Neutral Citation Number: [2016] EWCA Civ 1299

Case No: A3/2015/1183

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER
MR JUSTICE WARREN, CHAMBER PRESIDENT
[2015] UKUT 0071 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 21/12/2016

Before :

LADY JUSTICE GLOSTER
LORD JUSTICE PATTEN
and
MR JUSTICE BAKER

- -

Between :

G B HOUSLEY LIMITED	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondent**

- - - - - - - - - - - - - - - - -
- -

Michael Thomas (instructed by **Croner Taxwise**) for the **Appellant**
Vinesh L Mandalia (instructed by **the General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondent**

Hearing dates : 21 June 2016

- -

Approved Judgment

Lady Justice Gloster:

Introduction

1. This is an appeal by the appellant taxpayer, G B Housley Limited ("the appellant" or "the taxpayer") against a judgment[1] of the Upper Tribunal (Tax and Chancery Chamber) (Warren J) dated 13 February 2015 ("the second judgment") following the hearing of an appeal by the respondents, the Commissioners for HM Revenue and Customs ("the respondents" or "HMRC"), to the Upper Tribunal. The appeal relates to a disputed assessment dated 25 March 2009 ("the assessment") and made by the respondents under section 73 of the Value Added Tax Act 1994 ("VATA") in the sum of £337,381 plus interest representing VAT arrears for the periods 1 March 2006 to 31 August 2008.

2. The judge had given an earlier decision[2] on the respondents' appeal ("the first judgment") in which he had held in favour of the taxpayer, and against HMRC, and affirmed the First-tier Tribunal's ("FtT") decision[3] dated 15 February 2015 ("the FtT decision") insofar as it held that the failure of HMRC in July 2009, to consider exercising their discretion under regulation 29(2) ("regulation 29(2)") of the VAT Regulations 1995, Statutory Instrument 1995/2518 ("the regulations"), to accept, in the absence of proper self-billing invoices, alternative evidence in support of input tax deductions, was unreasonable. The FtT had held, as a result, that the assessment which had been raised against the appellant was invalid and that it should be discharged. Accordingly, the FtT had allowed the appellant's statutory appeal. However, in the course of the first judgment the judge had raised the issue as to what were the consequences of HMRC's failure properly to exercise their discretion; in particular, whether the assessment should be discharged or should stand. Because he had not heard argument on the point he adjourned the hearing for further argument.

3. The second judgment addressed this issue. The judge held (disagreeing in this respect with the FtT) that the FtT should not have allowed the appellant's statutory appeal. He concluded that the appellant's statutory appeal should be allowed only in one of the two following circumstances:

    i) HMRC revisited the exercise of their discretion under the regulation and decided to exercise it in favour of the appellant; or

    ii) the FtT (or the Upper Tribunal) decided that no reasonable body of commissioners could reach a decision not to exercise the discretion under regulation 29(2) in favour of the appellant.

4. He expressed the view that the correct course was as follows:

    i) that the appellant should within a particular period of time (to be determined by the FtT) provide any further material to HMRC which the appellant wished HMRC take into consideration when exercising its discretion;

---

[1] [2015] UKUT 0071 (TCC)
[2] [2014] UKUT 0320 (TCC).
[3] [2013] UKFTT 150 (TC).

ii) that HMRC should within a particular period of time (to be determined by the FtT) revisit the issue of the exercise of their discretion upon the basis of all the materials then available to it;

iii) for the FtT thereafter, and, if necessary, in the light of any decision made by HMRC, to decide whether HMRC would be acting within the proper exercise of their powers to decide not to exercise their discretion under regulation 29(2) in favour of the appellant.

5. Accordingly, he allowed HMRC's appeal and remitted the matter to the FtT for it to make a further decision in accordance with the principles set out in the second judgment. The appellant's appeal challenges that order.

6. On the appeal before us, as before the Upper Tribunal, Mr Michael Thomas appeared as counsel on behalf of the appellant and Mr Vinesh Mandalia appeared as counsel on behalf of the respondents.

The relevant legislative provisions

7. The following is a summary of the relevant legislative provisions.

8. The relevant charging provisions are found in section 29 and schedule 11 of VATA and in regulations 13 and 29 of the regulations. Paragraph 2B of schedule 11 to VATA establishes the self-billing regime. Paragraph 2B essentially provides that where conditions imposed by HMRC, either in regulations or in a VAT Notice, are complied with, then a taxable person can provide to himself a self-billing invoice which is treated as if it were the VAT invoice which would otherwise be required to be provided by his supplier.

9. The regulations contain provisions governing the self-billing regime. Regulation 13(3) provides that "a self-billed invoice", which is provided by a taxpayer who is a registered person to himself, is treated as a VAT invoice if it complies with both the conditions set out in regulation 13(3A) and any further conditions that may be contained in a VAT Notice published by HMRC. A "self-billed invoice" must purport to be a VAT invoice in respect of a supply of goods and services to him by another registered person. Regulation 13(3A) in turn sets out the three conditions which must be complied with if a self-billed invoice is to be treated as a VAT invoice:

i) first, it must have been provided pursuant to a prior "self-billing agreement" entered into by the supplier of the goods or services and their recipient which satisfies the requirements in paragraph (3B);

ii) second, it must contain the particulars required under regulation 14(1) or (2);

iii) third, it must relate to a supply or supplies made by a supplier who is a taxable person; in that context, section 3 of VATA provides that a person is a taxable person "while he is, or is required to be, registered…".

10. Regulation 13(3B) sets out the conditions for a self-billing agreement. regulation 13(3C) provides that a self-billing agreement is treated as having expired when the supplier ceases to be registered for VAT.

11. Regulation 29(2) provides that at the time of claiming deduction of input tax a person shall, in respect of a supply from another taxable person, hold the document which is required to be issued under regulation 13. In the case of supplies to the appellant by the four suppliers concerned in the present case, the document was the one which is required under regulation 13, that is to say either an ordinary VAT invoice from the supplier or a self-billed invoice satisfying the three conditions mentioned above. However, regulation 29(2) is subject to this proviso ("the proviso"):

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

12. As was common ground between the parties, the effect of regulation 29(2) is that HMRC have a discretion to allow a credit for input tax notwithstanding that the taxable person does not hold a valid tax invoice: see *Kohanzad v Customs and Excise Commissioners* [1994] STC 967 at 969 per Schiemann J, followed in *Best Buys Supplies Ltd v Revenue & Customs Commissioners* [2012] STC 885 at [48].

13. Section 73 of VATA deals with the power of HMRC to make assessments. In so far as material it provides as follows:

> **"73. Failure to make returns etc.**
>
> (1) Where a person has failed to make any returns required under this Act (or under any provision repealed by this Act) or to keep any documents and afford the facilities necessary to verify such returns or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT due from him to the best of their judgment and notify it to him.
>
> (2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—
>
> (a) as being a repayment or refund of VAT, or
>
> (b) as being due to him as a VAT credit,
>
> an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.
>
> (3) ……
>
> (4) ……
>
> (5) ……

> (6) An assessment under subsection (1), (2) or (3) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following—
>
> (a) 2 years after the end of the prescribed accounting period; or
>
> (b) one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge,
>
> but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment."

14. Section 77 sets out the various time limits applying to the making of assessments. In so far as material it provides as follows:

> "77 **Assessments: time limits and supplementary assessments.**
>
> (1) Subject to the following provisions of this section, an assessment under section 73, 75 or 76, shall not be made—
>
> (a) more than 3 years after the end of the prescribed accounting period or importation or acquisition concerned, or
>
> (b) in the case of an assessment under section 76 of an amount due by way of a penalty which is not among those referred to in subsection (3) of that section, 3 years after the event giving rise to the penalty.
>
> (2) Subject to subsection (5) below, an assessment under section 76 of an amount due by way of any penalty, interest or surcharge referred to in subsection (3) of that section may be made at any time before the expiry of the period of 2 years beginning with the time when the amount of VAT due for the prescribed accounting period concerned has been finally determined.
>
> (2A) Subject to subsection (5) below, an assessment under section 76 of a penalty under section 65 or 66 may be made at any time before the expiry of the period of 2 years beginning with the time when facts sufficient in the opinion of the Commissioners to indicate, as the case may be—
>
> (a) that the statement in question contained a material inaccuracy, or

> (b) that there had been a default within the meaning of section 66(1),
>
> came to the Commissioners' knowledge.
>
> (3) In relation to an assessment under section 76, any reference in subsection (1) or (2) above to the prescribed accounting period concerned is a reference to that period which, in the case of the penalty, interest or surcharge concerned, is the relevant period referred to in subsection (3) of that section.
>
> (4) Subject to subsection (5) below, if VAT has been lost—
>
> (a) as a result of conduct falling within section 60(1) or for which a person has been convicted of fraud, or
>
> (b) in circumstances giving rise to liability to a penalty under section 67,
>
> an assessment may be made as if, in subsection (1) above, each reference to 3 years were a reference to 20 years. ……"

15. The appellant's statutory appeal against the assessment lay to the FtT by virtue of section 83(1)(c) and (p) of VATA which, so far as material, was in the following terms:

> "83(1) Subject to sections 83G and 84, an appeal shall lie to the tribunal with respect to any of the following matters;-
>
> …
>
> (c) the amount of any input tax which may be credited to a person;
>
> …
>
> (p) an assessment
>
> (i) under section 73(1) or (2) in respect of a period for which the appellant has made a return under this act or; …"

16. By operation of section 83A(1) of VATA the respondents were required to offer the appellant a review of their decision and, by operation of section 83F, where, as here, the appellant requested a review:

    i) the nature and extent of the review would be such as appears appropriate to HMRC in the circumstances: see section 83F(2);

ii) HMRC must, in particular, have regard to steps taken before the beginning of the review by HMRC on reaching the decision, and by any person in seeking to resolve disagreement about the decision; see section 83F(3);

iii) the review must take account of any representations made by the appellant, at a stage which gives HMRC a reasonable opportunity to consider them; see section 83F(4);

iv) the review may conclude that the decision is to be upheld, varied, or cancelled; see section 83F(5);

v) HMRC must give notice of the conclusions of the review and their reasoning within a period of 45 days or such other period as may be agreed; see section 83F(6).

