Neutral Citation Number: [2014] EWCA Civ 684

Case No: A3/2013/1012

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX & CHANCERY CHAMBER)
THE UPPER TRIBUNAL
FTC/40/2011

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 22 May 2014

Before :

LORD JUSTICE LEWISON
LADY JUSTICE SHARP
and
LORD JUSTICE VOS

- -

Between :

BIRMINGHAM HIPPODROME THEATRE TRUST LTD	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

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- -

MR DAVID MILNE QC & MR DAVID YATES (instructed by Forbes Hall LLP) for the **Appellant**
MS PHILIPPA WHIPPLE QC & MR BRENDAN McGURK (instructed by the General Counsel and Solicitors for HM Revenue and Customs) for the **Respondents**

Hearing date : 15 May 2014

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Approved Judgment

Lord Justice Lewison:

Introduction

1. Birmingham Hippodrome Theatre Trust Ltd ("the Trust") is a registered charity which operates the Birmingham Hippodrome. Its principal supplies are supplies of theatre tickets. Under EU law those supplies ought to have been exempt from VAT with effect from 1 January 1990. That would have meant that it was not liable to pay output tax on those supplies; but, by the same token, that it was not entitled to deduct or reclaim input tax on supplies made to it. However, the UK failed to comply with EU law until 1996; and even then misinterpreted its scope. It was not until 2004 that the law was set on the correct footing.

2. The upshot is that the Trust is, in principle, entitled to apply for repayment of output tax that it paid HMRC in the period between 1990 and 1996. But between 2000 and 2001 when the theatre was closed for refurbishment, the Trust paid input tax but made no taxable supplies. In response to a claim made at the time by the Trust, HMRC paid the input tax to the Trust. The question that arises on this appeal is whether HMRC is entitled to set off those amounts of input tax that it (wrongly) paid to the Trust against the amount that the Trust now claims to be repaid in respect of output tax that it (wrongly) paid to HMRC. The main complication arises because HMRC is out of time for making its own free-standing claim to recover the input tax (wrongly) paid to the Trust.

3. Both the First Tier Tribunal (Judge Peter Kempster and Ms Helen Folorunso) and the Upper Tribunal (Proudman J and Judge Charles Hellier) held that HMRC was so entitled. The decision of the First Tier Tribunal is at [2011] UKFTT 117 (TC), [2011] SFTD 473. The decision of the Upper Tribunal is at [2013] UKUT 057 (TCC); [2013] STC 1079. With the permission of the Upper Tribunal the Trust appeals.

4. For the reasons that follow I would dismiss the appeal.

Legal background

5. The FTT set out the legislative background with admirable clarity, which the Upper Tribunal simply adopted without more. Anyone who is interested in the full story should read the decision of the FTT. But a short summary is necessary to understand the context in which the dispute arises.

6. At the relevant time VAT was governed principally by EC Council Directive 77/388 (the Sixth Directive). Article 13A (1) (n) of the Sixth Directive required member states to exempt from VAT "certain cultural services and goods closely linked thereto supplied by bodies governed by public law or by other cultural bodies recognised by the Member State concerned." The UK should have complied with this obligation by 1 January 1990; but in fact did nothing until 1996. Article 17 confers on the taxable person the right to deduct input tax on goods and services supplied to him "in so far as the goods and services are used for the purpose of his taxable transactions."

7. In order to comply with article 13A (1) (n) the UK made the VAT (Cultural Services) Order 1996, effective from 1 June 1996. That inserted a new Group 13 into Schedule 9 to the VAT Act 1994 ("VATA"). It exempted supplies by an eligible body of

admission to a theatrical performance. However, in order to be "eligible" a body had to be "managed and administered on a voluntary basis by persons who have no direct or indirect financial interest in its activities." HMRC interpreted this to mean that payment of *any* person involved in the general management and administration of a cultural body would disqualify that organisation from being an eligible body. However, in March 2002 the ECJ held that HMRC's interpretation was wrong: *Customs and Excise Commissioners v Zoological Society of London* (Case C-267/00) [2002] STC 521. It was only payment to those persons who are designated in the body's constitution to direct it at the highest level that would prevent a body from being eligible.

