

COMMENTS ON RECENT VAT CASES

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RAL (Channel Islands) Ltd v C & E Comrs, (2002) VAT Decision 17914

Gaming machine VAT avoidance scheme involving establishment of Channel Island Company fails as Tribunal holds that place of supply remains in the UK

This was an appeal by a number of associated companies, including a Channel Islands subsidiary company ("CI"), arising out of an avoidance scheme involving gaming machines operated in the UK by companies in the group of RAL Holdings Ltd ("the Parent"). The machines, located in amusement arcades in the UK, were leased by "Machines" to the newly formed CI. CI was granted licences by "RAL" to use the arcades. "Services" contracted with CI to provide staff at the arcades. Machines, Services and RAL were all UK subsidiaries of the Parent. Before the scheme RAL had made the supplies. It had owned the machines, owned or leased the arcades and employed its own staff, although maintenance of the machines and cash banking had been carried out by unconnected third parties. Output tax had been paid.

The idea of the scheme was that the place of supply of gaming machine services to players ("gaming supplies") would be in Guernsey, where CI was registered and had its office, with the intended result that those supplies would not be liable to VAT. CI employed two directors and two other staff in Guernsey, and aside from the intra-group contractual arrangements, entered into a contract with Securicor to collect monies for banking. Machines sub-contracted maintenance of the machines to an independent third party.

Customs decided that CI was liable to output tax on the Gaming Supplies and consequently liable to register for VAT. It refused claims by CI for refunds under the Thirteenth VAT Directive.

The principal issue was the application of the place of supply rules to the gaming supplies. Customs contended that the arcades were fixed establishments of CI in the UK from which the gaming supplies were made. Accordingly, the place of supply was the UK. They did, however, accept that CI had established its business in Guernsey. In the alternative, Customs contended that *Halifax (2001 VAT Decision 17124)* principles applied to the transactions

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with the result that the gaming supplies had continued to be made by RAL. Customs also contended in the alternative that, although not a sham, the restructuring amounted to an abuse of rights.

On the facts, the Tribunal held that real functions were performed at CI's Guernsey office, but CI's only real involvement was in monitoring after the event. It had no real involvement in the day-to-day management control or marketing of the gaming supplies. It concluded that the purpose of the project was to avoid VAT. Other benefits from the establishment of CI were speculative and arose from a desire to exploit CI's existence, rather than being purposes in themselves.

The Tribunal approached the issue of place of supply in two stages:

- 1 Did CI have fixed establishments in the UK?
- 2 If it did, did reference to CI's place of business in Guernsey not lead to a rational result?

The Tribunal concluded that CI did have fixed establishments at the arcades and that reference to CI's place of business in Guernsey produced an irrational result.

On the facts the Tribunal had no difficulty in concluding that the amusement arcades were of sufficient size to constitute fixed establishments. However, they accepted that the permanent installation of gaming machines was not sufficient to constitute a fixed establishment. The Tribunal was most concerned whether CI had the required permanent presence of human resources. That presence was necessary, applying the *Berkholz* case [1985] ECR 2251, because a fixed establishment requires "permanent presence of both the human and technical resources necessary for the provision of the services". CI had no staff of its own present in the UK. However, it was clear from the *DFDS* case (*Case C-280/95 [1997] STC 384, ECJ*) that such presence was not necessary. Resources could be present as a result of a structure such as a subsidiary. The Tribunal, analysing the ECJ's decision in *DFDS*, concluded that the parent-subsidary relationship did not of itself suffice to make a fixed establishment of a subsidiary the fixed establishment of a parent. The question was whether the subsidiary had been acting merely as an auxiliary organ of the parent. In *DFDS* this had been addressed by considering both the parent-subsidary relationship and the contractual relationship between parent and subsidiary. For the Tribunal it was the lack of independence which was crucial, not the precise group relationship between the companies. Noting that CI, Services, Machines and RAL were all subsidiaries of the same Parent, the Tribunal stated:

"In practical terms we can see no material difference from the position if they were subsidiaries of CI, particularly since Services and Machines were formed with a view to providing services to CI, and in the case of Services, with a view to providing services [to players] on behalf of CI."

Looking at the combination of (1) the group relationships, (2) the purposes for which CI and other companies were established, (3) the intra-group contracts and (4) the services supplied pursuant to those contracts, Services was acting as a mere auxiliary to CI when providing necessary human resources. For the Tribunal that was sufficient to conclude that CI had fixed establishments at the arcades. It would have concluded that Machines and RAL were also acting as mere auxiliaries of CI in providing the premises and machines, if it had been necessary.