17. By section 83(F)(8), where HMRC are required to undertake a review but do not give notice of the conclusions within a time limit (45 days or such other period as HMRC and the taxpayer agree) the review "is to be treated as having concluded that the decision is upheld".

18. Where there is an entitlement to bring an appeal before the tribunal, sections 83G(3) and (4) provides that an appeal may not be made until the conclusion of any review.

Factual and procedural background

Events leading up to the assessment

19. The appellant carries on business as a scrap metal dealer from premises at 404-416 Effingham Road, Sheffield, S9 3BQ. A major part of its business was to buy from smaller merchants and sell to the end users. The appellant was registered for VAT on 1 April 1973 and had been operating a self-billing system since before 1996.

20. The way in which the appellant operated the self-billing procedure was not in accordance with the rules set out in the regulations. Regulation 13(3A) requires that a self-billed invoice must be provided pursuant to a prior "self-billing agreement" entered into between the supplier of the goods and the recipient which satisfies certain conditions. The appellant's self-billing arrangements did not comply with the regulations because no self-billing agreements were entered into between the appellant and its suppliers.

21. According to the appellant:

i) HMRC were well aware that the appellant was operating a self-billing scheme;

ii) the appellant provided annual lists of self-billing suppliers to HMRC;

iii) the appellant received various visits from HMRC, including a "Full Premises Visit" on 6 March 2007 which indicated that there was nothing fundamentally outstanding; and

iv) when the appellant contracted with a new supplier it telephoned the local VAT Office to check that the supplier's VAT certificate was correct having first obtained a copy of that certificate.

22. Nevertheless, the appellant accepted that its self-billing arrangements were fundamentally flawed owing to the lack of any self-billing agreements.

23. As I have said, it was common ground that the effect of the proviso to regulation 29(2) was that HMRC has a discretion to allow a credit to input tax notwithstanding that the taxable person does not hold a valid tax invoice.

24. During 2008 HMRC queried the appellant's ability to recover input tax. On 21 October 2008 the appellant was visited by HMRC Officers as part of a National Scrap Metal Campaign.

25. In a letter dated 22 October 2008, referring to his visit the day before, one of HMRC's officer, Mr Day, referred to four suppliers shown in the appellant's record as having made supplies to the appellant ("the relevant suppliers"). The relevant suppliers had all been de-registered for VAT by HMRC as a result of its investigation into scrap metal merchants. Mr Day considered the invoices from the relevant suppliers to be invalid for the reasons which he set out. Mr Day relied on a number of factors. They can be summarised as follows (although not every feature applied in every case):

i) supplier deregistered (all cases, although not all supplies post deregistration in some cases);

ii) address on self-billed invoice incorrect:

iii) no other documentary evidence provided (i.e. to demonstrate supply made or made by a taxable person);

iv) the appellant had not visited any of the premises of the supplier (all cases);

v) the goods were not believed by the appellant to have been stolen (all cases).

26. In the letter, Mr Day referred the appellant to the HMRC guidance *"VAT Strategy: Input Tax deduction without a valid VAT invoice Statement of Practice – March 2007"* ("the Statement of Practice"). Mr Day advised the appellant that it should obtain "valid evidence to reclaim the amounts shown in your records" and that "if satisfactory evidence could not be obtained, paragraphs 17 onwards of the Statement of Practice should be followed" pointing out that "this should be done if you wish HM Revenue & Customs to consider exercising its discretion in allowing your input claims". The relevant paragraphs essentially say that the taxpayer will need to provide alternative evidence to show that the supply had been made.

27. Following correspondence over a period of several months, on 18 March 2009 Mr Day wrote to the appellant, reiterating his conclusion that the relevant invoices were invalid for the reasons which he had previously given ("the March 2009 decision"). He stated that he had attempted to visit the premises relevant to two of the relevant suppliers, and had concluded that they did not operate from the address shown on the self-billed invoice. Mr Day was clearly alive to the existence of the discretion for

HMRC to allow deduction notwithstanding the absence of an invoice. He wrote, clearly with the Statement of Practice in mind:

> "You have had the opportunity to provide further information which might permit me to exercise discretion in allowing these claims.
>
> In final conclusion, **I do not consider that I can exercise discretion** and will therefore be issuing an assessment……".

28. On 25 March, 2009 the assessment was issued by the respondents, acting by Mr Day, pursuant to section 73 of VATA. In substance, the assessment was a rejection of the appellant's claim to recover input tax in respect of the supplies made by the relevant suppliers during the relevant period (viz. the periods between 1 March 2006 and 31 August 2008) on the grounds that there were no self-billing agreements in place at the material time between the appellant and those suppliers.

29. However, HMRC did not reject the input tax which the appellant had reclaimed in respect of its other suppliers, notwithstanding that the self-billing procedure was equally flawed in relation to them.

30. On 8 May 2009, the appellant's representatives, its accountants, Hart Shaw, wrote to HMRC expressing their disagreement with the decision and asking for a review of the case by an independent officer.

31. The requested review was carried out by the respondents' review officer, Mrs H J Thomas, who wrote to Hart Shaw on 2 June 2009, confirming the previous decision. Mrs Thomas based her conclusion on the absence of any self-billing agreements. Mrs Thomas did not go on to the next stage and ask herself whether HMRC's discretion to allow the input tax deduction should nonetheless be exercised.

32. Hart Shaw responded on 25 June 2009 and asked Mrs Thomas to reconsider her decision. In a lengthy letter, they addressed a number of issues which they claimed were relevant to the exercise of the discretion, repeating matters which had already been raised with Mr Day. As part of this letter they identified evidence of supplies taking place and enclosed with their letter a set of answers to the standard questions set out in Appendix 2 to the Statement of Practice.

33. On 3 July 2009 Mrs Thomas replied to that letter informing Hart Shaw that there was no mechanism for a reviewing officer to undertake a further review and that new or further information should be referred to the original decision maker.

34. Hart Shaw duly wrote to Mr Day on 10 July 2009. Their letter repeated much of the contents of the letter which they had written to Mrs Thomas following her review and attached the same answers under Appendix 2 to the Statement of Practice.

35. Mr Day replied on 17 July 2009 ("the July 2009 decision"). He accepted that the conditions in paragraph 5 of HMRC's Statement of Practice, which sets out the requirements to be met for input tax to be incurred, were satisfied. However, he wrote that the appellant's input tax deduction had been disallowed as the appellant:

> "failed to correctly operate the self-billing procedure. **Consequently it would be inappropriate for HMRC to consider applying its discretion under the Statement of Practice".** [4]

Accordingly, Mr Day maintained the respondents' original decision.

The FtT decision

36. By notice of appeal dated 14 August 2009, the appellant appealed against the assessment dated 25 March 2009 in the sum of £337,381 seeking the result "that the assessment should be wholly withdrawn." The stated grounds were that:

> "The appellants incurred VAT on purchases from suppliers who either were or ought to have been registered for VAT.
>
> HM Revenue & Customs have refused the appellants the right to deduct this input VAT in contravention of the appellants' fundamental right to deduction in respect of their taxable activities."

37. The appeal was heard in the first instance by the FtT on 22nd January 2013 before Tribunal Judge Mr. David Porter, sitting with a member, Ms Susan Stott. Its judgment was released on 15 February 2013.

38. HMRC's primary argument was that the appellant's case was untenable because, as it did not have self-billing agreements in place, the exercise of the discretion under regulation 29(2) could not be called in aid. The FtT rejected this submission. (HMRC abandoned the submission before the Upper Tribunal which endorsed the FtT's conclusion on this point: see the first judgment at paragraph 53.)

39. In relation to the question of the exercise of the discretion under regulation 29(2), the FtT concluded, having heard Mr Day cross-examined, that Mr Day had not considered exercising the discretion under regulation 29(2). Thus at paragraph 32 of the FtT decision, the FtT stated:

> "We are also satisfied that Mr. Day did not consider exercising the discretion because he considered all of the appeal invoices were invalid because no self-billing agreement was in place."

Likewise, at paragraphs 48, the FtT said:

> "Mr. Mandalia submitted that [appellant's] case was untenable because, as it had not had a self-billing agreement in place, regulation 29(2) could not be called in aid. Mr. Day was of the same opinion. He never, therefore, considered the application of the discretion."

40. Finally, at paragraph 59 of its judgment, the FtT concluded:

[4] All emphases in bold type are mine.

> "We are satisfied that HMRC made no attempt to consider the discretion, having decided that the lack of a self-billing agreement was critical. We therefore allow the appeal as HMRC have acted unreasonably in not exercising their discretion and **we agree with Mr Edwards [the appellant's representative at the hearing] that the failure of the officer to consider the discretion renders the assessment invalid *per se*.":**

41. The FtT did not differentiate between the March 2009 decision and the July 2009 decision. Its conclusion (based on Mr. Day's cross-examination) appears to have been that at neither date did Mr. Day *consider exercising* the discretion because he considered all of the appeal invoices were invalid because no self-billing agreement was in place.

42. Accordingly, the FtT allowed the appellant's appeal. That was on the basis that HMRC had acted unreasonably in not considering the exercise of their discretion, not because they had, upon actual exercise of the discretion, reached the wrong answer. The result, according to the FtT, was that that failure rendered the assessment invalid per se; see the FtT decision at paragraph 59.

