

A New Interpretation

The recent decision by the Court of Appeal in the *IDT Card Services* case,¹ concerning VAT on the distribution in the UK of phonecards (entitling holders to services from a telecoms supplier established in the Republic of Ireland) resolved 'a point of novelty and difficulty' in the area of face-value vouchers (and telecommunications). It also raises a question as to the likelihood of an increase in judicial activism, using a more robust purposive approach to construction in VAT cases, whenever the judges consider it required. That means an approach based on (judicial understanding of) 'the purposes of the Sixth Directive'.

The judgment of Arden LJ, with whom the other judges agreed, recognises in the flexible and robust interpretative techniques now used by the courts 'to make legislation compatible with the ECHR' techniques

Peter Mantle, barrister, Monckton Chambers, considers a robust new approach by the Court of Appeal to the interpretation of VAT legislation following the IDT Card Services case

deciding the case, the Court (CA) considered it necessary to read words into VATA 1994, if it was to be brought into conformity with the Sixth Directive, and concluded that it was appropriate so to do. The outcome was, as most readers will know, that UK distributors of the phonecards were held liable to pay VAT on the issue of those phonecards to them on the basis that they received a supply of telecoms services in the UK where they were established (a face-value voucher representing a promise to make telecoms services available). From the traders' point of view, and probably the CA's own, the CA filled a gap in VATA

was non-taxation of some telecoms services as a result of the use of face-value vouchers and differences of approach in Irish and UK domestic law. It is understood that a number of companies had incurred expense in structuring their businesses to exploit the tax advantage they perceived as open to them.

The cards in issue were multi-functional, but that complication can be largely overlooked and for simplicity I shall describe them as phonecards. ICSIL, based in Ireland, issued phonecards to distributors based in the UK. They resold them to members of the public in the UK, who used them to obtain telecoms services from Indirect, based in Ireland and part of the same group as ICSIL. No VAT was payable in Ireland when the phonecards were supplied to businesses, such as the distributors, outside Ireland, or when the phonecards were redeemed, even if the telecoms services were supplied in Ireland and the end-user received his supply from a distributor outside Ireland who received his cards from an Irish issuer. It was crucial to the dispute that Indirect did not issue the voucher. Therefore it was a credit voucher and in UK VATA Schedule 10A, paragraph 3 was relevant. VATA, Schedule 10A, paragraph 3(2), apparently crucially, required that for the purposes of VATA the consideration for any supply of a credit voucher be disregarded (unless it exceeded the face value, not the case here). Those plain words were subject to disapplication, but according to the words of paragraph 3(3) only '[where goods and services are obtained through the credit voucher] from a person other

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equally appropriate 'to make domestic legislation comply with the laws of the European Union'. As Arden LJ has since put it, 'The very basis of the technique is that the Courts may be obliged to read [domestic] legislation as containing a measure which the legislature *ought to have made under Community law but failed so to do.*'² In *IDT* the Court concluded that the 'principle of conforming interpretation' meant that the court might be obliged to write words into a tax statute, although that did not mean that the court was subject to the discipline of having to identify exactly what words should be written in. In

to the disadvantage of phonecard distributors as taxpayers.

The specific statutory provisions that had to be construed and the facts of the case may appear to be of little general importance, in comparison with the more general principles of approach to interpretation of VAT statutes laid out by the Court. However, in order to gauge how radical this development is it is necessary to have a grasp of the facts and the relevance of VATA, Schedule 10A, paragraph 3, which concerns the treatment of credit vouchers. The case involved cross-border supplies. The traders' view of VATA meant that there

than the issuer and that person fails to account for any VAT due on the supply of those goods or services to the person using the voucher to obtain them'. HMRC took the view that UK distributors of the phonecards were liable to account for VAT on the supplies of phonecards to them by ICSIL.

The CA held that paragraph 3(3) could and should be interpreted to be compatible with general principles of the Sixth Directive. As a result, the disregard in paragraph 3(2) is to be disapplied, whenever the disregard would result in non-taxation, contrary to the objectives of the Sixth Directive, of a taxable supply of goods or services in the UK. That included supplies to distributors where the supply of telecoms by Indirect was not liable to VAT under Irish law. The CA was not constrained in its approach because;

- there was no indication that Parliament had specifically intended to depart from the Sixth Directive on this particular point;
- there was no fundamental feature in Schedule 10A inconsistent with reading into it a further disapplication to conform to the Sixth Directive; and
- the effect of the robust interpretation did not raise policy issues beyond those a court could properly resolve in its judicial role.

