



VAT – “the issue of a bank note” – Item 1, Group 11, Sch 8 VATA – distinction with authorised issuing banks and others – distinction with Bank of England – Bank Notes (Scotland) Act 1845 – Banking Act 2009 – HMRC policy – appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

TC07234

Appeal number: TC/2017/03975

BETWEEN

CLYDESDALE BANK plc

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY’S
REVENUE & CUSTOMS**

Respondents

TRIBUNAL: JUDGE ANNE SCOTT

**Sitting in public at George House, 126 George Street, Edinburgh on Monday 28
January 2019**

Philip Simpson, QC, for the Appellant

**David Thomson, QC instructed by the General Counsel and Solicitor to HM
Revenue and Customs, for the Respondents**

DECISION

Introduction

1. The decision under appeal is a policy decision (communicated by letters dated 2 November 2016 and 12 April 2017) in respect of the interpretation of the VAT legislation and the VAT treatment applicable to the issue of banknotes.
2. The appellant's partial exemption special method is inconsistent with that policy.
3. It is not in dispute that the issue of new banknotes is a supply that is within Item 1 Group 11 of Schedule 8 to the Value Added Tax Act 1994 ("VATA") and therefore zero-rated for VAT purposes. Consequently, banks that make a supply within that Item have a right to recover VAT attributable to that activity.
4. The appellant's argument is that each time a banknote passes into circulation, having been returned to the appellant after first issue, it is "issued" both as a matter of ordinary language and authority.
5. HMRC argues that the only statutory meaning of the concept of "issue" of a banknote both when VAT was introduced in 1972 and when VATA was enacted is the first issue of a banknote and not any second or subsequent "re-issue".
6. As a preliminary matter, on 6 June 2018, the appellant had made an application for a site visit to the Cash Centre ("CC") used by the appellant for handling both new and used notes and a branch of the bank. That was vigorously opposed by HMRC and on 13 July 2018, I rejected that application on the basis that it seemed appropriate to hear the evidence and then decide whether or not a site visit was necessary. In the event, it was not.

The facts

7. At the hearing, the appellant's witness spoke to the factual background in this matter. Somewhat to my surprise, Mr Thomson chose not to cross-examine the witness and explained that he considered that the factual background was not relevant.
8. HMRC's stance was that the issue was purely one of interpretation of the statutory provisions and since it was a matter of pure law the facts were not therefore relevant.
9. It was, and is, my view that one of the primary roles of the First-tier Tribunal is to find the facts in any appeal and thereafter to apply the relevant law. The law does not stand in isolation and as can be seen below this appeal is no exception.
10. Since there was no cross examination the facts in this appeal are not in dispute.
11. The appellant's witness, Derek Walker, was clear, succinct and entirely credible and explained precisely how the appellant dealt with banknotes.

12. The Bank of England acts as the UK's central bank and regulates the issue of banknotes made by banks in Scotland and Northern Ireland. The appellant has issued banknotes since 7 May 1838 when it came into being.

13. The appellant is an issuing bank, that is to say a bank authorised to issue banknotes pursuant to Part 6 of the Banking Act 2009 Act (the "2009 Act"), and before that the Bank Notes (Scotland) Act 1845 (the "1845 Act"). The 2009 Act did not repeal all of the 1845 Act. The other relevant legislation is The Scottish and Northern Ireland Banknote Regulations 2009 (the "2009 Regulations") and The Scottish and Northern Ireland Banknote Rules 2017 (the "2017 Rules").

14. This appeal concerns only banknotes that the appellant issues as an issuing bank which is to say banknotes in terms of which the appellant promises to pay the bearer on demand the amount stated on the face of the note.

15. In terms of the 2017 Rules there are three types of banknotes:

- a. Notes with the Potential to Enter Circulation
- b. Notes in Circulation
- c. Excluded Notes

16. Notes with Potential to Enter Circulation are obviously banknotes which are about to be put into circulation. An example would be banknotes held within an ATM and which are therefore still under the appellant's control or banknotes in a bank branch.

