

R v (1) Commissioners of Customs & Excise (2) The Attorney General, ex parte Federation of Technological Industries [2004] EWHC 254 (Admin)

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Section 77A and paragraph 4 of Schedule 11, VATA 1994 – An argument that these provisions lacked vires under the Sixth Directive was likely to succeed and the matter should be referred to the ECJ for a preliminary ruling. All other arguments put forward by the Claimants, including incompatibility with general principles of Community law and breaches of the European Convention on Human Rights lacked any foundation.

Before considering the judgment in detail, readers should be aware that this was a judgment given on an application for leave to judicial review. Accordingly, paragraphs 6.1 and 6.2 of Practice Direction (Citation of Authorities) [2001] 1WLR 1001 would appear to prevent citation of this judgment before any court, as the judgment does not contain an express statement to the effect that it “establishes a new principle or extends the present law”. Nevertheless, the judgment was handed down following a fully contested hearing before Lightman J, and many of the conclusions reached by the learned judge conclusively disposed of several of the arguments before him. Taking those factors into account, it might be possible to convince the court to allow citation in appropriate circumstances.

The claimants sought to challenge the legality of the new provisions relating to “joint and several liability” in s.77A VATA 1994 and the requirements for security in amended paragraph 4 of Schedule 11 VATA which the Commissioners are empowered to impose on traders involved in mobile phones and computer supplies, both these markets being regarded by the Commissioners as subject to a higher risk of evasion, particularly arising out of carousel fraud and missing trader fraud. These provisions were introduced by amendment to the VATA 1994 by sections 17 and 18 of the Finance Act 2003 and sought to counter widespread abuse of the VAT system. In essence, pursuant to those provisions a taxable person may be required to provide security to the VAT due from his suppliers or from the person he supplies to and may be

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made jointly and severally liable with them for that VAT, subject to certain statutory tests being fulfilled.

The claimants argued that the relevant provisions were *ultra vires* as there was no power to enact them under Community law and therefore requested that the matter be referred to the ECJ for a preliminary reference. The claimants also argued that those provisions were contrary to Articles 4 and 11 of the Sixth Directive, imposed disproportionate obligations on taxable persons operating in the industry and were contrary to Articles 1 and 6 of the European Convention on Human Rights ("the Convention").

As to the question of *vires*, the Commissioners contended that such power derived from Articles 21(3) and 22(8) of the Sixth Directive. They contended that Article 21(3), which allows Member States to impose joint and several liability in relation to certain supplies, should be widely interpreted and allowed the Commissioners to provide in all cases that someone other than the specified taxable person could be jointly and severally liable with the taxable person. The Claimants, on the other hand, contended that a more restrictive interpretation should be given to Article 21(3), so that it would only apply to the four specific situations where a discretion or power of derogation was expressly conferred on Member States pursuant to Article 21(1) and 21(2).

The learned judge concluded that the Claimants' argument did not merely have a substantial prospect of success, the normal threshold for leave applications, but indeed was likely to succeed. He regarded as improbable that Article 21(3) was intended to give Member States "the power to make such fundamental change in the structure of the VAT legislation", as the Commissioners contended for.

The Commissioners further relied upon Article 22(8) as authorising both the imposition of joint and several liability and the requirement of provision of security for a third person. That Article allows Member States to impose "other obligations" which are deemed necessary for the correct collection of the tax and for the prevention of evasion. In relation to the imposition of joint and several liability, the learned judge concluded that Article 22(8) could not be sensibly read as imposing any obligation on anyone else to pay the VAT due from another taxable person. The Article only went as far as imposing on persons other than the taxable person limited obligation to secure the payment by the taxable person of the VAT due from him. Accordingly, Article 22(8) could not be relied on by the Commissioners to authorise imposition of joint and several liability on third parties and the claimants has a substantial prospect of success on this issue.

