

Local Authorities Mutual Investment Trust v Commissioners of Customs and Excise [2003] EWHC 2766 (Ch), 21st November 2003

Three-year cap – Regulation 29(1A), Value Added Tax Regulations 1995 – Whether compatible with Community Law and Human Rights Act 1998

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The High Court dismissed the appeal by the Local Authorities Mutual Investment Trust ("LAMIT") against a decision of the VAT and Duties Tribunal upholding the Commissioners refusal of a claim for input tax made more than 3 years after the relevant return date, relying on the three-year cap contained in Regulation 29(1A). In so doing, the High Court explicitly held that the three-year cap introduced by reg.29(1A) was not contrary to Community law.

LAMIT is a taxable person acting as trustee for charities and public authority pension funds. Following a change in its method of account for VAT on certain supplies relating to properties for which the option to charge VAT had been exercised, LAMIT discovered a that it had failed to claim credit for a number of items of input tax for the periods 02/98 to 05/01. The existence of these errors was discovered around June 2001, but an extensive accounting review was necessary before detailed claims could be submitted. That review was only completed in November 2001 and voluntary disclosures to correct the errors were not submitted until 20th November 2001.

The Commissioners allowed the claims for later periods but refused the claims relating to periods 02/98, 05/98 and 08/98 as having been made more than 3 years after the relevant return date and therefore time-barred pursuant to Regulation 29(1A) of the Value Added Tax Regulations 1995, introduced with effect from 1st May 1997 by the Value Added Tax (Amendment) Regulations (SI 1997/1086).

The Tribunal, relying on the decision of the ECJ in Case C-62/00 *Marks and Spencer plc v Commissioners of Customs and Excise* [2002] ECR I-6325, [2002] STC 1036, had dismissed LAMIT's appeal. The Tribunal decided that, although the ECJ decision only related to the three-year cap on recovery of overpaid output tax, contained in s.80(4) of the Value Added Tax Act 1994, and therefore not directly applicable to the case before it, the same reasoning applied in relation to LAMIT's claim and the interest of legal certainty required that finality should be achieved, whereby the time limit laid down in Reg.29(1A) was not unlawful. The

¹ For more information on **Mario Angiolini**, please contact the Clerks on 020 7405 7211 or consult the 'Find a Barrister' Section on www.monckton.com.

Tribunal had also ruled that the retrospectivity issue in *Marks and Spencer* was not applicable to the case before it, since all periods in issue occurred after the imposition of the three-year cap, the claim had been submitted 4½ years after the introduction of the cap and the errors in recovery of input tax could have been discovered at any earlier time had the appellant carried out the investigation into its accounts earlier.

Essentially, LAMIT contended that:

- (1) reg.29 did not correctly implement Articles 17 and 18 of the Sixth Directive. The right to deduct arises when the deductible tax becomes chargeable and Article 18(2) provides how that right is to be exercised. In particular, Article 18(2) is not "time specific" and it is not open to the Member State to cut down such a right by the imposition of a time limit. Although Article 18(3) allows a Member State to impose "conditions" on the exercise of the right, these relate solely to evidential and procedural matters. Further, the discretionary nature of reg.29 in cases where the taxable person has not exercised the right to deduct in the return for the prescribed accounting period in which the VAT became chargeable renders it contrary to Article 18(1) and 18(2), which make the right to recover automatic in such circumstances;
- (2) the imposition of a "special" limitation period was not justified and the time limit imposed by reg.29 was unreasonable and disproportionate. Limitation periods laid down in national rules relating to Community law must be reasonable, not less favourable than those governing similar domestic actions, not render virtually impossible or excessively difficult the exercise of Community Rights and take account of the potential costs and legal uncertainty of late claims and the potential unjust enrichment of the recipients. LAMIT suggested that the appropriate comparator for claims under reg.29 were claims for direct tax repayments, which had a limitation period of 5 years and 10 months. The observations of the ECJ in *Marks and Spencer* were not relevant to the present case as there was no risk of loss of tax or of unjust enrichment. Accordingly, a "special" limitation period was unjustified;
- (3) Finally, LAMIT also contended that reg.29(1A) infringed Article 1 of the First Protocol to the European Convention on Human Rights, as an unlawful interference with the peaceful enjoyment of the appellant's property (i.e. its right to deduct input tax).

The Commissioners' answers to the appellant's arguments were that:

- (1) The selection of the appropriate limitation period was a matter of legislative choice and the setting of reasonable limitation periods, such as that in reg.29(1A), was consistent with the requirements of Community law;
- (2) A limitation period such as that found in reg.29(1A) cannot be regarded as rendering virtually impossible or excessively difficult the exercise of the right to deduct merely because it cuts off all or part of a claim. The Sixth Directive does not create an absolute and enduring right to deduct which cannot be taken away through the imposition of reasonable time limits;
- (3) The assertion that the word "conditions" in the Sixth Directive related to evidential and procedural matters was misconceived, as limitation periods are classified as procedural matters in any event;
- (4) There was no basis for asserting that reg.29(1A) was fundamentally flawed in the present case as: (a) it was not retrospective, (b) all of LAMIT's claims arose after reg.29(1A) came into effect and (c) LAMIT's claims were not based upon any directly effective Community law right, as they arose out of LAMIT's own accounting mistakes and not from any failure on the part of the United Kingdom to properly implement or apply any provision of the Sixth Directive.

