable person has both the liability to account for VAT on its supplies but the right to recover VAT on its purchases:

> "[19] …the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way." (per CJEU in *Rompelman* C-268/83)

Here, HMRC say Zipvit has not borne the economic burden of the VAT on Mailmedia supplies, so should have no right to recover the VAT on the supply.

96. While I agree that passing the economic burden to the final consumer is a fundamental driver underlying the PVD, nevertheless I do not think it dictates the answer to every question, and in particular it does not dictate the answer to the question of who must account for VAT when a supply is given the *incorrect* VAT treatment. When the rules of VAT are properly applied, the economic burden is borne by the final consumer and not intermediate suppliers; but where the rules have not been properly operated by taxpayers, different considerations apply. A taxpayer cannot avoid VAT liability where it has improperly applied the VAT rules on the basis that that would leave it with an economic burden it was not intended to have. If that were the case, there would be no incentive on taxpayers to apply VAT law.

97. So, for instance, in *Tulica* it would have been no answer to the assessment on the taxpayers (the suppliers) to say that the effect of the assessment was that the suppliers would bear the economic burden of VAT rather than the final consumers. On the contrary, the answer to that submission would have been that it is for the supplier to recognise its VAT liabilities and charge a price which covers its liability to pay VAT. Where it fails to do this, it must take the unfortunate financial consequences: it cannot escape liability for the VAT because it failed to add VAT to its prices. An example where the CJEU did not use the rules of economic burden to determine the outcome of a case where the VAT rules had been misapplied by the trader is *Genius Holding* where the CJEU at §12-13 and §18 rejected the economic burden argument put at §10.

98. I see no reason why the PVD should be interpreted as meaning that in such a case as *Tulica* or on the facts of this appeal, the supplier's customer should have no right to recover the VAT, despite paying the contract price, just because the price it paid was determined without any reference to the suppliers' VAT liability.

99. Mr Grodzinski suggested HMRC's case was supported by considering the example of a supplier and customer who agreed that the price was £100 plus VAT of £20, but it was later discovered the supply was exempt. The supplier would be able to recover the £20 it had accounted for to HMRC (if it made an in-time claim and subject to rules on unjust enrichment) but, says Mr Grodzinski, would the customer be able to reclaim the £20 from the supplier?

100. I find this is an unhelpful scenario because it is not the provisions of the PVD or VATA which matter but the national rules of contract and restitution (money paid by mistake) which would apply to determine whether the customer could recover the £20 from the supplier, or, if the customer had not yet paid the contract price, whether the

customer was liable to pay £100 or £120 to the supplier. Mr Grodzinski's scenario provides no insight into the customer's right to deduct VAT as it is obvious it would have no right to deduct VAT as the supply was exempt.

101. On economic burden, HMRC also relied on the recent case of *MDDP*.

MDDP C-319/12 [2014] STC 699

102. In this case at §54 the CJEU ruled:

> "It follows from the foregoing that, event where an exemption provided for by national law is incompatible with the VAT Directive, Article 168 of that Directive does not permit a taxable person both to benefit from that exemption and to exercise the right to deduct tax." (my emphasis)

103. This citation is, however, taken entirely out of the context which the CJEU was considering and I do not think it applies in the context in which HMRC seek to use it. In *MDDP* the CJEU had to consider a taxpayer who wished to rely on a national exemption for his services and so not account for VAT, but in respect of the same supply the taxpayer wished to rely on the EU treatment of the same service as standard rated in order to recover attributable input tax. The CJEU effectively said he could not have his cake and eat it. If he elected for the national treatment his supply would be exempt with all the normal consequences, such as the inability to recover attributable input tax; if he elected for the EU treatment, his supply would be taxable with all the normal consequences, such as liability to account for output tax.

104. In this appeal the context is that of a customer, and not a supplier. Zipvit has not 'benefited' from exemption in the sense intended by the CJEU in *MDDP*. In that case the CJEU clearly used the word "benefited" with the meaning that the appellant's supplies were treated as exempt. Here the supplies to Zipvit were (with the benefit of hindsight) standard rated so it has not benefited from the exemption in the sense intended by CJEU.

105. Zipvit has only 'benefited' in that Royal Mail did not charge it VAT in the mistaken belief that its supplies to Zipvit were exempt. But that does not matter: as is clear from *Tulica* that does not affect the supplier's liability to account for VAT, and I see no reason why it would affect the customer's right of recovery.

Requirement for an invoice

106. Further, the PVD (as did its forerunners) requires the supplier to issue a VAT invoice containing all the particulars of the sale including the exact amount of VAT charged. Why would the PVD therefore require that the contract also contain provisions about the payment of VAT before the fully taxable customer could deduct input tax? The exercise of the right of deduction requires a VAT invoice (see below at §§150-153) so any requirement that the contract itself contain provisions on VAT would seem superfluous.

Further submissions?