On first reading it may seem odd that the arcades could be considered the fixed establishments of CI without concluding that it was necessary for CI either to own the machines located there or the premises themselves or control them through an auxiliary company, although the Tribunal would have found such control if necessary for its decision. However CI, had, by the contracts, use of the machines and right to use the premises on a continuing basis. In the case of the supply of gambling services, there is some force in the Tribunal's conclusion that the existence of a fixed establishment should not turn on whether the actual premises or equipment are leased from a third party, and the *Berkholz* case gives some support for that view. The Tribunal recognised that whether or not there was a fixed establishment in a particular case would depend on the type of services being supplied

as “the resources necessary depend on what the services are”. However, it shows the considerable emphasis the Tribunal placed on human resources, in the case.

It was therefore surprising that the Tribunal so readily dismissed the significance of the fact that maintenance work was carried out by the employees of an independent third party sub-contracted to Machines, despite accepting that maintenance resources were necessary for the supply. CI had placed emphasis on that supply by an independent third party. Thus the Tribunal seemed to have been satisfied that a fixed establishment could exist although necessary equipment, premises and some necessary staff were all supplied by third parties who were not auxiliaries. Nevertheless, it would be an odd result, creating a risk of distortions, if a company was held not to have a fixed establishment simply because a small proportion of essential staff were provided by an independent sub-contractor.

The decision of whether treating Guernsey as the place of supply did produce a rational result, though hotly disputed, was perhaps easier. The Tribunal was careful not to fall into the error of assuming that the result was not rational because the service was supplied from CI’s fixed establishment in the UK. It logically deduced from the *DFDS* case that the possibility of avoidance of taxation was relevant to the rational result. Therefore it took into account that Guernsey was chosen specifically to avoid tax. It was also relevant that the resources necessary for the gaming supplies had to be physically provided in the UK. The Tribunal concluded that the place of supply was the fixed establishments in the UK.

The Tribunal’s decision is a significant development in the understanding of when the resources of one company can constitute or count towards a fixed establishment of another company. It most obviously extends the approach of the ECJ in *DFDS* beyond the situation where a parent contracts with a subsidiary which has a branch in another country to a case in which two subsidiaries of the same parent contract with each other. The concept of lack of independence was clearly fundamental to the ECJ in the *DFDS* case. As the Tribunal recognised it cannot be assumed that a subsidiary lacks the necessary legal and economic independence. In the case of two subsidiaries an equally, if not more detailed examination of the particular relationship is warranted. It is difficult to see the basis for any conclusion that CI had legal or economic control over the UK subsidiaries, who to an extent had or were developing other business activities, either because of their relationship as subsidiaries or the contracts between them. Legal and economic control was exercised by the Parent to an extent, because of its parent subsidiary relationships, but, significantly, it was not a contracting party. The Tribunal could scarcely be accused of failing to take a pragmatic view, but its approach to independence was at best imprecise.

This was a success for Customs in challenging a tax avoidance scheme without the need to argue out a *Halifax* or an abuse of rights approach. However, it is noteworthy that the Tribunal would have rejected Customs’ arguments based on *Halifax* and abuse of rights. The appellants submitted that Customs were in effect seeking to circumvent the place of supply rules. The Tribunal was clearly sympathetic. Customs’ argument was criticised as going well beyond *Halifax* and ignoring that under Article 9 of the Sixth Directive it was clearly possible for services consumed in the UK to escape tax because of the place of supply rules. Customs’ submissions on abuse of rights were said to fall down at stage one. It was impossible to maintain, given the place of supply rules, that circumstances existed in which the purpose of Community rules had not been achieved. If by application of Provisions of the Directive a supply was not subject to tax, the Tribunal was not prepared to accept that the result was contrary to the Directive unless clearly contrary to the purpose of the specific provision by which it escapes tax. That was not the case with respect to Article 9.

Dr Beynon and Partners v C & E Comrs, 19 December 2002, CA

When GPs personally administer drugs, that they have themselves dispensed, to a “regulation 20” patient there are multiple supplies, including a separate supply of drugs that is zero-rated. The right approach on a single/multiple supply appeal is to treat the legal effect of the transaction as a question of law on which the appeal court should reach its own conclusion

The Court of Appeal has found in favour of a GP practice, overturning the decision of the VAT Tribunal, initially upheld by Lawrence Collins J. The appeal focused on whether there was a single or multiple supply in another case of the provision of both goods and services in the medical care sector. The Court of Appeal held that the personal administration by GPs (or their nurses) of drugs prescribed and dispensed by the GPs comprises two separate supplies. The doctor supplies medical care and goods. The first supply is exempt. The second supply is zero-rated under VATA 1994 Sch 8 Group 12 item 1.

