

Case I/S Fini H v Skatteministeriet (Judgment released on 3 March 2005)

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Cessation of business – Taxable traders who have ceased their economic activity but continue to be liable for rent and other charges relating to business premises, the lease of which contains a non-termination clause, are entitled to deduct input tax, provided the absence of any fraudulent or abusive intent has been established.

This case concerned the right to deduct input tax on rental and other payments relating to business premises for a period of some five years following cessation of any economic activity.

Fini H, a limited partnership created in 1989 with the object of running a restaurant, leased restaurant premises from 20 May 1989 for a period of 10 years. The lease contained a clause preventing termination of the lease on either side until 30 September 1998.

The restaurant closed in July 1993 and, following that date, Fini H ceased all economic activities and the restaurant premises remained unused. It appears that the taxpayer sought to terminate the lease but the landlord, relying on the non-termination clause, refused such termination and/or any surrender of the lease prior to September 1998, some five years after cessation of the business. While Fini H did seek alternative tenants for the premises, none could be found which would have taken over the lease on terms which were acceptable to Fini H, who would, in any event, remain liable to the landlord for any shortfall in the rent.

Despite having ceased trading, Fini H continued to remain registered for VAT and submitted repayment claims to the Danish Authorities, deducting input tax on rent, heating, electricity and other charges, all of which continued to be payable in respect of the premises previously used for the purpose of the business.

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In September 1998 the Danish tax authorities demanded repayment of the sums already refunded to Fini H as, following cessation of its restaurant business, Fini H had not carried on an economic activity and was therefore no longer qualified as a taxable trader. The authority argued that the lease could not, by itself, establish a continuing entitlement to be regarded as a taxable trader between the third quarter of 1993 and termination of the lease.

That decision was upheld by the Danish court at first instance. On appeal by the taxpayer a number of questions were referred to the ECJ, essentially seeking to establish whether a right to deduct input tax on premises initially used for the purpose of an economic activity could continue following cessation of that activity where the lease for the premises prevented the tenant from seeking early termination of the same.

Both the Danish Government and the Commission argued that, where a taxable person no longer exercises an economic activity, the right to deduct ceased to apply from the date on which he ceased that activity. A taxable person could not enjoy a right to deduct indefinitely on account of the fact that, in the past, he had exercised an economic activity.

Fini H, on the other hand, argued that the right to deduct in the present case derived from the fact that the lease had been concluded for the purpose of carrying on an economic activity and, therefore, even payments made pursuant to the lease after the restaurant had closed were to be treated as payments for supplies received for business purposes.

The ECJ, agreeing with Advocate-General Jacobs' opinion, held that Fini H ought to be entitled to deduct input tax until the lease could be properly terminated (i.e. until September 1998). By analogy to Case C-408/98 *Abbey National* [2001] ECR I-1361; [2001] STC 297, the Court concluded that transactions such as the payments which Fini H continued to have to make during the period over which its restaurant business was being wound up had to be regarded as forming part of its economic activity as a whole, provided a direct and immediate link could be established between those payments and its economic activity.

The ECJ then concluded that such a direct and immediate link existed, in principle, in the present case. As Fini H had entered into the lease in order to have the premises necessary for carrying out its restaurant business, and given that the premises were actually used for the purpose of that business, the taxpayer's obligation to continue paying rent and other charges after it had ceased that business was a direct consequence of the carrying on of that business.

In this respect, the duration of the obligation to pay the rent and charges (which in this case continued for some five years after ceasing to trade) had no bearing on the existence of an economic activity, provided that such period of time was strictly necessary to complete the winding up of the business. Accordingly, Fini H must be entitled to deduct input tax on such payments.

Despite the absence, at least on the face of the Judgment and Opinion, of any suggestion that Fini H had been seeking to rely on his right to deduct abusively or fraudulently, the ECJ went on to consider the effect such an abusive or fraudulent intent would have had on his right to deduct (see paragraphs 31 to 35 of the Judgment). This is, perhaps, the most interesting point of this judgment, and one which might well have wider application than the somewhat unusual factual background of this case.

The ECJ first of all restated a general principle that Community law cannot be relied on for abusive or fraudulent ends, citing cases such as Case C-367/96 *Kefalas and Others* [1998] ECR I-2843 and Case C-373/97 *Diamantis* [2000] ECR I-1705, both cases dealing with Community provisions outside the field of VAT.

It then continued by stating that, had Fini H continued to use the premises previously used as a restaurant for purely private purposes, while continuing to claim deduction, such behaviour would have constituted an example of abusive or fraudulent reliance. This proposition is perhaps

uncontroversial. In any event, on the facts, this did not arise in the present proceedings, as the premises had been left unused from 1993 to 1998.

Had the taxing authorities concluded that the right to deduct had been exercised fraudulently or abusively, they would have been entitled to demand, with retrospective effect, repayment of the amounts deducted. It would be for the national court to refuse to allow the right to deduct where it is established that the right is being relied on for fraudulent or abusive ends.

It is not entirely clear, from the reasoning of the ECJ, whether, in this respect, the burden of proof would fall on the taxing authority to establish such fraudulent or abusive reliance or whether it should be for the taxpayer to prove the absence of such intent. Paragraph 33 and 34 of the Judgment suggest that the burden falls on the taxing authority. Nevertheless, the wording chosen by the ECJ in its response to the first question posed by the national court, which indicates that the entitlement to deduct only arises provided "*the absence of any fraudulent or abusive intent has been established*" [emphasis added], would appear to suggest the opposite.

The application of any principle in relation to abusive or fraudulent reliance on Community law in the field of VAT is one which has been the subject of much litigation in the UK and it seems unlikely that we will have a definitive answer until the ECJ finally delivers its judgment in the *Halifax/Huddersfield/Bupa* cases. The Advocate-General is due to release his opinion in those cases during April and, hopefully, we will have some initial clarification of those principles and their application to VAT.

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