107. In conclusion, when Zipvit paid the contract price on the taxable supply to it of Mailmedia services, the amount of that contract price dictated the amount of VAT which arose on that supply and I do not accept that the contract between Zipvit and Mailmedia affected the question of whether that VAT was "due or paid."

108. But that does not resolve the case. After the hearing I formed the view that neither party had really addressed me on the possibility that "due or paid" meant 'due or paid by the person liable to pay the VAT' rather than 'due or paid by the person seeking to recover the VAT as input tax.'

109. I consider this point below without the benefit of the parties' submissions. I did have what I consider to be the highly relevant and indeed decisive for this appeal ruling of the CJEU in *Société Véléclair* drawn to my attention, because that had been relied on to support HMRC's case that the contract terms were relevant. It was not relied on in the context in which I use it below.

110. Ordinarily, I would therefore have asked for further submissions from the parties. I have chosen not to do on a pragmatic basis. Firstly, I decide the case against the appellant on the third ground in any event, so it makes no difference to the overall outcome that I decide it against them on the second ground too. Secondly, as I have said at §38, I do not consider that the FTT ruling will be the end of this case. An appeal is virtually inevitable. The parties will therefore have the opportunity to argue this point fully in higher courts and I do not need to delay the process.

Whose VAT liability?

111. The customer's liability is to pay the consideration to the supplier. The customer, except in circumstances which do not apply in this appeal, is not liable to pay VAT. Only the supplier is liable to pay VAT. See s 1(2) VATA and Art 193 PVD.

> "VAT on any supply of goods or services is a liability of the person making the supply….." s 1(2) VATA
>
> "VAT shall be payable by any taxable person carrying out a taxable supply, except [inapplicable exceptions]" Art 193 PVD

112. While s 19(2) calculates the supplier's VAT liability as a percentage of the consideration, that does not mean any part of the consideration is VAT owed to HMRC. HMRC has no interest in equity in the consideration. The consideration when paid belongs to the supplier. There is no obligation on the supplier to use the consideration from the customer to pay its VAT liability on that supply.

113. Therefore, apart from in cases which do not apply in this appeal, the liability to pay VAT rests on the supplier and the customer has no liability to pay VAT. As a matter of contract law, its obligation is to pay the contract price (which may of course be expressed as being the total of 'price plus VAT')

114. So it seems to me that the appellant and HMRC labour under a misapprehension in presenting their cases on the basis that "VAT due or paid" referred to whether or not the appellant had paid VAT. The appellant considered it only needed to show it had paid the contract price, while HMRC considered the appellant needed to show the contract expressly included VAT. On the contrary, I consider that the question is whether the supplier had paid or was due to pay the VAT.

115. This seems obvious to me when Art 168 is read in its full context.

> "In so far as the goods and services are used for the purposes of the 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;
>
> (b) the VAT due in respect of transactions treated as supplies of goods or services pursuant to Art 18(a) and Art 27;
>
> (c) the VAT due in respect of intra-Community acquisitions of goods pursuant to Art 2(1)(b)(i);
>
> (d) the VAT due on transactions treated as intra-Community acquisitions in accordance with Art 21 and 22;
>
> (e) the VAT due or paid in respect of the importation of goods into that Member State." (my emphasis)

116. Firstly, while the article is dealing with the tax position of the customer, it does not say "VAT due or paid" by the taxable person. On the contrary "VAT due or paid" contrasts with the words "VAT which he is liable to pay". The latter clearly refers to the customer's output tax. The Article does not require the customer (the taxable person referred to in that article) to pay or be liable to pay the input tax. All it requires in (a) is that the input tax is due or paid in that Member State.

117. Indeed, it makes no sense for the directive to require the customer to pay the "VAT" where elsewhere in the Directive it is clearly stated that on intra-State supplies the liability is on the supplier to pay the VAT.

118. Further confirmation (if required) comes from an analysis of the the five sub-sections. Sub-section (a) and (e) refer to "VAT due or paid", while sub-sections (b)-(d) only refer to "VAT due". Why the difference?

119. It seems to me that the difference is because of the type of VAT each subsection deals with. Sub-sections (b)-(d) only refer to situations where the taxable person seeking input tax deduction (the customer) is the same person as the person who has the liability to account for the output tax. This is because subsection (b) applies to self-supply charges; (c) to acquisitions and (d) to deemed acquisitions. In other words, these three subsections deal exclusively with the position where a taxable person is deemed to make a supply to itself. It is both supplier and customer. As the liability to account for the VAT arises in the same accounting period as any

entitlement to recover, the liability could never be 'paid' by the deemed supplier in a period before that same taxable person claims recovery, so Art 168 only refers to VAT 'due'. And while the VAT here is due from the customer, that, it seems to me is only because the customer is also the supplier.

