[2017] UKFTT 410 (TC)

# TC05874

**Appeal number: TC/2014/4640**

***VAT – appellant incorrectly treated standard rated contract as zero rated – customer insolvent – HMRC assessed VAT on net amount received from customer – whether any directly enforceable right infringed by assessment of 'windfall' to HMRC – no – whether tribunal has jurisdiction to consider HMRC's decision to assess – no – whether assessment of 'windfall' not to best judgment – no - appeal dismissed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**J & B HOPKINS LTD** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE BARBARA MOSEDALE**

**Sitting in public at the Royal Courts of Justice, the Strand, London on 25 October 2016 with later written submissions, the last being received on 9 and 24 March 2017.**

**Mr T Brown, Counsel, for the Appellant**

**Mrs J Ashworth, HMRC presenting officer, for the Respondents**

DECISION

## The facts

1. The facts were not in dispute. I find as follows:

2. In 2009, the appellant entered into a construction contract with Rok Building Ltd ('Rok'). Under this contract it agreed with Rok to construct a new place of worship for a charity. Rok was the main contractor, in that it had contracted with the charity to build the place of worship.

3. The appellant commenced work under this contract on 23 September 2009. Payments were made to the appellant by Rok and over the period from 6 November 2009 to 5 November 2010 the appellant issued Rok with 11 invoices.

4. On 8 November 2010 Rok was placed in administration; on 6 November 2012 it was placed into liquidation. The appellant's contract with Rok ended when Rok went into administration; in practice, the appellant took over Rok's position as main contractor and thereafter made its supplies direct to the charity.

5. HMRC undertook a compliance visit on the appellant in 2013 and the result of this was that two assessments were issued on the appellant, one on 10 January 2014 for £26,397.00 and one on 21 January 2014 for £373,846.00, both assessing the appellant to VAT on the supplies it made to Rok.

6. The reason for the assessments was that the appellant had treated its supplies to Rok as zero rated. It did this because Rok had provided the appellant with a zero rating certificate. In fact, the zero rated certificate was issued by the charity to Rok and was not even addressed to the appellant; in any event Note (12) of Schedule 8 Group 5 of the Value Added Tax Act 1994 ('VATA') means that only a supply by a main contractor could be zero rated. As is now accepted by the appellant, its supply to Rok was standard rated.

7. But, as I have said, in ignorance of the position as outlined in the previous paragraph, the appellant had treated its supplies to Rok as zero rated and did not charge VAT on any of the invoices issued to Rok, and still has not issued VAT invoices to Rok.

8. The appellant also treated its supplies after 8 November 2010 to the charity as zero rated, but HMRC have accepted a retrospective zero rating certificate issued by the charity to the appellant as at that point the appellant became the main contractor. The VAT status of those supplies as zero rated is therefore not disputed by HMRC and the assessment does not relate to them.

9. The appellant applied for ADR in respect of the assessments which charged it the VAT on its supplies to Rok, but was refused; it then requested a review of the

assessments. The assessments were upheld on 24 July 2014 and the appellant then appealed to the tribunal.

10. The contract between Rok and the appellant was VAT exclusive so it follows that Rok owes the appellant an amount equal to the VAT which the appellant should have charged on the net amount which Rok paid. Both parties were content to assume that Rok did not recoup any of this VAT from HMRC. The contracts were zero rated at Rok's instigation so it did not have any VAT invoices on which to recover the VAT now assessed on the appellant. Therefore, I find, as it is far more likely than not, that Rok did not recover any VAT from HMRC in relation to the supplies at issue in this appeal.

11. HMRC also did not dispute the appellant's case that Rok's assets had been realised and distributed to its creditors and HMRC accepted the claim that the appellant had against Rok for the unpaid VAT due under the contract would never be paid in whole or part.

12. The appellant accepted that it was not entirely blameless in this matter: it should not have accepted the zero rating certificate as valid. If it had checked out the legal position with HMRC in advance of invoicing Rok, it would have known that it was liable to account for VAT on its supplies to Rok and would have done so. Rok would have recovered this VAT from HMRC as that VAT would have been directly attributable to its zero rated supplies to the charity. The VAT would have washed through; instead, unable now to recover an amount equal to the VAT from Rok, the appellant is faced with 'sticking' VAT on a transaction which should have had a nil net VAT position.

**The dispute**

13. Some elements of the assessment do not relate to the above supplies to Rok and are not in dispute. What is in dispute is the amount charged to the appellant on the basis it should have accounted for VAT on its supplies to Rok but failed to do so. That amounted to a total of £319,073.85 although that assessment has now been recalculated and reduced by around £98,000. Both parties were agreed that the assessment as it stands is effectively calculated on a VAT inclusive basis. In other words, the appellant stands assessed to VAT on the basis that the amounts actually paid by Rok included the appropriate percentage of VAT.

14. The appellant accepts that it was not entitled to zero rate its supply to Rok. Nevertheless, it appeals against the assessment on the basis that HMRC would be unjustly enriched by the appellant's payment of the assessment. HMRC applied for the appeal to be struck out on the basis it was outside the jurisdiction of the Tribunal.

