TC02250

Appeal number: LON/2008/0457, LON/2008/0682 & LON/2007/1677

PROCEDURE –applications for stay of proceedings pending two references to the CJEU – applications refused

FIRST-TIER TRIBUNAL
TAX CHAMBER

GANDALF IT LIMITED **Appellants**
(in administration)

GANDALF ASIA LIMITED
(in administration)

SIRRNET LIMITED
(in administration)

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at Bedford Square, London on 8 May 2012

On the appellants' applications to stand over their appeals until after the Court of Justice of the European Union ("CJEU") has handed down judgments in the cases of *Mahagében* C-80/11 and *Dávid* C-142/11.

Mr R. Holland, solicitor, of Dass solicitors for the Appellants
Mr S. Mehta, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

IT IS DIRECTED THAT:

1. the appellants' applications to stand over the appeals are refused.

2. there be a Pre Trial Review on the first available date after 29 June 2012.

DECISION

Introduction

1. The appellants appeal against HMRC's refusal to allow to them to reclaim input tax incurred by the appellants in VAT periods in 2006. The appeals are travelling together because of commonality of ownership / management of the appellants. HMRC say the appellants are part of closely connected network of companies whose pattern of trading was not commercial and the companies knew or should have known their transactions were connected with the fraudulent evasion of VAT. Accordingly the input tax reclaims are denied following the test established by the CJEU in *Kittel* C-439/04 and applied by the Court of Appeal in *Mobilx and others v HMRC* [2010] EWCA Civ. 517. The amount of input tax at stake is nearly £7.4 million.

2. This decision concerns the appellants' applications to stand over their appeals until after the CJEU has handed down judgments in the cases of *Mahagében* C-80/11 and *Dávid* C-142/11. These applications are contested by HMRC.

Stage reached in appeals before this Tribunal

3. I understand from the parties that the evidence has largely been served. HMRC having served replacement witness evidence (Officer Yeomans), the appellants were due to serve any further evidence in response to Officer Yeomans' material and/or to earlier supplemental evidence of HMRC by 29 February 2012, but had made applications to stay on 22 December 2011. Following closure of evidence the next step would be to finalise the pre-hearing directions and list the matter for hearing. Mr Mehta has indicated a time estimate in the order of 3 weeks to hear all 3 matters. Given the additional challenges of listing cases of this length it is likely that the case would not come on until some time next year.

Tribunal's discretion to stay

4. Under Rule 5(3)(j) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, the Tribunal has discretion to stay (or in Scotland, sist) proceedings. In terms of the test which I should apply I was referred to the decision of the Inner House of the Court of Session in the case of *HMRC v RBS Deutschland Holdings GmbH* [2006] ScotCS CSIH 10 and in particular the test suggested there of first considering whether the decision in the other case would be of material assistance to resolving issues in the current matter, and then considering whether it was expedient to order a stay.

5. The test was expressed by the Court as follows:

> "a Tribunal or court might sist proceedings against the wish of a party if it considered that a decision in another court would be of material assistance in resolving the issues before the Tribunal or court in question and that it was expedient to do so."

6. I was also referred by the parties to a number of First-tier Tribunal decisions dealing with applications to stay of similar appeals behind similar CJEU references which amongst others included *Mahagében* and *Dávid*. These decisions were *Unistar Group Limited v HMRC* MAN/07/1441, *Matrix Europe Limited v HMRC* MAN/07/0671, *C Narain Bros v HMRC* [2012] UKFTT 188 (TC), *Teletape v HMRC* LON/2007/1244 and LON/2007/915, and *Enta Technologies Limited v HMRC* TC/2011/4444.

Would a stay materially assist the Tribunal in resolving issues in these proceedings?

7. In relation to the first test of material assistance Mr Mehta drew attention to the particular formulation given in *RBS Deutschland.* The test was whether the decision in the other court *will* materially assist in resolving issues. Given the inherent uncertainties in predicting what another court might decide and on what basis I do not understand the court in *RBS Deutschland* to mean that there must be absolute certainty that the case will assist. Rather, the judgment's reference to "would be of material assistance…" indicates I think that where there is a high degree of probability that the decision would materially assist in resolving issues, then that would be a reason, subject to expediency considerations, to ordering a stay.

