MONCKTON CHAMBERS

Abuse of Law and Sales on the High Seas to Final Consumers

By Alan Bates
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***Nissan Motor Manufacturing (UK) Limited v Commissioners for H.M. Revenue and Customs* (VAT Tribunal, Manchester; Chairman: Mr Colin Bishopp; decision released on 26 January 2007)**

The dividing line between legitimate VAT avoidance and 'abuse of law' (or 'abuse of rights') remains a hot topic following the ECJ's judgment in *Halifax plc v C&E Com'rs* (Case C-255/02) [2006] STC 919. An interesting illustration of the approach which the VAT Tribunal will take in applying the *Halifax* judgment has recently been provided by *Nissan Motor Manufacturing*, which concerned an audacious scheme intended to reduce liability for VAT within a supply chain by selling cars to final consumers while those cars were still on the high seas. Although the taxpayer's appeal was technically allowed, the Tribunal (chaired by Mr Colin Bishopp) held that the scheme constituted an abuse of law and, accordingly, was not capable of delivering the intended result.

The scheme the effectiveness of which at the heart of the appeal is best illustrated by considering the way in which, in the absence of that scheme, Nissan cars made in Japan were imported into, and sold within, the United Kingdom. All cars manufactured in Japan by Nissan Motors Limited ("NML") (a Japanese company) which were destined for sale within the European Union were first sold to a French company, Nissan Europe SAS ("NESAS"). NESAS then sold the cars, after applying a mark-up, to the relevant Nissan distribution company in each EU country. In the case of Great Britain, this was Nissan Motors GB Limited ("NMGB"). In the case of both transactions, title passed when an invoice was issued. When the cars first arrived in the UK from Japan, they were stored in a customs warehouse kept by another company, Nissan Motor Manufacturing (UK) Limited ("NMUK"), before subsequently being released, on payment by NMGB of the appropriate import VAT and customs duties, to NMGB's customers (i.e. the UK motor dealers who sold on to the final purchasers).

Under this arrangement, the import VAT and customs duties paid by NMGB were, pursuant to article 29(1) of Council Regulation 2913/92/EEC ("the Code") and article 11.1 of the Sixth Directive, calculated on the basis of "the price actually paid or payable for the goods when sold for export to the customs territory of the Community". It was common ground between NMGB and the Commissioners that this was the price payable by NESAS to NML. NMGB charged VAT on its supplies of the cars to the dealers, and was entitled to recover as input tax the import VAT which it had paid. NMGB's dealer customers made onward intra-UK supplies of the cars to final purchasers and charged output tax on those supplies. Accordingly, the Exchequer ultimately received 17.5 percent on the net price paid by final consumers.

Monckton Chambers
1 & 2 Raymond Buildings
Gray's Inn
London WC1R 5NR

Tel 020 7405 7211
Fax 020 7405 2084
DX LDE 257

chambers@monckton.com
www.monckton.com

The various Nissan companies ("Nissan") devised a scheme which they considered would reduce, to the benefit of NMGB, the amount of VAT which the Exchequer would receive in respect of each supply chain leading to a final purchaser. Under that scheme, final consumers in the UK wishing to buy a car via a UK dealer would be asked, in addition to contracting with the dealer, to sign:

(a) a contract of purchase with NMGB in respect of a particular new car while that car was still on the high seas; and

(b) an authority enabling NMGB to act as his agent in respect of the importation of that car.

Once the car had arrived at NMUK's customs warehouse, NMUK or NMGB would complete a DV1 declaration form for the final purchaser to sign. The car would then be delivered to the dealer's premises, where the dealer would carry out the usual pre-delivery tasks, such as procuring the registration of the car and paying the initial road tax. The dealer would then deliver the car to the final purchaser. Pursuant to the terms of the contract between NMGB and the final purchaser, NMGB was responsible for discharging on the purchaser's behalf his liability for import VAT and customs duties, and the purchaser was not required to make any payment in addition to the price which he would have had to pay the dealer for the car in the absence of the scheme.

The advantage which Nissan sought to provide itself by way of the scheme was to significantly reduce the total amount of VAT which NMGB had to account for, whether itself or on behalf of the final purchaser. That advantage was considered by Nissan to arise on the basis that, although NMGB would have to account, on behalf of the final purchaser, for import VAT and duty calculated by reference to the value of the transaction between NML and NESAS, and although that import VAT could not be recovered by NMGB as its input tax, NMGB would not have to account for output tax on the higher priced supply to the final purchaser since that supply would have been made outside of the territory of the EC; and since the value of the transaction between NML and NESAS was significantly lower than the price which NMGB would have charged its dealer customers for the same car, on which price NMGB would have had to charge output tax, there would be a significant reduction in the overall amount which NMGB had to pay to the Commissioners.