120. Sub-sections (a) and (e) deal with different situations. Subsection (a) is the norm: a supply within a single member state. There is no deemed 'self-supply'. Customer and supplier are never the same person. Subsection (e) deals with importations. There is no self supply and the customer and the supplier will not be the same person, but the liability to account for import VAT does not necessarily fall on either the customer or the supplier. It falls on the importer who may be the customer, but that is not always the case. So in (e) the taxpayer (the customer) may be the person with the liability to pay the VAT or it may not be.

121. Sub-section (a) and (e) therefore recognise that at the time input tax deduction is claimed the VAT may still be outstanding or it may already have been paid. While the right to deduct arises when the deductible tax becomes chargeable (Art 167), supplier and customer may have different accounting periods and in any event the supplier may have failed to account for VAT due.

122. In other words, as long as VAT is 'due or paid' by the supplier, the customer has a right to deduct it in so far as it is attributable to his taxable activities. So the right to deduct arises even if the customer has not paid any part of the contract price, as long as the VAT was 'due or paid' by the supplier. The terms of the contract on VAT as between the supplier and customer are therefore entirely irrelevant to the customer's entitlement to deduction. It does not matter if the contract is inclusive, exclusive or silent on VAT. How much VAT can be deducted will depend upon the contractual amount paid as per s 19(2).

123. Therefore, in *Tulica,* although it appears the contracts were silent on VAT, as VAT was due or paid by the suppliers, the customers would have had a right of recovery, although, as I have said, this point was not addressed by the CJEU.

124. That does not, however, resolve the case in favour of the appellant. Zipvit must show that VAT was "due or paid" by the Royal Mail. Everyone was agreed VAT was not paid to HMRC by the Royal Mail on supplies of Mailmedia services to the appellant, so the question is whether the VAT is was "due" at the time of Zipvit's voluntary disclosure.

Société Véléclair C-414/10 [2012] STC 1281

125. The facts of this case were that the taxpayer had (by miscalculating and underpaying the customs duties) underpaid VAT due on the importation of bicycles. In its liquidation, the liquidator took the view that the tax authority was out of time to assess it for the import VAT but that nevertheless it was entitled to deduct the import VAT that the tax authority was out of time to assess because the VAT was "due" albeit unpaid.

126. This case concerned what was then Art 17(2)(b) 6VD (now Art 168(e) PVD to which I have referred above).

127. So far as "due or paid" was concerned, the Advocate General and CJEU decided that it was enough for the right of deduction to arise if the VAT was 'due': it did not also have to have been 'paid'. In that case, of course, the VAT was unpaid and was no longer due as the tax authority was out of time to assess it.

128. HMRC relies on what General Kokott said:

> "[56] The term 'due' does not preclude an interpretation that it requires the legal enforceability of the State's claim for tax. According to the spirit and purpose of the right to deduct, such an interpretation appears plainly to be required. 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 in fact no longer bear at all.
>
> [57] The need for a uniform application of the common VAT system also point towards such an interpretation. If a case such as the one at issue depended upon the legal consequences under the relevant national insolvency law in the event of late declaration of a claim for tax, such uniform application in comparable cases would not be ensured.
>
> [58] Accordingly, the tem 'due' within the meaning of Art 17(2)(b) of the Directive must be interpreted as meaning that it requires that the taxable person has a legally enforceable obligation to pay the amount of VAT which he seeks to deduct as input VAT. If there is no such an obligation, then he cannot be entitled to a right to deduct in respect of VAT on importation which has not yet been paid."

129. The CJEU endorsed this at §20. It said at:

> "As the Advocate General observed in points 56 to 58 of her Opinion, 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" (my emphasis)

130. The first point to note is that although at §20 the CJEU referred to the taxable person being obliged to pay VAT, that must be understood in the context where the taxable person seeking deduction was the importer, and therefore simultaneously liable to the import VAT.

131. In the context of an Art 168(a) claim to deduction, the CJEU's comment at §20 must be read as meaning that the supplier had an obligation to pay the amount of VAT which the customer seeks deduction of as input VAT.

132. I note in passing that HMRC is wrong to consider that this case requires the contract between the customer and supplier to expressly require the customer to pay VAT. The CJEU here were not answering the question of whether there would be a right to deduct where the contract price was both due and paid, but the contract

expressly stated that there was no VAT. That was a question which could not arise in that case because the person liable to pay the VAT (the importer) was the same person as the person entitled to recover it (if the conditions to deduct were met). So the obligation the CJEU referred to was not the obligation of a customer to pay a supplier, which did not exist in that case, but the obligation by the importer to pay the import VAT. It just so happened in that case that the importer was the same as the person who would (if all conditions were met) be entitled to the input tax. This accounts for the wording used by the CJEU in §20 and in particular the reference to the taxable person paying the VAT being the same as the person seeking to deduct the VAT.

