THE IMPORTANCE OF *FLEMING (T/A BODYCRAFT) AND CONDÉ NAST PUBLICATIONS LIMITED (RESPONDENTS) V HER MAJESTY'S REVENUE AND CUSTOMS (APPELLANTS)*

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Introduction

The recent case of *Fleming* at the House of Lords concerned the proper application by the State, and the proper disapplication by the Courts, of section 80(4) of the VATA 1994 and Regulation 29(1A) of the VAT Regulations 1995. The VATA 1994 and the Regulations transpose the Sixth Directive into national law. Articles 17 and 18 of the Sixth Directive, both of which are in Title X1 which deals with deductions, provide the legislative foundation for one of the most fundamental features of VAT, that being the passing on of input tax (to be credited against output tax) along a chain of traders to the ultimate consumer of the goods.

Section 80(4) of the VATA 1994 and Regulation 29(1A) of the VAT Regulations 1995 amended the earlier legislation by way of placing restrictions upon the time limits by which taxpayers could claim for both overpayments of output tax and previously under claimed deductions of input tax. As the legislation was originally enacted, section 80 of the VATA 1994 set a period of six years as the time-limit by which any overpayment of VAT could be claimed back from the Commissioners. In the event that a taxpayer had mistakenly overpaid VAT, the six year period ran from the date on which the taxpayer discovered the mistake or could with reasonable diligence have discovered it (subsections 4 and 5). In the ordinary course of business, claims would of course be made in the accounting period to which

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the return in question relates. Interestingly, the original regulation 29 was even more hospitable to the taxpayer's actual or possible administrative oversights - it permitted claims for *deductions* of input tax to be made later that the accounting period to which the return related, but *without* specifying a time-limit for such claims.

Mr Fleming, the respondent in the first appeal, made a claim on the 23rd of October 2000 for repayment of input tax paid on the acquisition of three specialist sports cars ten years before. Conde Nast made a claim on the 27th of June 2003 for input tax paid on staff entertainment during the preceding 30 years.

The Amendments to the Statutory Scheme

With effect from the 18th of July 1996, an amendment to section 80(4) of the VATA 1994 was enacted by section 47 of the Finance Act 1997. The amendment was significant because it significantly increased the administrative strictures to which the taxpayer was subject. First, it halved the six year time limit for overpaid output tax to a three year limit, and second, it removed the exception in the cases of mistake. The period would be three years *simpliciter*. Regulation 29 of the VAT regulations 1995 was also changed by way of an insertion, paragraph (1A), with effect from the 1st May 1997. This brought the rule regarding the reclaiming of input tax into line with that concerning the repayment of output tax, for 29(1A) provided that the Commissioners were not to allow a claim for a deduction of input tax more than three years after the date of the return for the relevant period. In the case of overpaid input tax though, there had been no pre-existing time limit on such claims prior to the insertion of 29(1A) and the time limit had previously been an unlimited one.

Transitional Periods and Retrospectivity

In both cases - that of the amendment to section 80(4) of the VATA 1994 and the inserted Regulation 29(1A) - neither included any transitional period in which a tax payer could issue a pre-existing claim for overpaid output tax or under claimed input tax. No provisions were made for those claims - (which some media reports following the taxpayer's victory in the case put at approximately £1bn) - where a right to claim for overpaid output tax or under claimed input tax *already existed*. The changes were therefore *retrospective* - their effect was to eradicate the enforceability of any outstanding claims that pre-existed the changes themselves.

Developments in European Community Law

One interesting aspect of *Fleming* is the fact that the legal rights of the taxpayers vis-a-via these provisions became clear on the basis of developments in the EC case law *following* the entering into law of the revised provisions themselves. In *Marks and Spencer II* and *Grundig Italiana SpA v Ministero delle Finanze (Grundig II)* the ECJ affirmed the importance of the principles of effectiveness and legitimate expectation in Community law in the context of limitation periods and the need for transitional arrangements in the face of such limitation periods.

Marks and Spencer II concerned both the issue of way in which the VAT payments should have been calculated and the issue of the reduction of the limitation period under section 80. To focus on the present issue of limitation periods, the ECJ made clear that such periods must be fixed in advance and that they must be of reasonable duration (see paras 34-39 of that judgment).

In *Grundig II* the taxpayer challenged the legality under EU law of an Italian law (no.428 of 29th December 1990) that extended the scope of a statutory five-year limitation period that was applicable to customs duties so as to apply to all claims for refunds relating to Customs operations, including the very consumption tax that had been considered in *Grundig I.* The effect of this measure was not only to broaden the scope of the limitation period, but also to *reduce* the previous five-year period to three years as of the 90th day from the date by which the law came in force (that being the 27th of January 1991). Grundig Italiana brought a claim for repayments of consumption tax 5 days short of 3 months after the expiry of the 90 day transitional period.