43. However, Mr Thomas apparently submitted that the FtT also appeared to have accepted the appellant's argument[5] that, had HMRC considered the exercise of its discretion, "the natural conclusion of any reasonable body of Commissioners would [have been] to allow deduction of the input tax in question".[6]

44. In order to understand precisely what the FtT did actually decide it is necessary to set out the relevant paragraphs of its judgment setting out its decision:

> "**The decision**
>
> 48. We have considered the facts and the law and allow the appeal. Mr Mandalia submitted that the Company's case was untenable because, as it had not had a self-billing agreement in place, Regulation 29 (2) could not be called in aid. **Mr Day was of the same opinion. He never, therefore, considered the application of the discretion. He accepted that he had seen much of the documentation and that the Company was in all other respects compliant. He had, in any event, allowed the validity of the other 55 invoices.** We have not been told what format those invoices took, but we assume they must have been in the same format as those produced to the Tribunal.
>
> 49. If Mr Mandalia's proposition that the failure to have entered into a self-billing agreement is fatal to the Company's

[5] As referred to in paragraph 45 of the FtT's judgment.

[6] In post-judgment submissions, however, Mr Thomas informed the court that that was not in fact his precise argument; he said it was rather that, if the Upper Tribunal was correct that the decision could or should now be revisited, then there was only one permissible result, namely that the discretion had to be exercised in the appellant's favour, and that followed from both EU Law and HMRC's own criteria being satisfied.

claim, then there would appear to have been no need to establish that the four suppliers were deregistered, save that if the discretion was to have been exercised, the lack of registration would inevitably (See *John Dee)* have meant that the invoices could not have been valid. **We do not accept on the evidence that the Company could have known that the four suppliers were deregistered. We are satisfied that Mr Burkhill spoke to the local VAT office which confirmed the registration**. Mr Day's evidence was inconclusive as to the timing of the deregistration. The dates for the de-registration may have been-back dated following the necessary enquiries.

50. In the case of *Boguslaw Juliusz Dankowski v Dyrektor Izby Skarbowej w Lodzi* (Case -438/09) referred to by Mr Edwards, the court held at paragraph 47:

"47. It follows from all of the foregoing that Article 17 (6) of the Sixth Directive must be interpreted as precluding national legislation which excludes the right to deduct VAT paid by a taxable person to another taxable person, who has provided services, where the latter has not registered for the purpose of that VAT"

On the evidence provided, we have decided that the local VAT Office had advised the Company that the VAT registrations were correct and in the light of *Boguslaw Juliusz Dankowski* there was no prospect, on that basis, of HMRC establishing that the invoices were invalid.

51. Regulation 13 of VAT Regulations 1994 requires the Company to provide its suppliers with VAT invoices. Where it provides a self-billed invoice, that purports to be a VAT invoice in respect of a supply of goods to it, that document is treated as the VAT under paragraph (1) (a) **if it complies with the conditions** (our emphasis) set out in paragraph (3A) and with any further conditions that may be contained in a notice published by the Commissioners or may be imposed in a particular case. Regulation 13(3A) provide inter alia that the Company must enter into a self-billing agreement with its suppliers, which satisfies the requirements in paragraph (3B). The Company has agreed that it had no such agreements.

52. We accept that where a customer completes a self-billing invoice he is more likely to complete it correctly. There must, however, be occasions when the mistakes are made. The invoices, the subject of this appeal, were completed correctly as there was no error on the face of them that would take them outside regulation 14. Mr Mandalia contends that the failure to have a self-billing agreement means that the documents cannot qualify as an invoice at all and cannot therefore fall within the ambit of Regulation 29 (2).

53. Regulation 13 deals with two types of invoices; the more common one produced by a supplier and the self-billed invoice. Both types of invoices have to comply with the requirements of Regulation 14 as to their contents and self-billed invoices have, in addition, to be backed up by self-billing agreements. Regulation 2B (2) specifically states:-

"a self-billed invoice shall be treated as the VAT invoice required by the regulations under paragraph 2A to be provided by the supplier"

If, therefore, either invoice is non-compliant then the taxpayer can ask HMRC to exercise its discretion under regulation 29 (2) and in those circumstances the lack of a self-billing agreement cannot be fatal.

55. **We fail to see how an invoice, which is otherwise compliant, cannot be considered an invoice. In this appeal, HMRC has accepted that all the other invoices were compliant and it has not sought to extend the assessment to those invoices. The Regulation anticipates that there will be some irregularity causing even a standard invoice to be invalid. The failure to have a self-billing agreement is clearly irregular. HMRC have discretion to remedy irregular invoices if they are otherwise satisfied from other documentation, that the invoice should be treated as such.**

56. Having decided that self-billed invoices come within regulation 13, Regulation 29 (2) must apply as it states:

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

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

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

There is no doubt that the company held such other evidence of the charge to VAT. HMRC was fully aware that the Company was self-billing as evidenced by the many visits and the notes arising there from. Further, Mr Day conceded that he had seen most of the necessary documents. In fact, he can not deny the validity of the invoices, other than for the lack of the self-billing agreement, as he appears to have allowed all the other invoices. The invoices

> **contained all the necessary information under regulation 14 and the legislation.**
>
> 58. Nor can we accept that HMRC's decision would inevitably have been the same because the four suppliers were deregistered. We have decided that the Company was entitled to rely on the advice from the local VAT office. **We accept that no evidence, other than verbally from Mr Burkhill, has been produced of those telephone calls. We are not satisfied, however, from the evidence that the dates of the deregistration necessarily confirmed that the four suppliers were so deregistered at the time of the telephone request made by the Company. Mr Day was unable to tell us with any degree of certainty how the dates were arrived at.**
>
> 59. **We are satisfied that HMRC made no attempt to consider the discretion, having decided that the lack of a self-billing agreement was critical. We therefore allow the appeal as HMRC have acted unreasonably in not exercising its discretion and we agree with Mr Edwards' submission that the failure of the officer to consider the discretion renders the assessment invalid *per se".***

The first hearing before the Upper Tribunal and the first judgment

45. HMRC appealed the FTT's decision to the Upper Tribunal.

46. In contrast to the FtT's decision, the Upper Tribunal held that, in relation to the March 2009 decision, Mr Day *had actually exercised* the discretion, but not in favour of the appellant. In this respect the judge stated:

> "37. On 18 March 2009, Mr Day wrote to the Company following some correspondence over the previous months which I do not need to go into. Mr Day reiterated his conclusion that the relevant invoices were invalid for the reasons which he had previously given and which I have summarised above. He stated that he had attempted to visit the premises relevant to [two of the relevant suppliers], concluding that they did not operate from the address shown on the self-billed invoice. Mr Day was clearly alive to the existence of the discretion for HMRC to allow deduction notwithstanding the absence of an invoice. He wrote, clearly with the Statement of Practice in mind:
>
> "You have had the opportunity to provide further information which might permit me to exercise discretion in allowing these claims.

> In final conclusion, I do not consider that I can exercise discretion and will therefore be issuing an assessment……".
>
> 38. A formal assessment followed in due course on 25 March 2009.
>
> 39. Whether Mr Day acted in a way which is not open to challenge is something I will need to look at later. But what is apparent from this letter **is that he was aware that HMRC had a discretion and that he decided that it should not be exercised in the Company's favour.** He was not, at this stage, suggesting that, because there were no self-billing agreements, a necessary pre-condition for the exercise of the discretion had not been fulfilled so that there was, as yet, no discretion for him to exercise. Rather, he was saying that he had requested further evidence which would justify the exercise of the discretion but none had been provided**. I reject Mr Thomas' submission that Mr Day failed, at this stage, to consider on behalf of HMRC the exercise of the discretion vested in them: he did consider it, but decided on his view of the merits not to exercise it.**
>
> **……**
>
> **59. …Mr Day made two relevant decisions. The first appears from his letter dated 18 March 2009 which resulted in the assessment. For the reasons which I have already given, I am of the view that that decision was not based on the proposition that it was simply not open to him to exercise the discretion in the absence of self-billing agreements. Rather, it was a decision not to exercise the discretion in favour of the Company in relation to which no doubt the absence of self-billing agreements was a factor (properly I might add) taken into account."**

47. However, in relation to the July 2009 decision, as I have already stated, the Upper Tribunal by the first judgment, affirmed the FtT's decision that the failure of HMRC to consider the exercise of its discretion in July 2009, having embarked upon a review, was not reasonable; see paragraphs 53, 65 and 75 of the first judgment. In the alternative, the Upper Tribunal concluded that, if Mr Day had exercised the discretion in July 2009, his decision was nonetheless flawed because it was based "almost entirely on the absence of any self-billing agreement". The Upper Tribunal also rejected HMRC's argument that their decision would necessarily have been to refuse to allow the deduction of input tax had they approached the matter correctly: see paragraph 67 of the first judgment.

48. Nevertheless, the Upper Tribunal rejected the appellant's submission that, in light of the above, the correct conclusion, as reached by the FtT, was that the appellant's appeal should be allowed and the assessment discharged: see the first judgment at paragraphs 74 and 75. The Upper Tribunal decided instead that HMRC should now exercise, or re-exercise, their discretion to determine whether the appellant should be

allowed to deduct the relevant input tax, in the light of the totality of the evidence available at the time of the exercise of the discretion and that a further hearing should be fixed to determine whether or not, absent agreement, the assessment should be discharged: see paragraphs 11 and 66 to 76 of the first decision.

49. The Upper Tribunal based its conclusions partly on a finding that the appeal concerned not only the exercise of HMRC's discretion in July 2009 but also the exercise of that discretion in March 2009 following which the assessment was made: see especially at paragraphs 59 and 74 of the first judgment. As the Upper Tribunal recognised, it did not hear arguments on this point because it raised the point itself following the decision in relation to the exercise of the discretion, which decision was made after the hearing: see paragraphs 74 and 75.