8. Having said that I hesitate to interpret the test set out in *RBS Deutschland* in the rigid terms that if there is *not* a high probability then that is the end of the matter given the context in which the test operates is that of a general case management discretion accorded to the Tribunal. The reference to "might" in the extract at paragraph 4 above suggests that it was not thought that a Tribunal *must* order a stay if the two part test was satisfied. Also, given that even if the material assistance test is established, there will be other factors to throw into the balance, I suggest it is appropriate to consider the level of probability of material assistance and weigh that in the scale in deciding whether or not to order a stay. That means the higher the likelihood of material assistance the stronger the case for ordering a stay subject to taking into account any other relevant factors. I do not think this approach is inconsistent with *RBS Deutschland*. In particular, it does not fall foul of error of law highlighted there which was that it was wrong of the Tribunal in that matter to insist that the court decision awaited for should be determinative of the issues.

Does Mynt bind the Tribunal?

9. Mr Holland submits that I am bound by the Upper Tribunal decision in *Mynt Limited & Others v HMRC PTA/140/2011* not on the basis of the particular facts of that matter but on the basis of the legal issues which were put to the Upper Tribunal there. The determination there was that the referred decisions "may provide answers of relevance to the outcome..." of the appeals which were under consideration there. That determination is something I take into account but I disagree that *Mynt* binds me to finding that the material assistance test is made out for the purposes of these applications to stay.

10. The nature of the proceedings being stayed is I think relevant to the question of material assistance. The material assistance to be derived in the context of fact finding proceedings such as these ones, being appeals before the First-tier Tribunal, are different from the material assistance to be derived in the context of proceedings which are predicated on an appeal on a point of law as was the case for the appeals to the Upper Tribunal and the permissions to appeal to the Upper Tribunal in *Mynt*. In any case the level of probability as expressed in *Mynt* falls short of the high probability of assistance I suggest was envisaged in *RBS Deutschland* to indicate a stay might be appropriate, subject to expediency. At best, even if *Mynt* were binding, it would only indicate the CJEU references *may* be of relevance.

11. I was referred to the First-tier Tribunal decision in *Enta Technologies Limited* where *Mynt* was regarded as binding. That does not lead me to alter my conclusion above. As pointed out by Mr Mehta a concession was made there by the party opposing the stay on the point of material assistance which is not made here.

Degree of probability of material assistance

12. I therefore must consider the degree of probability that the decisions in *Mahagében* and *Dávid* will materially assist the Tribunal in these cases in resolving the issues in these appeals.

13. Mr Mehta in his skeleton drew attention to the very different factual scenarios of the references. *Mahagében* concerns a timber trader in possession of otherwise valid VAT invoices for the supply of logs where the Hungarian authorities considered the alleged supplier could not have fulfilled the order and sought to deny the right to deduct input tax on the basis that the invoices could not be regarded as authentic. *Dávid* raises the question of whether the right to deduct input tax can be denied on the basis that the issuer of an invoice for the construction of a dam could not guarantee the involvement of further subcontractors and such that the invoices they had issued complied with the requisite formalities.

14. Different factual scenarios are not in themselves a reason to refuse the stay. I must consider the questions of interpretation referred to the CJEU and the likelihood that the CJEU, in answering the questions referred, would uncover issues of legal principle which will materially assist in the resolution of the issues in the appeals before the Tribunal.

15. I have already dealt with Mr Holland's primary submission that the Tribunal is bound by *Mynt* above. But, his submissions also made it clear that the appellants wish to stay is founded on the expectation that the CJEU will deal with a particular legal point of principle namely whether HMRC may deny the right of the taxpayer to recover input tax only where there is privity of contract between the taxpayer and the fraudulent trader.

16. Mr Holland referred to me to the 3 questions referred to the CJEU in *Mahagében* (annexed to this decision) and the 3 questions referred to the CJEU in *Dávid* (set out at [18] below). Mr Holland suggested that only one of the questions, the third question in *Dávid*, could be said to speak to the principle in *Kittel*. The three questions are inter-linked so I set out all of them below. In the course of his submissions on the likelihood of the CJEU tackling this issue Mr Holland also asked me to consider certain questions which had been raised by the European Commission in the context

of the CJEU proceedings as well as observations he states were made by the UK. The Commission observations and details of the UK observations were not before Judge Bishopp when he gave his decision in *Mynt* and Mr Holland invited me to find that both sets of observations make it more likely to be the case that material assistance will be provided than would have been apparent from just looking at the actual questions referred.

17. In relation to the Commission's proposed answers to the questions referred to the CJEU, Mr Holland referred to me an unofficial translation of those as taken from the French language version of the Judge Rapporteur report.