The principle it applied has been described as that of 'conforming interpretation' and Arden LJ has even described it *simply as the Marleasing principle*, well known as that is, but in my view it is at least an enhanced principle, and one that brings features that most tax practitioners would be surprised to encounter. Words can be written into a UK statute, indeed it can be interpreted against its natural meaning and there is no need to find a simple linguistic device for this. The approach draws heavily on human rights cases, especially the House of Lords in *Ghaidan v Godin-Mendoza* [2004] 2 AC 557.

Six features of the robust application of the principle of conforming interpretation in this case should be remarked upon. It undoubtedly seems to be the case that the approach to interpretation adopted in this case led to taxpayers being held liable to pay VAT where, but for that robust approach, they would not have been. A traditionalist could only see it as a judicial technique that effectively created a liability to tax (in the UK).



Peter Mantle

Arden LJ's comments reveal that she was clearly prepared to use the principle of conforming interpretation to depart from the otherwise 'correct' interpretation of VATA.

In terms of this particular application of the robust approach, the Court found it necessary and permissible to apply it in a case where the trader had argued that there was no Sixth Directive obligation on the UK to apply VAT, and many others, including *Moses J* below, had agreed.³ Of course, it should not have mattered to the CA whether the application of the Sixth Directive to the situation it was concerned with was

lay the EC law foundations for its bold interpretation. A reference to the ECJ was considered unnecessary. However, there was at least incomplete harmonisation at the Sixth Directive level, and scope for different Irish and UK approaches to the Directive, but that proved no deterrent to the robust approach.

Although Article 9 featured prominently in the submissions and reasoning, this was not a case where the interpretative exercise can be seen as predominantly directed to ensuring that the specific provisions of a directive article are implemented by domestic legislation. The approach to the issues adopted treats the place of supply rules as a potential exclusion from reliance on more general principles of the Sixth Directive. In reaching its conclusions, the CA found Article 9 no obstacle, but its primary concern appears to be the possible violation of principles of non-taxation, the avoidance of double taxation, the prevention of distortion of competition and neutrality. That contributes to giving the judgments a radical appearance. This was not a robust interpretation in the face of the demands of particular articles of the Directive, but principally reliant on recitals and general principles, well recognised in the jurisprudence of the ECJ, but liable to take courts in altogether less certain directions.

The CA, whilst concerned with the principle of legal certainty, ultimately

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controversial, as opposed to whether it applied or not. Moreover, the Court importantly recognised that it was engaged on two levels of interpretation. The first was at the level of the Sixth Directive, the second was at the level of VATA 1994. The Court described the first as a 'greater burden', a result of EU legislation worked out in less detail, and implicit within that burden is more scope for differences of opinion and for judicial opinion to impact on the law. The CA considered that *Moses J* had approached Article 9 of the Sixth Directive wrongly and it was careful to

allowed it no significant impact in this case. More difficult cases may see it feature more prominently.

It is notable that in a great many cases where the Sixth Directive is of relevance to a dispute the taxpayer will already have a directly effective EC law right. It can rely on that right, in effect, regardless of the domestic 'implementing' provisions. Thus for taxpayers, a more robust approach to a conforming interpretation may simply be the alternative means to an end they can already attain and give them no additional benefit. Indeed, a taxpayer

may conceivably be better placed, in terms of remedies, if there has not been proper implementation in domestic legislation. Of course, where a taxpayer does not have a directly effective right the more robust approach *could* work to its advantage, depending on the degree of intervention the courts will be prepared to undertake in the absence of a directly effective right. As remarked above, this decision is not particularly closely tied to a particular article. Therefore, a more interventionist approach to statutory construction may on occasion, favour the taxpayer. However, as this case itself demonstrates, it is likely to be a tool of greater significance to HMRC where, at first sight, domestic legislation fails to place obligations on taxpayers that can be spelled out of the Sixth Directive. This is in marked contrast to the impact of robust statutory interpretation involving human rights on the relationship between the subject and the state.

The crucial paragraph 3(3) of Schedule 10A was described as granting

although in other respects Pill LJ may be seen as more conservative than the other judges.