50. Thus the judge left open, for further argument, whether the consequence of his decision should be that the appellant's statutory appeal should be allowed with the result that the assessment should be discharged. To follow the judge's thinking in this respect, it is necessary to cite paragraphs 11 and 66 to 75 of the first judgment:

> "11**. Since the tribunal's jurisdiction is only supervisory, it follows that if HMRC have not exercised their discretion properly (including by failing to exercise it at all) the result is that the exercise of the discretion must be revisited. However, there is an exception where HMRC are able to show that, had the discretion been properly exercised, the decision would inevitably have been the same:** see again *John Dee Ltd* [1995] STC 941 at 952 to 953 and *Best Buy Supplies Ltd* at [50] to [56].
>
> ……
>
> 66. It follows from what I have said that the discretion must be exercised afresh unless either (i) HMRC can demonstrate that their decision would inevitably have been the same in July 2009, when Mr Day refused to allow the deduction of input tax, had he applied the correct principles or (ii) the Company can demonstrate that no reasonable body of Commissioners could conclude other than that deduction of the input tax should be allowed. In relation to (i), I say July 2009 rather than any later date because that is the date as of which it is being asked whether the exercise of the discretion would have been the same**. In contrast, if HMRC are now to exercise their discretion afresh, it should be exercised on the basis of all of the material provided to them by the time of the exercise of the discretion.**
>
> 67. As to (i), it is, in my judgment, far from clear to me that, if this matter were to be reconsidered by HMRC, their decision would necessarily be to refuse to allow the deduction of the input tax. If nothing else, the appeal to the First-tier Tribunal and now to the Upper Tribunal **has clarified factors which should play a part in the decision-making process**

and has identified factual areas where further elucidation may be necessary, in particular in relation to the back-dating of the deregistrations before a decision is made.

68. As to (**ii), it is, in my judgment, also far from clear to me that the only reasonable decision which HMRC could make would be to allow the deduction of the input tax. I do not consider that the findings of the Tribunal compel them to make such a decision. In the first place, given the decision of the Tribunal that HMRC had not even considered the exercise of their discretion, many of their findings were unnecessary to their decision and may simply be obiter. But that point apart, I have identified at paragraph 54 above a number of unsatisfactory aspects of the Decision. I do not consider that the Decision can be taken as making clear findings which bind HMRC when it comes, if it comes, to considering how to exercise their discretion.**

69. Quite apart from that, it seems to me that the Tribunal approached the whole question of reasonableness in the light of their reading of *Dankowski* so that, provided that HMRC were satisfied that input tax had been paid to a taxable person, they should allow deduction. Dankowski is a decision to the effect that a Member State cannot impose extra conditions over and above those laid down in the relevant Directive for the deductibility of input tax which would render the right given by the Directive ineffective for practical purposes. But where the Directive itself lays down conditions for deductibility, the issue is different. The Directive itself gives no right to deduction when those conditions are not fulfilled. Instead, Member States are permitted to determine the conditions and procedures under which deduction is permissible where deduction is not in conformity with the express provisions of the Directive: see Article 18(3) of the Sixth Directive and Article 180 of the Principal Directive. The right to deduct in accordance with the relevant Directive is one thing: national legislation cannot be allowed to stand if it would, for practical purposes, render that right ineffective (save in special cases, such as the prevention of fraud in a proportionate manner). But where the relevant Directive itself lays down conditions under which that right can be exercised, it would not, in my view, be right to conclude that national legislation or administrative practice (justified by reference to what it now Article 180 of the Principal Directive) must always allow that right to be exercised notwithstanding non-compliance with the conditions but subject only to the same exceptions as would justify a derogation from the right to deduct.

70. No doubt, in laying down its national procedures, a Member State should take account of the fundamental principles of the EU VAT legislation but the Member State is not thereby compelled to adopt a system under which a taxpayer is to have a right to deduct whenever he can prove that he has paid input tax in relation to a supply by a taxable person.

71. I do not doubt that the scheme of the UK self-billing legislation, and in particular the provisions of Regulations 13 and 14, is compliant with EU law in that it does not impose disproportionate requirements as to the conditions to be met to obtain a deduction in the absence of a valid invoice. In particular, the proviso to Regulation 29(2) provides a mechanism to ensure that, in appropriate cases, a deduction can be obtained notwithstanding non-compliance with the statutory conditions. In exercising their discretion, HMRC are permitted, in my view, to take a wider view of the purpose of the discretion than simply giving effect, so far as possible, to the fundamental principle that a taxable person has a right to deduct input tax in respect of supplies from another taxable person. As the Tribunal has observed in *UDL Construction PLC v CCER* [195] V&DR 396, the self-billing system can be seen "as a gross violation of the integrity of the VAT system. ….. It goes without saying that such a dangerous procedure should be strictly controlled and policed." In my view, HMRC is entitled to take account of that when considering whether to exercise its discretion under Regulation 29(2). In that context, it will be permissible to take into account, among other matters, (i) the consequences (and the dangers) of there being no self-billing agreement and (ii) the fact of deregistration (with a more thorough assessment of when the deregistration took place); and in relation to that, it may be relevant to bear in mind that had there been any self-billing agreement in place with any of the four suppliers, such an agreement would be treated as terminated on deregistration.

72. There is one other point which I need to come back to. It relates to Mr Day's acceptance that the four suppliers were taxable persons. **If and when it comes to a re-exercise of HMRC's discretion, then it will, I consider, be open to HMRC to revisit the question whether the four suppliers were or were not taxable persons; they are not bound by Mr Day's apparent concession and the Tribunal made no finding that they were.**

73. It follows from this discussion that the Tribunal were correct to decide that HMRC did not properly exercise their discretion through Mr Day when he refused to allow the deduction of input tax in July 2009. **It is not, in my judgment, clear how he would have exercised his discretion had he**

> **adopted the correct approach to the exercise of the discretion.** Accordingly, the discretion must be exercised afresh, which is a matter for HMRC, not for the First-tier Tribunal or the Upper Tribunal.
>
> 74. **It does not necessarily follow from this conclusion that the assessment should be discharged at this stage. Whether the assessment is to be discharged may be a matter of some importance since it has been suggested that HMRC would be out of time to make a new assessment even were they able properly to refuse to exercise their discretion to allow deduction of the input tax. If this case concerned only the exercise (or rather non-exercise) of the discretion in July 2009, there would be some force in the argument that the Company's appeal should be allowed and the assessment therefore be discharged. But it does not concern only that exercise of the discretion. It also concerns the exercise of the discretion in March 2009 following which the assessment was made.**
>
> …….
>
> **Conclusions**
>
> 75. I have not heard any argument on this potentially important point. I make no criticism of that since it comes into focus only as result of my decision in relation to the exercise of the discretion. I do not, therefore, propose to decide it in this Decision. For the present, I confine myself to affirming the Tribunal's decision that the failure of HMRC to consider exercising its discretion in July 2009, having embarked upon a review, was not reasonable. But if that is wrong in the sense that Mr Day did exercise the discretion, his decision was nonetheless flawed for the reasons which I have given. HMRC should now exercise, or re-exercise as the case may be, their discretion to determine whether the Company should be allowed to deduct the relevant input tax, in the light of the totality of the evidence available at the time of the exercise of the discretion.
>
> 76. A further hearing should be fixed to determine whether or not, in the absence of agreement, the assessment should be discharged. ……"

The second hearing before the Upper Tribunal and the second judgment

51. Following release of the first judgment, a further hearing was held before the Upper Tribunal on 16 January 2015 to determine whether the assessment should be discharged.

52. HMRC essentially submitted that the assessment should not be discharged because they had exercised their discretion in March 2009. They also contended that the proper remedy was for the matter to be remitted to HMRC for the decision to be remade. HMRC further submitted that the July 2009 decision made by Mr Day was not the relevant decision as it was made following the end of the review process.

53. The appellant, on the other hand, essentially argued that the assessment should simply be discharged and that any decision made by HMRC in March 2009 was irrelevant as the appeal was against the decision as it stood, following the outcome of the review.

54. As stated above, the judge, however concluded that the matter had to be remitted to the FtT for it to decide whether HMRC would be acting within the proper exercise of their powers to decide not to exercise their discretion under regulation 29(2) in favour of the appellant: see paragraph 63 of the second judgment. He expressed the view that the appellant's appeal could only be allowed in one of the two circumstances referred to in paragraph 3 above: viz. either because HMRC would revisit the exercise of their discretion under regulation 29(2) and decide to exercise it in favour of the appellant, or because the FtT or the Upper Tribunal would in the future decide "that no reasonable body of Commissioners could reach a decision not to exercise the discretion [in Regulation 29(2)] in favour of [the appellant]".

55. On the question of whether or not the March decision was valid, the Upper Tribunal concluded that this question did not need answering. If HMRC could now properly refuse to exercise the discretion, then the March decision could not be invalid. Whereas, if HMRC could not now properly refuse to exercise the discretion in favour of the appellant, then it was irrelevant whether the March decision was valid or not: see the second judgment at paragraph 62.

56. I set out the relevant paragraphs of Warren J's judgment in relation to the issue which arises on the appeal (paragraphs 8 - 12, 41 - 43, 44, 45, 46, 47, 48, 51, 61 and 68):

> "Jurisdiction
>
> 8. I need to say a little more than I said in the UT Decision about the function and jurisdiction of the F-tT in relation to this matter and how they have come to be exercisable.
>
> 9. The matter came before the Tribunal by way of a statutory appeal against the assessment. The ultimate question on the appeal is whether the assessment should stand or not. Within that appeal, various issues have arisen. One issue is whether HMRC properly exercised their discretion when they refused to accept the evidence provided by the Company as sufficient for the proviso to Regulation 29(2) ("the Proviso") to be invoked. HMRC maintained before the Tribunal that their decision was proper; the Company maintained that it was not. The Tribunal decided in favour of the Company. It allowed the appeal, that is to say the appeal against the assessment. As they said in [59] of the Decision:

"We are satisfied that HMRC made no attempt to consider the discretion having decided that the lack of self-billing agreement was critical. We therefore allow the appeal as HMRC have acted unreasonably in not exercising the discretion and we agree with Mr Edwards' submission that the failure of the officer to consider the discretion renders the assessment invalid *per se*."

10. It is important to appreciate that the appeal before the Tribunal is, as I have just said, an appeal against the assessment; it is not an appeal against HMRC's decision in relation to the Proviso, which is no more than an issue within the appeal. There is no right to appeal against HMRC's decision as such. The reason why the point is important is because of the arguments which have been raised about whether the FtT's function is appellate or whether it is supervisory.