15. I heard that application on 3 June 2017 and refused to strike out the appeal: the appeal was against an assessment and it was clear that the Tribunal has jurisdiction to hear appeals against VAT assessments. There may have been an issue whether the appellant's grounds of appeal had any prospect of success but HMRC had not applied to strike out the appeal on that basis nor were the parties in a position to argue it: I

directed that the appeal be heard on a later date and it came back before me on 25 October 2016. After that hearing, further submissions were requested, with the last being received on 9 and 24 March 2017.

*The appellant's case*

16. Had the appellant, as it ought to have done, charged VAT to Rok, it is accepted that Rok would have been entitled to recover the VAT from HMRC. The VAT would have recoverable by Rok as it was directly attributable to an onwards taxable (albeit zero rated) supply of the services by Rok to the charity.

17. The appellant's point is that if HMRC are able to maintain the assessment against the appellant, HMRC will obtain a windfall of the amount of the assessment, because HMRC would have been in a nil net VAT position if the appellant had actually invoiced the VAT to Rok when it should have done. The VAT would have washed through: the 'sticking' VAT on the appellant amounted, says the appellant, to a windfall on HMRC.

18. The appellant says that such a windfall is incompatible and inconsistent with the fundamental principles on which VAT law is based. The root of the UK's VAT law is the Principle VAT Directive ('PVD') (superseding the earlier Sixth VAT directive - 6VD). The basis of the 6VD and PVD is that the state should receive an amount equal to VAT on the price paid by the final consumer (see, as an example of this principle in action, *Elida Gibbs* (1996) C-317/94). Here, says the appellant, there was no VAT on the price paid by the final consumer, the charity, as the supply to it by Rok was zero rated. So the amount of the sticking VAT on the appellant is the amount of the windfall on HMRC and an amount to which under the PVD/6VD it is not entitled.

19. The appellant also made out a case based on UK VAT law, and that case was that the assessment was not to HMRC's best judgment as it was made without considering Rok's insolvency and the resulting windfall on HMRC.

**The appellant's case based on EU VAT law**

20. The appellant is wrong to say that in all cases a tax authority is not entitled to a windfall, or not entitled to receive an amount of VAT which exceeds the VAT on the final price paid by the consumer. It is clear, on the contrary, that other underlying principles in the PVD/6VD, such as enforcement, can lead to a tax authority being entitled to retain a 'windfall'. For instance, it is entitled to retain VAT shown on an invoice even where a supply has not taken place unless it is proved by the appellant that there was no risk to the exchequer of the VAT being recovered: *Stadeco (C-566/07)*.

21. So the appellant cannot succeed simply by relying on the principle set out in Art 1(2) of the PVD: to succeed on its case under the PVD it seems to me that the appellant must succeed in showing one of two alternatives: either that it has a directly effective right not to be assessed or that it has a claim against HMRC which

effectively cancels out the assessment. I was referred by the appellant to the case of *Reemtsma* (2007) C-35/05 in support of its case: but does this case establish for an appellant in the position of the appellant a right not to be assessed and/or a claim against HMRC which can be offset against the assessment?

*Reemtsma*

22. In that case a German company paid VAT to its Italian supplier on a supply on which VAT was charged when no VAT was due. The German company sought to recover the VAT from the Italian tax authority under the Eighth Directive but the CJEU said it was not entitled to do this. The CJEU went on to say that, while usually a customer who paid VAT when no VAT was due would have no rights to recover VAT from the tax authority but must rely on its right to recover VAT from its supplier, nevertheless

> [41]...if reimbursement of the VAT becomes impossible or excessively difficult, in particular in the case of the insolvency of the supplier, those principles [ie neutrality and effectiveness] may require that the recipient of the services to be able to address his application for reimbursement to the tax authorities directly.....

23. The CJEU has applied this decision on a number of occasions. For instance, in *Danfoss* (2011) C94/10, the supplier passed on the cost of excise duty to its customer. When it became apparent that the excise duty was not due, the customer then sought to recover the duty directly from the tax authorities rather than its supplier. The CJEU's decision was:

> a Member State may oppose a claim for reimbursement of a duty unduly paid, brought by the purchaser to whom that duty has been passed on, on the ground that it is not the purchaser who has paid the duty to the tax authorities, provided that the purchaser is able, on the basis of national law, to bring a civil action against the taxable person for recovery of the sum unduly paid and provided that the reimbursement, by that taxable person, of the duty unduly paid is not virtually impossible or excessively difficult

24. But it must be borne in mind that these cases are suggestive but not directly comparable to the issue in this appeal. They concerned customers which paid VAT to their supplier which was not due: this case concerns a supplier who failed to pay to HMRC VAT which was due to HMRC.

*Reemtsma in the UK: the Premier Foods case*

25. There is no doubt that *Reemtsma* does create directly effective rights justiciable in the UK. It was applied, for instance, in the case of *R (oao Premier Foods) v HMRC* [2015] EWHC 1483 (Admin). In that case, the supplier (Q) incorrectly charged the taxpayer (PF) VAT on a zero rated supply. PF recovered the VAT as input tax from HMRC while Q had accounted for VAT to HMRC. Later, Q made a claim to recover VAT from HMRC; HMRC assessed PF for the input tax.

26. If PF had been able to reclaim the VAT from Q, the circle of repayments could have been completed and no one would have been out-of-pocket, but Q went into administration and it was accepted that PF would be unable to recover much, if anything, of the VAT it had overpaid to Q.