133. So the case most certainly does not support HMRC's contention that the *customer* must have an obligation to pay VAT under the contract with the supplier for the customer to have a right to deduct under Art 168(a). On the contrary it is clear from *Société Véléclair* that the "due or paid" refers to whether the person with the obligation to pay the VAT is liable to or has paid the VAT. In that case, an Art 168(e) case, the person with that obligation was the importer; in an Art 168(a) case that person is the supplier.

The meaning of "due"

134. But does this case have any relevance to this appeal? In this case it is accepted that Royal Mail never paid any VAT on the supplies of Mailmedia services. The evidence, such as it was, indicates that no assessments were issued on Royal Mail. This was also the position adopted by both parties. I find that the appellant has not shown that the Royal Mail entered the VAT due (with hindsight) on its supplies of Mailmedia services into its VAT books, made a voluntary disclosure of it, nor that HMRC ever assessed it to pay this VAT.

135. So was VAT "due" by the Royal Mail on the Mailmedia supplies at issue in this appeal?

136. The CJEU in *Société Véléclair* said that there must be an 'enforceable tax claim'. It is not enough, therefore, to show that the supply was subject to VAT, as it was not enough in *Société Véléclair* to show that the import was subject to (extra) VAT.

137. There was no enforceable tax claim against Royal Mail. HMRC could only enforce against the Royal Mail its liability to pay VAT due on the Mailmedia supplies in one of four situations:

- The VAT was declared by Royal Mail in its VAT returns;
- The VAT was later declared by Royal Mail in a voluntary disclosure of underpayment of VAT;
- Royal Mail issued an invoice showing the VAT as due (see Sch 11 para 5(2) which implements Art 203 mentioned at §49 above); or
- HMRC assessed Royal Mail to pay it.

138. None of these events has been shown to have happened. There is and never was any enforceable tax claim. The VAT on the Mailmedia supplies was therefore neither 'due or paid'.

139. Had the appellant considered this, its reposte would have been that HMRC ought to have assessed Royal Mail, much as during the hearing it repeatedly said that Royal Mail "ought" to have paid VAT.

140. It appears to me that HMRC is now largely if not entirely out of time to assess the Royal Mail. However, that would not have been the case at the time that the appellant lodged its voluntary disclosures and that is, it seems to me to be the relevant date at which "due or paid" should be measured.

141. Was there an enforceable tax claim when HMRC was in time to assess but had chosen not to assess? As I have said strictly speaking, I do not see how a tax claim can be said to be enforceable unless one of those four things identified at §137 have happened. In *Société Véléclair* therefore it seems to me that the significant facts was that there had never been an assessment and the taxpayer had never shown the VAT as due in its VAT accounts.

142. That, therefore, is the end of the appellant's claim. VAT which had arisen on the supplies of Mailmedia by Royal Mail to Zipvit was not "due or paid" by Royal Mail to HMRC. Therefore, Zipvit had no right to recovery it.

143. I recognise that the appellant might argue for a different interpretion of *Société Véléclair*. It could be said that the CJEU considered that the liability to VAT was not 'enforceable' only because it was too late to issue an assessment and not that no assessment had ever been issued.

144. That would suggest it was enough for the appellant to show that at the time it made its claim HMRC could have assessed Royal Mail. An assessment on the Royal mail would have been in time at the date of the claims in 2009 and 2010.

145. However, I do not think *Société Véléclair* should be read in that fashion. It would mean VAT was "due or paid" by the supplier for the period of time when an assessment in theory could be raised and then cease to be "due or paid" later when it fell out of time. That would lead to very odd results and raise the question whether the input tax would have to be repaid at the date the VAT ceased to be assessable. It would also suggest that in *Société Véléclair* itself the taxpayer could have recovered the import VAT as input tax if it had claimed it before the tax authorities were out of time to assess it, despite not declaring its mirror liability to the import tax in its return at the same time.

146. There is also no logical reason why *Société Véléclair* should be limited in that way. The right of VAT recovery is limited to when VAT is "due or paid". Why should there be a right of recovery where no liability to pay VAT has been recognised? Paying "VAT" charged on an invoice does not generate a right of recovery: *Genius Holding*. So the question is not the customer's perception of whether it has paid VAT. The question of "due or paid" is whether the state has or

will receive the VAT. If the taxpayer has not declared it and the state has not assessed it, the state is not going to collect any VAT.

147. Even if, despite these considerations, *Société Véléclair* should be read in that limited fashion, then it seems to me the court would have to consider whether HMRC could have assessed Royal Mail. While there is no doubt the supply was subject to VAT, it is a question of public law whether HMRC could have lawfully assessed Royal Mail. I was not addressed on or given any evidence about any representations HMRC may have made to Royal Mail either specifically or in the form of publically available notices, but it appears this is a case where parties have all mistakenly proceeded on the basis that the supplies were exempt and HMRC have chosen only to enforce the correct interpretation from a date going forward.

