RANK GROUP PLC v HMRC – THE WHEEL SPINS ONCE MORE

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When I began working in tax I was told that you knew how senior someone was by the number of boxes contained in the diagrams on the white-boards in their office. Fifteen years later I still use diagrams to map out the flows of even the most basic transactions, however, never, until now, have I needed a diagram just to keep track of the progression of an appeal.

There have now been three separate FTT decisions, one Upper Tribunal Decision (which saw the case remitted to the FTT), a High Court Decision dealing with separate aspects of the case, an appeal from that decision to the Court of Appeal, simultaneous references by both the Upper Tribunal and the Court of Appeal to the Court of Justice and a decision of the Court of Appeal. And it's not over yet.

Before discussing the Court of Appeal's Judgment of 30 October it is useful to explain where that judgment fits into the overall context of the Rank litigation.

Background

Rank brought two separate appeals to the VAT & Duties Tribunal. The first being in respect of mechanised cash bingo ("MCB") and the second being in respect of slot machines.

The essence of the MCB claim was that it was in breach of the principle of fiscal neutrality for MCB to be exempt if the stake was lower than or equal to 50 pence and the prize was lower than or equal to £25 but to be otherwise taxable in circumstances where the exempt and taxable MCB were identical from the customer's perspective. This formed part of a Tribunal decision dated 15 May 2008 in *Rank's* favour, a High Court appeal on 8 June 2008 affirming that decision, an appeal to the Court of Appeal and a reference to the Court of Justice. In the wake of the Judgment of the Court of Justice HMRC have discontinued their appeal in respect of MCB.

The appeal in respect of slot machines is somewhat more complex. It is an issue that has bifurcated and has resulted in two streams of litigation, referred to as "Slots 1" and "Slots 2".

Slots 1, is the appeal in respect of which the Court of Appeal gave its judgment on 30 October 2013. The essence of this case is that the VAT legislation in force at the time included "gaming machines". One of the conditions which applied in order to determine whether the machine was a taxable gaming machine was "whether the element of chance is generated by the means of the machine."

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There is a close relationship between the provisions of the VAT legislation and relevant gaming legislation and a practice developed in the gaming industry of removing the random number generator ('RNG') from the machine so as to ensure, it was thought, that the machines fell outwith the unfavourable VAT and gaming legislation. Rank argued that the treatment of slot machines as exempt when the RNG was located outside the machine but taxable when inside the machine was in breach of fiscal neutrality such that all slot machines should be exempt. The VAT & Duties Tribunal delivered its decision in respect of such machines on 19 August 2008. The appeal in respect of that decision was heard (along with the MCB appeal) by the High Court pursuant to s 11(1) of the Tribunals and Enquiries Act 1992 and both the MCB and Slots 1 were appealed to the Court of Appeal by HMRC which was then the subject of the Article 267 Reference to the Court of Justice. Having conceded defeat on the MCB appeal HMRC relied upon a single ground of appeal in respect of the Slots 1 case at the resumed hearing before the Court of Appeal.

As regards Slots 2, the essence of that case is that the Appellant's machines which were treated as taxable were similar to Fixed Odds Betting Terminals ('FOBTs'). These include formats such as roulette and virtual horse racing a central feature of which is that the terminal is connected to a remote random number generator. It is accepted by HMRC that FOBTs were exempt (the basis for this acceptance will be discussed below) but it is disputed that they are similar to the taxable machines in the sense required by the Fiscal Neutrality principle. Slots 2 was the subject of a Tribunal decision on 11 December 2009 and an appeal to the Upper Tribunal. The Upper Tribunal referred questions to the Court of Justice, which were joined with the questions referred by the Court of Appeal and, on receipt of the decision of the Court of Justice the Upper Tribunal agreed with HMRC that the First Tier Tribunal had made two errors of law in assessing the similarity as between FOBTs and the machines in respect of which tax was chargeable (see [2012] STC 420). The matter was remitted to the FTT and those proceedings have been stayed pending the outcome of the Court of Appeal decision. It would appear, therefore, that irrespective of whether the Court of Appeal Judgment is appealed to the Supreme Court, the Slots 2 aspect of the *Rank* litigation will continue for some time.