17. Notes in Circulation are equally obviously banknotes that are in the public domain and not controlled by the appellant. When a customer withdraws money from a branch or an ATM then the banknote is in circulation. The appellant also sells banknotes to other financial institutions and to other businesses.

18. In terms of Rule 1.8 of the 2017 Rules the value of Notes in Circulation is calculated by starting with the value of all banknotes ever printed and then deducting the value of all banknotes that have been destroyed by the bank or on its behalf, the value of Notes with the Potential to Enter Circulation and the value of Excluded Notes.

19. The 2009 Act requires that Notes with Potential to Enter Circulation and Notes in Circulation, must be fully "backed" with ring fenced assets which consist of either equivalent funds held on deposit at the Bank of England or Bank of England banknotes or coins ("Backing Assets) held at an "Approved Site" which is regulated by the Bank of England.

20. In reality the amount of capital held on deposit at the Bank of England plus the Backing Assets is higher than the total value of banknotes being backed in order to allow for fluctuations and contingencies.

21. If a note-issuing bank holds "Excluded Notes", and those are banknotes that are not "backed" by the Bank of England, then those must be held in a secure vault at a

“Designated Site” which is regulated by the Bank of England. Rule 3.1c of the 2017 Rules defines Excluded Notes as being:

- i. New Notes;
- ii. Notes Awaiting Destruction;
- iii. Notes Held by the Printer;
- iv. Returned Notes;
- v. Working Stock.

22. The appellant has a CC which is both a Designated and an Approved Site and has outsourced the management of that since 2003. There is a very high level of security.

23. Within the CC the banknotes (and coins) have to be processed. That involves sorting, checking if they are fit for purpose, packaging, labelling and then storage.

24. A banknote can only become an Excluded Note once it has been processed to the point that, together with other such banknotes, say to a total of £50,000, they have been formed into a “brick”, sealed in a plastic sleeve, labelled as Excluded and placed in a cage which in turn is sealed and stored in a vault that has additional security measures.

25. The number of Excluded Notes will depend on how many banknotes are required to be either Notes in Circulation or Notes with Potential to Enter Circulation. Clearly, the number of Excluded Notes has an impact on the appellant’s financial position since they do not require to be backed. Mr Walker gave as an example that the quantum of Excluded Notes held on Friday 2 February 2018 was £184,750,000.

26. Reports are generated at 3pm every day to confirm how many Excluded Notes and Backing Assets are held. The following day a further report is generated quantifying the level of Notes with Potential to Enter Circulation that are held in the CC, ATMs and the appellant’s branch network. Those reports quantify the level of Notes in Circulation based on the difference between the total number of banknotes issued and the banknotes held by the appellant as Notes with Potential to Enter Circulation and Excluded Notes as well as banknotes that have been destroyed.

27. Those reports are sent to the Bank of England (via a secure web based portal) daily for Excluded Notes and Backing Assets by 4.30pm and on a Friday the figures for the weekend are also reported. Notes with Potential to Enter Circulation and Notes in Circulation are reported by 5.00pm on a Thursday weekly for the previous seven days.

28. The CC has four processing areas:-

- (a) Bulk Lodgement area: This holds customer deposits for the appellant and Santander cash processing. This is also where all of the appellant’s branch orders are prepared for despatch.
- (b) Coin store: This is where coins are processed through coin scanning machines and held in coin cages. Coin Backing Assets are held in this area.
- (c) Vault area: This is where Excluded Notes, Notes with Potential to Enter Circulation and banknote Backing Assets are held.

(d) ATM Packing area: This is where Notes with Potential are held prior to dispatch.

29. The appellant's branches are supplied with notes by G4S. Branch ATMs are filled by branch staff and remote ATMs are supplied with banknotes directly by G4S.

30. Where a business banks its takings at one of the appellant's branches, the amount paid in may contain both the appellant's banknotes and other banknotes that have been issued by different issuing banks such as the Bank of Scotland. Those banknotes are bundled by the branch staff and returned to the CC to be processed and sorted via calibrated specialist sorting machinery. That machinery sorts banknotes according to the issuer.