This case has potentially wide-ranging implications for all “non-dispensing” NHS GPs. The vast majority have previously regarded themselves as exclusively making exempt supplies, in line with the views of Customs. Whilst the decision only considers supplies to regulation 20 patients, it threatens that large partnerships may be obliged to register, on the basis that they are making taxable supplies of goods when giving injections. This will be a particular concern whenever they recover a separate payment for the drug or vaccine administered.

At first instance, the Tribunal, having made detailed findings of fact, applied the guidance given by the ECJ in the *Card Protection Plan* (“CPP”) case [1999] STC 270. Its conclusion was that “the dominant purpose of the provision and personal administration of drugs by the [GPs] to their regulation 20 patients is as part of a single supply of medical services”. “Regulation 20” is part of the NHS (Pharmaceuticals Services) Regulations 1992, allowing and requiring GPs to provide pharmaceutical (dispensing) services to patients who have difficulty in reaching a pharmacy. GPs can dispense and supply drugs to a regulation 20 patient to be taken at home. Customs did not dispute that such a supply was zero-rated. GPs also personally administer drugs, typically vaccines injected in the surgery, to regulation 20 patients (and other patients) which they dispense from their own stocks. The GP practice contended that, for a regulation 20 patient, the transaction involved a zero-rated supply of goods.

There appears to have been no suggestion that the Tribunal had applied an incorrect test. However, the Tribunal did make an error in its findings of fact, concluding that when a doctor personally administered a drug he did not prepare a prescription and that there was no separate price for drugs personally administered by GPs. The evidence had been that a prescription was written every time a drug was provided by the doctor, whether personally administered or not, so that there was a prescription charge and separate price. Lawrence Collins J dismissed an appeal holding that (1) there was no proper basis on which he could intervene; (2) in any event the Tribunal had reached the right conclusion.

Chadwick LJ considered the personal administration of drugs had three distinct features: (1) the consultation, diagnosis and act of prescribing; (2) the provision of the drug; and (3) the administration of the drug. The last two were not dissociable, but the first was. Hence there were two supplies. It is this running together of dispensing and injecting which may give the decision wider repercussions for GPs. Aldous LJ took a broadly similar approach concluding that the first and second were distinct features. Munby J simply agreed with both.

The Court of Appeal’s approach can certainly be criticised as (1) highly artificial and (2) difficult to reconcile with the evidence. Moreover the two full judgments do not adopt the same analysis. Chadwick LJ clearly considered it “not open to serious dispute” that the second and third features were indissociable. Aldous LJ, unsure as to whether the third feature was distinct at all, stated that if the third feature “is not ancillary to the first, then it is ancillary to the second ...”. If his view was

that the first and third elements were ancillary, he found that one type of medical care was ancillary to another. That betrays an artificiality of approach in the treatment of the medical care and a somewhat different conception of the transaction from Chadwick LJ.

Aldous LJ was influenced by his view that a person who went to his GP for a flu vaccination had the aim of obtaining the vaccine. That can be contrasted with the parent who takes his baby to the surgery and, after advice, agrees that the MMR vaccine should be administered. An aim may be to minimise the risks of childhood diseases, but is it generally realistic to conclude that the aim is to obtain the vaccine, rather than the broader aim of minimising risks to health and maximising benefits through appropriate medical care. The selected examples tend to demonstrate on how the analysis can depend on the way in which the typical patient (customer) is identified, or on conjecture, if not mere assertion. Aldous LJ's example assumes a patient positively seeking the vaccine.

The case is also noteworthy for the conclusion by the Court of Appeal that the courts should be prepared to intervene on appeal in a single/multiple supply case despite the fact that the Tribunal has, on the face of the decision, applied the correct test to the facts and not erred on an *Edwards v Birstow* [1955] 3 All ER 48 at 57, HL basis. Customs had submitted that the question of whether there was a single supply from the economic point of view, is a question of fact. Collins J had accepted that and concluded that the right approach was to treat the question "as one of fact, or more accurately the appreciation of facts, unless the matter turns on the evaluation and appreciation of contractual documents".