Collins J, dismissing LAMIT's appeal, firstly accepted, following the recent Court of Appeal decision in *Marks and Spencer v Commissioners of Customs and Excise* [2003] EWCA Civ 1448, that the relevant provision in United Kingdom law for determining time limits for deduction of input tax was reg.29(1A) and not section 80(4) of the VATA 1994. He then continued by holding that, in the absence of Community rules, it was for the domestic legal systems of each Member State to

determine the procedural conditions governing actions intended to ensure the protection of directly effective rights, including the imposition of time limits.

The learned judge then continued, relying on well established principles of Community law, that the laying down of such time limits with regard to actions of a fiscal nature was an application of the fundamental principle of legal certainty, protecting both the tax-payer and the administration concerned. In imposing such time limits, the Member State was bound to ensure that such time limits were not less favourable than those relating to similar actions of a domestic nature (principle of equivalence) and that the time limits did not make it impossible in practice to exercise the rights which national courts are obliged to protect (principle of effectiveness).

After considering the relevant caselaw, Collins J concluded that the words "conditions and procedures" in Article 18(3) of the Sixth Directive included time limits and that, accordingly, reg.29(1A) was authorised by Article 18(3). Even if that Article had not authorised the imposition of time limits, the effect would not have been that Community law prohibited such time limits, but only that it was silent in this respect. In that case, the principle in Case 33/76 *Rewe v Landwirtschaftskammer Saarland* [1976] ECR 1989 would operate, so that it would be for the Member State to lay down time limits which conformed with the principles of equivalence and effectiveness. Contrary to LAMIT's contention, there was no basis for limiting the power of national legislation to impose limitation periods only when "special circumstances" arose, such as cases where it was necessary to prevent serious disturbance as regards the past.

Finally, at paragraph 68 of the judgment, Collins J concluded that there was no basis for suggesting that a three-year limit was disproportionate or that it prevented the effective exercise of directly effective rights, nor that it breached the principle of equivalence. Reg. 29(1A) applied generally to all claims to deduct input tax, whether or not based on directly effective rights, and the fact that it applied exclusively to VAT claims and that the Commissioners could not point to comparable time limits for revenue claims did not mean that it offended the principle of equivalence.

The learned judge also rejected the challenge based on Article 1 of the First Protocol to the European Convention on Human Rights for the similar reason that the ECHR has consistently held that Contracting States enjoy a margin of appreciation in the imposition of time limits, provided the legislation pursues a legitimate aim, which in this case was the need for legal certainty, and was proportionate to that aim.

This case is the latest instalment in the apparently endless saga surrounding the three-year caps introduced by the Commissioners in various VAT provisions between 1996 and 1997, which started with the *Marks and Spencer* litigation, recently the subject of a second Court of Appeal decision, discussed more fully in last month's De Voil Indirect Tax Intelligence. In all the circumstances of the present dispute, the judgment of Collins J is largely unsurprising, and no doubt a welcome clarification for the Commissioners. In the present case, the taxpayer's claims arose solely out of errors in its own accounting procedures and not as a result of any faulty implementation or application of the VAT Directive nor as a result of any action and/or advice from the Commissioners. All of the facts giving rise to the appellant's claim arose long after the relevant time limits had already become part of United Kingdom law so that, from the start, those claims were subject to a known limitation period. Furthermore, unlike the introduction of s.80(4) of the VATA, which had made no provision for a transitional period, the introduction of the new time limits in reg.29(1A) was announced several months in advance, thereby enabling taxpayers to present claims without limit of time before the new provision took effect. With respect to the arguments put forward by LAMIT, any contrary judgment by Collins J in the circumstances of the present case would have been tantamount to a ruling that no time limits could ever be imposed on claims for deduction of input tax, a proposition which would be extremely difficult to support. As it did not arise on the facts, the judgment leaves open the question of whether the three year cap will be upheld in cases where the taxpayer's claim, rather than being caused by the taxpayer's own errors, can be attributed to the Commissioners' actions, for example through faulty implementation or faulty application by them of relevant Community law. It will be interesting to see how the interaction between the time limits and breaches of Community law by the Commissioners will be resolved, particularly in cases where claims first arose before implementation of the new time limits and the taxpayer was "discouraged"

from submitting a claim during the transitional period due to the Commissioners' actions in breach of Community law.