27. The result, if HMRC repaid Q and assessed PF, would be that PF would be out of pocket in the amount of the VAT, and Q's creditors would have effectively have received a windfall.

28. The administrative court ruled that it would be improper for HMRC to repay Q in these circumstances as that would amount to unjust enrichment of Q (because Q would not repay the VAT to PF) and the assessment on PF was quashed. This must have been because *Reemtsma* gave PF a directly effective right against HMRC for repayment of the VAT it had overpaid Q, so that this right of repayment cancelled out the assessments, leaving PF in a VAT -neutral position.

29. At §23 the Judge indicated that PF could have defended the assessment in the VAT Tribunal: it only needed to bring a judicial review action because it was challenging HMRC's decision to repay Q. This indicates that the judge thought that a Tribunal, if satisfied HMRC should not repay Q, could have allowed PF's appeal.

*Does Reemtsma only apply to customers?*

30. As I have said, the above cases consider the position of a customer; they do not consider the position of a supplier, such as the appellant in this case. A case which did consider the position of the supplier was *Banca Antoniana Popolare Veneta SpA* [2011] EUECJ C-417/10. In that case the supplier charged a supply to VAT when it was outside the scope: its customers were in time to make a claim for repayment of overcharged VAT against the supplier, but the supplier was out of time to reclaim the overpaid tax from the tax authority. The Court ruled:

> [28] The court has held, however, that where reimbursement of the VAT would become impossible or excessively difficult, the Member States must, in order to respect the principle of effectiveness, provide the instruments necessary to enable the recipient of the services to recover the tax which was invoiced but not due ...[citing *Reemtsma*...]
>
> [29] Those same considerations must prevail where the fact that it is impossible or excessively difficult to obtain reimbursement of the VAT paid but not due affects, not the recipient of the services, but the provider.

31. In other words, the *Reemtsma* principle can apply for the benefit of a supplier as much as for a customer. The tax authority had to repay overpaid VAT to the supplier where the claim was out-of-time because the claims by the customers against the supplier were not out-of-time.

32. But again this case is not directly comparable to the appellant's position in this appeal because in *Banca Antoniana* the supplier was seeking to recover <u>overpaid</u> VAT: here the appellant seeks to avoid liability on an assessment of VAT which

assessed it to VAT which was due but unpaid. I'll consider in depth whether there are principles in these four cases which can be applied to assist the appellant, a supplier who owes unpaid VAT.

*Analysis*

33. What does *Reemtsma* mean? It seems to be saying that where a mistake is made, and VAT charged which should not have been charged, the national law ought to provide a route for this incorrect charge to be reversed up the chain, but, where due to something like insolvency or time limits, it ceases to be possible to reverse the incorrect payment of VAT, the insolvent party can be cut out of the chain, or the time limit disapplied, as appropriate.

34. So in *Reemtsma* itself, it allowed the customer to reclaim the overpaid VAT directly from the German tax authority, cutting out the insolvent supplier's right to the reclaim; in *Danfoss,* as the supplier was not insolvent, the customer had to make its reclaim against its supplier; in *Premier Foods,* it led to the assessment for overpaid input tax being quashed as it was offset against PF's direct *Reemtsma* claim against HMRC for the overpaid VAT. In *Banca Antoniana*, the tax authority was obliged to repay overpaid VAT out-of-time to the supplier because under national law its customer was still in-time to claim against the supplier.

35. So *Reemtsma* is about allowing repayments of overpaid VAT to flow through the chain. Has it got any application to a situation where VAT has been underpaid? Whether VAT is overpaid or underpaid there is a 'chain' of over or underpayment, and the mechanisms to put right an underpayment can be blocked by timing issues or by insolvency as much as the mechanisms to put right an overpayment. And that indeed is what has happened to the appellant in this case: if it were not for Rok's insolvency, the appellant would simply have claimed an amount equal to VAT on the contract price from Rok (as the contract was VAT exclusive), and Rok would have been entitled to recover VAT on the purchase price from HMRC. The chain could have been completed.

36. But this mechanism is blocked because the chain is broken by Rok's insolvency. HMRC accept that in practical terms the appellant would receive nothing from Rok if it were to sue on the contract for its right to be paid the VAT (which it has not been paid) on top of the net price (which it has been paid). It seems to me that the appellant's case amounts to saying that *Reemtsma* means that Rok should be cut out of the chain of payments.

37. This is because, even if HMRC refunded the input tax to Rok, Rok would pay nothing to the appellant. Any monies paid to Rok would be for the benefit of all its creditors. But if Rok is cut out of the chain of payments under *Reemstma,* the repayment of input tax which HMRC would owe Rok would be owed instead to the appellant. That would entirely offset the overpaid VAT which the appellant owes to HMRC. That would result in a nil liability on the appellant: neither Rok nor HMRC would obtain a windfall and the appellant would not be out of pocket.