18. I should point out that there was some discussion at the hearing over the fact the translation of the Commission's answer to the second question did not make sense in English in particular because of the inconsistency of the sentence containing both the words "nor can" and "cannot". I note a virtually identical unofficial translation of this text was also put before the Tribunal in *Teletape* which omits the "cannot" which gives rise to difficulties of sense and have used that version for the second question. This version is also more consistent with the sense of the subsequent paragraph which begins "on the other hand…" (I have placed the "cannot" in the version which was before me in square brackets.) In the event, given what I say below on the relevance of the Commission observations to the application before this Tribunal little, if anything, turns on this translation issue.

> *Question referred*
>
> "1. Are the provisions relating to VAT deductions in Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, as amended by Council Directive 2001/115/EC of 20 December 2001 ('*the Sixth Directive*') and, as regards 2007, in Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax to be interpreted as meaning that the right of deduction of a taxable person may be restricted or prohibited by the tax authority, on the basis of strict liability, if the invoice issuer cannot guarantee that the involvement of further subcontractors complied with the rules?"
>
> *Unofficial translation of Commission's suggested answer*
>
> Articles 167, 178, 220 and 273 of Directive [2006/112] and Article 17, 18(1) and 22(8) of the Sixth Directive must be interpreted in conformity with the principles of proportionality, neutrality and legal certainty, such that they do not permit national legislation or administrative practice which, as regards "necessary precautions"; makes the right to deduction conditional upon the recipient of the invoice proving that the company drawing up the invoice respected its legal obligations, and in that regard establishes an objective responsibility on the part of the recipient of the invoice.
>
> *Question referred*

> "2. Where the tax authority does not dispute that the economic activity detailed in the invoice actually took place, nor that the from of the invoice complies with the legal provisions, may the authority lawfully prohibit a VAT refund if the identity of the other subcontractors used by the invoice issuer cannot be determined, or invoices have not been issued in accordance with the rules by the latter?"
>
> *Unofficial translation of Commission's suggested answer*
>
> "Nor can the right of deduction of VAT [cannot] be affected by the fact that the taxpayer knew or could have known that; in the supply chain in which his own transaction – not itself tainted with fraud – was carried out, another transaction either before or after the said taxpayer's transaction, amounted to VAT fraud or another violation."
>
> *Question referred*
>
> "3. Is a tax authority which prohibits the exercise of the right of deduction in accordance with paragraph 2 obliged to ensure during its procedures that the taxable person with the right of deduction was aware of the unlawful conduct, possibly engaged in for the purpose of tax avoidance, of the companies behind the subcontracting chain, or even colluded in such conduct?"
>
> *Unofficial translation of Commission's suggested answer*
>
> "On the other hand, once it is established, in the light of objective elements, that the delivery is made to a taxpayer who knew or ought to have known that, in making the purchase, he was participating in an operation that was part of [literally "implicated in"] VAT fraud, it is at the point possible to refuse the right of deduction."

Commission observations and their relevance

19. The relevance of the Commission observations needs to be put into the context of the CJEU proceedings. While the observations will no doubt put before the CJEU the perspective of the Commission and may, as Mr Holland pointed out, raise matters of general importance from a Community point of view which might not otherwise have been brought to the CJEU's attention, the CJEU is under no obligation to reframe the scope of its questions or to specifically address the Commission observations in giving its judgment. This is consistent with Article 63 of the Court's Rules of Procedure, which contains the mandatory contents for the judgment, and beyond a requirement to state the grounds for the decision and the operative part of the judgment, says nothing about the judgment being required to address the observations the Commission have made. *Kittel* is an example of a judgment which, while it records the Commission's observations, does not then specifically deal with the points raised.

20. In addition when it comes to the content of the Commission observations while this is not directionally inconsistent with the finding in *Mynt* that the references may be of assistance to the proceedings I do not agree that they make it more likely that

the reference will be of material assistance to the proceedings before this Tribunal. The likelihood of the CJEU finding that privity of contract is essential to the application of *Kittel* is analysed at [27] – [33] of *Teletape.* I agree with what is said there that it seems very unlikely that the CJEU would diverge from its earlier decisions in *Kittel* and *Optigen & ors* C-484/03 and rule that privity of contract is a prerequisite to liability under *Kittel.* Even if the Commission observations can be interpreted as suggesting that privity of contract is required between the defaulter and the taxpayer, which is by no means clear, the likelihood of the CJEU adopting that approach and thereby, in Mr Holland's submission rendering fact-finding on actual or constructive knowledge of fraud irrelevant, is low.

