

JUST SUPPOSING ...

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Introduction

By now, everyone knows that the House of Lords devised and applied a judicial anti-tax avoidance doctrine in a line of cases which started with *W. T. Ramsay v. IRC*¹ and ended with *Macniven v. Westmorland Investments Limited*.² However, practically each time they have had a chance to tackle this doctrine, they have gone about it in a different way, so that *Westmoreland* just happens to be the most recent and radical variation on this theme. However, even after 20 years of development, the exact shape of the concept remains elusive. One only need have regard to the difficulties expressed by the Court of Appeal in *Barclays Mercantile Business Finance v. Mawson*³ to see that the dichotomy between legal concepts and commercial concepts explained in *Westmoreland* seems to raise as many problems as it solves, so that it is not surprising that the House of Lords will be hearing *Barclays Mercantile Business Finance* next year.

However, whatever the exact scope of this doctrine, it does not apply to all taxes. VAT is one notable exception (which also rather contradicts the notion of the doctrine being a rule of statutory construction): see further Lord Hoffmann, *C&E v. Thorn*

*Materials Supply Limited*⁴. This has led to the first signs of a different approach to issues of VAT avoidance in the VAT and Duties Tribunal, based on concepts of European Law. I believe that these concepts will ultimately supplant *Ramsay/Westmoreland* as the judicial approach in the United Kingdom in direct tax cases, as well as VAT.

The European Court of Justice is due to hear three landmark VAT avoidance cases next year. Two of those cases have been joined - *Halifax plc*⁵ and *BUPA Hospitals Limited* (“*BUPA*”)⁶; the other is *University of Huddersfield*.⁷ Together those cases provide that Court with an opportunity to begin the development of the general principle of “abuse of rights” as a judicial anti-tax avoidance tool. It is true that Customs and Excise are putting forward two principal arguments, but one of those is limited in its application to VAT (or at least for now).⁸

Development and Integration of European General Legal Principles

In developing European law, the European Court extrapolates various general principles of law which it finds in the laws of the Member States and uses those principles to supplement the Treaties and other European instruments. In this way, principles like *legitimate expectation* and *proportionality* have been taken by the Court from their French and German origins and incorporated, as fundamental principles, into European law. Fundamental principles of European law then tend

to be “imported” into our law and take on a role that can be somewhat separate from their European origins. There are several examples of this, and – referring to the two principles I have already mentioned – legitimate expectation has slowly grown in importance in English administrative law. In 1989, it was merely a “valuable developing doctrine”;⁹ by only 2000, it had become a rule of English law capable of giving protection to an expectation of substantive benefits.¹⁰ Similarly, the doctrine of proportionality has moved from a mere mention in *Council of Civil Service Unions v. Minister for the Civil Service*¹¹ to a firm part of English Law, admittedly by way of the incorporation of the European Convention on Human Rights into our law.

Whilst the notion of “abuse of rights” is a slightly difficult one for common lawyers (since the common law permits everything that it does not strictly prohibit, whereas civil law systems take the opposite approach), the fact that it is an unfamiliar and continental rule is not of itself a bar to its ultimate incorporation into United Kingdom tax law. Nor is the fact that it has not (yet) expressly been elevated into a general principle of EC law; it has been applied by the Court on several occasions and most Member States have such a principle as part of their law. *Halifax* will, I believe, be the case that promotes abuse of rights into such a principle, and, even if it does not, such a principle will incontrovertibly become part of United Kingdom VAT law.¹²

The fact that *Halifax* will be a decision in relation to VAT will not prevent abuse of rights from being of

wider application. Principles of Community law are capable of application in all areas of Community law, and there are already a number of European-based rules in direct taxation. This being so, it is entirely possible that future questions on direct tax avoidance – and not necessarily United Kingdom questions – could come before the European court and follow a similar pattern to that illustrated by what I suggest will happen in *Halifax*.

Indeed, having regard to the pattern of incorporation of EC principles into our law, and the very relevant fact that the people who hear VAT appeals are also Special Commissioners, the question to be asked is not whether abuse of rights will become part of direct tax law, but rather, *when* will abuse of rights be the judicial anti-avoidance rule applied generally in all taxes.

Meaning of “Abuse of Rights”

According to the VAT Tribunal in *BUPA*¹³ there is no generally accepted definition of “abuse of rights” in European law. In fact, in some of the earlier cases it is not even described in those terms. For example in *van Binsbergen*¹⁴ the Court treated it as self evident that the Netherlands could take measures to prevent a Dutch lawyer resident in Belgium from using Article 59 of the Treaty of Rome¹⁵ and they did not mention abuse of rights in terms.