8. This was not the only mistake that the UK made in implementing the EU requirements about tax. By July 1996 the government became alarmed at the mounting scale of its potential liability to make repayments of tax that it had wrongly collected. It decided to impose a three year time limit on the making by a taxpayer of a retrospective claim for repayment. The time limit, according to the Act which introduced it, was deemed to have come into force on 18 July 1996 (the day on which it was announced). But the ECJ then held that that was incompatible with EU law because it failed to give taxpayers a transitional period in which to make claims: *Marks and Spencer plc v Customs and Excise Commissioners* (Case C-62/00) [2002] STC 1036. In response HMRC introduced a transitional period from 4 December 1996 to 31 March 1997. But that was also unlawful, because the ECJ subsequently held that any such transitional period had to be at least six months: *Grundig Italiana SpA v Ministero delle Finanze* (Case 255/00) [2003] All ER (EC) 176.

9. In *Fleming v HMRC* [2008] UKHL 2; [2008] 1 WLR 195 the House of Lords, upholding the Court of Appeal (which had reached its decision in 2006), held that the transitional period could not be applied to claims that had accrued before the introduction of the time limit.

Accounting for VAT

10. VAT is charged on any supply of goods or services made in the UK if the supply is a taxable supply made by a taxable person in the course of a business. An exempt supply is not a taxable supply. A taxable person must account for and pay VAT in respect of taxable supplies made by him. This is output tax. He is entitled to credit for VAT paid on supplies to him and to deduct it from any output tax that is due from him. This is input tax. If the amount of the credit exceeds the amount of the output tax due, then HMRC must pay the excess to the taxable person. However, where a business makes only exempt supplies, it cannot claim credit for input tax; and where it makes supplies some of which are exempt and some are not, then the amount of input tax for which credit may be given is limited.

11. The obligation to account for VAT takes effect by reference to accounting periods, which are specified by regulations: VATA s. 25 (1).

12. Section 73 (2) of VATA provides:

> "(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."

13. Thus if a taxable person has wrongly claimed a credit for input tax the mechanism by which HMRC reclaims it is by way of an assessment for VAT. Section 73 (6) and section 77 impose time limits for the making of an assessment under section 73 (2). The long stop time limit was three years after the end of the prescribed accounting period. It has since been extended to four years.

14. If a person has accounted to HMRC for output tax that was not output tax due, then HMRC must credit that person with that amount: VATA s. 80 (1). Similarly, if a person has paid an amount by way of VAT that was not due, then HMRC must repay that amount: VATA s. 80 (1B). These sub-sections also deal with overpayment by reference to accounting periods. Section 80 (2A) provides that:

> "Where—
>
> (a) as a result of a claim under this section by virtue of subsection (1) or (1A) above an amount falls to be credited to a person, and
>
> (b) after setting any sums against it under or by virtue of this Act, some or all of that amount remains to his credit,
>
> the Commissioners shall be liable to pay (or repay) to him so much of that amount as so remains."

15. This section thus deals with set-off within the same accounting period (although it may not be limited to the same accounting period).

16. In general a taxpayer had to make a claim within three years of the relevant date: s. 80 (4). That period, too, has since been extended to four years. The relevant date is likewise defined by reference to accounting periods: s. 80 (5). Finally, it is to be noticed that section 80 (3) provides that:

> "It shall be a defence, in relation to a claim under this section by virtue of subsection (1) or (1A) above, that the crediting of the amount would unjustly enrich the claimant."

17. Section 81 of VATA provides so far as relevant:

> "(3) … in any case where—
>
> (a) an amount is due from the Commissioners to any person under any provision of this Act, and

> (b) that person is liable to pay a sum by way of VAT, penalty, interest or surcharge,
>
> the amount referred to in paragraph (a) above shall be set against the sum referred to in paragraph (b) above and, accordingly, to the extent of the set-off, the obligations of the Commissioners and the person concerned shall be discharged.
>
> (3A) Where—
>
> (a) the Commissioners are liable to pay or repay any amount to any person under this Act,
>
> (b) that amount falls to be paid or repaid in consequence of a mistake previously made about whether or to what extent amounts were payable under this Act to or by that person, and
>
> (c) by reason of that mistake a liability of that person to pay a sum by way of VAT, penalty, interest or surcharge was not assessed, was not enforced or was not satisfied,
>
> any limitation on the time within which the Commissioners are entitled to take steps for recovering that sum shall be disregarded in determining whether that sum is required by subsection (3) above to be set against the amount mentioned in paragraph (a) above."