31. Banknotes which belong to another issuing bank are returned to it after being processed by the appellant's sorting procedure. On return of the other banks' banknotes, the appellant is paid the face value electronically. If another issuing bank receives the appellant's banknotes it will process them in the same way and return those banknotes to the appellant.

32. Destroyed banknotes account for approximately 2% of the banknotes that the appellant receives and processes. When banknotes are destroyed, a destruction certificate is produced and that is verified with a double signature. The banknote will then be shredded and recycled. Destruction figures are reported to the Bank of England on a weekly basis at the same time as Notes with Potential to Enter Circulation.

33. The appellant contracts the physical creation of banknotes to a specialist third party who manufactures banknotes for all of the issuing banks in the UK. A new banknote is created when the date, promise to pay and signature is added. That provider has an Approved and Designated site so the new banknotes are Excluded Notes at that stage. On delivery to the CC the banknotes are then processed and either sold or distributed to ATMs or branches.

34. Where the banknote is being issued for a subsequent time, that process involves the receipt of the banknote, whether directly from a customer or from another bank that has received the banknote from its bearer, and its sorting and distribution by a CC.

35. Because the appellant is an issuing bank, its costs include not only the manufacture costs but also the collection and distribution of previously issued banknotes leading to higher costs than those incurred by non-issuing banks. The appellant also incurs costs of destruction that those banks do not.

The Law

36. A banknote is defined in section 208 of the 2009 Act which reads as follows:-

208 “bank note”

In this Part “bank note” means a promissory note, bill of exchange or other document which—

- (a) records an engagement to pay money,
- (b) is payable to the bearer on demand, and
- (c) is designed to circulate as money.

37. Section 209 of the 2009 Act defines when a banknote is issued and reads as follows:

“209 (1) For the purposes of this Part a banknote is issued when it passes –

- (a) from a person who holds it not as bearer but as a person carrying on the business of banking (‘the issuing bank’), and
- (b) to a person taking as bearer (‘the bearer’).

(2) In subsection (1)(a) the reference to a banknote passing from the issuing bank includes a reference to it passing –

- (a) from the issuing bank’s agent, or
- (b) from a person printing or preparing the banknote for, or taking it to, the issuing bank or its agent.

(3) For the purposes of subsections (1)(b) it does not matter whether the bearer also holds the banknote for use in the business of banking.”

This section replaced the provisions in sections viii and xxii of the 1845 Act.

38. Until its repeal on 23 November 2009 by the 2009 Act, the Preamble to the 1845 Act provided:

“...it shall be lawful for every such Banker to continue to issue his own Bank Notes ... in the Proportion and Manner herein-after mentioned, but not to any further Extent; and... it shall not be lawful for any Banker to make or issue Bank Notes in Scotland, save and except only such Bankers as shall have obtained such Certificate from the Commissioners of Stamps and Taxes.”

39. Section viii of the 1845 Act read:-

“viii What shall be deemed to be Bank Notes in Circulation

And be it enacted, That all Bank Notes shall be deemed to be in Circulation from the Time the same shall have been issued by any Banker, or any Servant or Agent of such Banker, until the same shall have been actually returned to such Banker, or some Servant or Agent of such Banker.”

40. The relevant provision in section xxii of the 1845 Act reads:-

“xxii Interpretation of Act

And be it enacted, That the Term ‘Bank Notes’ used in this Act shall extend and apply to all Bills or Notes for the Payment of Money to the Bearer on demand, other than Bills and Notes of the Governor and Company of the Bank of England ...”.

41. Section xviii of the 1845 Act, as amended by the 2009 Act, reads:

“... if any Body Politic or Corporate or any Person or Persons shall...make, sign, issue, or re-issue in Scotland any Promissory Note payable on demand to the Bearer thereof for any Sum of Money less than the Sum of Five Pounds, except the Bank Notes issued in reliance on section 213 of the Banking Act 2009, then and in either of such Cases every such Body Politic or Corporate or Person or Persons so making, signing, issuing, or re-issuing any such Promissory Note as aforesaid, except as aforesaid, shall for every such Note so made, signed, issued, or re-issued forfeit the Sum of Twenty Pounds.”

