

COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS V THE RANK GROUP PLC [2015] UKSC 48

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It is perhaps apposite to say for a decision given on the first day of the Ashes Test cricket match, that the Supreme Court has bowled a googly in the *Rank* litigation. The outcome was determined by an argument neither party ran at any stage nor was picked up in the lower courts.

The Supreme Court's decision concerned a narrow point of whether the machines in question (the "**disputed machines**") were gaming machines. The answer to that question determines whether their takings were exempt or taxable. The tribunal concluded the disputed machines were not gaming machines, so their takings were exempt. Norris J in the High Court agreed with the tribunal. The Court of Appeal concluded they were gaming machines, so their takings were taxable. The Supreme Court agreed with the Court of Appeal, but for different reasons.

Rank also had a breach of fiscal neutrality claim for the refund of VAT paid on similar machines (which were clearly subject to VAT under domestic law) for periods going back to 1973 when Rank claimed that the disputed machines were in use. To the extent that claim relied on the disputed machines being relevant as comparators, this decision settles that the disputed machines are not relevant as comparators.

EU law background

The case had also been before the Court of Justice of the European Union. Article 135(1)(i) of the Principal VAT Directive 2006/112/EC provides for the exemption of "betting, lotteries and other forms of gambling, subject to conditions and limitations laid down by each Member State". The CJEU held that although Member States may limit exemption to certain forms of games of chance, "*in order not to deprive the principle of fiscal neutrality of meaning and so as not to distort the system of VAT*" essentially, not all slot machines which fell within a single category of games could be taken out of the exemption (Case C-259/10 and C-260/10, para [55]). The CJEU also held that the principle of fiscal neutrality precluded similar supplies being treated differently and "*the determination whether games of chance which are taxed differently are similar... is for the national court to make*". The CJEU had also held that Rank could not rely on the fact that HMRC had, at the time, treated the disputed machines as exempt. If as a matter of UK law the disputed machines were not exempt, HMRC's erroneous treatment of them as exempt could not found a claim by Rank for the repayment of VAT paid on its similar taxable machines.

That left for domestic determination a narrow question of domestic law whether the disputed machines were gaming machines and whether their takings should have been subject to tax at all. The issue turns on the meaning of gaming machine in UK VAT legislation.

Gaming regulatory control

A feature of the litigation has been the relevance of the different regulatory regime for gaming, in particular the Gaming Act 1968. That Act has, to an extent, influenced the VAT provisions. The Gaming Act 1968 provided for different regulatory control of machines falling within sections 16 and 21 and those falling in Part III of that Act ("**Part III machines**").

The disputed machines

At the material times, gaming machines where, as one of three conditions, "*the element of chance in the game was provided by means of the machine*" were taken out of VAT exemption. The dispute centred on the meaning of that expression. A critical feature of the disputed machines, or so it appeared to all concerned, was that the element of chance was generated by a random number generator (RNG) which was located outside the disputed machines but connected to the terminal by a wire. The RNG was supplied by the same manufacturer and designed to be used with the terminal. The agreed facts recited in the Supreme Court's judgment described the RNG as follows:

"The RNG is constantly generating random numbers, at a rate of hundreds or maybe thousands per second. As soon as the lever is pulled or the "Play" button is pressed, the most recent random number is used to determine the result. This means that the result varies depending on exactly when the game is played. A fraction of a second earlier or later, and the result would be different."

Rank's argument, in essence, was that the element of chance was provided by the RNG and as the RNG was located outside the disputed machines, the element of chance was not "provide by means of **the** machine". Although that argument found favour with the tribunal and the High Court, Rimer LJ in the Court of Appeal, relying on the gaming regulatory context, found that it could not have been the purpose of Part III of the Gaming Act 1968

"to confine its control to equipment comprised in a self-contained single unit or terminal or to exclude from such control two separate, but linked, items of equipment that together perform an identical function".

Rimer LJ therefore concluded that in the case of the disputed machines, the word "machine" has to be interpreted so as to include both the terminal and the connected RNG. As a result, the element of chance was determined "by means of the machine". That

result read over into the construction of the parallel VAT legislation.