38. But is this right in law? Can *Reemstsma* apply in such a situation?

*Does Reemtsma apply to underpayments?*

39. But is it right to apply *Reemtsma* to an underpayment rather than a repayment? Superficially chains of overpayment are mirror images of chains of underpayment, but in law they are not. Where a zero rated supply is treated as standard rated, the amount paid on top of the net price is overpaid VAT. But where a standard rated supply is treated as zero rated, the amount that is actually paid partially comprises consideration (ie price) and partly VAT. While colloquially this situation may be described by saying 'they failed to add VAT to the price', the money actually paid in law includes a VAT element. In other words, the supplier must account for VAT on the money actually paid to him. What has really happened is that the contract price was too low: the supplier has simply charged or collected too little from his customer, but what he did collect included the VAT percentage.

40. So far as the appellant is concerned, what Rok paid to it contained no element of VAT. But so far as the PVD and VATA is concerned, the appellant is liable to account for VAT on any sums paid to it. To explain this point further, it is fundamental principle of the common system of VAT introduced by the 6VD and PVD that VAT involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods or services. The VAT Act, in compliance with this EU law, provides that where a supply is made for a consideration, its value is the amount that, with the addition of the VAT chargeable, is equal to the consideration.

41. So when Rok paid the appellant, the amount paid included an amount of VAT (albeit neither Rok nor the appellant appreciated this at the time because they considered the supply to be zero rated).

42. What has happened is that there is a bad debt for the difference between what the customer actually paid and what the customer actually owes. The VAT element of that bad debt is recoverable from HMRC under the bad debt relief rules. The problem for the appellant is that that bad debt relief only relieves it of liability for the VAT element of the unpaid amount. Moreover, in this case HMRC have already allowed the appellant a relief equivalent to BDR because, although the contract is VAT exclusive, they have reduced the assessment so that they are only claiming VAT on the amount actually paid. They are legally right to have made this concession: if they had not, the appellant would be entitled to be relieved, under the BDR rules, of liability to VAT on the unpaid element of the price.

43. Put another way, while the appellant sees itself as unable to reclaim the entire VAT amount from its customer, as a matter of law, the customer has paid 4/5ths of what it owed, and $1/5^{th}$ of what it actually paid was VAT (albeit neither party appreciated this at the time). And that $1/5^{th}$ is owing to HMRC and has been assessed by HMRC. The appellant is liable to pay it.

44. Moreover, Rok has paid that amount of VAT to the appellant (although the appellant does not see it like that) and Rok would ordinarily be entitled to recover it from HMRC as input tax (albeit there may now be timing issues). Rok has not in fact recovered it from HMRC so HMRC really will have a 'windfall' if the assessment on the appellant is upheld.

45. Does this affect whether or not *Reemstma* can be read across into situations of underpayment rather than overpayment? All the above analysis shows is that the assessment on the appellant is correct: it does not deal with the case that *Reemtsma* entitles the appellant to step into Rok's shoes and claim from HMRC the input VAT that is owed but unclaimed by Rok. Is this a case where the *Reemtsma*-right of repayment is offset against the assessment as in *Premier Foods?* Does *Reemtsma* mean that HMRC must treat the appellant as if it were Rok in so far as the right to repayment of input tax is concerned?

46. To consider that question, I consider the reasons why the CJEU ruled as it did in that case: are those reasons as applicable to VAT overpayments as to VAT underpayments? The CJEU reached the decision it did in *Reemtsma* by reference to the principles of fiscal neutrality and effectiveness: see [34-45]. (The reference to non-discrimination is a red herring – it was referred to because of the particular facts of the case and formed no part of the rationale for the ruling: see [44-45].) So would the principles of fiscal neutrality and effectiveness lead to the same outcome for underpayments as overpayments?

*Principle of effectiveness*

47. By effectiveness, it is clear from [38-39] that the CJEU considered that the Sixth Directive impliedly incorporated the right for customers overcharged VAT to be able to recover it, albeit in most cases that right was met by the right to reclaim it from the supplier.

48. In this case, the appellant has the *right* under its contract to recover an amount equal to VAT from its customer, and is unable to exercise that right effectively due to Rok's insolvency. Rok also had a right to recover from HMRC the VAT on the supply to it. (Note: s 26A VATA is inapplicable because Rok did pay the VAT inclusive sum to the appellant: only 1/5$^{th}$ of the price is outstanding and the appellant has not been charged VAT on that sum). Does *Reemtsma* and the principle of effectiveness mean that Rok (like the supplier in *Reemtsma*, or Q in *Premier Foods)* should be cut out of the chain of payments, so the appellant steps into Rok's shoes?

49. That would leave the appellant entitled to exercise Rok's right to input tax recovery against HMRC, with the result that the appellant's obligation to pay output VAT to HMRC is cancelled out.

50. But there is a major distinction between *Reemtsma* and this case. In *Reemstma*, the supplier did not (re-)pay to the customer the amount overpaid. But here Rok actually paid the appellant the VAT on which it has been assessed: while Rok has not paid 20% of the purchase price, HMRC has not assessed the appellant for VAT on

that 20%. There is a dissonance: the amount which Rok has not paid to the appellant is a different amount to the amount on which the appellant has been assessed. While HMRC has a windfall (because Rok has not recovered the VAT on what it paid to the appellant), that windfall is at the expense of Rok (or its creditors) and not the appellant.

51. What the appellant is really asking to do is to be let off its assessment for VAT which it actually received because HMRC has had a windfall at the expense of Rok, on the basis that Rok owes the appellant a different sum (ie the unpaid purchase price). In fact, as Rok paid it the amount on which the appellant has been assessed to VAT, allowing the appellant to stand in Rok's shoes to reclaim the input tax from HMRC would be allowing the appellant to be paid the same amount of VAT twice.