42. Regulation 2(2) of the 2009 Regulations reads:

(2) For the purposes of these Regulations—

(a) a banknote is in circulation from the time that it is issued by an authorised bank until the time that it is returned to the bank;

(b) a banknote has the potential to enter circulation if the banknote is not—

- (i) in circulation; or
- (ii) an excluded banknote;

(c) a reference to the value of a banknote is a reference to the face value of the banknote.”

43. The other relevant sections of the 2009 Act read as follows:

“210. In this Part

‘authorised bank’ means

(a) a bank which immediately before commencement was authorised to issue banknotes in Scotland or Northern Ireland (unless by virtue of regulations under section 214A it is no longer an authorised bank for the purposes of this Part), or

(b) a bank which is designated as an authorised bank for the purposes of this Part by regulations under section 214A(1)(a).

213. (1) An authorised bank within section 210(a) may continue to issue banknotes after commencement, but only—

(a) in accordance with the provisions of this Part, and

(b) in the part of the United Kingdom in which it was authorised to issue banknotes before commencement.

(2) An authorised bank within section 210(b) may issue banknotes, but only—

(a) in accordance with the provisions of this Part, and

(b) in the part of the United Kingdom which is specified in relation to the bank in regulations under section 214A(1)(b).

214A. (1) The Treasury may by regulations—

- (a) specify a bank which on and after the designation date is designated as an authorised bank for the purposes of this Part,
- (b) specify a part of the United Kingdom in which the bank may issue banknotes, and
- (c) make provision about how the bank is to be identified on those banknotes.”

44. The currently applicable statutory provisions in this appeal are to be found in section 30 and Schedule 8, Group 11, Item 1 of VATA. Section 30 provides *inter alia*:

“(1) Where a taxable person supplies goods or services and the supply is zero-rated, then, whether or not VAT would be chargeable on the supply apart from this section -

- (a) no VAT shall be charged on the supply; but
- (b) it shall in all other respects be treated as a taxable supply;

and accordingly the rate at which VAT is treated as charged on the supply shall be nil.

(2) A supply of goods or services is zero-rated by virtue of this subsection if the goods or services are of a description for the time being specified in Schedule 8 or the supply is of a description so specified.”

45. VATA Schedule 8, Group 11, Item 1 provides:

“1. The issue by a bank of a note payable to a bearer on demand.”

That wording has been in place since the introduction of VAT in 1972 (Finance Act 1972, Schedule 4, Group 13, Item 1 and Value Added Tax Act 1983, Schedule 5, Group 13, Item 1.)

46. Promissory Notes are defined in the Bills of Exchange Act 1882 as follows:

“83 Promissory note defined

- (1) A promissory note is an unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer.
- (2) An instrument in the form of a note payable to maker’s order is not a note within the meaning of this section unless and until it is indorsed by the maker.
- (3) A note is not invalid by reason only that it contains also a pledge of collateral security with authority to sell or dispose thereof.
- (4) A note which is, or on the face of it purports to be, both made and payable within the British Islands is an inland note. Any other note is a foreign note.

84 Delivery necessary

A promissory note is inchoate and incomplete until delivery thereof to the payee or bearer. “

The history

47. Only the Bank of England is authorised to issue bank notes in England and Wales. The parties both argued that since 1845 in Scotland and Northern Ireland, seven commercial banks are also authorised and approved by statute to issue banknotes. That is far from the whole story. With the Union of the Parliaments in 1707 there was Monetary Union. Certainly in Scotland, apart from the major banks, there had been a very large number of small banks who issued banknotes.

48. My, albeit cloudy, recollection of the historical background to the retention of the facility to issue banknotes in Scotland and Ireland is that in February 1826, after a large banking crisis in England, England passed an Act forbidding the circulation of banknotes of under £5 value. Most Scottish and Irish banknotes were for a value of £1. A furore erupted and Sir Walter Scott, amongst others, launched a vigorous campaign. A Parliamentary Enquiry was established and after investigation it was decided to retain the facility to issue non-Bank of England banknotes. Following another severe financial crisis in 1844, Sir Robert Peel promoted the 1845 Act.