Lord Carnwath, giving the unanimous judgement in the Supreme Court, found it difficult to accept that a construction of VAT legislation could be based essentially on the purpose of similar gaming regulatory legislation. The sole issue here concerned the construction of VAT legislation at the relevant time. His Lordship did not expressly identify the purpose of the VAT legislation. Instead, first Lord Carnwath considered the dictionary definition of “machine” and sided with the Court of Appeal that a machine was not confined to a single item of equipment. However, the relevant phrase requiring construction was *“the element of chance in the game was provided by means of the machine”*.

At this point, their Lordships in the Supreme Court appear to depart from what appeared to be agreed between the parties throughout the litigation, namely that the element of chance was provided by the RNG. Lord Carnwath held instead that

“the element of chance in any game is provided “by means of” the action of the particular player in pressing the button and so interrupting that ever-changing sequence at a particular moment. The RNG is a necessary part of that process, but its response (wherever situated) is entirely automatic. In those circumstances, it is a fair use of language in my view, and consistent with the apparent policy of the legislation, to describe the element of chance as provided “by means of” the terminal” (para [31]).

The reasoning comes to a sudden end there. The apparent policy of the VAT legislation is not clear. Relevant EU law left it to Member States to set down conditions for supplies which do and don't qualify for exemption, subject to the principle of fiscal neutrality. The Supreme Court's decision casts doubt over the extent to which “the policy thinking of the VAT draftsman was guided by that of the 1968 Act.” That makes it difficult to assess the purpose of the relevant provision in the VAT legislation.

It is reasonably clear that the button or lever on the terminal has assumed greater importance than had been contemplated by anyone; but clearly that on its own does not provide the element of chance. The button/lever, however is critically the “means” by which the element of chance is provided. As the button or lever is on the terminal, the terminal provides the means for the element of chance. The ‘element of chance in the game’ is the player not knowing what sequence of numbers will result from playing the game and not having any control over them. It appears that element of chance is no longer provided by means of the RNG, albeit the RNG is necessary for the whole process of providing the element of chance. The element of chance appears to be provided by means of the combination of the player deciding to press the button or pull the lever “in the game” and then doing so. The button/lever plays a critical part because it triggers the selection of the random number by the connection of the terminal to the RNG. It appears to follow that the element of chance in the game was provided by means of the machine.

Where does this leave us?

The Supreme Court's decision concludes that the disputed machines did not qualify for exemption. As a result, they cease to be relevant comparators for Rank's fiscal neutrality claim in respect of its similar machines.

Rank has another fiscal neutrality claim based on a difference of tax treatment between fixed-odds betting terminals (FOBTs) and its taxed gaming machines. That claim is for the refund of VAT on its gaming machines between 1998 (when FOBTs came on the scene) to 2005. At an earlier stage in this complex litigation, Rank persuaded the First-tier Tribunal ("**FtT**") that FOBTs and gaming machines were similar. In October 2012 the Upper Tribunal upheld HMRC's appeal against that finding on the basis that the FtT had applied the wrong legal test, and remitted the question back to the FtT¹. So the litigation is by no means over even in this case or a number of other claims by operators in the gaming industry for VAT refunds as a result of alleged breaches of the principle of fiscal neutrality. Those claims will not be affected by the narrow, albeit important point decided by the Supreme Court. How HMRC respond to this decision and its impact on other claims remains to be seen.

The decision itself appears to be concerned solely with construction of VAT legislation. The construction was not just of the words "the machine" but the phrase in which they appeared. The Supreme Court's approach to that question is not clear. This does not appear to be a case of purposive construction, as it is not clear what the apparent policy of the legislation was. Hence the analogy with a batsman facing a googly.

Paul Lasok QC and Valentina Sloane acted for Rank; George Peretz QC and Laura Elizabeth John acted for HMRC.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

¹ Rank v HMRC [2012] UKUT 347 (TCC); [2013] S.T.C. 420.