The facts

18. From October 1979 the Trust treated its ticket sales as standard rated output supplies, charging VAT to its customers. Between January 2000 and November 2001 the theatre was closed for a major refurbishment. During that period the Trust submitted VAT repayment claims totalling almost £5 million. HMRC met those repayment claims.

19. With effect from 1 June 2004 the Trust treated ticket sales as exempt supplies for VAT purposes.

20. The FTT summarised the position thus:

> "(1) October 1979 to December 1999 – Ticket sales treated as taxable, with reclaim of input tax.
>
> (2) January 2000 to October 2001 – Theatre closed for refurbishment, reclaim of input tax on refurbishment costs of approximately £5 million.
>
> (3) November 2001 to May 2004 – Ticket sales treated as taxable, with reclaim of input tax.
>
> (4) June 2004 onwards – Ticket sales exempt, reclaim of input tax restricted."

21. The FTT also tabulated the financial consequences of this as follows:

Item	Period		£ million
1	January 1990 to November 1996	Net overpayment – the subject of the appeal	1.1
2	December 1996 to December 1999	Net overpayment – out of time	0.9
3	January 2000 to November 2001	Net repayment of input tax – theatre closed for refurbishment	(5.0)
4	December 2001 to May 2004	Net overpayment – out of time	1.0
	Net position		(2.0)

22. In March 2004 the Trust's then advisers wrote to HMRC saying that they believed that the Trust was likely to be exempt from VAT. HMRC confirmed that in the following month. In their letter to HMRC the Trust's advisers explained that they had considered whether the Trust should make a retrospective claim in respect of its box office income. They continued:

> "However, as the Theatre was closed between 1 January 2000 and 1 November 2001 to undertake a significant capital project, it is necessary to consider the impact that a retrospective claim would have in terms of the Theatre's output VAT recovery position. Taking into account the necessary input tax and output tax adjustments the Theatre has decided not to submit a retrospective claim."

23. Thus it was not until 14 May 2007 that the Trust made a claim for repayment of output tax charged on ticket sales for the accounting periods 03/90 to 12/96. The rationale for the start of the period was that before 1 January 1990 (the deadline by which the UK ought to have implemented article 13.A. (1) (n)) the Trust had no directly enforceable right to exemption. But after that deadline, an enforceable right arose as a result of EU law. The end date was chosen because claims relating to periods after that time had become time barred. They had become time barred because the Trust had waited for more than three years before making its claim. The amount claimed was less than the sum that HMRC had paid the Trust in relation to the refurbishment.

24. HMRC rejected the claim on the ground that under section 81 (3A) of VATA it was entitled to set off against that claim the amounts that they had paid to the Trust in relation to the reclaim of input tax relating to the refurbishment. In the alternative HMRC argued that the claim was abusive (according to EU law).

The decision of the Upper Tribunal

25. The Upper Tribunal found in favour of HMRC on section 81 (3A) and did not therefore need to deal with the abuse argument. It is common ground that if that argument is live a reference to the CJEU may be necessary. At [16] the Upper

Tribunal identified five issues that arose in relation to the provisions of section 81 (3A):

> "(1) whether HMRC may pick and choose between past out of time periods; (2) whether the set-off should be limited to amounts connected in some way to the claim for repayment; (3) time limits; (4) whether there had been one mistake or two; and (5) whether there should have been a transitional period before s. 81 (3A) came into force."

26. The first of these issues needs a little explaining. The "pick and choose" point was whether, as the Trust contended, section 81 (3A) purported to permit HMRC to rely on any accounting period of their choosing as a means of reducing a claim to repayment of overpaid VAT or whether, as HMRC contended, section 81 (3A) required a netting off of underpayments and over payments over the whole period covered by the relevant mistake. The Trust's argument (which on the face of it was against its own interests) was designed to prepare the ground for a contention that, interpreted in that way, section 81 (3A) would be incompatible with EU law.