49. The fact that Scotland and Northern Ireland still have authorised issuing banks remains a continuing consequence of that demonstration of independence and separate identity. The 2009 Act confirmed that.

50. From 1 January 1973 both HMCE (now HMRC) and issuing banks shared the opinion that the applicable zero-rating provisions encompassed the supply of banknotes which, following their first issue had been returned to the issuing bank and were issued for a second or subsequent time. This approach followed correspondence from 1972 to 1973 between the Committee of Scottish Clearing Banks and the British Bankers Association and HMCE on the other.

51. Apparently, an agreement was entered into with HMCE on 6 April 1973 but despite extensive searches it has proved impossible to trace it. However, HMRC have located the form of words utilised, which is believed to have been based on that agreement, and it is annexed at Appendix A.

52. In 2016, the law not having changed, HMRC changed their stance and set out its policy in VAT Notice 701/49. At 2.3 that reads:

“The first issue, by the bank of issue, of Bank of England, Scottish and Northern Irish banknotes is zero-rated. This provision overrides the exemption allowed for dealing with legal tender banknotes.”

53. HMRC acknowledge their change of view and seek to apply their new policy with effect from 1 January 2017.

Overview of HMRC’s arguments

54. The appeal raises a short question of statutory construction, namely, what is meant by the phrase “the issue of a banknote” where it appears in Schedule 8, Group 11, Item 1 of VATA.

55. HMRC’s historic approach to the matter was erroneous.

56. The impact of the zero-rate is restricted to those activities that only banks that are authorised to issue bank notes can undertake, namely the creation of new banknotes. It is not affected by the private law characteristics of banknotes as promissory notes.

57. Non-issuing banks certainly put banknotes into circulation via their ATMs etc but that it is not the issue of a bank note. HMRC state that the Court of Session in *The Royal Bank of Scotland Group plc v HMRC*¹ (“RBS”) proceeded on the basis that the dispensing of a banknote from an ATM (by agreement of the parties, characterised in that case as the “issue” of a banknote) involves only an exempt supply being part of an exempt supply of retail banking or exempt facility fees to other banks.

58. HMRC argue that that case is authority for the proposition that the issue of a banknote from an ATM/branch cannot be zero-rated, regardless of whether this is the first or subsequent time that the banknote is issued.

59. The intention of the zero-rating legislation was to protect the issuing banks from the costs of creating and issuing banknotes such as the design and production of the banknotes. The zero-rate should not be allowed to allow VAT recovery on costs common to all retail banks for which non-issuing banks are not permitted the same level of recovery.

60. The 2009 Act cannot legitimately be used for the purposes of identifying the proper construction or interpretation of VATA which was enacted many years earlier.

Overview of the appellant’s arguments

61. In essence the appellant argues that, banknotes having been returned to them and the promissory note embodied therein honoured, the second or subsequent issue of a banknote payable to bearer on demand falls properly to be classified as “The issue by a bank of a note payable to bearer on demand” since that is a new promise. The supply is the same as on the first occasion. The only difference is the fact that the banknotes have not been newly manufactured but rather removed from, and then restored to, circulation.

62. The appellant argues that what is supplied is a service consisting of the making of the promise embodied by the banknote to pay a specified sum of money to the bearer on demand rather than a supply of goods being the transfer of the physical note. The appellant argues that there is no distinction between the issue of a banknote that is newly manufactured and the issue of a banknote that is being issued for a second or subsequent time.

63. The appellant also relies on *RBS* and that is discussed below.

¹ 2002 STC 575

Discussion

64. Both parties were agreed that Schedule 8, Group 11, Item 1 of VATA falls to be construed strictly.

65. Both parties agree that the banknotes in question are certainly “notes payable to bearer on demand” so the question is what does “issue” mean?

66. I agree with HMRC’s skeleton argument that a starting point is to look at the pre-existing law on the “issue” of a banknote at the time that VAT was introduced.