It appears that the European concept of abuse of rights has developed in three particular sorts of circumstances.¹⁶

The first is where there has been an abusive use of Community law to circumvent provisions of national law. For instance, in *R v. Customs & Excise Commissioners, ex parte EMU Tabac and Others*¹⁷ where there was an attempt to use an Excise Duty Directive¹⁸ in a scheme to supply tobacco from Luxembourg to individuals in the United Kingdom via an agency arrangement without the payment of UK duty. The Advocate General (but not the Court) referred to “abuse of rights” –

“...if it were necessary to do so as a last resort, the national court could decline to apply the rule contended for by the appellants ... on the basis that to apply it to the present case would clearly run counter to the spirit and purpose of the directive and would be inimical to the effectiveness of other provisions of it. By so doing it would merely be applying the general legal principle prohibiting acts in fraud of the law.”¹⁹

Stripped down, it can be seen that this is simply an expression of the purposive rule of interpretation.²⁰ This, of course, makes it very similar (in one sense) to the *Ramsay/Westmoreland* doctrine, which further suggests that it will not be too difficult replacing (refining even) *Ramsay* with the European concept. Furthermore, this first set of circumstances is the one most likely to give

rise to an application of abuse of rights in direct tax. If one thinks of the variety of European Directives applying to the direct taxes (say, the Parent/Subsidiary Directive²¹) or even the Treaty of Rome, it is fairly easy to think of occasions when the Inland Revenue might think of putting the argument to counteract a taxpayer's arrangements. In *BUPA*, the Tribunal suggested that the principle as manifested in this first area seemed to have two forms – the purposive interpretation rule and a rule which disqualifies claims which amount to the abusive use of EC law to circumvent national law. I am not sure that I agree, since the former is an expression of what the rule is, and the latter is an expression of what its application means: that does not seem like two manifestations of a rule. However, it probably does not matter very much, since a quibble like this would not stand in the way of its importation into United Kingdom tax law.

The second instance where abuse of rights has been applied by the European Court is where there is an “abusive” use of Community law to gain a financial advantage from Community funds.²² In a tax matter this is unlikely to arise. But since this second instance has produced the recent and influential case of *Emsland-Stärke GmbH v. Oberfinanzdirektion München*²³ (“*Emsland-Stärke*”), it merits mention. This is because *Emsland-Stärke* elevates abuse of rights from merely an aid to interpretation to a separate free-standing principle of Community law. In *Emsland-Stärke*, a German exporter exported goods outside the Community (to Switzerland). Immediately after the goods had been

released for home use in Switzerland, they were transported back into the Community (Germany and Italy) and were there released for home use on payment of import duties. The German company had sought and obtained export refunds²⁴ based on the Swiss Customs' papers and freight documents.²⁵

According to the European Court in *Emsland-Stärke* there are two conditions which must be satisfied to establish a finding of abuse of rights: the first is objective; the second subjective.

The first requirement is at paragraph 52 of the Court's judgment:

“A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of those conditions laid down by the Community rules, the purpose of those rules has not been achieved.”

The analysis here begins by examining the purpose of relevant provisions (which, is nothing more than another expression of the purposive rule of interpretation) and determining that that purpose has not been complied with. However, it is not clear how one makes this determination at the first stage: it seems to me that one may only do this by incorporating the second test or making some sort of value judgment at this stage. This is supported by the Commission, who had submitted that this first element required “evidence that the conditions for the grant of a benefit were created artificially, that is

to say, that a commercial operation was not carried out for an economic purpose but solely to obtain from the Community the financial aid that accompanies the operation”. They elaborated that this meant that one must undertake an analysis, on a case-by-case basis, of both the meaning of the provision and the conduct of a prudent trader who manages his affairs in accordance with the applicable rules of law and with current commercial and economic practices in the sector in question.²⁶ This approach, though not taken up by the Court itself, seems eminently sensible: judges are lawyers, not economists or business-people. To incorporate an evidential requirement so that they can hear what the prudent business-person would do according to expert evidence witnesses must be far more satisfactory than the hazarding of an uninformed guess – which is the *Ramsay/Westmoreland* position.²⁷

And the second condition is at paragraph 53, it is that there is

“... the intention to obtain an advantage from the Community rules by creating artificially the conditions for obtaining it”.

This is more difficult, since the one must see into the minds of the parties to a transaction and determine that they have a particular intention at a particular point, which causes them to do something “artificial”. In some cases this will not be too difficult: a case where a lorry load of goods takes a trip to a non-EC country and returns without anything happening, except certain

customs formalities are complied with is such a case. But greater difficulties will be experienced in more complicated commercial transactions. It should be remembered that as a rule of common sense, if not law, “no commercial man in his senses is going to carry out a commercial transaction except on the footing of paying the smallest amount of tax he can”.²⁸ And in such cases there will be difficult commercial issues for the Court to grapple with. The EC Commission’s approach would be useful in such matters in respect of this second element, as well as the first. I hope that either a United Kingdom Court or the European Court sees the value of a requirement for expert witnesses, so that the abuse of rights doctrine can, even from its early days, incorporate valuable, additional evidential requirements: after all, we do not expect judges to decide, without expert help, what reasonable doctors do; but we have allowed them to say, unguided, what reasonable businessmen do.