The learned judge also rejected the Commissioners' contention that Article 22(8) allowed the imposition of security requirements on persons other than the taxable person liable for the tax. He concluded that the language of Article 22(8) was apposite for imposing obligations on the taxable person necessary for the collection of tax due from the taxable person and preventing evasion by him, not for the collection of tax and the prevention of evasion by others, as the Commissioners contended. The Commissioners sought to support their arguments in this respect by citing Case C-217/94 *Eismann Alto Adige Srl v Ufficio IVA di Bolzano* [1996] ECR I-5287, [1996] STC 1374 as authority for the proposition that the relevant provisions were within the scope of residual discretion left for national legislation in areas in which the Community legislature had not yet completely harmonised VAT law. The Court rejected this further argument and stated that there was no scope for the national legislature to extend the limits of Article 22(8) in the manner sought.

Having found that the Claimants had a substantial prospect of success or were likely to succeed on the question of *vires*, the Court decided that this question should be referred to the ECJ for a preliminary ruling.

The Court rejected outright arguments based on the alleged incompatibility with Articles 4 and 11 of the Sixth Directive as being "without foundation". Likewise, in relation to the proportionality of relevant provision and of the rebuttable presumptions contained therein, were also rejected. The Court found that there was nothing disproportionate in requiring taxable persons to undertake reasonable checks to ensure the integrity of the supply chain, bearing in mind the challenge facing

the VAT system in this area. Further, there was nothing disproportionate in imposing a rebuttable presumption on taxable persons and such a presumption did not make it impossible or excessively difficult to exercise Community rights.

Finally, in relation to the challenges pursuant to the Convention, the Court stated that, in accordance with established caselaw, in the field of taxation the Convention afforded Member States a considerable degree of latitude in determining the appropriate measures to levy and collect tax and the courts would not readily interfere where the State has made a judgment about the public of general interest and will only do so if that judgment is "manifestly without reasonable foundation". The possible existence of alternative legislative solutions did not render the contested legislation unjustified, this being a matter for the national legislature. The Court also found that none of the contested provisions conferred powers on the Commissioners which were arbitrary or could be arbitrarily exercised, as the actions of the Commissioners would be subject to public law scrutiny and would need to be exercised in good faith, fairly and reasonably. There was also no question of the provisions failing to satisfy the requirements of precision and foreseeability. Accordingly, there could be no doubt that the relevant provision did not contravene Article 1 of Protocol 1 to the Convention.

As to incompatibility with Article 6 of the Convention, the Court concluded that such a contention was "hopeless" as Article 6.1 had no application to ordinary tax matter (see *Ferrazzini v Italy* [2001] STC 1314) and that none of the provision could be described as imposing any criminal liability, so that Article 6.2 would also be inapplicable in the present context.

The area of cross-border VAT fraud involving trades in mobile phone, computers and related parts and accessories is one that has been concerning both Member States and the Community institutions for some time. The writer understands that a number of other Member States have also enacted powers similar to those subject matter of the present dispute and are therefore likely to have an interest in the outcome of this reference to the ECJ. From reading the current judgment, it would appear that the current fraud costs the UK economy in excess of £1.5 billion each year. On a Community wide scale, the amount is likely to be far higher. In this same area, two further references (Bond House and Optigen/Fulcrum) relating to "carousel fraud" have already been referred to the ECJ, though both are still at an early stage and judgment is unlikely to be given before 2005 at the earliest.

The current judgment is likely to cause significant problems for the Commissioners in applying the disputed provisions in their continued efforts to counter VAT fraud in what they regard as "high risk" trades. As the Commissioners were not currently applying the relevant provisions to the claimants, no application for interim relief was before the Court and, accordingly, no order for interim relief was granted. Nevertheless, it would appear likely that, should the Commissioners seek to use the powers granted by paragraph 4 of Schedule 11 and/or section 77A, VATA 1994, it would be open to the affected trader to apply for interim relief from the Court while the question of *vires* is pending before the ECJ. As at the date of publication neither Notice 700/52, dealing with the requirement of security, nor Notice 726, dealing with the imposition of joint and several liability, have either been withdrawn or amended so as to take into account the judgment of Lightman J in the present case.

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