148. I do not have to finally resolve that issue as I have decided (§142) that the question of enforceability depends on whether tax was assessed (or self-assessed) and not on whether it was assessable at the time of the input tax claim. And, as I have said in any event, I decide the appeal against the appellant on the third ground in any event, and I move on to consider that ground.

Submission three – absence of VAT invoice

149. Having decided the second point against the appellant I do not strictly need to consider the third matter. But I do go on to consider it because, as I have said, I do not have the parties' full representations on the second issue and in any event this is bound to go on appeal so it is helpful to record the submissions. So this last section of the decision is predicated on the basis that the appellant won the second issue whereas in fact that is not the position.

150. Article 178 PVD provides that to exercise the right to deduct the taxable person must hold an invoice drawn up in accordance with the terms of the PVD:

> "In order to exercise the right of deduction, a taxable person must meet the following conditions:
>
> (a) for the purposes of deductions pursuant to Art 168(a), in respect of the supply of goods or services, he must hold an invoice drawn up in accordance with Sections 3 to 6 of Chapter 3 of Title XI;…."

151. In the case of *Terra Baubedarf-Handel* C-152/02 [2005] STC 525 the customer was not given a VAT invoice until a year after the supply took place. It was unable to reclaim the VAT at the time of the supply because it did not have the VAT invoice; by the time it had the VAT invoice the tax authorities said it was too late to reclaim the VAT on the supply. The Court held that the right to deduct first arose when the invoice was received. HMRC's point is that there is no right to deduct unless and until an invoice is received. In this appeal the appellant does not have any VAT invoices and has not even requested that the Royal Mail issue them.

152. In the case of *Petroma Transport* C-271/12 [2013] STC 1466 invoices with insufficient details were issued by supplier to customer. The customer was refused input tax deduction and then obtained from the supplier (a connected company)

additional information which the tax authorities still did not regard as acceptable. The CJEU ruled that VAT invoices could be retrospectively corrected as long as this was done before the tax authorities made a decision on deduction (§34-36). A failure to hold valid invoices as at the date the tax authorities made the decision was fatal.

153. All parties were agreed, and I find, that the appellant sought to exercise a right of deduction under Art 168(a), in other words, the Royal Mail's supply was a supply of services made by a taxable person within the UK. Therefore, to exercise the right of deduction, the PVD required Zipvit to hold valid VAT invoices for the supplies on which it claims to recover VAT. It does not. It has no *right* to input tax deduction.

154. But Art 180 PVD provides:

> "Member States may authorise a taxable person to make a deduction which he has not made in accordance with Articles 178 and 179"

And the UK has chosen to give such an authorisation and this is contained in VAT Regulations 1995/2518 at Regulation 29(2) which provides:

> "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 [ie a VAT invoice]….
>
> 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."

So while Zipvit has no right to input tax deduction, it may be that HMRC should nevertheless authorise input tax deduction in the exercise of their discretion to admit alternative evidence.

155. The appellant's case is that the absence of a VAT invoice is not fatal to its claim because (in Mr Thomas' view) it would be contrary to *Wednesbury* principles if HMRC refused to authorise Zipvit to make the deduction in the absence of a VAT invoice. HMRC are satisfied that the supply took place and ought to have been satisfied that VAT was due on the supply (as I have found it to be).

156. HMRC disagree and say that they were entitled to take into account the fact that no VAT was actually applied to the contract price, even if the supply was actually standard rated.

Tribunal's jurisdiction on exercise of HMRC's discretion

157. The parties agreed that I had jurisdiction over the exercise of HMRC's discretion on whether to accept alternative evidence because of s 83(2)(c) VATA which confers on the Tribunal jurisdiction over the amount of input tax to be credited to the appellant. I was referred to two cases on this.

John Dee Ltd [1995] STC 941 CA

158. This case concerned HMRC's requirement that the taxpayer issue security to HMRC for payment of its VAT liabilities before it traded. The VATA gave a specific right of appeal against a decision of HMRC to require security. At first instance, both parties were agreed that on an appeal the Tribunal's jurisdiction was supervisory only. That agreement was retracted in the Court of Appeal.

159. Neill LJ's ruling was that the Tribunal's function on appeal was appellate. Nevertheless, it seems because the particular decision reached by HMRC was a discretionary one, the public law rules which determine whether the exercise of discretionary powers was lawful (in other words, the rules articulated in *Wednesbury)* would apply. The Court's decision was that the taxpayer should win the appeal because the Tribunal had found HMRC's decision flawed in the Wednesbury sense and the Tribunal could not be certain what the decision would have been had it not been so flawed. The effect (although this was not spelt out by the Court of Appeal) was that HMRC would have had to consider again whether to require security.

Best Buys Supplies Ltd [2012] STC 885 (UT)

160. HMRC refused to refund the appellant certain 'input tax' charged to it by a supplier, who had been de-registered and not put a VAT registration number on some of its invoices. The taxpayer appealed.