27. The Upper Tribunal summarised their conclusions on those issues at [129] as follows:

> "(1) properly construed s. 81 (3A) does not permit HMRC to pick and choose; (2) set-off is limited to the same mistake, not to items linked in any other way; (3) no time limitation is required, although some modification of normal procedural rules may be needed; (4) it is unhelpful to characterise the mistakes by asking the question 'one mistake or two?' but the same mistake was made; and (5) no transitional period was required for the implementation of s. 81 (3A)."

28. The mistake that the Upper Tribunal identified in their answer to issue (4) was that supplies of tickets were mistakenly treated as standard rated supplies, whereas they ought to have been treated as exempt supplies.

29. But they added at [130]:

> "S. 81 (3A) is to be construed subject to the conditions, (1) that all relevant previous years need to be considered and (2) that in relation to the consideration of years in which the taxpayer is not required to keep records, the onus should be on HMRC to show that any adjustment should be made. However the operation of s. 81 (3A) is not precluded by the principles of legal certainty, equality, equivalence, or the supremacy of Community law."

The appeal

30. The Trust appeals on a number of grounds:

i) The Upper Tribunal were wrong on the "pick and choose" point. It was not open to them to interpret section 81 (3A) as they did.

ii) On the basis that the Upper Tribunal were wrong, section 81 (3A) must be interpreted in some other way so as to avoid a breach of EU law. They should have held that time limits could only be disregarded where the input tax was directly linked to the output tax.

iii) The interpretation of section 81 (3A) that the Upper Tribunal adopted contravened the EU principles of effectiveness, equality and legal certainty.

31. There is no challenge to the Upper Tribunal's conclusion on the question "one mistake or two;" or on its conclusion that no additional transitional period was necessary.

Applicable principles of EU law

32. The Trust's underlying claim for repayment relies on the principle of EU law that whenever the provisions of a directive appear, so far as their subject matter is concerned, to be unconditional and sufficiently precise, they may be relied upon before the national courts by individuals against the state where the latter has failed to implement the directive in domestic law by the end of the period prescribed or where it has failed to implement the directive correctly: *Marks and Spencer plc v Customs and Excise Commissioners* (Case C-62/00) [2002] STC 1036. Thus the Trust's claim rests on article 13A (1) (n) of the Sixth Directive, which the UK failed to implement until 1996, and even then failed to interpret correctly.

33. It is, therefore, necessary to examine the scope of the principle of EU law on which the Trust relies. In the *Marks and Spencer* case the ECJ went on to say at [26]:

> "… it has been consistently held that implementation of a directive must be such as to ensure its application in full."

34. The notion that a directive must be (or be treated as having been) implemented in full means that it must be implemented (or be treated as having been implemented) even-handedly as between a citizen and the member state concerned. The ECJ made this clear in *Amministrazione delle Finanze dello Stato v Simmenthal SpA* (Case C-106/77) [1978] ECR 629:

> "[14] Direct applicability in such circumstances means that rules of Community law must be fully and uniformly applied in all the member-States from the date of their entry into force and for so long as they continue in force.
>
> [15] These provisions are therefore a direct source of rights and duties for all those affected thereby, whether member-States or individuals, who are parties to legal relationships under Community law."

35. If the UK had implemented article 13A (1) (n) in full by the deadline of 1 January 1990 the consequences would have been that (a) the Trust would not have charged VAT on its supplies of tickets as from that date but (b) would not have been entitled

to credit for input tax as from that date. In my judgment to the extent that the Trust's claim rests upon this principle, it must take the rough with the smooth. Thus in *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* Case (C-62/93) [1995] STC 805 Jacobs A-G said at [31]:

> "… in the case of a directive such as the Sixth Directive, which lays down a comprehensive scheme of taxation, it is in my view possible to determine whether a taxable person has overpaid tax under national rules only by considering the combined effect of all relevant provisions of the directive on the transactions in question and by comparing the resultant liability with that arising under the national rules. The provisions determining the liability of a taxable person in respect of particular transactions must be regarded as an inseparable whole."