NMGB proposed to retain the benefit of this reduction for itself, rather than passing it on to the final purchasers. Indeed, the consumer was unlikely to notice any practical difference between purchasing a car under the scheme and purchasing a car from the dealer in the ordinary way, save for having to sign first a piece of paper to form a contract with NMGB and subsequently the DV1 declaration form. The total price which the final purchaser had to pay for the car was the same whether or not the scheme was followed.

Nissan sought to test the effectiveness of the scheme by way of three sample importations of cars which NMGB claimed to have supplied to directly to final purchasers while those cars were still on the high seas. Each of the final purchasers of those cars was a Nissan employee who had previously placed an order for a Nissan 350Z car with the UK motor dealer Reg Vardy plc ("Vardy"). Vardy was persuaded to set aside these orders, and each purchaser was asked to enter into the arrangements which on which the operation of the scheme depended, including the purchase contract with NMGB. Each of the three final purchasers were declared as the importer of the car destined for his use, and import VAT and duty accounted for on his behalf by NMGB, that import VAT and duty being calculated on the basis of the transaction value of the supply by NML to NESAS.

The Commissioners decided that the final purchasers were liable for import VAT and duty calculated on the basis of the significantly higher prices which each of them had actually paid in respect of their purchases. NMGB were subsequently issued with a C18 post-clearance demand for the difference between the VAT and duty which had been paid and the VAT and duty which the Commissioners had decided was due. NMUK requested a review, the Commissioners confirmed their earlier decision, and NMUK then appealed to the Tribunal.

Arguments of the parties

Before the Tribunal, the Commissioners argued that the scheme was ineffective by reason of the *Halifax* doctrine of abuse of law. The only purpose of that scheme was to seek to defeat or circumvent the fundamental objective of the Community VAT regime as expressed in article 2 of the First VAT Directive (Council Directive 67/227/EEC, now article 2 of Council Directive

2006/112/EC) and article 11(1) of the Sixth Directive, which was to ensure that the tax was borne by the final consumer on the price actually paid by him, while being fiscally neutral for others in the transaction chain. As the ECJ had stated in *Dansk Denkavit* (Case 42/83) [1984] ECR I-2649:

> "*... the principle of the common system consists in charging on goods and services, up to and including the retail stage, a general tax on consumption which is exactly proportional to the price of the goods and services, irrespective of the number of transactions involved in the production and distribution process before the stage of taxation*".

NMUK, while accepting that the scheme's only purpose was to reduce NMGB's VAT liability, nevertheless argued that the scheme was not an abuse of law. The cars had been sold to their final purchasers while those cars were still on the high seas, and it followed that NMGB's supplies to those customers were outside of the Community VAT regime. Further, the value of those cars for import VAT and duty purposes had been correctly declared in accordance with the 'first transaction' rule as a natural reading of article 29 of the Code required. The scheme did not involve the artificial generation of sales: the transactions were sales of cars, NMGB was in the business of selling cars, and the final purchasers were willing buyers of the cars which they required for their own use. Nor did the scheme artificially create conditions in which the 'first transaction' rule applied, since that was the rule that was ordinarily applicable for the purpose of calculating the import VAT and duty payable on the importation of the cars into the UK; and the Commissioners had not shown, nor could they show, how the transactions might properly be redefined.

NMUK further submitted that the situation was analogous to that considered by the ECJ in *Centros Limited v Ehrvervs-Og Selksabsstyrelsen* (Case C-212/97) [1999] ECR I-1459 in which it was held that it was not an abuse for a national of a Member State who wished to set up a company to choose to form it in the Member State whose rules of company law appeared to him the least restrictive, and to then set up branches of that company in other Member States. Like Centros, NMGB had chosen to structure its arrangements in the way that was beneficial to it, but there was an underlying commercial purpose – that of selling cars – which prevented any finding of abuse.

The Tribunal's decision

With regard to the burden of proof for establishing an 'abuse of law' (or 'abuse of rights'), the Tribunal referred to the words of Advocate General Alber in *Emsland-Stärke Gmbh v Hauptzollamt Hamburg-Jonas* (Case C-110/99) [2000] ECR I-11569 (at para 83 of his Opinion):

> "*The actual determination whether the subjective element of the intention to commit an abuse of rights is established is a matter for the court of the Member State. The basic presumption as regards the burden of proof is that when asserting a right of recovery, it is for the authority to show and prove the required facts. However, a relaxation of the burden of proof is conceivable in the sense that prima facie evidence of irregular conduct would suffice initially, and the indicted trader would then have to show that he was not at fault.*"

It was therefore, the Tribunal found, for the Commissioners to show that the transactions were a departure from recognised practice, that they had (or, if not nullified, would have had) the effect of reducing or avoiding a tax burden in a manner contrary to the perceived purpose of the legislation, and that they had no apparent purpose other than the reduction or avoidance of that tax burden. Once the Commissioners had done so, however, the burden then shifted to the trader (he being the person in possession of all the facts) to demonstrate that the transactions did in fact have a commercial purpose other than the reduction or avoidance of the tax burden.