52. *Reemtsma* appears to say that where the customer's restitutionary rights against its supplier for an amount equal of overpaid VAT is ineffective due to the supplier's insolvency then the tax authority's obligation to repay the supplier transfers to the customer. It is difficult to see how that principle could apply here, because, in so far as the assessment at issue in this appeal is concerned, the appellant's rights have been effective. Rok paid it the 4/5ths of the purchase price in respect of which it was assessed for VAT.

53. I accept that the appellant may not be able to understand that conclusion: it sees itself as out of pocket of the VAT, and HMRC as receiving a windfall of an amount equal to the VAT if the appellant pays the assessment. But legally I do not think that is the correct analysis. HMRC will have a windfall, but not because of the assessment but because Rok has not reclaimed the VAT which it actually paid to the appellant (when it paid the VAT inclusive purchase price). I think *Reemstma* only applies where the windfall is at the expense of the appellant and that leads me to discussion of the other EU principle said to be at root of the decision in *Reemstma,* fiscal neutrality.

*Neutrality*

54. Fiscal neutrality is often cited as a paired principle with effectiveness, but it is distinct. It refers to the intention of the Sixth Directive, and its successor the Principle VAT Directive, to achieve fiscal neutrality in the sense that VAT should be charged on the exact amount paid by the final customer, no more and no less. The VAT system should not result in windfalls for taxpayers nor tax authorities.

55. The appellant's case is that the assessment will result in a windfall on HMRC because, if VAT had been charged as it ought to have been at the time of supply, Rok would have paid the VAT to the appellant, and recovered it from HMRC. As it is, the appellant considers Rok has not and will not reclaim the VAT and therefore the assessment on the appellant would leave HMRC with an amount of money it would not have received if the system had operated as it should have done.

56. It is not clear to the extent that the CJEU's decision in *Reemtsma* relied on the principle of fiscal neutrality: while it is referred to, it is not analysed nor is it given as

the reason why customers may in some cases have a direct right to recover an overpayment from the tax authority: see [42] in particular the last sentence.

57. *Stadeco,* on the other hand, is a case which did consider fiscal neutrality in a case where the assessment would put the tax authority in a better position than if the law had been applied properly in the first place. In that sense, it is similar to the case here, although the facts are quite different. In that case, the supplier charged VAT to its customer when no VAT was due on the supply. It later recovered VAT from the tax authority, but neither passed on the VAT to its customer nor issued its customer with a credit note, as it was obliged to do. The tax authority discovered this and assessed to recoup the repaid VAT. The supplier pointed out that as a public body acting outside the scope of VAT, its customer could not recover VAT from the tax authority, so fiscal neutrality was (it said) offended by the assessment (see [34]).

58. The CJEU held that fiscal neutrality meant that tax authorities only had to repay overpaid VAT where all risk to the revenue was proved to be eliminated and where there was no unjust enrichment: see [47-48]. So this appears to indicate that a windfall on a taxpayer authority is acceptable if the alternative is a windfall on someone else: but where there is no windfall on anyone else, and no risk of a further claim on the tax authority, then fiscal neutrality requires the tax authority to give up the windfall.

59. The effect of the decision in *Reemtsma* was that a potential windfall on the tax authority was averted because the customer was allowed to make the reclaim that the supplier would otherwise be entitled to make. *Reemtsma* does not actually appear to deal with the supplier's position: it seems to presume that the supplier would not or could not make a claim against the tax authority. If this were not the case, allowing the customer to make the claim as well would, so far from leaving the tax authority in a windfall position, would have given rise to a loss to them. The solution is explained in *Premier Foods:* the supplier is unable to make a claim against the tax authority for the overpaid VAT because a repayment to it would unjustly enrich it because it is insolvent and any repayment would go to the benefit of all creditors and not to the customer alone.

60. In other words, because the supplier in *Reemstma,* being insolvent could not make the reclaim of the overpaid tax, the customer was allowed to do so to avoid an unfair windfall on the tax authority.

61. But this is a case of underpaid VAT. Rok had a valid right to repayment of the output VAT it paid (albeit unknowingly) to the appellant. The claim may still be in time as the four year time limit in Reg 29(1A) only starts to run on receipt of the VAT invoice, and the appellant has yet to deliver a VAT invoice to Rok. So if the appellant were held to be able to offset against the assessment the input tax which Rok ought to have reclaimed from HMRC but has not yet done so, that might put HMRC at risk of a double reclaim.

62. HMRC is not allowed to refuse to repay input tax on the grounds of unjust enrichment. The right to a reclaim of input tax is absolute (save in cases of fraud –

see *Kittel).* While it is true that Rok may not be able to meet the technical requirements for an input tax reclaim, in particular, in that it has no VAT invoices, in a case where it is clear that the supply took place and was paid for (as it was here), there would seem no grounds, other than timing, on which HMRC could refuse repayment to Rok on the basis of alternative evidence (as per Reg 29).

63. Of course, the appellant might fail to issue the VAT invoices which it should issue: that would perhaps prevent a claim by Rok and leave HMRC with a windfall. But the appellant should not be able to rely on its own failure to issue VAT invoices to its customer.

