A GENERAL ANTI-AVOIDANCE PROVISION FOR VAT?

By Hugh M[c]Kay and Conrad McDonnell

In his Budget speech, as is well known by now, the Chancellor announced that he was instructing the Revenue to carry out a wide ranging review of areas of tax avoidance with a view to further legislation in future finance bills. There is nothing particularly new about such an announcement.

Historically the general United Kingdom approach to thwarting tax avoidance has been to legislate against specific instances of avoidance — the so-called "hole and plug" process. However, this time the Chancellor added that he would specifically ask the Revenue to consider a general anti-avoidance rule.

Since this announcement came hard on the heels of the House of Lords' decision in IRC v. McGuckian [1997] STC 908 it sent a

shiver down the spine of many practitioners. Indeed, much recent debate has been concerned with whether the Revenue would even need such provision (see for instance Ian Saunders - Issue 411; Stephen Edge - Issue 412).

The nearest thing to a general anti-avoidance measure is the inheritance tax "Associated operations" provision — s.268 Inheritance Tax Act 1984. This provision has been in the inheritance tax legislation since 1974; its effect is to treat associated operations as resulting in a single transfer of value made at the time the last of them is carried out. Despite the width of this provision, the two most recent inheritance tax cases concerned with avoidance - Hatton v. IRC [1992] STC 140 and Fitzwilliam v. IRC [1993] STC 503 - have both been applications of the well-known Furniss v. Dawson principle, although in Fitzwilliam the Revenue's argument failed.

In many senses, a general judicial anti-avoidance rule is more flexible and better equipped to deal with difficult cases than a wide-ranging statutory anti-avoidance provision. A further weakness of a statutory anti-avoidance provision is that it creates a need for pre-transaction rulings in a large number of cases, which runs counter to

the principle of self-assessment.

While the judicial rule in Furniss v. Dawson is well-suited to the field of direct taxation, it is thought that it is incapable of applying to VAT.

Furniss v. Dawson has been presented as a rule of statutory interpretation (see most particularly McGuckian), but it is doubtful whether it applies to all statutes. In Belvedere Court Management Ltd v Frogmore Developments Ltd [1996] 1 All ER 312, a case concerning a landlord's scheme for avoiding the provisions of the recent leasehold enfranchisement legislation, Sir Thomas Bingham MR said ([1996] 1 All ER 326e)

> "I am not for my part satisfied that in the field of real property the principles in *W T Ramsay Ltd v IRC* [1981] 1 All ER 865, [1982] AC 300 and *Furniss v Dawson* [1984] 1 All ER 530, [1984] AC 474 entitle the Court simply to ignore or override apparently effective transactions which on their face confer an interest in land on the transferee. Many transactions between group companies may be artificial. That does not entitle the court in ordinary circumstances to treat such transactions as null."

(There is only one instance of the Furniss v. Dawson rule being applied in a non-fiscal case. That was Gisbourne v. Burton [1989] QB 390 which was concerned with a series of artificial transactions

carried out in swift succession in an attempt to defeat the provisions of the Agricultural Holdings Act 1948.)

The reason why Furniss v. Dawson probably does not apply to VAT in particular is because its approach, which requires inserted steps to be ignored and looks only at the end result of a series of transactions, is inconsistent with the European Court decision in BLP Group plc v. Customs & Excise Commissioners [1995] STC 424 as explained by the House of Lords in C&E Commissioners v. Robert Gordon's College [1995] STC 1093.

In the latter case, Lord Hoffman explained how the European Community legislation contemplated the general scheme of VAT. Lord Hoffman referred to BLP, to the Advocate General's conclusion (paragraph 30 of the Advocate General's opinion) that the Community legislature proceeds from

> "an ideal image of 'chains of transactions' intended to attach to each transaction only so much VAT liability as corresponds to the added value accruing in that transaction, so that there is to be deduced from the total amount the tax which has been occasioned by the preceding 'link in the chain'".

He added that, as the European Court had emphasised in BLP, each

transaction in a chain must be examined separately to ascertain objectively what output tax is payable and what input tax is deductible at that stage.

Lord Hoffman then went on to criticise the approach of the Inner House of the Court of Session in Robert Gordon's College [1994] STC 698. The Court of Session, without the benefit of the European Court's judgment in BLP, had decided the question of the self-supply charge on a particular step in a transaction by going back up the chain of supply and taking into account earlier events, that is by looking at the supply in question "against the totality of the transactions involved". Lord Hoffman, on the other hand, said that BLP made it clear that for the purposes of European VAT legislation, it is not permissible to take such a global view of the series of transactions in the chain of supply.

On the one hand, the House of Lords says that it is not appropriate to take a global view of a series of transactions for VAT purposes; on the other hand (in McGuckian) the House of Lords advocates a general reconstructive approach to avoidance schemes: a tension between the two lines of authority arises. Happily, for VAT

purposes this can be resolved by having regard to the source of the views expressed in Robert Gordon's College; namely, the European Court in BLP. In VAT matters the European Court of course reigns supreme.

Accordingly, both Belvedere Court and Robert Gordon's College lead to the conclusion that the Furniss v. Dawson rule of statutory interpretation is a peculiar one in that, unlike other rules of statutory interpretation, it is of limited rather than general effect.

