

A matter of timing ~

R (on the application of BMW AG) and others v HMRC

[2008] EWHC 712 (Admin)

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R (on the application of BMW AG) v Commissioners of Her Majesty's Revenue and Customs ("HMRC")

R (on the application of Jaguar Cars Exports Ltd) v HMRC

R (on the application of Land Rover Exports Ltd) v HMRC

These cases related to the VAT accounting arrangements operated by the three applicant taxpayers, BMW AG, Jaguar Cars Exports Limited ("JCEL") and Land Rover Exports Limited ("LREL"). More widely, they relate to the Commissioners' declared policy of tackling schemes which are designed to deliver a cashflow benefit to taxpayers by exploiting a mismatch between the VAT accounting periods operated by different businesses.

Accounting arrangements which produce a cashflow benefit

The arrangements affected by the result of the *BMW* case are various, but in each case the cashflow benefit arises in the same way. Company A makes supplies to Company B. Company A must account for output tax on the supply to the Commissioners and Company B has a corresponding right to reclaim input tax. If B claims and receives the input tax before A accounts for the output tax, then there is a cashflow cost to the Treasury (which has to

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pay tax out before it receives the same amount back). There is also a corresponding cashflow benefit to one or other or both of the taxpayers, although which taxpayer actually experiences that benefit will depend on the arrangements existing between the two businesses, including the terms of payment. Taxpayers may seek to maximise the cashflow benefit arising from the arrangements by manipulating the timing or valuation of supplies. Alternatively, taxpayers may seek systematically to benefit from such arrangements, without manipulation, by moving Company B onto monthly returns if it is a repayment trader.

The Commissioners' Policy

The Commissioners' policy is set out in Business Brief 12/05 and in the VAT Manual Section V1-24A. As set out in the judgment, the policy has evolved considerably over time. However, broadly speaking, the Commissioners state that they will challenge arrangements involving the manipulation of the timing or valuation of supplies by aligning the two companies VAT return periods. They will challenge arrangements where one company is on monthly returns where "there is little or no commercial rationale for the VAT period 'stagger' between the associated businesses besides obtaining the cashflow advantage".¹ However, the Commissioners state that "there is no intention to use these powers except in cases where a significant cash flow advantage arises and there is a need to protect the revenue."²

The facts

BMW AG was part of the BMW group. In Germany its principal business activity was the manufacture of cars. Outside Germany, including in the UK, its principal activity was the purchase and export of vehicles manufactured under contract, including vehicles manufactured by subsidiaries of the BMW group. In the UK, one of those subsidiaries was BMW (UK) Manufacturing Ltd ("BUKM") which manufactured cars under the Mini brand. BUKM was part of a UK VAT Group ("the BMW VAT Group"), but BMW AG remained outside that group. The BMW VAT group was routinely a payment trader and was on quarterly returns. By reason of its being an exporter, BMW AG under its UK VAT registration was routinely a repayment trader. Accordingly, it applied and was permitted to submit monthly returns from 2002.

Accordingly, in June 2006, the Commissioners issued a formal direction, on the basis of the policy set out above, moving BMW AG from monthly to quarterly returns. BMW AG applied for judicial review of the Decision in September 2006.

The facts of *Jaguar* and *Land Rover* were substantially similar. The significant difference for the purposes of understanding the judgment, is that the decision in relation to Jaguar and Land Rover was taken in November 2005 and confirmed in January 2006, but proceedings were not issued until September 2006, outside the 3 month judicial review time limit.

The judgment

BMW challenged the Commissioners' decision on various grounds. Firstly, it argued that Regulation 25 contained no express power to direct from monthly to quarterly returns, and that no such power could be implied into either Regulation 25(1)(a) or (c) ("the Vires Challenge"). Secondly, it challenged the Commissioner's policy both on the ground that it was unlawful under Community law, in that it took account of links between taxpayers rather than treating each transaction on its

¹ Business Brief 12/05, as quoted in the judgment of the Court at paragraph 23.

² Business Brief 12/05, as quoted in the judgment of the Court at paragraph 26.

merits, and on the ground that it was vague and incoherent. In particular, BMW argued that there was no rational basis for distinguishing export companies which are connected to a manufacturing company from export companies which are not so connected, in that the flows of input and output tax are the same in both cases ("the Policy Challenge"). Finally, it challenged the application of the policy to its particular facts, arguing that HMRC had not properly considered the financial outcomes of the various alternative arrangements ("the Decision Challenge").

Identical arguments were advanced for Jaguar and Land Rover. In addition, those applicants requested permission to apply for judicial review out of time.

Tugendhat J rejected both the Vires Challenge and the Policy challenge, but held that the process by which the Commissioners had reached their decision in the case of BMW was flawed and accordingly quashed the decision. He also refused permission for Jaguar and Land Rover to apply out of time.

As regards the Vires Challenge, he held that Regulation 25 must be construed purposively and considered that Parliament could not have intended that, once the Commissioners had directed or allowed a taxpayer to submit monthly returns, the taxpayer would have to submit monthly returns forever thereafter. Accordingly, he concluded that the Commissioners did have the power to direct a taxpayer from monthly to quarterly returns and he refused BMW permission on the basis that its case was not arguable.³

As regards the Policy Challenge, the judge rejected each of BMW's arguments. He held that it was not irrational or unfair for the Commissioners to treat an export company differently where it is associated with its supplier from the situation where it is not so associated.⁴ He further held that the Commissioners' policy did not fail for being vague or incoherent, in particular as regards the reference in Business Brief 12/05 to a "significant" cash flow advantage. The policy documents were "no more than guidance" and should be interpreted "in a broad and untechnical way", not "as if it were legislation".⁵ He further rejected the submission that *Optigen*⁶ required that the Commissioners treat each trader in isolation and to ignore its economic links with other traders.

Turning to the Decision Challenge, the judge found that the Commissioners had failed to consider two material matters before proceeding to a decision. First, they had not considered the effect that a direction would have on BMW AG's ability to recover promptly input tax incurred on transactions with unconnected parties.⁷ Secondly, they did not consider whether the group could obtain the same cashflow benefit without the interposition of a dedicated export company.⁸

Finally, the judge rejected Jaguar's and Land Rover's arguments that they should be allowed to apply for judicial review outside the ordinary time limit. He held that they had not acted reasonably in delaying the issue of proceedings, did not accept that an attempt to pursue a complaint to the Adjudicator was a sufficient reason and rejected the argument that the Ford group was in difficult circumstances.⁹

³ Judgment, paragraphs 63-64

⁴ Judgment, paragraph 76

⁵ Judgment, paragraphs 81 to 82

⁶ Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen Ltd and Others v Customs and Excise Commissioners* [2006] Ch 218

⁷ Judgment, paragraphs 42 and 101

⁸ Judgment, paragraphs 95 to 106 and in particular paragraph 103.

⁹ Judgment, paragraphs 110-115.

Conclusion

The judgment is less important for the points on which the taxpayer won as for the points on which it lost. Taxpayers which have implemented such arrangements, or which are involved in the export business in particular, should be aware that the Commissioners' power to direct taxpayers from monthly to quarterly returns was upheld, as was the overall rationality of the Commissioners' policy in challenging such arrangements. Further, taxpayers should be aware of the key points which the judge held that the Commissioners should consider before issuing such a direction. Finally, the judgment gives an up to date indication of the attitude of the Administrative Court to applications to extend time in tax cases.

*Paul Harris and Philip Woolfe appeared for the Commissioners for
Her Majesty's Revenue and Customs.*

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