The Court of Appeal Judgment

The single issue remaining in dispute before the Court of Appeal was the correct interpretation of the words "gaming machine" in Note (3) of Item 1 of Group 4 to Schedule 9. Although the legislation changed in content and numbering between 1973 and 2005, in essence, it provided that the provision of any facilities for the placing of bets or the playing of games of chance was exempt from VAT. With effect from 1 November 1975, Note 1(d) to Group 4 provided that the exemption did not apply to the provision of a 'gaming machine'. "Gaming Machine" was defined as:

> *"a machine in respect of which the following conditions are satisfied, namely –*
> …
> *(c) the element of chance in the game is provided by means of the machine."*

Until the commencement of the *Rank* proceedings HMRC's position as regards slot machines where the RNG was located outside of the physical casing of the slot machine itself was as set out in guidance issued in January 2005 to the following effect:

> *"Because the element of chance is not provided by the terminals themselves, but by a RNG which is outside the machine … section 16 and section 21 terminals cannot be treated as gaming machines…"*

The essence of the Slots 1 aspect of Rank's claim was that because such machines, referred to as section 16/21 machines, were exempt from VAT, it was a breach of fiscal neutrality to treat machines where the RNG was inside the casing as taxable. In order to defeat thatclaim HMRC abandoned their position as stated above and argued instead that the section 16/21 machines were in law taxable and had always been taxable and, in fact went so far as to describe their previous position as "absurd".

In its judgment the Court of Justice confirmed that if the section 16/21 machines were taxable under domestic law then the fact that HMRC treated them as exempt did not give rise to a breach of fiscal neutrality since that principle was subject to the principle of legality so that the sole issue was whether, as a matter of domestic law, they were properly taxable or exempt.

What is a section 16/21 Terminal?

The legislative short-hand for this category of machine derives from the similar, but not identical, provisions of section 16 of the Lotteries and Amusements Act 1976 and section 21 of the Gaming Act 1968.

Section 21 of the Gaming Act contains special provision as to 'gaming for prizes' and is the provision under which gaming machines not falling within Part III of the Act were regulated. Section 26 of the Gaming Act provides as follows:

> *"(1) [Part III] of this Act applies to any machine which –*
> *(a) is constructed or adapted for playing a game of chance by means of the machine, and*
> *(b) has a slot or other aperture for the insertion of money or money's worth in the form of cash or tokens.*
> *(2) In the preceding subsection the reference to playing a game of chance by means of a machine includes playing a game of chance partly by means of a machine and partly by other means if (but only if) the element of chance in the game is provided by means of the machine."*

Section 52 of the Act goes on to define a "machine" as including any apparatus.

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Ultimately, the Court held:

> *"There can be no doubt that the definition of a 'gaming machine' in Note (3) of the VAT legislation was in material respects drawn from the definition of a 'machine' in section 26 of the Gaming Act. It is inconceivable that the draftsman of Note (3) did not have section 26 in front of him. Equally, however, he did not follow it slavishly. First, he did not confine a 'gaming machine' to a slot machine, although I do not regard this departure as of present significant materiality. Second, perhaps of more significance, he did not incorporate the definition of a 'machine' in section 52 of the Gaming Act. If, therefore, section 52's amplification of the section 26 definition so as to include 'any apparatus' is critical to a conclusion that the disputed machines fell within Part III, whereas otherwise they would not, there may be a logical difficulty in regarding such machines as 'gaming machines' within Note (3).*
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> *Ultimately, this appeal is concerned only with the correct interpretation of the words 'gaming machine' in Note (3). Given, however, that it is apparent that the meaning of those words was in material respects drawn from section 26(2) of the Gaming Act, I regard it logical as to consider first whether the disputed machines were or were not Part III machines; and much of the argument before us was directed to that question."*