On the underlying facts of the appeal, the Tribunal found that NMUK in fact had failed to discharge another burden of proof which had to be discharged before questions of abuse of law needed to be considered: that of showing that the sales to the final purchasers took place before the cars had reached the territory of the Community. The evidence pointed to sales of the cars having been made to Vardy, which then made onward sales to the final purchasers, rather than to sales directly from NMGB to those final purchasers and to those purchasers having imported the cars into the UK.

Nevertheless, the Tribunal also decided that, even if the transactions had occurred in the way that NMUK had intended, the scheme had constituted an abuse and was therefore ineffective to achieve the intended tax reducing result. In that regard, the Tribunal analysed the Halifax judgment as meaning that conduct was abusive if, by formal application of the rules of Community law, it achieved a result which was contrary to the purposes of the legislation; but conduct was not abusive where there was an explanation which showed that there was a purpose to the transactions other than the obtaining of a tax advantage. It was for the national courts to determine, as a matter of fact, whether abuse as so defined had taken place, and also to determine the "real substance and significance of the transactions".

In the Tribunal's assessment, there could no real doubt that the purpose of Nissan's scheme was to secure a tax advantage. That scheme depended on the formal application of article 29 of the Code in order to reduce the amount of VAT paid by the final purchaser to an amount less than that which the final purchaser would have had to pay had the scheme not been in operation, and thereby to achieve a result which was clearly contrary to the purpose of article 11 of the Sixth Directive. The customer obtained essentially the same car at the price he would in any event have had to pay, but by a mechanism which diminished the tax value, thereby benefiting the seller.

Nissan had not been able to demonstrate any other commercial purpose to the scheme. Although it was true that the scheme involved the selling of cars and that NMGB was in the business of selling cars, the scheme itself did not advance that purpose. Instead, it distorted Nissan's normal method of distributing within the UK cars which it had manufactured in Japan, and the scheme could not be said to be seeking to achieve anything apart from the tax advantage. In that regard, the real substance of the transactions was that NMGB sold cars to customers in order that they could enjoy those cars in the UK; it did not sell cars on board a ship, leaving the customers, even notionally, to their own devices in what they did with those cars after purchasing them. Indeed, it was inconceivable that any of the final purchasers would have entered into an arrangement under which, for no personal advantage, they would buy a car at sea and make their own arrangements for its offloading from the ship, importation, registration, taxation and preparation for delivery. They each wanted a delivered car exactly as they would have received from Vardy, and this is what NMGB offered them.

Accordingly, the scheme, which had been designed to distort the reality of intra-UK supplies made by NMGB to Vardy, was negated by the *Halifax* doctrine of abuse of law. NMGB was therefore obliged to account for the difference between the import VAT which it had paid (which was properly its input tax) and the output tax which it should have charged on supplies to Vardy. It followed that the Commissioners' attempt to remedy the loss of revenue by way of a post-clearance demand had been in error, and the appeal had therefore technically to be allowed. Given the Commissioners' victory on the matter of substance, however, the Appellants were ordered to pay the Commissioners' costs.

In an interesting postscript, the Tribunal expressed its doubts as to the correctness of the acceptance by the Commissioners that, had the scheme operated as intended and not been an abuse, the value of the transactions between NML and NESAS would have been the correct transaction value for the purpose of calculating liability for import VAT and duty. In the Tribunal's view, there was a logical difficulty in arguing that the sale by NML to NESAS would, in that situation, have been a sale "for" export to the Community when in fact the car was intended to be subject to a sale on the high seas to a customer who, however notionally, was at liberty to take that car anywhere in the world. Even if, because the car was already on a ship, the purchaser was forced to allow it to reach the UK, he would not be obliged to import it, but could arrange for it to be sent elsewhere without passing through UK customs controls. The sale "for" export to the Community would in fact have been that made by NMGB, since only at that point could an intention to import the car into the Community have been demonstrated.

Melanie Hall QC acted for the Commissioners for H.M. Revenue and Customs.

For more information on Melanie Hall QC and Alan Bates, please contact the Clerks on 020 7405 7211 or consult the 'Find a Barrister' section on www.monckton.com