In our view, therefore, as the law stands at present, in VAT cases a series of valid transactions cannot be collapsed so that the intermediate steps may be ignored, allowing the VAT treatment of the scheme to be dictated by the end result. The analysis for VAT purposes must always take place at each and every separate stage of a transaction and no stage must be missed out.

The failure of Furniss v. Dawson to have general application to VAT gives impetus to the introduction of a statutory anti-avoidance provision applicable solely to VAT. And such a provision could perhaps satisfy the Chancellor's desire for a statutory anti-avoidance

mechanism without the drawbacks that would follow if one were introduced in the direct taxation field.

That Customs have been giving thought to such a provision is something of an open secret.

However, Article 27(1) of the Sixth Directive must first be complied with. This provides

> "The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance".

There appears to be no other way in which VAT avoidance, even under artificial schemes, may generally be countered. An anti-avoidance measure which is not approved under the Article 27(1) procedure is invalid (Direct Cosmetics Ltd v C&E Commissioners [1985] STC 479) .

This necessity to seek a special derogation before any kind of anti-avoidance measure can be introduced has always hindered Customs & Excise. The few examples of specific anti-avoidance

measures in UK law include: the valuation of supplies and intra-Community acquisitions between connected persons (VATA 1994 Sch 6 para 1); the special treatment of sales through non-VAT registered resellers (VATA 1994 Sch 6 para 2) with which Direct Cosmetics was concerned; the FA 1989 amendments to the treatment of buildings and land; the FA 1995 amendments to VAT on cars; the special scheme for the supply of gold (s.55 VATA 1994); and the commencement provisions for the new telecommunications services rules (VAT (Reverse Charge) (Anti-avoidance) Order 1997).

In the 1995 Budget Customs & Excise announced the introduction of a complex anti-avoidance provision for groups of companies. This was greeted by the profession with many objections (ICAEW Memorandum TAX 5/96), not least that the new provision required authorisation under Article 27(1) of the Sixth Directive. Despite these objections, Schedule 9A VATA 1994 was enacted in the Finance Act 1996 without any derogation being authorised. The validity of this Schedule's detailed provisions has not yet been tested under European Law.

This difficulty that Customs & Excise apparently has with

seeking European authorisation for its anti-avoidance measures is surprising, particularly since under the procedure set out in Article 27 of the Sixth Directive it is possible for any reasonable derogation measure to be authorised within a period of three months. (Article 27(4) provides for the automatic authorisation of special measures where they are simply notified to the Commission and no objection is raised by any Member State within a certain period.)

Of course it is not the case that every anti-avoidance provision will receive authorisation. The fundamental European Law principle of proportionality comes into play: any anti-avoidance measure must be proportionate to the loss which it is attempting to stem, that is it must not derogate from the general rules of the Sixth Directive any more than is strictly necessary to achieve its anti avoidance purpose. In EC Commission v Belgium (Case 324/82) [1984] ECR 1861, [1985] 1 CMLR 364, the Commission successfully challenged Belgian provisions which imposed VAT on all new cars at the full catalogue price:

> The Commission contends that the national measures in question are not covered by Article 27(5) because they are too general in character. It argues in particular that, in so far as they apply to new cars, they render the system laid down in Article 11 practically purposeless in the market sector in question and are therefore disproportionate to the aim

> in view; even where Article 27(5) of the Sixth Directive is applied, Member States are obliged to observe the fundamental principles and scheme of the directive as well as general principles of Community law, such as the principle of proportionality.
>
> (Judgment paragraph 22)

> The Belgian government maintains, however, that the rules in question do in fact satisfy the requirements of proportionality because there is widespread tax evasion in the motor trade.
>
> (Judgment paragraph 25)

The Court held that:

> The measures notified must be of such a nature as to prevent tax evasion or avoidance and that in principle they may not derogate from the basis for charging VAT ... except within the limits strictly necessary for achieving that aim.
>
> (Judgment paragraph 29)

> The Belgian legislation entails such a complete and general amendment of the basis of assessment that it is impossible to accept that it contains only the derogations needed to avoid the risk of tax evasion or avoidance.
>
> (Judgment paragraph 31)

The Belgium case shows that a non-directed rule of general application, even if introduced in the face of widespread tax evasion, is not acceptable in European terms. In the authors' view, however, a statutory anti-avoidance provision, even a general provision, that in its terms is specifically directed at avoidance, could satisfy the requirement for proportionality.

One important obstacle to a general anti-avoidance provision is the inclusion, in Article 27(1), of the words "certain types of tax

evasion or avoidance". This would seem to preclude a totally general anti-avoidance provision, although it should still be possible to draft legislation which successfully quashes VAT avoidance schemes falling within certain limits.

It may be that a statutory anti-avoidance provision for VAT is only just over the horizon, however the fact that a special measure must first enjoy the consent of the European Commission and the other Member States under the Article 27 procedure should ensure that any provision which Customs & Excise do decide to introduce would have a sufficiently long gestation period for practitioners to have ample warning of its effects, and to have the opportunity to make representations. Furthermore, any provision which is disproportionate or too broad-reaching in its terms will always be open to challenge in the European Court.