161. The Upper Tribunal said that the FTT's jurisdiction was appellate but that in so far as the FTT's jurisdiction over a discretionary decision by HMRC under Regulation 29(2) was concerned, the Tribunal could only decide whether that discretion was reasonably exercised.

162. It follows that if the Tribunal finds that HMRC's decision was not flawed, it must dismiss the appeal. If it finds that HMRC's decision was flawed, but would inevitably have been the same had the decision not been flawed, then the Tribunal must dismiss the appeal. If the Tribunal finds that HMRC's decision was flawed, and had it reached a properly reasoned decision the Tribunal cannot be certain it would have been the same, then the appeal must be allowed. Allowing the appeal, however, merely forces HMRC to take the decision again: it does not compel HMRC to make the decision in favour of the appellant still less does allowing the appeal mean that the Tribunal has re-made the decision at issue in the appeal in favour of the appellant.

What is a flawed decision?

163. Despite the reference at p 952a of *John Dee* to *Wednesbury* principles being a source of confusion, it is clear that both *John Dee* and *Best Buys* applied them and the parties to this appeal did not suggest otherwise. The test for a flawed decision is therefore whether the decision maker:

(1) took something irrelevant into account;

(2) failed to take something relevant into account;

(3) reached a decision that no reasonable decision maker could have reached; or

(4) made an error of law in reaching the decision.

164. It may be that the test in the FTT is in law slightly different to the *Wednesbury* test in that the Tribunal may be permitted to take into account matters arising (or discovered) after the date of HMRC's decision, but I do not need to consider this as there was no suggestion that something happened after HMRC's review decision in this case which could or should have altered the decision.

The review decision

165. The review decision is dated 2 July 2010. After rejecting the claim on the basis that HMRC did not accept that the supply was taxable or that the Zipvit had paid any VAT, the review officer went on to consider the absence of VAT invoices.

166. The officer rightly considered that alternative evidence could be proffered. He rightly considered that there was no doubt that the claimed supplies had taken place. He went on to say:

> "The issue is whether you have incurred input tax. To date you have provided no substantiating information to categorically confirm that this was the case"

167. The Officer went on to distinguish Zipvit's situation from the taxpayer in *Greenall* MAN/85/114 where the customer paid but did not receive the supply. Other than that, no other matters appear to have been considered by HMRC in reaching their decision not to exercise their discretion to allow recovery in the absence of VAT invoices.

Was the decision flawed?

168. Did the supply take place? The officer considered, as the parties agree, and as I find, that the supplies did take place.

169. Supply was standard rated: it is the appellant's case that the supplies at issue were standard rated. I agree. I have found that a conforming interpretation means that the Mailmedia supplies were standard rated (as it was conceded by HMRC that Mailmedia supplies were standard rated under the *TNT* decision).

170. The review officer does not appear to consider this point. He merely says:

> "At the time of the supply the services provided by Royal Mail were either exempt or zero rated to you….."

171. HMRC's Statement of Practice: HMRC's 2007 guidance on Input Tax Deduction without a valid VAT invoice. This guidance was produced to me in the hearing but not considered by the review officer. 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.

172. The tenor of the guidance is that HMRC need to be satisfied that the supply took place. The Statement does not state a prerequisite to HMRC's exercise of discretion is that the claimant has paid (or will pay) the contract price, or that the supplier has paid or will pay the VAT. It does state that (for supplies not in the suspect categories) if you can satisfactorily answer most of the questions at Appendix 2 'the Commissioners will permit input tax deduction'. The question in Appendix 2 are geared towards whether the customer took care to ensure the supply to him was bona fide but include the question "Do you have evidence of payment?"

173. HMRC's case, of course is that Zipvit did not pay VAT. Zipvit's case is that it paid the contract price. I find that there was no clear representation that HMRC would repay VAT on a supply which both parties treated as exempt and as in any event the appellant said it did not rely on this Statement to support its case, the officer's failure to consider it does not make his decision flawed.

174. Windfall on Royal Mail? Mr Thomas' position is that the Royal Mail has been given a windfall. Under UK law it ought to have accounted for VAT: but HMRC has chosen not to enforce this liability.

175. It was assumed by both parties that HMRC had taken a decision not to collect the back VAT from Royal Mail. A number of times the appellant said that the Royal Mail 'ought' to account for VAT to HMRC on the supplies made to Zipvit and implied it was a concession, or even dereliction of duty, by HMRC not to seek recovery from Royal Mail and that Royal Mail 'should' have made a voluntary disclosure. I do not accept that Mr Thomas has demonstrated that to me as a matter of law. He also suggested 'any other supplier' than Royal Mail would have been pursued by HMRC for back VAT. He appeared to have no grounds for such an assertion and indeed it seems unjustified. There have been a number of instances where HMRC have made public announcements that they would not collect 'back' taxes where everyone's understanding of a particular provision was shown to be wrong, although obviously expecting taxpayers to apply the new and correct understanding of the law from a specified date in the near future.