36. It follows from this that by availing himself of an exemption from VAT the person entitled to the exemption necessarily waives the right to claim a deduction in respect of input: *Becker v Finanzamt Münster-Innenstadt* (Case 8/81) [1982] ECR 53; *Sunningdale Golf Club v Commissioners of Customs & Excise* [1997] V & DR 79.

37. I agree, therefore, with HMRC that the Trust's directly effective right is to be put into the position in which it would have been if the UK had correctly implemented article 13A (1) (n) by the deadline imposed by the Sixth Directive. I do not agree with the Trust's argument that the right is a right to be put into that position only as regards those accounting periods in respect of which it chooses to make a claim.

38. It is common ground that in interpreting domestic legislation the court ought, so far as possible, to interpret it in a manner that is consistent with the directive. This interpretative obligation is usually known as the *Marleasing* principle (see *Marleasing SA v La Comercial Internacional de Alimentacion SA* (Case C-106/89) [1990] ECR I-4135). In *Vodafone 2 v HMRC (No 2)* [2009] EWCA Civ 446; [2009] STC 1480 at [37] and [38] this court set out a summary of the principle in terms which I reproduce (but without citation of the supporting authorities):

> "…the obligation on the English courts to construe domestic legislation consistently with Community law obligations is both broad and far-reaching. In particular:
>
> (a) It is not constrained by conventional rules of construction;
>
> (b) It does not require ambiguity in the legislative language;
>
> (c) It is not an exercise in semantics or linguistics;
>
> (d) It permits departure from the strict and literal application of the words which the legislature has elected to use;
>
> (e) It permits the implication of words necessary to comply with Community law obligations; and
>
> (f) The precise form of the words to be implied does not matter.

> The only constraints on the broad and far-reaching nature of the interpretative obligation are that:
>
> (a) The meaning should "go with the grain of the legislation" and be "compatible with the underlying thrust of the legislation being construed."…. An interpretation should not be adopted which is inconsistent with a fundamental or cardinal feature of the legislation since this would cross the boundary between interpretation and amendment; and
>
> (b) The exercise of the interpretative obligation cannot require the courts to make decisions for which they are not equipped or give rise to important practical repercussions which the court is not equipped to evaluate."

39. It follows, in my judgment, that section 81 (3A) of VATA ought to be interpreted, so far as it can be, to achieve the result that the Trust is put into the position in which it would have been if the UK had correctly implemented article 13A (1) (n) by the deadline imposed by the Sixth Directive.

40. Moreover, as it seems to me any other conclusion would unjustly enrich the Trust, which is contrary to the sense of section 80 (3) of VATA.

41. The Trust relied on three other principles of EU law in support of its appeal. The first is the principle of effectiveness. Shortly stated this principle means that domestic provisions should not make it virtually impossible or excessively difficult to exercise rights conferred by EU law. It was the application of this principle which led to the decision in *Marks & Spencer* that the UK was required to provide for a transitional period in which claims for repayment of tax could be made. That principle has, in my judgment, been satisfied. The Trust has a claim and has made it. The right of set-off does not prevent the Trust from making its claim. It merely provides for a reduction of that claim in appropriate circumstances. Moreover, the principle is concerned with the *enforcement* of rights under EU law. It does not identify what those rights are.

42. The second principle is that of equality; namely that comparable situations should not be treated differently and different situations should not be treated in the same way without objective justification. However, the Trust accepts that this principle is not infringed where a limitation period applicable to the recovery of underpaid tax by a taxing authority is longer than a limitation period applicable to the recovery of overpaid tax by a taxpayer: *Ecotrade SpA v Agenzia delle Entrate* (Joined Cases C-95/07 and C-96/07) [2008] STC 2626 at [51] – [52]. The underlying rationale of this decision is that the taxpayer and the taxing authority are not in comparable positions.

43. The third principle is that of legal certainty. In *Ecotrade* at [44] the court held that:

> "…the possibility of exercising the right to deduct without any temporal limit would be contrary to the principle of legal certainty, which requires the tax position of the taxable person, having regard to his rights and obligations vis-à-vis the tax authority, not to be open to challenge indefinitely."