64. Moreover, the windfall is not really at the appellant's expense. As explained, the appellant is liable to pay the assessment because it received from Rok the sum on which it has been assessed. HMRC has not assessed the appellant on the sum still unpaid by Rok.

65. So my conclusion is that on a proper construction of the law, the assessment will not result in a windfall on HMRC. On the contrary, the appellant owes the VAT element of the monies actually received from Rok to HMRC; it should issue Rok with a VAT invoice, and Rok's liquidator is entitled to reclaim this money from HMRC. Fiscal neutrality does not help the appellant.

66. I appreciate that the appellant will be aggrieved by this: Rok appears to have misled it into zero-rating its services in the first place, it has failed to pay 1/5$^{th}$ of the price owing, and yet, if and when the VAT invoices are issued by the appellant, will be entitled to recover from HMRC the amount HMRC have assessed from the appellant. While the appellant clearly has an action against Rok for unpaid purchase price, and may have an action for misrepresentation, these rights of action may well be worthless to it as Rok is insolvent, and are unlikely to provide any consolation to it for the position in which it finds itself.

67. Nevertheless, while I sympathise with the appellant's directors, I consider my analysis of the law is right and its defence to the assessment based on *Reemtsma* must be dismissed.

68. In conclusion, I consider *Reemtsma* in principle could apply to a situation of underpaid, and not just overpaid, VAT. But it cannot apply where the supplier has actually been paid for the supply on which it is assessed to tax. In such a situation, any windfall on HMRC is at the customer's, and not supplier's, expense. (And, of course, *Reemsta* would never actually be applied in a case where the customer did not pay for the supply because the supplier would not be assessed for the unpaid VAT as it could rely on BDR.)

69. Properly analysed, what the appellant seeks to do here is off-set its claim against Rok for <u>unpaid</u> purchase price against Rok's entitlement to be repaid its input tax from HMRC on the <u>paid</u> purchase price. Yet the appellant's VAT liability on the paid purchase price is quite distinct to Rok's contractual liability to the unpaid purchase price. They are two different sums of money: it is not a case, like *Reemsta,* of a

single sum of money going around in a chain. *Reemstma* does not apply. Considerations of effectiveness and fiscal neutrality do not advance the appellant's case because it has been paid the sum on which it is assessed to VAT.

70. The appellant is out of pocket of 1/5th of the purchase price (ie an amount equal to VAT on the contract price); Rok owes it that sum of money but will not pay it; that is a 'windfall', if it can be described as such, on Rok's creditors. This unfortunate situation results from Rok's insolvency and not because of any failing in the VAT system. At the same time, the appellant owes to HMRC as VAT 1/5th of the purchase price it actually received from Rok (it having received 4/5ths of what was due under the contract) and Rok has an unexercised right to recover an equal amount from HMRC. That is a windfall on HMRC. The appellant may consider it just if it can appropriate from Rok its unexercised right to recover VAT from HMRC in compensation for Rok's failure to pay the appellant the full amount owed, but the law does not enable it to do so. There is no breach of fiscal neutrality or effectiveness of the VAT system: it is just the effect of the laws of insolvency. Creditors are only entitled to share in the estate: if the appellant issues Rok with the VAT invoice to which it is entitled, Rok can exercise its right of recovery against HMRC, and HMRC will not retain the windfall. The input tax which would be so recovered would increase the pool available to creditors, such as the appellant. If this is no longer possible as Rok's liquidation is complete and the company wound up, then that is because the appellant ought to have issued the VAT invoices earlier.

71. I dismiss the appellant's claim based on *Reemstma* and consider its second claim that the assessment is not to best judgment.

**Assessment not to best judgment?**

72. S 73(1) VATA provides:

> "...where it appears to the Commissioners that ...returns are incomplete or incorrect, they may assess the amount of VAT due from [the taxpayer] to the best of their judgment and notify it to him"

73. S 83(1) VATA provides:

> ....an appeal shall lie to the tribunal with respect to ....
>
> (p) an assessment (i) under s 73(1).....

74. Mr Brown's case was that S 73(1) gave HMRC a discretion whether or not to assess in circumstances where a VAT return was incomplete, as the appellant's was in this case. His case was that HMRC had not even considered whether it would have been appropriate to exercise their discretion not to assess in this case and therefore the appeal should be allowed because, if they had exercised such discretion, they would not assess, as the result of the assessment would be a windfall on HMRC.

75. He also said, for the same reason, that the assessment was not to best judgment.

*HMRC's discretion not to assess*

76. I accept, as is clear on the face of the legislation, that HMRC have a discretion not to assess. What I am unable to accept is that this Tribunal has any jurisdiction to consider the exercise, or failure to exercise, that discretion.

77. The exercise by a public body of a discretion conferred on it by the Government is a matter of public law. While this tribunal has no inherent jurisdiction to consider matters of public law, Parliament can confer on it such jurisdiction. The Tribunal's jurisdiction, conferred by s 83(1)(p) is against the 'assessment' and as such it is not immediately apparent whether this jurisdiction includes jurisdiction to consider matters of public law.