176. Was HMRC wrong in law following *TNT* not to collect the tax due on Mailmedia supplies from Royal Mail? While I have accepted that the appellant is right about conforming interpretation so that the UK's postal exemption always had the restriction identified by the CJEU in *TNT*, and the Mailmedia service was standard rated, that does not mean that HMRC can or ought to retrospectively recover the VAT from Royal Mail. I have considered this briefly above (see §147). I was not addressed on the issue and so my conclusion is that the appellant has not shown that HMRC was wrong in public law not to have assessed Royal Mail to tax on Mailmedia supplies following *TNT*. Therefore I do not accept that Royal Mail has received a 'windfall' or that it 'ought' to have been assessed.

177. Mr Thomas also stated, but without producing any evidence to support it, that the German government had required Deutscheposte to pay back taxes of half a billion euros following the *TNT* case. HMRC do not agree that this is correct factually: it is certainly unproven in this Tribunal. And in any event, even if true, tells

me nothing. Whether HMRC could lawfully seek to collect the tax which was due as a matter of EU law is, as I have stated in the previous paragraph, a matter of UK public law. German laws on how public bodies can act are irrelevant here.

178. The appellant's case is that HMRC's decision not to enforce the law against Royal Mail cannot limit the appellant's rights. But it follows from what I have said above that the appellant has not shown that HMRC ought as a matter of public law to have recovered the tax from Royal Mail, nor has it shown that the Royal Mail received a windfall. Therefore, there is nothing in this complaint that the officer ought to have considered before reaching his conclusion.

179. HMRC benefiting from own error? The appellant appears to say that dismissing the appeal would allow HMRC to benefit from its own error. For HMRC to successfully defend this appeal, says Mr Thomas, would be to allow HMRC to rely on their own wrongful implementation of the Directive. I note in passing that it seems odd to suggest that the UK Government failed in its obligations when enacting the postal exemption: the enactment is virtually verbatim the 6VD and PVD. The only justifiable accusation is that HMRC failed to understand the limited extent of the EU exemption and therefore failed to understand the limited nature of the UK exemption as a matter of practice until (at the earliest) the CJEU decision in *TNT*. That error was was made by Royal Mail and the appellant too at the time.

180. Be that as it may, as a matter of practice HMRC were and (it appears) still are prepared to treat the relevant supplies of Mailmedia made by the Royal Mail to Zipvit as exempt when they were standard rated as a matter of law. The effect may be that less VAT was recoverable (by the Royal Mail) from HMRC at least than would have been recoverable if the supplies were treated as standard rated. To that extent HMRC has benefited, but the amount which the appellant claims to be affected is at most 2.5% of the price: see §29.

181. And as I note below, the review decision did not consider this factor.

182. Appellant out of pocket? The appellant originally claimed that HMRC's misapplication of the law has left it out of pocket and that this is a breach of the principle of equal treatment. The appellant dropped this element of its claim at the hearing and I do not refer to it again.

183. HMRC's reply is that there is nothing to stop Zipvit suing the UK Government for damages if they can show that HMRC's misunderstanding of the law caused them loss. The appellant's claim is that the Royal Mail's inability to recover VAT attributable to supplies made to Zipvit meant that its net price was 2.5% higher than it would otherwise have been. Zipvit suggests that this is the right figure because of what the postal services regulator, Postcomm, said in a consultation document in 2004:

> "3.7 As Royal Mail cannot reclaim VAT charged to it, this irrecoverable VAT forms part of the costs to Royal Mail and is taken into account in setting the price of its services. Postcomm estimates that irrecoverable VAT leads to Royal Mail's prices being on average

around 2.5% higher than they would be if Royal Mail did not incur this cost."

184. HMRC do not accept this figure but point out that it is considerably lower than the 'windfall' of 17.5% which Zipvit seeks and, if proved, should justify an award of damages under the *Francovich* doctrine.

185. That the appellant may have been out of pocket was something which the review officer did not consider but on the other hand the matter does not appear to have been drawn to his attention either; further if he had considered it, in my view he must have considered that what was at most a loss of 2.5% and one which would be recoverable by a separate action against HMRC, could not justify a repayment at 17.5%.

186. HMRC consider that the decision not to refund can be justified.

187. Appellant error? HMRC want to draw an analogy with the *Langhorst* case referred to at §92 above. In that case the supplier who did not correct a self-billed invoice but left it showing the wrong rate of VAT was found liable to account for VAT on the rate of VAT shown in the self-billed invoice. Here, says HMRC, the customer did not query with Royal Mail the treatment of the supply to it as exempt, and can therefore hardly be heard to complain now that the supply should have been treated as standard rated.

188. Windfall on appellant? HMRC's position is that Zipvit seeks a windfall by its claim: the price it paid Royal Mail did not include VAT in any real sense as Royal Mail at the time considered the supply to be exempt, yet Zipvit seek to recover a proportion of the price it paid as VAT from HMRC.