67. It seems clear to me that the 1845 Act clearly envisaged that a banknote could be issued by an authorised bank more than once. There can be no other explanation for the use of the words “...make, sign, issue, or re-issue...” in paragraph xviii, and that was retained after the amendment by the 2009 Act, as can be seen at paragraph 41 above. If it had been intended that “issue” in this context would only apply to the issue after the manufacture (“make”) and the signing (“sign”) there would have been no need for the use of the word “re-issue”. It is not an error since similar wording was included again further in the same section.

68. Section viii defines Notes in Circulation and they cease to be in circulation once returned to the appellant. That is consistent with the use of the word “re-issue” elsewhere in the 1845 Act.

69. At paragraph 18 of the Skeleton Argument HMRC ask me to agree that it “...is plainly relevant to have regard to the 1845 Act...” when construing VATA. I agree although I do not agree with their construction. I find that “issue” is capable of including “re-issue”.

70. In their Skeleton Argument HMRC conceded that section 209 of the 2009 Act supported the appellant’s argument on the meaning of “issue” but could not be prayed in aid of construction of the VAT legislation. In this particular case, as I find in paragraph 67 above, the 2009 Act revisited the 1845 Act amending it and therefore it is of assistance that section 209 is consistent with the amended section xviii. Both are consistent with more than one issue of a banknote.

71. For completeness, since this matter may well go further, whilst the Skeleton Argument relied on HMRC’s interpretation of the 1845 Act, I observe that the letter of 2 November 2016 stated:

“The point of entry to circulation occurs when the new banknotes leave the bonded floor or secure storage area within the cash centres for the first time. We understand this is the definition and position adopted by the Bank of England”.

72. In the letter of 12 April 2017 HMRC argued that:

“However and in any event, we do not take the view that the text of Group 11 needs to be read consistently with banking legislation. As stated in our letter of 2 November 2016, the purpose of the legislation when drafted, and carried forward to the present day, was to provide equivalence to the issuing banks with the Bank of England and to only allow zero-rating to extend to activities in relation to the first issue of a banknote by a bank with a statutory entitlement to issue banknotes.

As such, the meaning of the word ‘issue’ in Group 11 must be read restrictively and cannot extend to activities that non-issuing banks are able to undertake such as passing banknotes into circulation in accordance with the sense and intention of the legislation when originally introduced.”

73. Clearly, this in large part underpins HMRC’s thinking.

74. No evidence has been produced in relation to the purpose of the VAT legislation when drafted. A submission is not evidence².

75. Secondly, I take the appellant’s point that HMRC are not at liberty to argue that the Bank of England’s approach to zero-rating, which again is simply a submission and not evidence, should be relevant to the treatment of the appellant.

76. However, even if HMRC are accurate in what they say, what has also not been addressed is the very big distinction between the Bank of England’s activities and those of the appellant and that turns on the facts of this case.

77. In my view the crucial differences are Excluded Notes and the concept of Backing Assets which apply only to the issuing banks but obviously not to the Bank of England.

78. By contrast, as can be seen from the extensive fact finding above, the economic reality is that banknotes are issued and go into circulation. If they are withdrawn by an issuing bank, which if it wishes to issue those Excluded Notes again, it then has to ring fence Backing Assets with all the accounting, reporting and financial implications attached to that.

79. It is a very different scenario.

80. Lastly, on that aspect, like the appellant, I do not understand HMRC’s argument in their Statement of Case at paragraphs 21 and 22 that the banknote moves into circulation “...at an earlier stage in the process..” than issue from the ATM or branch. In my view there is no supply until the banknote is issued which is what brings it into circulation.

Lifecycle of an average banknote issued by the appellant

81. Following manufacture, the banknote is issued for the first time by any issuing bank when it is dispensed from their ATMs or branches or transferred to a business or another financial institution.