UK observations at oral hearing of Mahagében and Dávid and their relevance

21. Mr Holland referred to me to correspondence between himself and HMRC in which he had sought confirmation that a summary of the points he understood had been raised by the UK in its oral submissions to the CJEU was correct. These included points stressing the importance of *Kittel* and *Optigen* and a caution against departing from the general principles in those cases. HMRC not having availed itself of the several opportunities to correct the summary, Mr Holland invited me find that the summary recorded the UK submissions at the hearing. This was on the basis that the submissions were relevant to the question of whether the references would offer material assistance in resolving issues.

22. From the correspondence it is clear to me that HMRC responded to Mr Holland did not confirm the summary was correct. I decline to make the finding I am invited to in those circumstances. But, in any case even if the summary is correct I do not think it would change my view on the probability of material assistance being derived from the references. Probably even more so than with the Commission observations there is no indication one way or the other that the CJEU would choose to specifically deal with points raised by a Member State in its judgment. Further, even if the observations were addressed they would appear to point the CJEU towards confirming privity of contract between the taxpayer and the defaulter was not required.

Conclusion on likelihood of material assistance

23. While it cannot be ruled out that the CJEU decisions may be of material assistance in so far as its is possible they may recall or review the legal principles underpinning the current appeals, I find the likelihood that those decisions will materially assist resolution of issues in these appeals, and in particular that they will require there to be privity of contract between the taxpayer and defaulter to be low.

Expediency

Prejudice if stay not ordered

24. Mr Holland submits that if the CJEU decisions are answered in the way suggested by the Commission answers, with the effect that privity of contract is required between the taxpayer and the defaulter, findings of fact on actual or constructive knowledge will not be of any relevance. The prejudice in not ordering a stay in such circumstances lies in the significant wasted time and costs of the parties in preparing

for a lengthy hearing, and the wasted time of the parties and the Tribunal in hearing the matter unnecessarily.

25. It was not put to me that this was a case where the CJEU decisions would be likely to give rise to the need to file additional evidence so there are not additional resources issues flowing from further evidence gathering to weigh in the balance as there might be in other cases.

26. I have found above that the probability of the CJEU decisions requiring privity of contract is low but even if that were not the case and the probability were higher it would still seem necessary for the prejudice to the parties and the Tribunal of proceeding with the stay and issues such as deterioration of evidence to be weighed in the balance. In conducting this weighing exercise I need to consider the likely length of the delay occasioned by the proposed stay.

Likely length of delay if stay ordered

27. Mr Holland emphasised that in contrast to other applications for stay that had come before the First-tier Tribunal which had asked for a stay behind a number of the other cases mentioned in *Mynt* the appellants here were only asking for a stay behind the two specific cases. There had been an oral hearing on *Mahagében* and *Dávid* back on 15 March 2012, no Advocate General opinion had been sought which was anticipated to speed matters up, and Mr Holland estimated the decision could well be given by October of this year. He acknowledged his suggestion that the decision would be made in October was based on his experience of waiting for CJEU decisions rather than on particular piece of intelligence. Noting that other First-tier Tribunal decisions on similar applications to stay had expressed reservations about the unpredictability of the length of the stay I understood Mr Holland to be inviting me, if I had similar concerns, to order a stay not by reference to the decisions but until October this year. Mr Mehta raised the possibility that the CJEU might choose to defer giving its judgment in *Mahagében* and *Dávid* until the other associated references mentioned in *Mynt* had progressed. Mr Holland suggested there was no reason to think the CJEU would adopt that approach.

28. Beyond it being possible in principle that the CJEU might choose to hold off making its decision pending the other associated references there was no particular material before me to lead me to believe that that was a likely outcome. In the absence of any evidence to the contrary on timing I do not think Mr Holland's estimate is unreasonable and for the purposes of these applications to stay will proceed on the assumption that the CJEU decisions would be given by October 2012 or at the very least by the end of the year.

Impact of timing of CJEU decision on prejudice in terms of wasted resource in hearing time and preparation

29. While the evidence round in this case is not complete the proceedings are already fairly advanced, the bulk of the evidence has been served, and the parties are in a reasonable position to give a rough time estimate for the hearing. As mentioned above at [3] Mr Mehta suggests this is in the order of 3 weeks. Mr Holland did not dispute that figure and in any case his submissions on the issue of expediency and the worry that significant hearing costs will be unnecessarily incurred indicate to me that it is not in issue that the hearing will be relatively lengthy. Given the capacity of the

Tribunal, and the Tribunal's experience in listing cases of this kind of length it is very likely that the hearing of these appeals would not come on until some time in 2013.

30. That means it is highly likely that, if the CJEU decisions came out in October those decisions could be taken account of appropriately in the preparation of submissions in the run-up to the hearing and at the hearing itself. In terms of the resources spent in dealing with the outstanding issues of evidence, in the unlikely event those did prove to be wasted, I do not understand those resources to be significant in the context of the appeals as a whole.