78. But on this I am constrained by authority. In particular, the Upper Tribunal *Hok Ltd* [2012] UKUT 362 clearly ruled that Parliament did not intend to confer on the FTT jurisdiction to consider whether HMRC should have exercised a discretion not to assess a penalty:

> [54]...Here, the question is not the amount of a penalty, or even whether one is due as a matter of law....but whether HMRC should be precluded from imposing the penalties prescribed by that section, or from collecting them if imposed. That, in our judgment, is a quite separate question of administration, one which, in accordance with the authorities to which we have already referred, is capable of determination only by way of judicial review and therefore not by the First-tier Tribunal.

79. In so far as the appellant might argue that that decision applied only to assessment of penalties rather than assessment of tax, the authorities on which it relied, such as *J H Corbitt* and *Aspin v Estill* [1987] STC 723 at 727c make it clear that there is no general jurisdiction to judicially review HMRC. There is of course the more recent decision of the Court of Appeal in *BT Pension Trustees* [2015] EWCA Civ 713 which, although dealing with a case on legitimate expectations, reinforces how limited the jurisdiction of this Tribunal is in matters of public law.

80. The Tribunal may have some jurisdiction to consider public law matters, such that the Tribunal should not apply unlawful secondary legislation, and must consider whether the liability the subject of the assessment only arose due to an unlawful act of HMRC (eg as per *Pawlowski v Dunnington* [1999] EWCA Civ 3020*),* but there is no general public law jurisdiction in this Tribunal, and for good reason. Parliament did not intend this Tribunal to consider in every appeal against an assessment or penalty whether HMRC ought to have exercised its discretion not to assess: that review of HMRC's conduct can only take place in the Administrative Division of the High Court.

*Technip Coflexip Offshore Ltd (2005) V19298*

81. I was referred to the case of *Hollinger Print* (see below) but the relevant reasoning in that case was based on *Technip* so it makes sense to consider that case first.

82. HMRC assessed the taxpayer in *Technip* for over £600,000 because the taxpayer had issued to its customer invoices showing that amount of VAT as due, even though it was mistaken and VAT was not due (the reverse of the position in this case). The invoices were only part paid and the appellant sought relief for VAT on the balance through a claim for bad debt relief, which HMRC initially allowed. HMRC then assessed to recover the bad debt relief payment on the basis the taxpayer was not entitled to bad debt relief because the VAT should never have been charged in the first place.

83. The taxpayer appealed and won the appeal. The Tribunal chairman said:

> Although the matter does not seem to have been the subject of express decision hitherto the Tribunal considers it to be the case that the Commissioners do have a discretion in the matter of making an assessment. The enabling provisions use the word 'may'. The commissioners accordingly may make an assessment or they may not. There is nothing imperative in the statute. Even if there was an ascertained and justified sum due to the Commissioners still are not obliged to issue a demand for it.

84. The decision is of course not binding on me: it was a first instance decision in the predecessor of this Tribunal. Moreover, I have to respectively disagree with the Tribunal Chairman. The matter of HMRC's discretion and this Tribunal's jurisdiction to consider its exercise had been considered in *J H Corbitt* which made it clear that the Tribunal does not have a general judicial review jurisdiction. Later cases, such as *Hok Ltd,* which post-dates *Technip*, reiterate the point. The Tribunal has no jurisdiction to consider whether HMRC ought to have exercised its discretion not to assess.

85. That is not to say that the taxpayer in *Technip* should have lost its appeal: I think the result of the case was right but for the wrong reason. The taxpayer had clearly overpaid VAT; HMRC said it was out of time to recover it. But, of course, by making the bad debt relief claim, the taxpayer had already recovered the overpaid VAT and did not need to make a claim to recover it. When HMRC paid the BDR claim, they were paying the taxpayer no more than they owed the taxpayer albeit because the money was overpaid by mistake and not because there was a VAT bad debt. So the assessment was bad.

86. But that is not relevant to this appeal. What is relevant is that I do not consider that the analysis of the chairman in *Technip* was good law and, with respect to him, I decline to follow it. I do not consider this Tribunal has any jurisdiction to consider on an appeal against an assessment whether HMRC ought to have exercised its discretion not to assess.

87. I note in passing that even if this Tribunal did have jurisdiction to consider HMRC's discretion on whether or not to assess a liability, I do not consider the appellant would win its appeal. The appellant was paid the amount on which it has been assessed to VAT. In so far as there is a windfall on HMRC, it is at the expense

of Rok's creditors. I do not consider that there is any public law reason why HMRC would not exercise its discretion to assess the appellant in this case.

*Was the assessment to best judgement?*

88. As is made clear in s 73, any assessment must be to best judgement. Case law makes it clear that the Tribunal has the jurisdiction to determine whether an assessment is to best judgement eg *Pegasus Birds* [2004] STC 1515. The chairman in *Hollinger Print Ltd* [2013] UKFTT 739, relying on *Technip,* decided that 'best judgement' incorporated something akin to a discretion not to assess in cases where it would be inappropriate to do so.

*Hollinger Print*

89. The facts of that case are very similar to those in this appeal. The taxpayer had incorrectly treated certain printed items as zero rated rather than standard rated. Many of its customers were standard rated and may well have been able to reclaim the VAT had it been charged by the taxpayer. One of its main customers was now insolvent so the appellant would be unable to pass the VAT charge on to it.