The distinction drawn with cases turning on written contracts was unsurprising on the authorities. In the *British Telecom* case [1999] STC 758, Lord Slynn had treated the characterisation of the supply "as provided for ... in the contractual documents" as a question of law. On the other hand, Lord Hope described the question of single/multiple supply as "one of fact and degree", expressly referring to the guidance from the ECJ in the *CPP* case in support of that proposition. In the *CPP* case, Lord Slynn, emphasising that everything turned on the interpretation of contractual documents, identified the single/multiple supply question as "open as a matter of law" for the Lords to review afresh. In *CPP* the Tribunal had, of course, not had the benefit of the ECJ's *CPP* guidelines. There was inevitable difficulty in establishing that the right legal approach had been applied by the Tribunal. The written contract was also central to identifying the supplies, although, contrary to Lord Slynn's emphasis, doubt can be expressed as to the extent to which the application of the *CPP* tests turned on the parties differing interpretations of the contract. Indeed, both parties contended for a single supply, the issues being what predominated and the appropriate tax treatment of the predominant element(s).

In *C & E Comrs v FDR Ltd* [2000] STC 672 the Court of Appeal refused to interfere with the Tribunal's conclusion as to the proper description of the core supply because it was quintessentially a conclusion of fact and there was no conceivable *Wednesbury* challenge. Laws LJ's decision did leave some room for debate as to whether that approach applied equally to deciding whether other elements of the supply were ancillary to the core and the proper tax treatment of the core. Collins J interpreted it broadly. That was logical, at least in terms of Tribunal's conclusions as to what could be treated as ancillary. He described Laws LJ as treating the single/multiple supply question as "one of fact for the tribunal".

The Court of Appeal has now endorsed a directly contrary approach. Aldous LJ stated "What was in dispute was whether there was a supply which was zero-rated. That required the court to decide what was the legal effect of the transaction. That is a question of law." He expressed the view that the reasoning of the Lords in the *BT* case is only consistent with such a conclusion. The judge did not explain why this was so.

To an extent the judge recognised that there was a narrower basis on which the Court could interfere with the decision of the Tribunal and based his decision on that basis. The parties had agreed that the Tribunal had misunderstood the evidence and reached a wrong conclusion on prescription and separate price. Aldous LJ expressed the view that that error required the appellate

court to reconsider the case on its merits. Nevertheless, it now appears that the Court of Appeal has endorsed the approach that, in all cases, the question of single/multiple supply is a question of law on which an appeal court should form its own view, “although giving proper regard to the conclusion reached by the Tribunal”.

There is something of a paradox in the approach here. Since the decision of the ECJ in *CPP* the crucial importance of the particular facts and circumstances of the individual supply in question is beyond dispute. The examination of a transaction from an economic point of view and identification of the essential features from the point of view of the typical consumer, both vital in the *CPP* approach, suggest questions of fact. The process required may well be thought to consist of the inference of facts from primary facts. Despite the guidance on the correct approach to single/multiple supplies in the *CPP* case and subsequent guidance by the higher domestic courts, and despite the introduction of concepts such as the “apex or table-top models”, the Court of Appeal has, sensibly, warned against over-elaboration and needless complexity in this field. The House of Lords has cautioned against over-zealous dissecting and analysis. It is difficult to see why the Tribunal is not best-placed to take the decision on single/multiple supplies, whether or not the supply is made pursuant to a written contract. If the Tribunal applies the wrong test, or makes a material finding on the facts contradicted by the evidence, or can otherwise be impugned on an *Edwards v Bairstow* basis, then it is for the courts to intervene. However, if it is only the case that the primary facts justify alternative inferences of fact, the accepted view is that there is no error of law and the courts on appeal should not be free to substitute their own preference for that of the fact finding Tribunal (see *Furniss v Dawson* [1984] STC 153). The Court’s general approach is also to be contrasted with the long-established approach of appellate courts to other VAT appeals on mixed questions of fact and law (see *Potter v C & E Comrs* [1985] STC 45, CA).

If the approach set out in the *Beynon* case is followed, there is now every encouragement to a taxpayer disappointed by a Tribunal’s decision on single/multiple supply to consider pursuing a further appeal. Despite the attractions of a “common sense”, commercial or simple approach to the single/multiple supply issue, perhaps closer analysis needs to be given to the issues a single/multiple supply appeal raises. Any issue as to what is principal and predominant and what, if anything, is ancillary involves an appreciation of the facts and, on usual principles, is properly for the Tribunal. If there is an issue as to the tax liability of the principal element(s) there may well be an appealable question of law.

For some medical practitioners the Court of Appeal’s decision will clearly be welcome. On the basis of the Court of Appeal’s reasoning GPs will no longer have to pay VAT on drugs required by the practice, without being able to recover that VAT as input tax, given the absence of any allowance from the NHS to cover VAT on the cost of drugs supplied to regulation 20 patients.

Customs were refused permission to appeal. There is a need for more clarity in this area, given the Court of Appeal decisions which are not easy to reconcile. Customs may well seek permission from the Lords and it must be hoped that the Lords will permit a further appeal.

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