44. In *Alstom Power Hydro v Valsts ienemumu dienests* (Case C-472/08) [2010] STC 777 the CJEU applied this by analogy to a claim for repayment of VAT. At [16] it held:

> "First, by analogy with the situation applicable to the exercise of the right to deduct, the possibility of making an application for the refund of excess VAT without any temporal limit would be contrary to the principle of legal certainty, which requires the tax position of the taxable person, having regard to his rights and obligations vis-à-vis the tax authority, not to be open to challenge indefinitely."

45. Thus the court held that the member state (in that case Latvia) was entitled to impose a time limit on the making of claims for repayment of VAT which should not have been paid.

46. The principle of legal certainty is not a trump card. This is made clear by the decision of the court in *Amministrazione dell'Economia e delle Finanze and Agenzia delle entrate v Fallimento Olimpiclub Srl* (Case C-2/08) [2009] ECR 1-7501. That case concerned an allegation that a contract made in 1985 was abusive. The allegation had been contested in proceedings relating to the tax years 1988 to 1991 which had been resolved in the taxpayer's favour. The question was whether Italian procedural rules of *res judicata* which precluded the re-opening of that allegation as regards subsequent tax years were compatible with EU law. The taxpayer argued that the principle of legal certainty meant that they were not incompatible with EU law. But both Mazak A-G and the court rejected that argument. In the course of his opinion the Advocate-General said at [47]:

> "It is, nonetheless, also clear from the case law of the Court that the principle of legal certainty - and the finality of decisions, which flows from that principle - is not absolute in the sense that it prevails in every situation: rather it must be reconciled with other values worthy of protection, such as the principles of legality and the primacy of Community law, and the principle of effectiveness."

47. The court agreed. At [30] the court held:

> "Accordingly, if the principle of *res judicata* were to be applied in that manner, the effect would be that, if ever the judicial decision that had become final were based on an interpretation of the Community rules concerning abusive practice in the field of VAT which was at odds with Community law, those rules would continue to be misapplied for each new tax year, without it being possible to rectify the interpretation."

48. Thus the court concluded at [31]:

> "In those circumstances, it must be held that such extensive obstacles to the effective application of the Community rules on VAT cannot reasonably be regarded as justified in the

> interests of legal certainty and must therefore be considered to be contrary to the principle of effectiveness."

49. Accordingly in that case the principle of effectiveness overrode the principle of legal certainty. Moreover, it did so in a manner that was to the advantage of the member state and to the disadvantage of the taxpayer. The rationale for the decision was that the correct application of the principles of VAT contained in the Directive was more important than legal certainty.

Interpretation of section 81

50. The Upper Tribunal held that section 81 (3A) must be applied so as to take into account all accounting periods affected by the mistake in question, whether the balance at the end of the accounting period was in favour of the taxpayer or of HMRC. They reached their conclusion by two alternative routes. First, at [85] they said:

> "The effect of time limits is to curtail the objects of the Directive but such curtailment is permissible. The effect of s. 81 (3A) is to modify the effect of otherwise absolute time limits in favour of the state. That modification must be done in a way which does not violate fundamental principles of Community law and is in conformity with the object of the Directive. If s. 81 (3A) permitted the state to pick and choose between out of time periods so that it could choose only those in which the amounts were due to HMRC for the purpose of the set-off the result would not conform to that object. Thus if possible s. 81 (3A) should be construed so as to require all the amounts which would be due to or from HMRC if time limitations were disregarded to be taken into account for the purposes of this setting off."

51. Second at [87] they said:

> "The same conclusion obtains if the question is approached as an emanation of the directly enforceable right of an individual under the Directive. That right is to bear no more tax than the Directive requires. The set-off against a within-time claim of an otherwise out-of-time claim by HMRC offends that right if out-of-time claims of the individual are ignored because the individual may then end up paying more than the Directive requires. Thus a limitation of the claims for which the time bar is raised to claims against the taxpayer chosen only by HMRC could make the individual's right under the Directive impossible to exercise. That is cured by applying s. 81 (3) and (3A) so that all otherwise time-barred claims, whether of HMRC or the taxpayer, are taken into account for the purposes of the set-off in s. 81 (3A)."