11. …I do not consider that there can be any doubt about the nature of the proceedings. In relation to the statutory appeal against the assessment, the F-tT has a truly appellate function. It (and, on appeal, the Upper Tribunal) will either uphold the assessment or discharge it. But in relation to the decision in relation to the Proviso, the F-tT's function and jurisdiction are purely supervisory. In other words, the F-tT is to examine whether the discretion has been properly exercised. The F-tT's function is to rule on whether the discretion has been properly exercised. If, as in the present case, it decides that is has not been, then it will identify why that is so; but it is not for the F-tT to substitute its own view for that of HMRC "

12. The legislation does not say anything expressly about how effect is to be given to the supervisory jurisdiction described in the immediately preceding paragraph. Instead, the courts and the tribunals have proceeded in a way that recognises that Parliament has given the discretion in such matters to HMRC and has adopted a similar approach to that which is adopted by the Administrative Court in relation to challenges to the exercise by public authorities of administrative decisions…"

"41. I have found it helpful to start with a consideration of how the statutory scheme would operate if a taxpayer did not seek a review of a decision or if there were no review procedure at all. A taxpayer wishing to challenge a decision not to apply the Proviso and who has been assessed accordingly would bring an appeal against the assessment.

42. Suppose that the challenge is based on a merits defect and that it is successful. The F-tT would be saying that no

reasonable body of Commissioners could, on the material before it, have refused to apply the Proviso. It would then be appropriate to allow the taxpayer's appeal. HMRC should adduce before the F-tT all the material on which they seek to rely to justify their decision; the F-tT should not give HMRC another opportunity to find further material which might justify the decision which they in fact made when, all along, the nature of the challenge was known. In those circumstances, the F-tT would not be substituting its own exercise of the discretion for that of HMRC but would be doing no more than give effect to its conclusion that no reasonable Commissioners could act as HMRC had in fact acted.

43. But now suppose that the challenge is based only on a process defect and is again successful. The position is then very different. The F-tT will not have investigated the merits of HMRC's decision at all; indeed, HMRC themselves may not have done so because of their misunderstanding of the law. It may be that, on the facts, it would have been entirely within the proper exercise of their discretion on the merits for HMRC to refuse to apply the Proviso if there had been no process defect. The F-tT will, in the exercise of its supervisory function, rule that the discretion was not properly exercised. It does not follow that it should then, in the exercise of its appellate function on the statutory appeal, allow the appeal against the assessment.

44. It seems to me that whether the assessment is ultimately to be upheld depends on whether HMRC's discretion under the Proviso is to be treated as having been exercised. In the case of a merits defect, it inevitably follows from a finding that no reasonable body of Commissioners would have made a decision refusing to exercise their discretion in favour of the taxpayer that the discretion is to be treated as having been so exercised. The result is that the appeal against the assessment succeeds. It does not matter that there may be no power actually to quash the decision.

45. In contrast, in the case of a process defect, **all that follows is that the decision has not been properly made and the discretion has not been exercised in favour of the taxpayer. It does not follow that the contrary decision has been made, that is to say that HMRC are to be treated as having made a decision to exercise their discretion in favour of the taxpayer. In contrast with the situation in *John Dee*, the F-tT is not faced with binary choice.**

46. **The starting point, in my judgment, must be that the assessment is valid unless and until it is shown that the taxpayer is entitled to have the discretion exercised in his**

favour. This he can do by establishing a merits defect; but he cannot do it by establishing only a process defect….

47. So where does this leave the assessment once a process defect has been established? As Mr. Thomas says, HMRC cannot be directed to reconsider the exercise of their discretion. It does not, however, follow that HMRC should not be able, without the need for a direction, to reconsider the exercise of their discretion. Consider the position if they could and would do so. If they decide in favour of the taxpayer, that will be an end of the matter and the statutory appeal will be allowed. If they decide against the taxpayer, then the taxpayer can continue with his statutory appeal on the basis of a merits defect if he considers that the facts warrant it. There is no need for the original decision to be quashed in either of these cases and the absence of an express power to do so does not matter."

48. But what if HMRC simply sit on their hands and do nothing? In those circumstances, it would remain open to the taxpayer to continue with its appeal by seeking to establish a merits defect, in other words to attempt to persuade the F-tT that no reasonable body of Commissioners could refuse to exercise the discretion in his favour. If that were established, it would not matter whether or not HMRC had in fact reconsidered the exercise of their discretion. Having made a decision, in the exercise of its supervisory jurisdiction, that no reasonable body of Commissioners could refuse to exercise the discretion in favour of the taxpayer, the F-tT could then properly go on to allow the statutory appeal.

……

51. The consequence of my analysis is that the Tribunal should not have allowed the Company's appeal against the assessment (although it does not follow from that that they should have dismissed it). The F-tT can only properly allow the appeal once it has decided that no reasonable body of Commissioners could refuse to exercise the discretion under the Proviso in favour of the Company or once HMRC have decided to exercise their discretion in favour of the Company.

……

Conclusions

61. The Tribunal should not have allowed the Company's statutory appeal. That appeal should be allowed only in one of the two following circumstances:

a. HMRC revisit the exercise of their discretion under the Proviso and decide to exercise it in favour of the Company; or

> b. It is decided by the F-tT (or possibly the UT) that no reasonable body of Commissioners could reach a decision not to exercise the discretion under the Proviso in favour of the Company. **The information by reference to which that issue is to be decided clearly includes everything which was made available by the Company on the review and up to the time of the July decision. So far as I am aware, there is no further material on which the Company would wish to rely. However, it seems to me that if HMRC make a further decision, they should do so on the basis of all the material available when they do so and that any challenge by the Company should be on the basis of all that material.**
>
> ……
>
> 63. **The matter must be remitted to the F-tT for it to decide whether HMRC would be acting within the proper exercise of their powers to decide not to exercise their discretion under the Proviso in favour of the Company**. Judge Porter having now retired, any further hearing should be before a differently constituted panel. The F-tT is to take account of the contents of this decision when it determines the date as of which the enquiry is to be carried out and the evidence on which it is to make its decision. In the meantime, HMRC should consider whether to revisit the exercise of their discretion. If they do so, and if they exercise it in favour of the Company, that should be an end of the statutory appeal which will be allowed, but if they exercise it against the Company, the F-tT's enquiry should focus on that decision and all of the material on which it is properly to be based. If HMRC decision to revisit the exercise of their discretion, the F-tT should carry out its enquiry as if HMRC had decided not to exercise the discretion in favour of the Company."

57. Accordingly, the judge allowed HMRC's appeal and remitted the matter to the FtT. By a decision dated 17 March, 2015 he gave the appellant permission to appeal to this court on the basis inter-alia that the proposed grounds of appeal had a real prospect of success and also raised "an important point of principle concerning the powers of a tribunal when exercising its supervisory jurisdiction".

The appellant's arguments on this appeal

58. In summary, Mr Thomas submitted that the appellant's primary case was that:

> "**having concluded that HMRC had acted unreasonably in not exercising their discretion under Regulation 29(2) to accept, in the absence of proper self-billing invoices, alternative evidence in support of input tax deductions in July 2009** then the Upper Tribunal had no alternative open to it other than to conclude that HMRC's failure rendered the assessment invalid. There is no jurisdiction which enables the

> tribunal to make any other order. Accordingly, HMRC's appeal against the FTT Decision should have been dismissed.[7]"

59. I interpose to say that, in my view, Mr Thomas' formulation of what he says that the Upper Tribunal decided (as highlighted by me in bold) is not strictly accurate. Warren J did not decide "that HMRC had acted unreasonably in not exercising their discretion under Regulation 29(2) *to accept, in the absence of proper self-billing invoices, alternative evidence in support of input tax deductions in July 2009*"; on the contrary, the judge decided that in July 2009 Mr Day *had failed to consider the exercise of the discretion under the proviso at all*, because of his mistaken view as to his ability to exercise the discretion in the absence of self-billing agreements. The judge did not decide that HMRC was unreasonable in not accepting the appellant's alternative evidence. However, nothing turns on this.

60. In the alternative Mr. Thomas submitted:

> "that the Upper Tribunal failed to apply its own test correctly. HMRC has accepted that the relevant conditions which show that [the appellant] is entitled to deduct input tax are satisfied. The right to deduct input tax is an integral part of the VAT scheme and the CJEU has made clear that where a tax authority has the information necessary to establish a substantive right to deduct input tax then deduction of input tax must be allowed even if the taxpayer has failed to comply with some of the formal requirements. Accordingly, had the Upper Tribunal applied its own test to the facts then, again, it would inevitably have concluded that [the appellant's] appeal against the assessment must be allowed (and HMRC's appeal against the FTT's Decision dismissed)."