In interpreting the meaning of "machine" in the context of section 26(2) and concluding that it includes not just a single slot machine with a single RNG attached by a dedicated cable, but also a row of six slot machines connected to one single external RNG, the Court had significant regard to the purpose of the 1968 Act. The Court held:

> *"The control that Part III sought to impose was on the availability for use by the public of mechanical equipment providing the opportunity for playing of games of chance when the element of chance was provided by the equipment so used. It cannot have been the purpose of Part III to confine its control to equipment comprised in a self-contained single unit or terminal and to exclude from such control two separate, but linked, items of equipment that together perform an identical function. If that were the purpose, regulation under Part III would become entirely optional. Casinos which chose to remain within such control could leave the RNGs in the terminal; and those which preferred to be controlled instead under Part II of the Gaming Act could remove them and hang them on the wall."*

Paul Lasok QC, as leading Counsel for *Rank* laid heavy emphasis on the fact that the task facing the court was the interpretation of Note (3) in the VAT Act and not section 26 of the Gaming Act. It was submitted, in particular that:

> *"even if the language of Part III of the Gaming Act, construed against the legislative purpose of that Act, permitted the multi-terminal systems to be regarded as constituting one machine, that provides no assistance when it comes to the interpretation of the ordinary language used in Note (3), which did not simply incorporate the definition of a 'machine' in the Gaming Act. Part III of the Gaming Act defined a 'machine' by reference to criteria that*

were narrower than those of Note (3) It required the payment to play the machine to be by inserting a coin or token in a slot or aperture, whereas Note (3) did not so limit the method of payment, ... Part III was only directed at regulating a 'machine' meeting the criteria of its own definition of a machine. Machines which fell outside its definition were regulated by other provisions of the Act. Part III imposes regulatory provisions, the breach of which constitutes a criminal offence. The provisions should therefore be interpreted strictly and literally, and their definition of a 'machine' cannot be transposed to the VAT legislation."

Whilst the Court accepted that the task facing it was, clearly, the interpretation of Note (3) Rimer LJ concluded that, having established the appropriate interpretation of section 26 of the Gaming Act:

"I can … see no reason for not interpreting a 'gaming machine' in Note (3) in the like way. On the contrary I can see good reason for doing so… if it is if it is instead to be construed in the narrow, literal way urged by Mr Lasok, it would reduce VAT on 'gaming machines' to a voluntary tax, in the sense that the tax could be avoided by a simple re-design of the playing equipment, whilst leaving its essential function unchanged. The tax, however, was plainly not intended to be a tax on takings from gaming machines of a particular, singular configuration. It was intended to be a tax on takings from equipment meeting the Note (3) criteria. The multi-terminal systems were such equipment; and each terminal and linked RNG were, in my view, 'gaming machines' within the meaning of Note (3)."

It is on this critical point that the case was decided against Rank. In essence, the Court concluded that the purposive interpretation to be afforded to a legislative instrument of social protection should be carried across to the VAT Act because the definition in Note (3) was "in all material respects" drawn directly from the definition of machine in the 1956 Act. Although not referred to in the Judgment is worth recalling the words of the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* where Lord Nicholls held:

"As Lord Steyn explained in IRC v McGuckian [1997] 3 All ER 817, [1997] 1 WLR 991, 999, the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until the Ramsay case, however, revenue statutes were "remarkably resistant to the new non-formalist methods of interpretation". The particular vice of formalism in this area of the law was the insistence of the courts on treating every transaction which had an individual legal identity (such as a payment of money, transfer of property, creation of a debt, etc) as having its own separate tax consequences, whatever might be the terms of the statute. As Lord Steyn said, it was:

". . . those two features – literal interpretation of tax statutes and the formalistic insistence on examining steps in a composite scheme separately – [which] allowed tax avoidance schemes to flourish."