Indeed, in terms of the wider application of the approach to interpretation used by the CA, the judgments contain one firm hint of hesitation. Pill LJ acknowledging that the approach adopted involved the use of robust techniques, concluded that they were justified 'in the particular circumstances of this case, to which I would confine my comments'. Perhaps, for him, one factor was that it seemed to him an obvious case.

Anyone who thought the CA might not immediately find occasion to return to such a robust approach to interpretation in the VAT context has already been proved wrong. Readers of tax case news in the last issue will already know that the taxpayer has won its appeal in the latest decision on the three-year cap. *Fleming* is highly significant in terms of the cap. What this article can point out is that in giving effect to EC rights, threatened by the imposition of the cap, Arden LJ adopted the enhanced *IDT*

long-term discernable trend to more adventurous interpretation of VAT provisions by reference to EU law on the basis of a *Marleasing*-type approach, and a more robust approach in human rights cases, which were inevitably going to exercise some influence on cases involving other international and EU obligations. What is noteworthy is that whilst refusing to admit the possibility of the particular interpretation adopted by Arden LJ, in *Fleming* the majority do not attempt to deny the applicability of the approach to interpretation adopted in *IDT* in the VAT context.

The Court of Appeal has in the recent past been keen to adopt, in various VAT matters, a purposive approach to interpretation, but a measured approach to the use of general principles underlying the Sixth Directive. For example, it has rejected the notion that Article 13B exemptions are to be interpreted in 'a rigid and formulaic way', because exceptions to 'the general principle that [VAT] is to be levied on all services supplied for consideration by a taxable person'. Rather, in the field of exemptions the Court has looked to context and to other principles, for example securing equal treatment for taxable persons, as has the ECJ, as opposed to over-heavy reliance on the principle that, exceptions aside, VAT should be levied on all transactions. On its face at least, this is a somewhat more sensitive approach, which operates on both levels of interpretation. It should serve as a reminder that it is not in every case that the *IDT* enhanced principle of compliant construction will come into play, or that the principle will always have radical effects. However, subject to the ultimate constraint, of not crossing the line, re-emphasised in *Fleming*, wherever that Rubicon may be, the *IDT* approach is capable of producing what may well prove radical interpretations with very significant consequences in the VAT field.

Notes

¹ [2006] EWCA Civ 29, judgment of 27 January 2006, Pill, Latham, Arden LJJ. Arden LJ gave the leading judgment with which Latham LJ simply agreed. Pill LJ gave a concurring judgment.

² *Fleming v HMRC* [2006] EWCA Civ 70, judgment of 15 February 2006, Ward, Arden, Hallet LJJ.

³ Moses J had found any principle empowering or requiring the UK to charge VAT absent, the place of supply being Ireland under Article 9(1).

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relief to a supplier from double taxation, probably a fair description, and one accepted by CA. Although the end result is the same in each case, it may be easier for this purposive approach to spell out an obligation to pay VAT by reading something into an anti-double-taxation provision, rather than by interpreting widely a primary provision imposing liability. That will especially be so where difficult policy considerations occur. They may well arise at the margins of VAT, but it is impossible to gauge what sort of a brake that will be on judicial activism. On the bare facts of this case it may well have appeared to CA to be a clear case where telecoms services that should have been taxed somewhere in the EC were going untaxed altogether. Taxation in the UK did not appear to risk double taxation. Pill LJ thought the demands of EC law were strong and spoke of a 'fundamental duty arising from EU directives to impose VAT on the supply of services'. To taxpayers that must give some cause for alarm,

principle of conforming interpretation in relation to a UK court's ability to read a transitional period into national legislation. In reliance on it she concluded that a transitional period could be read into Regulation 29(1A). However, the other judges disagreed with her on that. As Hallet LJ put it, relying on *Gaidan*, 'however strong and radical the obligation on a court to interpret legislation, there is a line that it may not cross'. Thus there is a hint of the answer to the question as to the likelihood of an increase in judicial activism using this interpretative principle. *IDT* has certainly sowed the seeds but it may take particular cases for the enhanced principle to take root and other judges may be more willing to see the constraint that they must only interpret domestic legislation to give proper effect to EC rights 'so far as is possible' as a stricter restraint. How significant the impact will be depends in part on how radical a departure *IDT* is seen to be. It would go too far to say that it represents a fundamental shift, as it follows in a