61. In support of the appellant's primary case, Mr Thomas submitted in summary as follows:

    i) The Upper Tribunal had failed to appreciate that its jurisdiction was appellate and that its role was to review the decision which HMRC had made. Thus although the test to be applied when considering whether HMRC's discretion has been properly exercised was a supervisory one, nevertheless the jurisdiction exercised by the tribunal remained appellate. Accordingly, the issue was simply whether the assessment was valid. Where regulation 29(2) was in point, that would depend upon whether HMRC had acted in a way in which no reasonable panel of Commissioners could have acted. If HMRC had not so acted and the decision would not inevitably have been the same had they acted correctly, then the appeal had to be allowed: see the Upper Tribunal's decision in *Best Buys Supplies Ltd v Revenue & Customs Commissioners* (especially at paragraphs 48 to 57) where *John Dee* was applied. *Best Buys Supplies* also concerned HMRC's discretion under regulation 29(2). The tribunal had no power to direct HMRC to review the

[7] See paragraph 41 of the appellant's written submissions.

original decision and could only allow or dismiss the appeal. The role of the tribunal was to decide contested appeals.

ii) Accordingly, once a tribunal had decided, following the tests prescribed by *John Dee*, both that the exercise, or the non-exercise, of the discretion was totally unreasonable and that the result would not have inevitably been the same had HMRC exercised their discretion properly, then the only possible outcome was that the appeal must be allowed and the assessment discharged.

iii) Moreover, the supervisory jurisdiction had to be exercised in relation to materials which were before the Commissioners and not later materials: see e.g. *Kohanzad* [1994] STC 967 per Schiemann J at 969d-f; *Customs & Excise v Commrs v Peachtree Enterprises Ltd* [1994] STC 747 at 751 e-h. In directing that the FtT should take account of all available material in respect of a further decision which HMRC might make, as well as that further decision itself, the Upper Tribunal had made an error of law.

iv) Although the Upper Tribunal correctly recognised that HMRC could not be directed to reconsider the exercise of their discretion, the Upper Tribunal had effectively decided that the discretion should be reconsidered afresh. That was a result which was simply not open to it.

v) The Upper Tribunal had effectively created a jurisdiction to direct the Commissioners to carry out a further exercise of their discretion which was then to be scrutinised by the FtT. Such a jurisdiction required a specific statutory basis, as existed in section 16(4)(b) Finance Act 1994 in relation to non-restoration cases under the customs duties legislation. In the absence of such a statutory basis it was not open to the tribunal to direct the Commissioners to carry out a further review. No such jurisdiction existed here and the Upper Tribunal had erred in law by effectively creating one.

vi) Having HMRC's discretion reconsidered at this stage was also impractical and would be unfair. It was now nearly 6 years since HMRC made its decision on review. The appellant's key director had since been affected by serious ill-health.

vii) The Upper Tribunal had effectively reversed the applicable test as set out in *John Dee*. The issue was whether HMRC had acted in a way in which no reasonable panel of commissioners could have acted. Once that test had been satisfied by the taxpayer then HMRC could only escape the appeal being allowed if they could show that the decision would inevitably have been the same had the discretion been properly exercised. It was common ground that this exception did not apply in the present case.

viii) However, the Upper Tribunal had effectively and wrongly reversed the exception recognised in *John Dee*, so that the taxpayer must in this case now demonstrate that no reasonable body of Commissioners could *refuse* to exercise their discretion under regulation 29(2) in the taxpayer's favour if the appeal is to be allowed. There was no basis in law for removing the obligation on HMRC to show that their decision must inevitably be the same, if their

discretion were to be re-exercised, and imposing the burden on the taxpayer to show that the discretion must be exercised in its favour.

ix) The Upper Tribunal had drawn a false distinction in its reasoning between what it called "*process defects*" and "*merits defects*". There was no basis for such a distinction between process defects and merits defects

62. In the event that the appellant's primary submission (viz. that the Upper Tribunal failed to apply the correct test) failed, then, in the alternative, Mr. Thomas submitted as follows:

i) The Upper Tribunal failed to apply its *own* test correctly. The issue which the Upper Tribunal identified as requiring an answer was whether HMRC would be acting within the proper exercise of their powers not to exercise the discretion under regulation 29(2) in favour of the appellant: see the second judgment at paragraph 62. As the Upper Tribunal said, the appellant must succeed if it was able to show, on all the material available on the review, that no reasonable body of Commissioners could refuse to exercise their discretion in the appellant's favour.

ii) The appellant passed this test. Both in a letter dated 17 July 2009 and at the hearing before the FtT, Mr Day, on behalf of the Commissioners, stated that he accepted that the conditions in paragraph 5 of HMRC's Statement of Practice, which set out the conditions to be met for input tax to be incurred, were satisfied: see the FtT Decision at paragraphs 29 and 30.

iii) Moreover, the right to deduct input tax was an integral part of the VAT scheme and in principle could not be limited: see *Dankowski v Dyrektor Izby Skarbowej w Lodzi* [2011] (Case C-438/09) All ER (D) 01 at paragraph 22.

iv) Had the Upper Tribunal correctly applied its own test then it would inevitably have allowed the appeal on the basis that the discretion could only be exercised in favour of the appellant.

The respondents' arguments on this appeal

63. On behalf of HMRC Mr Mandalia supported the approach taken by the Upper Tribunal. He submitted that the Upper Tribunal had correctly stated the position in paragraphs 11 and 73 of the first judgment[8], namely that, since the tribunal's jurisdiction was only supervisory, and given that HMRC had not exercised their discretion properly (by failing to exercise it at all), the result was that the discretion had to be exercised afresh by HMRC, not by the FtT or by the Upper Tribunal.

64. In support of the argument that the FtT's jurisdiction over decisions by HMRC to disallow claimed input tax not covered by valid invoices was supervisory (in that the Tribunal could not substitute its own decision but only decide whether the HMRC's discretion had been exercised reasonably), Mr Mandalia relied upon the decision in *Best Buy Supplies Ltd*. He said that, upon finding unreasonableness, the Tribunal was

[8] Already quoted by me above.

entitled to apply the test in *John Dee Ltd* and determine whether HMRC's decision would inevitably have been the same had the discretion been reasonably exercised.

65. In the present case Mr Mandalia submitted that it could not be said, if it had exercised the discretion, that HMRC would necessarily have come to the same conclusion; it was for that reason that the Upper Tribunal correctly remitted the matter for a further hearing, since it was not possible on the evidence currently before the court to come to a conclusion what HMRC's view would have been.

66. Mr Mandalia submitted that it was not open to the Tribunal simply to allow an appeal because a Tribunal was *not* satisfied that the HMRC's decision would inevitably have been the same. That would involve the Tribunal effectively standing in the shoes of the primary decision maker and exercising a fresh discretion in the way that the Court of Appeal had held was not permissible. It was entirely logical that, in those cases where it was shown that, had the additional material been taken into account, the decision would *inevitably* have been the same, a Tribunal could dismiss an appeal. The test of 'inevitability' was a high one, and there was nothing to be gained in such cases by remitting the consideration of the discretion back to HMRC; the exercise of discretion in such cases, would inevitably, and properly, be the same. However, the same could not be said in cases such as the present one, where HMRC might have taken one of a number of different courses, had they exercised their discretion.

67. It was therefore entirely appropriate to draw a distinction between a 'process defect' and a 'merits defect', as Warren J did in this case. Here, neither the FtT nor HMRC had properly considered what the outcome would have been in the event that the discretion had properly been exercised. Rather, HMRC had, in reaching their decision, erroneously proceeded upon the premise that they could not exercise any discretion in the absence of a self-billing agreement. At paragraph 66 of its first decision, the Upper Tribunal had correctly noted that;

> "… the discretion must be exercised afresh unless either (i) HMRC can demonstrate that their decision would inevitably have been the same in July 2009, when Mr. Day refused to allow the deduction of input tax[9], had he applied the correct principles or (ii) the Company can demonstrate that no reasonable body of Commissioners could conclude other than that deduction of the input tax should be allowed."

68. Mr Mandalia further submitted that for the reasons set out at paragraphs 67 and 68 of the first judgment of the Upper Tribunal, it was far from clear what the outcome might be. Accordingly, he submitted, that, as adopted by Warren J, the proper course was for the matter to be remitted to the FtT for it to decide whether HMRC would be acting within the proper exercise of their powers to decide not to exercise their discretion under Regulation 29 in favour of the appellant. Mr Mandalia sought to draw an analogy with the procedure adopted in immigration cases such as *Secretary of State for the Home Department v Abdi [1996] Imm AR 148.* Thus, he submitted, Warren J was correct to conclude that HMRC should be afforded an opportunity to consider whether to revisit the exercise of their discretion. If they were to do so, and exercise their discretion against the appellant, the FtT's enquiry should focus on that

[9] Applying the test in John Dee Ltd

decision, and all of the material on which it was properly to be based, which would not suffer the same 'process defect' as their previous decision. In those circumstances Mr Mandalia submitted that this court should dismiss the appeal.

Discussion and determination

69. The difficulty in this case arises from the fact that (as we were informed by counsel) there is no express statutory articulation of the powers which a tribunal can exercise when deciding in favour of a taxpayer on its appeal under section 83.[10] In any event, we were not referred to any such provisions. However, it is clear, as was common ground, that the jurisdiction which the tribunal was exercising under section 83 was an appellate jurisdiction. It was also common ground that, based on decisions such as *Customs and Excise Commissioners v JH Corbitt (Numismatists) Ltd* [1981] 1 AC 22 at 60B-61B; *Customs and Excise Commissioners v Peachtree Enterprises Ltd supra* at 751b-h; *Kohanzad supra* at page 969; and *John Dee supra* at 952a – j, that, in relation to the issue as to whether HMRC had exercised its discretion under regulation 29(2) either properly, or at all, the function of the tribunal was supervisory; that is to say, that the tribunal could not (subject to the points made in paragraph 69 below) substitute its own views, in place of HMRC, as to the merits as to whether the discretion under regulation 29(2) should (or should not) be exercised in favour of the taxpayer.

70. The following propositions were also common ground:

    i) If HMRC had unreasonably failed to exercise their discretion at all, or had wrongly failed to take relevant material into account, then a tribunal could nevertheless dismiss a taxpayer's appeal if, on a proper exercise of the discretion, HMRC would inevitably have decided the same thing – i.e. in the present case, have declined to have exercised the discretion under regulation 29. That proposition was based on this court's decision in *John Dee supra* at 953 and the decision of the Upper Tribunal in *Best Buy Supplies supra* at [50] – [56].

    ii) If the tribunal was of the view that, on the basis of the material before HMRC, no body of Commissioners could reasonably have come to any conclusion other than to exercise the discretion under regulation 29 in the taxpayer's favour, then the tribunal should/could have allowed the taxpayer's appeal.

71. Therefore, the battle lines in the present case, at least in the argument before us, were focussed on the following issues:

    i) Had (as Mr Thomas for the appellant apparently submitted, and Mr Mandalia for HMRC challenged) the FtT actually decided that, on the basis of the material before Mr Day, no reasonable body of Commissioners would have been entitled to come to any conclusion other than to exercise the discretion under regulation 29 in the taxpayer's favour? The Upper Tribunal concluded that the FtT had not so decided: see paragraphs 54 to 59 of the first judgment.