52. The Trust argues that the interpretation of section 81 (3A) adopted by the Upper Tribunal goes against the grain of the legislation. That is because the legislation says

nothing about disapplying time limits in favour of the taxpayer. It only disapplies time limits in favour of HMRC. The Upper Tribunal's conclusion, which referred to the *taxpayer's* time-barred claims being taken into account, is an impermissible interpretation. Accordingly, so the argument goes, it is not open to HMRC to take into account past accounting periods (in respect of which the taxpayer has made no claim) in which the taxpayer overpaid VAT in order to reduce the amount to be set off in consequence of repayments or credits by HMRC which should not have been made.

53. There are two preliminary points to make about the way in which section 81 (3) operates. First, it only applies where a claim for repayment has been made by the taxpayer under section 80 (2). So it is the taxpayer who chooses to invoke the statutory machinery. Thus in our case HMRC cannot initiate any action to recover the amount of payments made to the Trust in connection with the refurbishment, because (as is common ground) they are out of time under sections 73 and 77.

54. So the Trust's tax position is not open to challenge by the state unless the Trust chooses to invoke the statutory machinery. I agree with the Upper Tribunal at [102] that there is a fundamental difference between, on the one hand, a freestanding claim by HMRC to recover repayments which should not have been made and, on the other, the use by HMRC of those payments to reduce or extinguish a claim for repayment of output tax by the Trust. To allow the Trust to advance its claim for repayment without taking into account the fact that it has received from HMRC monies to which, as it turns out, it was not entitled would in my judgment breach the principle that the directive must be applied in full; and would have the result of separating what is "an inseparable whole".

55. Second, section 81 (3) only goes so far as to provide that HMRC's obligation to make a repayment is "discharged" to the extent of the set off. It does not go so far as to say that the application of the set-off could result in the taxpayer having to make a further payment of VAT to HMRC. So although the taxpayer may be better off as a result of a claim, he cannot be worse off.

56. It follows from these two points that it is up to the taxpayer to decide whether or not to make a claim; and one might expect that he would only do so where the balance of credit and debit is likely to result in a net payment to him. It also follows from the fact that it is the taxpayer who decides whether or not to make a claim that, subject to any limitation period, it is also his decision which accounting periods are to be included in the claim. In other words the taxpayer may, subject to any limitation period, himself "pick and choose". We can see this at work in what the Trust in fact did (or attempted to do). It chose not to make a retrospective claim for the period after 2000 for fear that the overall outcome would be disadvantageous to it.

57. Consistently with the principles of equality and legal certainty the legislation under scrutiny may impose limitation periods on a taxpayer's right to claim repayment of overpaid VAT. Those limitation periods must be long enough so as not to infringe the principle of effectiveness. Thus it follows that if a taxpayer fails to comply with a compliant limitation period (a) none of the applicable principles of EU law are infringed; but (b) the result will be that the taxpayer ends up paying more than the Directive actually requires. But that is because the taxpayer has failed to avail himself of a right given to him under the implementing legislation. He has not "picked and chosen" in time.

58. Accordingly I am not convinced that there is anything necessarily and intrinsically wrong with a power on the part of HMRC to "pick and choose". It is the obverse of the taxpayer's own right to "pick and choose". However, I need not reach a firm conclusion on that point because HMRC seek to uphold the interpretation adopted by the Upper Tribunal for the reasons that they gave (since that is the way in which they have applied section 81 (3) and (3A) in practice). They do not argue for a more generous interpretation.

59. The purpose of section 81 (3A) is, in my judgment, clear. It is that where a taxpayer makes a claim for repayment of VAT which has been paid owing to a mistake, all the consequences of the mistake are to be taken into account in assessing the quantum of his claim. That purpose is consistent with the overarching scheme of VAT under the Sixth Directive which treats the payment of output tax and the deduction of input tax as an "inseparable whole". This is borne out by section 81 (3A) (b) which deals with amounts payable "to or by" the taxpayer. It is clear from this that section 81 (3A) was intended to allow HMRC to take into account both credits and debits. It is not, therefore, simply concerned with past claims by the taxpayer for credit of input tax. In evaluating those claims HMRC are also to look at amounts payable "by" the taxpayer: in other words output tax. Section 81 (3A) (b) is not limited to particular accounting periods. The main limiting factor is that the payment "to or by" the taxpayer must derive from the same mistake as that which gave rise to the claim. Section 81 (3A) is not part of the general scheme of VAT accounting, which requires a direct and immediate link between an input and an output. Rather it is a special provision, which seeks to undo the consequences (and all the consequences) of the same mistake.