Consequences

In the United Kingdom we have a very thick body of tax legislation. Much of it is anti-avoidance legislation. And whenever a new relief is introduced, the substantive provisions are often quite short, compared to the thicket of anti-avoidance provisions that accompany them. I believe if “abuse of rights” were part of the United Kingdom’s general tax law, we could have new legislation with that thicket cut away. It could even render large parts of the existing legislation redundant: for example, imagine the Group Relief rules without

Schedule 18 of the 1988 Act, as well as much of Chapter IV, Part X.

However, the price of such a development will probably be a loss of certainty as to how the rest of the tax law would apply. The two *Emsland-Stärke* conditions are a little opaque and will need further development, and, as I have suggested, that should come with carefully elaborated requirements about evidence – especially expert evidence – so that the matter does not become one of judges guessing at what a reasonable business-person would do.

¹(1981) 54 TC 101.

²[2001] STC 237.

³[2002] STC 66, 86-7 & 92-3.

⁴[1998] STC 725, 739h-j.

⁵[2002] STC 402 and [2001] V & DR 73.

⁶[2002] V&DR 428.

⁷Decision Number 17,854.

⁸Apart from “abuse of rights”, Customs are arguing that where something is undertaken wholly for the purposes of VAT avoidance, it is not a true “business” or “economic activity” within the meaning of Value Added Tax Act 1994 or the 6th EC VAT Directive. Since those arguments are peculiar to VAT law, I say nothing further about them.

⁹See *R v. IRC ex parte MFK* [1989] STC 873, 892j (Bingham LJ).

¹⁰See *R v. North & East Devon Health Authority ex parte Coughlan* [2001] QB 213, where the very severely disabled applicant had been told by the health authority, on moving from a hospital being closed by the authority to an NHS facility, that the facility would be her home for life. The authority later sought to close the facility. The Court said that it could not, because to do so would be so unfair that it would be an abuse of power to frustrate the applicant’s legitimate expectation that the authority would not resile from its promise.

¹¹[1985] AC 374, 410E (Lord Diplock).

¹²At the moment, differently constituted VAT & Duties Tribunals have taken different views as to whether abuse of rights could or should be part of our VAT law: compare *Blackqueen* (17,680) with *RBS Property Developments Limited* (17,789).

¹³[2002] V&DR 428, 468.

¹⁴[1974] ECR 1299, 1309, paragraph 13.

¹⁵which provides for the progressive removal of restrictions on the freedom to provide services by a person established within one Member State in other Member States.

¹⁶The third situation, which is not relevant in the United Kingdom, is where Community law has been used in a manner which is alleged to be contrary to a national abuse of rights provision.

¹⁷[1998] ECR I-1605, known as the “Man in Black” or “Death Cigarettes” case.

¹⁸92/12/EEC.

¹⁹[1998] ECR I-1605, 1627-8 (paragraph 89).

²⁰See also, *Centros Ltd. v. Ehrvorvs-og Selskabsseyrel-sem* [1999] ECR I-1459, 1476 where the Advocate General said that to determine whether or not a right is actually being exercised in an abusive manner is simply to define the material scope of the right in question.

²¹4325/90/EEC.

²²The basis for this appears to be Article 4(3) of Council Regulation 2988/95, concerning the protection of the Community’s financial interests – according to which acts which are established to have as their purpose the obtaining of an advantage contrary to the objectives of Community law applicable in that case, by artificially creating the conditions required to obtain that advantage, shall result in the advantage being withdraw or withheld.

²³[2000] ECR I-11579.

²⁴Such refunds are designed to compensate for the difference between commodity prices within the Community and international market prices – so as to make Community products competitive on the world market. In this way, their sale outside the Community becomes commercially viable, and effect is given to one of the intentions of the common agricultural policy: see further the second recital in the preamble to Council Regulation 800/99.

²⁵Thus apparently satisfying the *formal* requirements for export refunds under Articles 9(1), 10(1) and 20(2-6) of Regulation 2730/79.

²⁶See paragraph 39 of the Court's judgment.

²⁷The Commission also asserted that there was a third – procedural law pre-condition – but the Court did not accept this.

²⁸Lord Upjohn, *IRC v. Brebner* [1967] 2 AC 18, 30F-G and see also *Craven v. White* (1988) 62 TC 1, 171 A-B.