[10] It was not suggested, for example, that any relevant powers were conferred by the Tribunals, Courts and Enforcement Act 2007.

ii) If the FtT had not so decided, was the FtT nonetheless (a) obliged or (b) entitled to allow the taxpayer's appeal and discharge the assessment, leaving HMRC, if they were entitled to do so within the time limits prescribed by sections 73 and 77 of VATA, to raise a further assessment?[11]

iii) Or, in the alternative to ii) above, if the FtT had not so decided, should it have adjourned the appeal, without discharging the assessment, so as to give HMRC an opportunity to revisit the exercise of their discretion under regulation 29(2) on the proper basis, viz. that the absence of self-billing agreements did not per se preclude the exercise of the discretion in the taxpayer's favour?

iv) In the event that iii) was the correct course, should the HMRC have been invited to do so (as the Upper Tribunal did) on the basis of all appropriate available materials, upon which either party might want to rely at the time of such re- exercise or merely on the basis of the materials which were before HMRC in July 2009? If so, should the discretion have been exercised in favour of the taxpayer.

72. With respect to Warren J, I do not find his distinction between "process" defects and "merits" defects very helpful. Often it will be difficult to draw the line between the two. The Upper Tribunal's proposition at paragraphs 44 and 45 of the second judgment that, in the case of a merits defect, it inevitably follows that the discretion is to be treated as having being exercised in the taxpayer's favour so that the appeal must be allowed, is difficult to understand. Just because HMRC have made a decision which is perverse does not predicate that the taxpayer is entitled to have the discretion exercised in his favour to the full extent claimed. All that follows from either a process defect or a merits defect is that the decision has not been properly made.

73. In my judgment the decision of this court in *John Dee* is instructive as to the correct approach on appeals of this sort. In that case this court had to consider an appeal under what was then section 40(1)(n) of the Value Added Tax Act 1983. Section 40 was in similar terms to section 83 of VATA in that it provided for appeals against a variety of the Customs and Excise Commissioners' decisions ("the Commissioners") including assessments and the amount of any input tax. Section 40(1)(n) provided for an appeal against any decision by the Commissioners that a taxpayer should be required to provide security for the payment of any VAT which either was or might become payable. At the material time the power to require security was contained in para 5(2) of Sch 7 to the 1983 Act. The relevant provision was in these terms:

> 'Where it appears to the Commissioners requisite to do so for the protection of the revenue they may require a taxable person, as a condition of his supplying goods or services under a taxable supply, to give security, or further security, of such amount and in such manner as they may determine, for the payment of any tax which is or may become due from him.'

The material facts were as follows. John Dee Ltd ("the company") carried on the business of heavy road haulage, having been incorporated in January 1991. D and N

[11] The ability of HMRC to raise a new assessment was not an issue which either party requested the court to address.

were among its directors. Before the company's incorporation, the John Dee group of six companies had traded profitably as road hauliers for many years but by the beginning of 1990 had fallen into serious financial difficulties. In January 1991 receivers were appointed. At that date the group's total deficiencies were estimated at £24m, with value added tax (VAT) arrears amounting to over £1m. D had been a director of five of the six companies in the group and N had been a director of one such company. On the basis of those facts in addition to the fact that the company had taken over some 20% of the undertaking of the former John Dee group, the Commissioners, served a notice on the company requiring it to provide security as a condition of its making supplies. The company appealed pursuant to s 40(1)(n) of the 1983 Act on the grounds: (i) that it had no connection with the former group of companies apart from D and N; (ii) that the company was trading profitably and had made returns of VAT and payments thereof on the terms and conditions laid down by the Commissioners; and (iii) that ownership of the company was not vested in the former directors of the group and that there had been substantial third party investment. The Commissioners refused to reconsider their decision insisting that the notice had been issued because of D and N's involvement in the John Dee group. The tribunal took the view that the Commissioners should have, but had failed, to consider the possibility of seeking financial information from the company which could have assisted them in discharging their duty to act fairly. The tribunal then went on to consider what decision a reasonable body of commissioners might have taken if they had asked for and had taken into account financial information available as at 10 January 1992. It found that it was most likely that the Commissioners' concern for the protection of the revenue would have been fortified by such material and concluded that, had they sought financial information from the company, their decision would not have differed. Turner J allowed the company's appeal on the ground that the nature of the jurisdiction of the tribunal on an appeal against a requirement of security was appellate simpliciter and not supervisory and that accordingly, once the tribunal was satisfied that the Commissioners' original decision had been erroneous because of the failure to take into account relevant matters, it should simply have allowed the company's appeal. The Commissioners appealed, contending that the judge had erred in holding the tribunal was bound to allow the company's appeal without considering whether the Commissioners would have reached the same decision even if such relevant matters had been taken into account. By a respondent's notice the company contended that the judge's decision should be affirmed on the additional or alternative ground that on an appeal against a discretionary decision the tribunal was not precluded from taking account of the facts as they were at the date of the hearing before the tribunal, and on the basis of those facts the tribunal would have allowed the company's appeal. By the time of the hearing before the Court of Appeal the Commissioners accepted that the tribunal's jurisdiction in an appeal under s 40(1)(n) was appellate and not supervisory.

74. The Court of Appeal dismissed the Commissioners' appeal. Neill LJ (with whom Roch and Hutchinson LJJ agreed) quoted from the passage in Turner J's judgment (at 269) where the latter had identified the issues of law for his determination as follows

> "Issue 1: What is the true nature of the jurisdiction of the value added tax tribunal on an appeal from a discretionary decision of the commissioners? Issue 2: Given that the commissioners had wrongly exercised their initial discretion, should the value

> added tax tribunal then: (a) allow the appeal against the commissioners' initial decision and leave it to them to make a fresh decision on the basis of such facts as they ought properly to have considered or consider at the time of the fresh decision; or (b) itself come to a decision in the light of the current evidence; or (c) put itself in the position of the commissioners, in the light of the evidence as it existed at the time of the decision which they had taken and substitute its decision for that of the commissioners."

75. Neill LJ then summarised the conclusions reached by Turner J as follows:

> "In view, however, of the detailed arguments which were addressed to this court I do not think it is necessary to do more than attempt to summarise what I understand to have been the conclusions reached by Turner J in the course of his careful judgment. His conclusions, as I understand them, were as follows: (a) That the jurisdiction of the tribunal was not 'limited to the detection and quashing of any decision made by the Commissioners which is Wednesbury unreasonable' (at 272 and cf at 275, 276). The provisions contained in the 1986 rules were inconsistent with a purely supervisory function. Accordingly the jurisdiction was appellate and not supervisory. (b) That an appellate jurisdiction can be of two kinds--an appeal by way of rehearing or an appeal simpliciter (at 277). An appeal by way of rehearing is of the kind which is conferred on the Court of Appeal by s 15(3) of the Supreme Court Act 1981 (the 1981 Act) which provides:
>
> 'For all purposes of or incidental to--(a) the hearing and determination of any appeal to the civil division of the Court of Appeal ... the Court of Appeal shall have all the authority and jurisdiction of the court or tribunal from which the appeal was brought.'
>
> (c) That on an appeal to a value added tax tribunal the tribunal does not have powers equivalent to those contained in s 15(3) of the 1981 Act. One of the reasons for this (at 278) is that the tribunal 'cannot be expected to be invested with the same knowledge and experience as the commissioners for the purpose of substituting its own exercise of discretion in place of the discretion which ought to have been exercised by the commissioners'. It follows therefore that an appeal to a tribunal is an appeal simpliciter or at any rate something less than a full appeal by way of re-hearing. **(d) That once the tribunal had decided that the commissioners had misdirected themselves the appeal should have been allowed and the tribunal should have left it to the commissioners to take a fresh decision if they thought fit on the facts as they had become by the date of the fresh decision (at 278).** The tribunal had erred in substituting its own view of what the commissioners

> would have determined had they properly taken into account the facts as they were at the date of that determination (at 277).
>
> Accordingly Turner J allowed the company's appeal."

76. Neill LJ then went on to express his reasons for agreeing with Turner J's analysis of the function of the tribunal in a case involving an appeal from a discretionary decision of the Commissioners:

> "Counsel for the company was clearly right to emphasise that the function of the tribunal is an appellate function. Section 40(1) of the 1983 Act makes provision for an appeal. Furthermore, I agree that references in this context to Wednesbury principles are capable of being a source of confusion.
>
> …..
>
> It is clear from s 40 itself that the decisions from which an appeal may lie cover a wide field. It is also clear that, though the construction of the 1983 Act cannot be determined by the subordinate legislation, the 1986 rules show that the tribunal can, inter alia, hear evidence and make orders relating to discovery.
>
> It is true that there is no express provision in Sch 8 to the 1983 Act or elsewhere in the 1983 Act governing the powers of a value added tax tribunal on an appeal under s 40. I am, however, unable to accept Mr Engelhart's general proposition that, in the absence of any express limitation, the powers of a tribunal are akin to those of the Court of Appeal. In my judgment it is necessary in each case to examine the nature of the decision against which the appeal is brought. It is also necessary to take account of the fact that, by virtue of para 1(1) of Sch 7 to the 1983 Act, VAT is under the care and management of the commissioners.
>
> In furtherance of his argument that, once the tribunal had decided that the decision of the commissioners was flawed, it could substitute its own discretion, counsel for the company was constrained to submit that it was for the tribunal to decide whether it appeared to it 'requisite for the protection of the revenue' to require a taxable person to give security. I am quite unable to accept this submission. It seems to me that the 'statutory condition' (as Mr Richards termed it) which the tribunal has to examine in an appeal under s 40(1)(n) is whether it appeared to the commissioners requisite to require security. In examining whether that statutory condition is satisfied the tribunal will, to adopt the language of Lord Lane, consider

> whether the commissioners had acted in a way in which no reasonable panel of commissioners could have acted or whether they had taken into account some irrelevant matter or had disregarded something to which they should have given weight. The tribunal may also have to consider whether the commissioners have erred on a point of law. **I am quite satisfied, however, that the tribunal cannot exercise a fresh discretion on the lines indicated by Lord Diplock in Hadmor. The protection of the revenue is not a responsibility of the tribunal or of a court.**
>
> I do not consider that it is necessary or would be appropriate in this case to give guidance as to other categories of appeal under s 40(1), other than to say that in my view the function and powers of a tribunal in each case will de-pend in large measure on the nature of the decision appealed against and of course on any special statutory provisions.
>
> ……
>
> I turn therefore to the second matter raised in the appeal. I can deal with this very shortly.
>
> It was conceded by Mr Engelhart, in my view rightly, that where it is shown that, had the additional material been taken into account, the decision would inevitably have been the same, a tribunal can dismiss an appeal. In the present case, however, though in the final summary the tribunal's decision was more emphatic, the crucial words in the decision were (at 203):
>
> 'I find that it is most likely that, if the Commissioners had had regard to [the report to the licensing authority] their concern for the protection of the revenue would probably have been fortified.'
>
> I cannot equate a finding 'that it is most likely' with a finding of inevitability.
>
> On this narrow ground I would dismiss the appeal."