60. It is true that section 81 (3A) only disapplies time limits in favour of HMRC. But it does not do so in an unlimited way. There are in fact two limitations on the disapplication. The first, as mentioned, is that HMRC are confined to taking into account payments deriving from the same mistake. The second is that HMRC must credit the taxpayer with overpayments made by him. If section 81 (3A) is seen as a limitation on what would otherwise be HMRC's ability to set off rather than a disapplication of time limits in favour of the HMRC, then there is no difficulty with the grain of the legislation. Under the *Marleasing* principle there is no need for the national court to pinpoint the precise verbal interpolations needed to bring the national measure into conformity with EU law. In my judgment the interpretation adopted by the Upper Tribunal was well within the bounds of the principle.

61. In agreement with the Upper Tribunal I do not consider that this interpretation infringes the principle of legal certainty. The key points to my mind are that (a) it is up to the taxpayer whether to make the claim at all (b) it is up to the taxpayer to decide which accounting periods to put into his claim and (c) the outcome of the claim cannot result in the taxpayer having to pay anything more. Thus the taxpayer voluntarily subjects himself to the statutory process. That is quite different from a situation in which HMRC is able to initiate the process. In addition I agree with the Upper Tribunal that the principle of legal certainty is not an overriding one.

62. Unless HMRC has the opportunity to set off repayments (or credits) that it has made but should not have, the end result will be that the taxpayer will end up paying less by way of VAT than the Directive said that he should. That result would fail to give effect to the principles of EU law about the effect of direct applicability of directives. As in *Olimpiclub* the principle of legal certainty has to give way to the principle that a

directive must be applied in full and to the principle that the right to deduct is part of an "inseparable whole". I consider, therefore, that the Upper Tribunal were correct in rejecting this attack on their preferred interpretation.

63. The final point that troubled the Upper Tribunal was the problem that might arise if HMRC sought to bring into account accounting periods for which the taxpayer had no obligation to keep accounting records. That, they thought, might make it excessively difficult for the taxpayer to dispute the amount of a set-off claimed by HMRC. If so, there was a danger that the principle of effectiveness might be infringed. They attempted to square the circle by holding that the burden of proof shifted according to the age of the accounting period in question. At [97] they said:

> "Thus, whilst it could be expected that within the period for which domestic law requires records to be kept a taxpayer should have the onus of showing the amount of net effect of the relevant mistakes, in periods before this the onus of proof should be on the authority alleging otherwise - which would entail showing the net result was in its favour, not that there were only some periods in which that was the case. That approach we believe strikes the right balance between the full implementation of the Directive, effectiveness and legal certainty."

64. It is common ground that as a general rule the legal burden in tax appeals is on the taxpayer to prove his claim. I know of no principle that shifts the burden of proof according to the age of the accounting period in question. The Upper Tribunal's distinction strikes me as arbitrary. Moreover on the facts of this case the question does not arise because the facts are clear. If HMRC were to raise a defence of set-off they would, no doubt, have an evidential burden to surmount in order to advance the defence, which the taxpayer would then have to rebut. In deciding whether the taxpayer has succeeded in that task the tribunal would no doubt have regard to the difficulties of doing so, and make appropriate allowances. Moreover, in some cases the taxpayer may well have comprehensive records, even though he had no statutory obligation to keep them. In such a case there could be no justification for a rule that shifted the burden of proof. In my judgment this part of the Upper Tribunal's decision is wrong. However, the purpose of section 81 (3A) is clear, and its overall objective is plainly consistent with EU law. My disagreement with the Upper Tribunal on this point does not affect the outcome of the case.

Result

65. I would dismiss the appeal. The abuse argument does not arise. The result is clear. There is no need for a reference to the CJEU.

Lady Justice Sharp:

66. I agree.

Lord Justice Vos:

67. I also agree.