82. The recipient of the supply is the person into whose possession the banknote is delivered and the “lifecycle” of the banknote would be:

- (a) the banknote is used by that person, and usually one or more further holders, to pay for goods or services, or make gifts, and so on;
- (b) a holder or bearer of that banknote ultimately returns the banknote to the appellant. At that point, the appellant makes good the promise contained in

² *Quereshi v HMRC* [2018] UKFTT 0115 (TC)

the banknote, normally by crediting an amount to an account in the name of the person or business paying in the banknote to the appellant. The promise ceases to exist;

(c) the banknote is sorted by the appellant and, if not destroyed, or sold it is then designated either a Note with Potential to enter Circulation in which case it will be sent to an ATM or branch to be issued again;

(d) the banknote is issued again. At that time, the appellant makes a new promise to pay the banknote's bearer, on demand, the sum of money specified on the face of the banknote. This is a new promise: it is a promise being made for the first time; and once more it is made on the physical delivery of the banknote to the recipient. The physical note is not new, the promise is.

RBS

83. As I indicate above both parties referred to and relied on *RBS*. The opening line of that decision is a key point: "The essential question in this case is to identify the nature of the supply for which the reciprocity fee is paid...". Although the case deals with ATMs and the issue of banknotes, the fact is that the Court was concerned with the underlying contractual arrangements for reciprocal fees which were exempt in a context where the issue of the banknotes from the appellants own ATMs, as HMRC indeed argued, was zero-rated. The issue was the nature of the supply which was found not to be the issue of banknotes but the provision of reciprocal services. That is not case here.

84. I disagree with HMRC's assertion that this case is authority for the proposition that the issue of a banknote from an ATM/branch cannot be zero-rated, regardless of whether this is the first or subsequent time that the banknote is issued. In *RBS* the Court states clearly in the fourth paragraph under the heading "Banknotes" :

"It is agreed that the appellant does not 'issue' Bank of England notes. It merely circulates notes that are already in issue. But when it dispenses its own banknotes through an ATM, it 'issues' them and is required to cover the promise on the face of the notes to pay the bearer on demand."

85. In Closing Submissions Mr Thomson argued that the Court did not decide on the question of "issue" as it was "agreed". However, in its decision, rather than the narrative, the Court stated that the question to be answered is

"...whether the dispensing of the appellant's banknotes transforms the supply into a zero-rated supply because it then consists of the issuing by the appellant of notes payable to bearer on demand."

The appellant in that case was unsuccessful because inadequate account was taken of the nature of the reciprocal supply "...even if the service [to a third party customer using the ATM] is an 'issue' of banknotes".

86. In my view this case does not assist HMRC.

Conclusion

87. For the reasons set out above I find that the 1845 Act and successive legislation anticipated that physical banknotes could be issued more than once. Issue in that context means the issue into circulation of a promise to pay the bearer on demand.

88. The requirement for Backing Assets and provision for Excluded Notes with all the accounting and other implications attached thereto reinforces that.

89. The first supply is when a banknote leaves the appellant's control and that is consistent with the social and economic reality.

90. That supply is a single supply from an economic point of view, consisting of the promissory note printed on the paper or polymer. It is only a valid promissory note when delivered to the customer. The customer simply wishes the appellant to honour that promise. That promise is discharged when, for example, the business takings are credited to the business bank account. That promise is only valid if ring fenced by Backing Assets.

91. I accept that it makes no difference to a customer if they go to an HSBC ATM, the appellant's ATMs or a Bank of England branch or even ask for cashback in a supermarket. They get a banknote. However, only the issuing banks supply the promise to pay the bearer on demand. If a customer presents a banknote in a non-issuing bank the bank does not have to honour it, just as a taxi driver in London will frequently decline to take a Scottish banknote. The issuing bank must honour it. If it cannot the Backing Assets are deployed. Therein lies a crucial distinction between issuing and non-issuing banks and the reason for Backing Assets.

92. I do not accept HMRC's argument that to have what was described as an "arbitrary" distinction in the tax treatment if the appellant succeeds is irrational and unfair. The issuing and non-issuing banks are not identical in operation. The non-issuing banks appear to the customer to be the same as the issuing banks but the economic reality is that only the issuing bank has ring fenced assets to meet liabilities. That is a significant difference.