In *Grundig II* (at para 41) the ECJ held that while the retroactive application of limitation periods was not *in itself* in breach of the principle of effectiveness, retroactivity could in result in a breach of that principle if the amendment went beyond what was necessary to achieve the legislative objective. On that basis the Court held that a period of 90 days was not a sufficient transitional period before which the new limitation period would take effect, but that a period of six months would have qualified as a minimum period during which accrued claims that would otherwise have been disqualified under the new limitation period could have been made.

The approach of the ECJ in *Grundig II* was greatly scrutinised by counsel on both sides in *Fleming*. As will become clear, one important aspect of *Fleming* lies in the way in which their Lordships interpreted and applied the decision in *Grundig II*. This aspect of the case has important constitutional implications in terms of our understanding of the circumstances in which both the courts and the tax authorities are able to enforce and give effect to rights under EU law. In order consider this issue it is worth beginning with the way in which the Commissioners responded to

the developments in the law following *Marks and Spencer II* and, subsequently, *Grundig II*.

Following *Marks and Spencer II* the Commissioners announced that there would be a transitional period to cover claims for overpaid output tax under section 80. The amendment to section 80 was enacted on the 4th of December 1996, and the transitional period was to run from this date for a period of six months until 31 March 1997, and taxpayers were given the requisite six years in which to make claims from that date until the 31st of March 2003. Then, following the decision in the *Grundig II* case, the transitional period was extended by three months to 30 June 1997 and the period within which claims could be made was extended to 30 June 2003. These announcements were made in two separate 'Business Briefs' published by the Commissioners following each of these ECJ decisions.

Interestingly, the period for the making of late claims under regulation 29 for deduction of input tax was not affected by these announcements. No similar transitional provisions were introduced or announced with regard to those claims, and therefore the essential question that the House faced was whether, as Counsel for HMRC argued should in fact the case, the Court could adopt a six month transitional period for all claims that could have been made, (or indeed as Counsel alternatively suggested *would have or should have* been made) either from the passing into force of paragraph 1A amending regulation 29 *or* six months from the date on which an average taxpayer could or would or should have been aware that EU law required a reasonable transitional period. A number of possible candidates were offered as billboards on the basis of which the 'average taxpayer' would have or should have become aware of his rights in EC law, one of them being the date of the judgment of the ECJ in *Marks and Spencer II* and others being the publication dates of various HMRC 'business briefs'.

The Principle of Effectiveness and Legitimate Expectation

It is worth noting that the importance of maintaining stability in public finances was acknowledged by the ECJ in *Marks and Spencer II*, [2002] ECR I-6325 para 41, and indeed, this concept was alluded to in the submissions offered on behalf the HMRC. Yet this policy consideration does not stand in the face of the principles of effectiveness and legitimate expectation (see *Marks and Spencer II*, para 47): as Lord Hope made clear in his judgment (see para 9) both of these principles are infringed where a retrospective introduction of a time limit for the making of claims is introduced without an adequate transitional period of which sufficient notice has been given and communicated to the taxpayer (following *Grundig II* para 40).

Constitutional Considerations and 'mere Administrative practices'

From this relatively straightforward proposition emerged a difference both in emphasis and interpretation as expressed by their Lordships' judgments in *Fleming*. Lord Hope considered that while there may be circumstances where the court could reach its own decision as to what would be a reasonable time for the making and rejecting of claims made after a 'reasonable period', the gap in the legislation remained unfilled and therefore there could not be said to be any issue of statutory interpretation in *Fleming*. Lord Scott's judgment developed this theme as touched upon by Lord Hope by citing (at para 20) a constitutionally significant VAT case, *EC Commission v United Kingdom* [2005] STC 582, where are para 25 of the judgment the Court observed that: "*Mere administrative practices cannot be regarded as constituting the proper fulfilment of obligations under Community law"*. Thus, the Commissioners cannot publish a Business Brief to rectify an *absence* of something as important of a transitional period in an attempt to effectively amend an unsatisfactory statutory scheme. Since the VAT scheme is not made by either Commissioners or the Courts, it would be an improper exercise of power if judges were to attempt to give legal effect to the 'mere administrative practices' that are represented by the Commissioners' Business Briefs. The scheme itself can only be amended by Parliament passing new primary legislation or by others passing new secondary legislation on the basis of powers conferred by Parliament. As Lord Scott observed in his judgment (at para 21), it is not the function of judges to legislate, and the concept of an "adequate transitional period" is one that is too vague to permit for the necessary certainty that taxpayers legitimately expect from a system that regulates what input tax repayment claims they are able to bring. Finally, and on the basis of *EC Commission v United Kingdom* (para 25) Lord Scott determined that the incompatibility of national legislation with Community provisions can only be remedied by provisions which have the same or equivalent legal force as the rules which those provisions are designed to amend. The 'mere administrative practices' represented by the Business Briefs are not sufficient, and as a matter of constitutional law, judges are not empowered to legislate so as to create provisions with the requisite legal force.