90. The Judge considered that the principles explained in cases on best judgement meant the Tribunal should consider public law principles not only in considering the amount of the assessment but whether there should have been an assessment at all:

> [58] What...is striking about these cases is the concentration on the use of 'best judgement' to assess the tax. There is no express consideration of the question whether, if it is found that to the best of HMRC's judgement the tax is due, it should in fact be assessed, even though the *Wednesbury* principles, which are clearly in the linked to the requirement properly to consider the exercise of any discretion by a public body, were in the minds of the judges. But that approach must be viewed in the light of the arguments in the appeals before the courts, the attack in each case had not been on the decision to assess, but on the judgement used in making the assessment. It seems to us that the test is described is equally applicable to both questions and that the two question are not to be addressed separately; there is on question only and that is whether it was wholly unreasonable to make the particular assessment.

91. Moreover, he considered that cases, such as *Hok* and the later similar decision in *Noor* [2013] UKUT 71 (TCC) to which I have not previously referred, did not prevent this analysis:

> It seems to us that the width of the words in section 73(1)(p) 'against the assessment' indicate that this tribunal's role is not confined solely to the question of whether it was made to the best of HMRC's judgment. The section does not limit the appeal to one 'against the question of whether the amount of assessment was made to the best of HMRC's judgment.' But in our view the scheme of section 73 does not require a separate formal decision to exercise the power to assess,

> and a second separate form decision as to what amount should assessed. The two decision are one, and on appeal against eh assessment, there is one question which is to basked in relation to that single decision: was it made wholly unreasonably? If the answer is yes, then the appeal against the assessment must succeed. In any event if it was made wholly unreasonably it cannot have been made to the best of the judgement of the Commissioners.

92. I am unable to agree with the Judge's analysis. The assessment which HMRC decide to make must be to the best of their judgement: the decision to make the assessment precedes the decision of the amount of the assessment. The decision to make the assessment is an exercise of discretion which can only be judicially reviewed and this Tribunal does not have jurisdiction to do that; whether the amount of the assessment is to HMRC's judgment is within the jurisdiction of this Tribunal and is described in cases such as *Pegasus*. It does not include jurisdiction to decide whether on public law principles the decision to assess should not have been made at all.

93. I note, in passing only because I don't agree with the premise, that in any event the Judge in *Hollinger Print* considered that it would be a rare case where a decision to assess a liability would not be to best judgment. While at first his paragraph [64] might appear to say the opposite, I think the entirety of [64] and [68] make it clear that there is a 'not' missing in the first sentence cited below – it should read '*we do not consider....*':

> [64] ....(5) we do consider that [the HMRC officer] was required to consider any 'windfall' which might accrue to HMRC as a result of any assessment upon the appellant and the administrative near impossibility of the Appellant's invoicing its customers and their reclaiming the invoiced input tax. The process of assessment is directed to determining the tax due form the taxpayer under the law. The scheme of the legislation pays no attention to this process to the later reclaim of the tax by a trader's suppliers and customers. [The HMRC officer] was correct to ignore this fact.
>
> ....
>
> [68] ....even if it was rightly decided, *Technip* cannot dictate the result of this appeal in which any advantage to HMRC arises from the possible failure of the appellant to invoice and the possible failure or inability of its customers to reclaim input VAT.

94. In conclusion, with respect, I am unable to follow the reasoning in either *Technip* or *Hollinger Print:* I do not consider this Tribunal has any jurisdiction to consider whether it was proper in a public law sense for HMRC to assess a liability. Moreover, even if the Tribunal did have such jurisdiction I would still not have decided the case in favour of the appellant for the reasons set out at §51 and §70. In other words, I do not think that there is a windfall on HMRC, or at least there would not be one if the appellant issued Rok VAT invoices as it ought to do; and moreover I do not see it as a proper exercise of HMRC's discretion to forgo enforcement of the law to protect taxpayers from the effects of the insolvency of their customers.

*The facts on best judgment*

95. Mrs Ashworth had not appreciated that best judgment would be in issue and had therefore not brought along the decision maker to give evidence of whether he considered Rok's insolvency. It was agreed that the hearing could be reconvened to hear that evidence if I decided that it was relevant as a matter of law. For the reasons given above, I do not think that the law makes this factual enquiry relevant. The officer's evidence is not required and I see no reason to reconvene the hearing. I am able to resolve the appeal on the law.

96. The appeal is dismissed.

97. This decision will no doubt seem very harsh to the appellant's directors, whose only error was simply to take the VAT position on trust from Rok and not check it out with HMRC. And I sympathise with the directors of the appellant over the very unfortunate position the company now finds itself in, with a VAT assessment it must pay out of its own funds as it is unable to make Rok pay the outstanding balance (equivalent to VAT) on the contract. I have given the matter a great deal of consideration, as the length of this decision shows. Nevertheless, my view of the law is that the assessment is valid, and *Reemtsma* does not allow the appellant to off-set against it the input tax to which Rok is entitled; moreover, this tribunal has no jurisdiction to consider whether HMRC should not have imposed the assessment, and even if it did, I think HMRC were right to assess in the circumstances, and the appellants have no directly enforceable EU law rights which prevent HMRC raising the assessment.

98. 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.

**BARBARA MOSEDALE**
**TRIBUNAL JUDGE**

**RELEASE DATE: 5 MAY 2017**