77. Thus the Court of Appeal endorsed the approach adopted by Turner J namely that, save in circumstances where the Commissioners could show that, had the additional material which should have been taken into account, in fact been taken into account, the decision would *inevitably* have been the same, where a tribunal could nonetheless dismiss the taxpayer's appeal against a wrongly made decision of the Commissioners, the taxpayer's appeal should be allowed and that it was not for the tribunal to re-exercise the discretion. The tribunal should have allowed the taxpayer's appeal and "left it to the Commissioners to take a fresh decision if they thought fit on the facts as they had become by the date of the fresh decision."

78. In the subsequent case of *Best Buys Supplies Ltd v Revenue & Customs Commissioners supra,* the Upper Tribunal (Tax and Chancery Chamber) followed the Court of Appeal's approach in *John Dee* – interestingly in a case involving an appeal under section 83(1)(c) and (p) of VATA in respect of a discretionary decision of HMRC under regulation 29(2) to refuse to allow input tax. That case is not binding on us but it is nonetheless indicative of the practice of the Upper Tribunal. In that case the Upper Tribunal was not satisfied that the FtT had established the necessary facts for determination of the question whether HMRC's decision would *inevitably* have been the same (i.e. adverse to the taxpayer), had HMRC exercised its discretion properly. Accordingly, the Upper Tribunal remitted the matter to the FtT to establish on the evidence the answer to that question. That was not the position in the present case where there was no dispute that HMRC could not demonstrate that their decision would inevitably have been the same.

79. In my judgment a similar approach to that adopted by this court in *John Dee* is applicable to a case such as the present, where the relevant decision was a failure by HMRC, as a result of a misapprehension as to the necessity of a billing agreement, to consider the exercise of their discretion under regulation 29(2) to allow input tax. The present case was one where, on the findings of fact by the FtT, HMRC clearly could not have suggested that, if they had properly considered or re-considered the exercise of their discretion under regulation 29, they would have *inevitably* have come to the same result – i.e. to have refused to allow the credit for the input tax. Indeed, Mr Mandalia did not seek so to argue.

80. Now, of course, in *John Dee* the appeal was not, as in the present case, against an actual assessment or in respect of the amount of any input tax which might have been credited to the tax payer. But, in my judgment, it follows from the approach in *John Dee* that, if the appellant's appeal against the assessment is to be allowed, on the grounds that HMRC wrongly failed even to consider the exercise of the regulation 29(2) discretion, then necessarily – since the appeal is against the assessment itself – the assessment falls to be discharged, leaving HMRC, if they wish to do so, to consider the proper exercise of their discretion on the correct legal basis and, if they are able (given the statutory time constraints), to issue a new assessment if so advised. It follows that, in my judgment, the Upper Tribunal was wrong to have *allowed HMRC's appeal* against the FtT's decision, and, effectively, to have given HMRC a further opportunity retrospectively to have justified their assessment.

81. The directions given by the judge (viz. allowing HMRC's appeal and remitting the appellant's appeal against the assessment to be further considered by the FtT, once HMRC had considered or re-considered the exercise of its discretion, potentially on the basis of further materials), in my judgment and as Mr Thomas correctly submitted, wrongly preserved the existence of what had been found to have been a flawed assessment; it wrongly placed the burden of challenging any revised assessment on the appellant, without affording the latter the opportunity to raise the time-bar possibly available to challenge any new assessment raised by HMRC. It also wrongly enabled HMRC to support the correctness of their earlier July 2009 decision by reference to subsequent factual materials, which in itself was not legitimate: see *Customs & Excise v Commrs v Peachtree Enterprises* and *Kohanzad supra*. Once the earlier decision to raise the assessment had been found to be flawed, then the appeal against the assessment should have been allowed, the assessment should have been

discharged and HMRC - if they were so minded and entitled - should have started again.

82. Thus I do not, with respect, agree with the judge's "starting point" that "the assessment is valid unless and until it is shown that the taxpayer is entitled to have the discretion exercised in his favour"[12]. Moreover, why, in the event that HMRC declined to revisit the exercise of its discretion at all, as the judge envisaged in paragraph 48 of the second judgment, should the appellant be required to continue with the appeal proceedings and to surmount the further hurdle (after all these years) of demonstrating at a yet further hearing that on the materials no reasonable body of Commissioners could refuse to exercise the discretion in its favour?

83. But even if I am wrong in my conclusion that, since the appeal was against the assessment itself, the outcome was necessarily that the appeal should have been allowed and the existing assessment discharged, then it seems to me that the alternative analysis is that the FtT had a *discretion* as to whether to allow the appeal and to discharge the assessment, or to adjourn the proceedings pending the exercise or re-exercise of HMRC's discretion. I would base this view on the dictum of Neill LJ in *John Dee* at page 952h that:

> "the function and powers of a tribunal in each case will depend in large measure on the nature of the decision appealed against and of course on any special statutory provisions."

If that were the position, then, in my judgment, in the circumstances of this case, and on the basis of the facts found by the FtT as summarised e.g. at paragraphs 55-58 of its judgment (to the effect that HMRC had accepted that all the other invoices were compliant and that Mr Day accordingly could not deny the validity of the invoices, other than for the lack of the self-billing agreement), the FtT was clearly right to take the course which it did, namely allow the appeal against the assessment and discharge the latter. Such a course was clearly within the reasonable scope of its discretion. And, likewise, it follows that in my view the judge was clearly wrong in principle to have taken the course which he did, in particular after the length of time that had elapsed, the fact that there had been two hearings before the Upper Tribunal and the fact that he too had concluded that HMRC had wrongly failed in July 2009 to consider the exercise of its discretion.

84. However, contrary to Mr Thomas' further submissions, I do not agree that this was a case where the appellant was entitled to a declaration to the effect that, if HMRC had properly exercised their discretion in July 2009, no reasonable body of commissioners could have come to any conclusion other than that the discretion should be exercised in the taxpayer's favour. Like the judge I am not persuaded that, read in context, the sentence in paragraph 58 of the FtT's judgment:

> "We therefore allow the appeal as HMRC have acted unreasonably in not exercising its discretion …"

can be read as equivalent to the statement of a conclusion that the *only* reasonable decision which HMRC could have made, had they exercised the discretion under

[12] See paragraph [46] of the second judgment.

regulation 29(2) on the materials before them, would have been to allow the deduction of the input tax. That issue (unlike the converse issue as to whether HMRC's would have inevitably been the same, viz. adverse, had they actually exercised the discretion) was not directly before the FtT. Also, like the judge, I do not consider that the factual findings of the FtT *compelled* HMRC to reach such a conclusion, although they constituted strong reasons pointing towards a result where the regulation 29(2) discretion would be exercised in the appellant's favour.

Disposition

85. For the above reasons, I would allow the appellant's appeal against the Upper Tribunal's order. I would restore the order of the FtT allowing the appellant's appeal against the assessment and I would discharge the assessment. It will be a matter for HMRC as to whether, in all the circumstances, they consider it appropriate to seek to raise a further assessment and a question of law as to whether they have power to do so, given the passage of time and the statutory time constraints. I say nothing about those issues.

Mr Justice Baker:

86. I agree.

Lord Justice Patten:

87. I agree with Gloster LJ that this appeal should be allowed and the assessment of 25 March 2009 set aside in accordance with the decision of the FtT. The Upper Tribunal concluded that in relation at least to the July decision there had been no exercise of the Regulation 29(2) discretion because of a belief that the power was not exercisable in the absence of the necessary self-billing agreements and that this amounted to an error of law. There is no statutory right of appeal against a refusal to exercise the discretion or even an exercise of the discretion and the March and July Decisions are not therefore themselves under appeal. The appeal is against the assessment whose validity depends upon the proper exercise of the powers under the 1995 VAT Regulations. I agree with Gloster LJ that the distinction which the Upper Tribunal made in this regard between merits and process defects is difficult to follow and is apt to cause confusion.

88. In these circumstances, I consider that the Upper Tribunal was wrong to hold that because there had been no complete determination as to how the discretion would have been exercised following the review this somehow justified remitting the matter back to the FtT for a determination of that matter. The FtT had already determined that there had been no proper exercise of the Regulation 29(2) discretion and HMRC could only preserve the assessment by demonstrating that had the discretion been exercised the result would inevitably have been the same. This they were unable to do.

89. These considerations apply *a fortiori* to the Upper Tribunal's decision that HMRC should be allowed to re-consider and, if necessary, re-exercise the discretion prior to any final determination of the appeal. It is not clear to me what power the Upper Tribunal thought it was exercising and its approach was wrong in principle. If HMRC had not lawfully exercised its powers under the Regulations then the assessment was

invalid and it cannot be validated retrospectively by a re-exercise now of the discretion. The only legally relevant re-exercise of the Regulation 29(2) discretion would be in the context of a new assessment.