189. HMRC described Zipvit's appeal as an 'ingenious but unmeritorious attempt to get a windfall" and also described it as having a quality of unreality to rival Alice in Wonderland. They did not pay VAT, did not bear economic burden of VAT, yet claim they must be treated as having paid VAT. While the figures are irrelevant, it is relevant that it is a windfall. Mr Bailey accepted, as indeed it is obvious, that prior to the release of the decision in *TNT* all parties operated under the misapprehension that Mailmedia supplies were exempt. What little evidence I have is that Royal Mail did not price its services to include any liability to account for VAT: on the contrary they priced them to include the VAT on inputs which it could not recover as its services were exempt. If Zipvit succeed, I find it is it is in very real terms a windfall.

190. defeat purpose of PVD and VATA? Mr Grodzinsky says that if appellant's claim succeeds it would be a triumph of fiction over reality and defeat the underlying purpose of the VAT Directive and VATA. Another way of looking at this is to consider the economic burden. Irrespective of my conclusion on whether for the purposes of the PVD the VAT was due or paid by the appellant, as a matter of economics the appellant has not borne the burden of VAT (other than any VAT incurred by Royal Mail and thought to be irrecoverable which was rolled up in the net price for the Mailmedia service –see §§ above). It has not borne the economic burden because the supply was assumed to be exempt and priced without VAT.

191. I concluded that in the context of entitlement to VAT recovery, economic burden was irrelevant (see §§95-98) but does not mean such considerations are irrelevant when HMRC considers whether or not to exercise its discretion to permit a VAT recovery to which the appellant is not entitled under EU law.

Conclusion on third case

192. I find that the review decision did not consider all the matters which are relevant, as set out above. It did not expressly consider that:

- The supply was standard rated despite being treated as exempt;
- the appellant might have paid a higher net price than otherwise to compensate the Royal Mail for what was thought to be irrecoverable input VAT;
- HMRC has not sought to recover the underpayment from Royal Mail;
- HMRC may have benefited by up to 2.5% because Royal Mail will have been unable to recover input tax attributable to what was (in retrospect) a standard rated supply;
- The windfall on the appellant – or put it another way – that the appellant had not borne the economic burden of the VAT it seeks to recover.

These factors in my view are relevant and should have been but were not considered by the review officer. The next question is whether, had they been considered, a different conclusion might have been reached.

193. Where HMRC is exercising its discretion on whether to allow input tax recovery in circumstances where no VAT invoice is held, it must be right that HMRC should consider why a VAT invoice was not held. The reason in this case is that the supply was thought to be exempt and therefore no amount equivalent to VAT was charged.

194. Where it is satisfied the supply took place and (it appears) was paid for, HMRC's practice is to allow recovery even though normally that will leave HMRC out of pocket as the supplier will not have accounted for VAT to HMRC. As this is HMRC's normal policy, I consider HMRC ought not reasonably to have taken into account that repaying the VAT to Zipvit would leave HMRC out of pocket.

195. However, unlike those normal cases, the additional relevant factor in this case is that the claimant did not pay an amount representing VAT. That repayment would result in a windfall is it seems to me a highly relevant factor. 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 a real loss?

196. It seems to me here that whereas economic burden is irrelevant to the question whether VAT was 'due or paid', it is a relevant factor to take into account when HMRC is considering making what amounts to an ex gratia payment to a taxpayer.

197. While the appellant might be able to show (but has not yet shown) that irrecoverable VAT increased the price of the supply to it, and it might be able to show to a limited extent as referred to in §§179-180 above that HMRC benefited from the exemption, its claim is that this was by no more than 2.5% and no officer could reasonably think that (even if proved) a 2.5% increase in price would justify a repayment of 15-17.5% of the price in circumstances when the appellant has the right to prove the loss under EU law and claim the 2.5% in damages in any event.

198. Therefore, I consider that even had the review officer taken the matters at §192 into account it is inevitable he would have arrived at the same conclusion. None of the factors could reasonably be thought to outweigh the very significant point that repayment at HMRC's discretion out of public funds would confer a windfall on the appellant, because the appellant never suffered the economic burden of VAT on the supply to it of Mailmedia services by Royal Mail.

199. The answer to the preliminary issue posed at §8 is that the appellant, who received supplies of services which were treated by Royal Mail as exempt but which were properly standard rated under both UK and EU law, is not entitled to an input tax credit in respect of those supplies because on the facts of this case VAT was not 'due or paid' and in any event the appellant does not hold a VAT invoice and HMRC's decision not to accept alternative evidence cannot be impugned.

200. The answer to that preliminary issue means that the appeal is entirely resolved against the appellant. So I dismiss the appeal.

201. This document contains full findings of fact and reasons for the preliminary decision. Any party dissatisfied with this preliminary decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 3 July 2014