Impact of timing of CJEU decision and prejudice in terms of deterioration of evidence

31. As is typical with appeals of this nature it is anticipated that there will be a significant amount of oral evidence that will need to be given on behalf of the parties. The transactions having taken place in 2006, witnesses will be called upon to recall matters which happened nearly 7 years ago by the time the hearing comes on. I understood Mr Holland's submissions on this point to be to the effect that the prejudice is more acute to the appellants. HMRC witnesses are likely to speak to documents drawn from a centralised database and are often replaced by officer colleagues. This mitigates the prejudice caused officers moving on as time goes on. The appellants were however less able to make use of replacement evidence when witnesses move on. The appellants would rather suffer the prejudice to them if it meant the proceedings could have the benefit of the law being applied as determined by the CJEU decisions.

32. I am not persuaded the appellants are prejudiced by the delay to a greater extent than HMRC or that even if they were that this would be something they can effectively ask the Tribunal to waive. Mr Mehta mentioned that not all of HMRC's evidence was of the character suggested by Mr Holland, HMRC do have witnesses who attest to their dealings with the appellants. A similar point about the appellant suffering greater prejudice was also made in the application before Judge Canaan in *Enta Technologies Limited.* In my view his response at [20] applies equally here. The response was to the effect that impairment to the appellant's evidence may also prejudice HMRC in conducting effective cross-examination of the witnesses, given that it will be for HMRC to, amongst other matters, establish the appellants knew or should have known of the connection to fraud.

33. Further I agree with Mr Mehta that it is not enough to consider the prejudice to the parties, the Tribunal also has an interest in having the best evidence put before it so far as possible. That becomes more difficult with the passage of time where oral evidence is in issue. The fact that the delay occasioned by a stay is of a more limited period than may have been the case in other applications to stay before the Tribunal does not detract from there being prejudice which is avoidable. It does not change my view that concerns about prejudice in terms of evidence becoming stale are of significance.

34. If it turns out that the CJEU decisions are received later than the end of the year then that would only in my view serve to increase the prejudice in terms of deterioration in evidence. If the decisions were received significantly later, so much so that the hearing in the appeals would already have taken place that would not alter my conclusion. The likelihood of the CJEU decisions rendering the fact-finding unnecessary and any ensuing prejudice in terms of wasted resource is insufficiently

high to counter-balance the prejudice in terms of the evidence which is put before the Tribunal.

Conclusion

35. There is a probability that the references will materially assist in resolving the issues, but this is low. There is prejudice, not just to the parties, but to the Tribunal in having evidence before it which will become increasingly stale with further delay. In terms of resources being spent unnecessarily, the bulk of the evidence has largely been served and it is quite likely that the CJEU decisions will be received before the hearing of these appeals in any event. Taking all of these factors into account it would not, in my view, be fair and just to stay these proceedings.

36. The appellants' applications to stay are dismissed.

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

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 31 August 2012

Mahagében Kft v Nemzeti Adó és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága

(Case C-80/11)

Questions referred

1. Must Directive 2006/112/EC (1) be interpreted as meaning that a taxable person who fulfils the material conditions for the right to deduct VAT in accordance with the provisions of that Directive may be deprived of his right to deduct by national legislation or practice that prohibits deductions in respect of VAT paid when a product is bought, where the invoice is the only valid document that confirms that the product was sold, and the taxable person is not in possession of any document from the issuer of the invoice which certifies that it was in possession of the product, and could have supplied it or satisfied its obligations as regards declaration? May a Member State require the recipient of the invoice to be in possession of a document proving that it is in possession of the product, or that the product was supplied or delivered to it, to ensure the correct collection of VAT and to prevent evasion under Article 273 of the Directive?

2. Is the concept of due diligence set out in Paragraph 44(5) of the Hungarian Law on VAT compatible with the principles of neutrality and proportionality already upheld several times by the European Court of Justice in connection with the application of the Directive if, in applying that concept, the tax authority and established case-law require the recipient of the invoice to ascertain whether the issuer of the invoice is a taxable person, whether it has entered goods purchased in its records and is in possession of the purchase invoice, and whether it has satisfied its obligations as to declaration and payment of VAT ?

3. Must Articles 167 and 178(a) of the Directive 2006/112/EC on the common system of value added tax be interpreted as meaning that they preclude national legislation or practice that requires a taxable person receiving an invoice to verify compliance with the law by the company issuing the invoice in order for the former to assert his right to deduct?