Decision

93. For all these reasons I uphold the appeal.

94. 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.

**ANNE SCOTT
TRIBUNAL JUDGE**

RELEASE DATE: 26 June 2019

Issue of Banknotes

Special arrangements were agreed on 6 April 1973 to deal with input tax on supplies to the issuing banks for their Designated Cash Centres. The Scottish Banks through these Centres issue and re-issue their bank notes, circulate Bank of England notes and return other bank notes to them. The banks cannot issue or re-issue other banks' notes.

Input tax incurred on printing, security charges and carriage of new notes to the Centres is fully deductible and the deductible percentage of input tax on other supplies attributable to the Centres (eg carriage and security charges on transfers of notes from the Centres to branches and other banks) should be determined as follows:

$$\frac{\text{Number of notes issued and re-issued} \times 100}{\text{Total number of notes dealt with}}$$

“Notes issued and re-issued” means for this purpose all the bank’s own notes which leave the Centres for branches. This formula may be applied to input tax on overheads which are allocated on an internal costings basis to the Centres.

The outputs of the Centres must be excluded from the input tax recovery calculations.

The input tax calculated each quarter by the above method is provisional and subject to adjustment to the total number of notes issued etc dealt with in the four quarters of the tax year.

Calculations of percentages should be made to 2 decimal places and there is no rounding up in the year end adjustment.

APPENDIX B

Card Protection Plan Limited v Customs and Excise Commissioners [1992] 2 AC 601 (“**CPP**”)

Levob Verzekering BV v Staatssecretaris van Financiën [2004] ECR-I 9433 (“**Levob**”)

HMRC v Newey [2013] STC 2432 (ECJ) (“**Newey**”)

Dr Beynon and Partners v Commissioners of Customs and Excise [2005] 1 WLR 86 (“**Beynon**”)

Customs and Excise Commissioners v Redrow Group plc [1999] 1 WLR 408

College of Estate Management v Customs and Excise Commissioners [2005] 1 WLR 3351

First National Bank of Chicago v Customs and Excise Commissioners [1998] ECR I-4387

Skatteverket v Hedqvist [2016] STC 362

Royal Bank of Scotland plc v Commissioners of Customs and Excise 2002 SLT 664

Perth Local Board of Health v Maley [1904] 1 CLR 702

Kirkness v John Hudson & Co [1955] A.C. 696, 735

Ormond Investment Co v Betts [1928] A.C. 143, HL

Oak Tree Motor Homes Limited v The Commissioners for Her Majesty’s Revenue and Customs [2015] UKFTT 0251 T(TC); [2017] UKUT 0027 (TCC)

Customs and Excise Commissioners v Jacobs [2005] S.T.C 1518, 1520

Commissioners for Her Majesty’s Revenue and Customs v Axa UK plc [2012] S.T.C.754

Case C-175/09 *Commissioners for Her Majesty’s Revenue and Customs v Axa UK plc* [2010] S.T.C. 2825

Legislation and Literature:

1. Value Added Tax Act 1994, section 30, Schedule 8, Group 11, and Schedule 9, Group 5.
2. Finance Act 1972, Schedule 4, Group 13.
3. Value Added Tax Act 1983, Schedule 5, Group 13.
4. Banking Act 2009, Sections 208, 209, 210, 213 and 214A, as amended by the Bank of England and Financial Services Act 2016, s.38.
5. Banknotes (Scotland) Act 1845, Sections 1, 8, 18 and 22.
6. *Erskine, Institute of the Law of Scotland*, III.2.43 and 44.
7. *The Law of Contract in Scotland* (3rd edn, 2007), McBryde, paragraphs 4-02 to 4-07.
8. The Scottish and Northern Ireland Banknote Regulations 2009 (S.I. 2009 No 3056), Regulation 2.
9. The Scottish and Northern Ireland Banknotes Rules 2017, Rules 1 and 3.
10. Bills of Exchange Act 1882, sections 2, 21 and 83 to 89.
11. Sixth VAT Directive Article 13B.
12. VAT Notice 701/49.