The Ramsay case [1982] AC 300 liberated the construction of revenue statutes from being both literal and blinkered. It is worth quoting two passages from the influential speech of

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Lord Wilberforce. First, (at p 323) on the general approach to construction:

"What are 'clear words' is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant act as a whole, and its purpose may, indeed should, be regarded.""

There is in my view nothing, therefore, in principle objectionable about the Court having regard to a purposive interpretation of the word "machine". The objection which Rank would presumably now advance is simply that in doing so theCourt failed to have sufficient regard to the wording of Note (3) itself and was overly influenced by the interpretation afforded to a differently worded provision in a different Act.

The other critical issue which went against Rank was the manner in which the Court decided that six machines connected to one external RNG each constituted a Part III Machine. Before addressing this point a short diversion is required.

Last year M&S began to sell papples. Really. It is a cross between European and Asian Pear varieties and is, by all accounts, similar to an apple. So, an apple is similar to a papple, and a papple is similar to a pear. Does that mean that an apple is similar to a pear? Not necessarily. In the context of the application of the doctrine of fiscal neutrality, this is referred to as the domino effect of fiscal neutrality – if A is similar to B and B is similar to C then A is similar to C. On one view a domino approach to similarity might well benefit *Rank* in its Slots 2 cases when it seeks to argue that the otherwise taxable machines are similar to FOBTs, however, it appears to have been a similar approach to the interpretation of section 26(2) that ultimately caused the Court of Appeal to hold in favour of HMRC.

In considering whether six machines connected to a single RNG were each 'a machine whereby the element of chance was provided by the machine itself' the Court appears to have employed precisely this domino effect of similarity. The Court held first that a slot machine which incorporates a RNG is a Part III machine. Therefore, if one takes steps to deconstruct the machine and remove the RNG to an external casing connected by a wire, that machine must also be a Part III machine. Because such a machine is a Part III machine it follows, the Court held, that where a machine is purpose-built to have the RNG externally housed and connected by a cable, it must also be a Part III machine. The Court then held:

"If right so far, I also do not understand why the multi-terminal systems should be treated any differently. The fact that there is only one RNG serving several terminals cannot make a material difference. In substance, the systems are exactly the same as in both previous configurations. By like reasoning, I cannot see why each terminal and the single RNG do not together constitute a machine within section 26. That is the substance of any such multi-terminal system; and it is the substance of the matter that counts."

One would have thought that given the stakes at play, an application for leave to appeal to the Supreme Court is likely. If permission is given, one of the questions which would presumably be considered by the Supreme Court is whether this domino effect of

similarity is an appropriate manner in which to discern the application of Note (3). The difficulty with such reasoning is where to draw the line. For instance, it is accepted by HMRC that FOBTs are exempt from VAT but on the basis they are not used for games of chance at all but for betting. This, in my view, is important since, if HMRC were to have accepted that FOBTs were gaming machines which were not within Part III then arguably the serial slot machines (where a single RNG serves several machines) are at least as similar to FOBTs as they are to the slot machine which houses an internal RNG. That will no doubt be a central issue in the Slots 2 appeal but it is a position of some significance also to the Court of Appeal's Judgment.

When writing articles such as this it is always nice to be able to distil the judgment down to one or two key principles which are of general application. Unfortunately, that is impossible in the instant case. The similarity of the gaming and tax legislation was so unusual and of such significant importance to the Court of Appeal's judgment that it is hard to draw out any overarching principles. If the matter proceeds to the Supreme Court, however, I would expect that Judgment to focus on what now appear to be the two key issues, namely the approach of interpreting the Gaming Act in order to determine what is meant by the provisions of the VAT Act, rather than interpreting the VAT Act in isolation and second, the domino approach to determining what is and is not a machine whereby the element of chance is provided by the machine itself, in particular in the context of HMRC's position that FOBTs are not Part III machines but machines used for betting.

George Peretz and Laura Elizabeth John acted for HMRC
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