Transitional Periods and the Role of the Courts

Lord Walker did not concur in his judgment with Lord Hope and Lord Scott on the issue of 'mere administrative practices' being insufficient for the purposes of amending national legislation that is incompatible with Community provisions, and he distinguished *EC Commission v United Kingdom* Case C-33/03 [2005] STC 582 from the facts of *Fleming* on the basis that the former case concerned the incorrect transposition of a Council Directive, while *Fleming* concerned the duration of the "adequate transitional period" referred to in *Grundig II*.

Lord Walker determined that on this basis any announcement of an official administrative policy is relevant as to the duration of such an 'adequate transitional

period', and more strongly, that the definition of such a period is properly within the province of the court – it being 'the plain duty under EU law' for the national court to disapply offending legislation that did not satisfy the court's definition of what the duration of such an adequate transitional period ought to have been (see para 62). From these premises Lord Walker determined that the court *was* empowered to create what would have been a reasonable transitional period – that being in Lord Walker's judgment a period of six months after the 11th of July 2002 – the date of the judgment of the ECJ in *Marks and Spencers II*. On this basis Lord Walker dismissed the Commissioners' appeal in Mr Fleming's case – since his claim for a refund of input tax (a claim for a sum of approximately £127,000) was made on the 23rd of October 2000, but allowed the Commissioners' appeal in Condé Nast's case (and was in the sole minority in so ruling), which depended on a claim for the refund of input tax made on the 27th of June 2003.

In agreement with Lord Walker, and unlike Lord Hope and Lord Scott, Lord Neuberger did not interpret the issue what might constitute an adequate transitional period as having the corresponding constitutional implication that it engaged the question of what could be said to be properly a matter for the legislature as compared to the judiciary. Lord Neuberger determined instead that the Commissioners were and are empowered to make extra-statutory concessions and that, provided that such concessions are of sufficient duration and are effectively communicated, then such concessions are sufficient (para 104). Lord Neuberger distinguished *EC Commission v United Kingdom* (Case C-33/03) [2005] STC 582 from the facts of *Fleming* on the basis of applying a *procedural vs. substantive* test to the two cases (see para 105). Thus, the reference to the insufficiency of "tax authority guarantees" and the need for conforming "national legislation" in *EC Commission v United Kingdom* must be interpreted as against the context of a Member State's failure to give effect to a Directive – thereby engaging the substantive issue of the failure to even get off the ground in terms of giving legal effect to EC rights. In *Fleming*, on the other hand, Lord Neuberger determined that the issue was instead one concerning a Member State's failure *to disapply otherwise conforming legislation* so as to comply with the Community law procedural requirement that there be an adequate transitional period (again following para 41 in *Grundig II*) where there is the introduction of a new limitation period in relation to a directly effective right.

To return to the point of constitutional principle, Lord Neuberger determined (at para 82) that there was no apparent difference in principle between the two types of case. In fact, Lord Neuberger determined that the meaning of the phrase "no adequate transitional period" at para 41 of the ECJ's judgment in Grundig II should be taken to encompass cases where there was no period and to those where it was too short.

A Difference in Principle?

I would respectfully argue that, in fact, *Fleming* can be distinguished from *Grundig II* precisely on the basis that in *Fleming* the question of 'adequacy' simply did not arise because there was *no* transitional period, whereas on the contrary, in *Grundig II* there was *already* a transitional period of 90 days, and the ECJ simply deemed this *existing* transitional period as being insufficient.

Thus, when Lord Walker referred to the issue (at para 62) of "whether the definition of an adequate transitional period is properly a matter for the national court" this was perhaps to put the point in terms that already put this issue within the remit of judicial discretion. Lord Walker ruled that six months after the decision in *Marks and Spencer II* best corresponded with the guidance given in *Grundig II*, yet again, in *Fleming* this has the effect of creating a transitional period when previously there was previously no such a period, whereas in *Grundig II* the issue was *not* one of there being *no* period, but rather that the *pre-existing* period was an insufficient one.

Indeed, Advocate-General Colomer interpreted the issue in such narrow terms, observing at para 23 of his opinion that "the Court bases its view on a *specific understanding* of the temporal scope of the provision" and in the next paragraph expressed the court's doubt as turning on the specific issue of whether a 90 day period is in keeping with the principle of effectiveness.

I would therefore suggest that in *Grundig II* the notion of duration was of the essence, while in *Fleming* a more clear-cut breach of the principle of effectiveness was at hand since there was *no* transitional period in place at all. In short, while *the definition* of an adequate transitional period may be within the Courts' remit in a case where there is a *pre-existing but inadequate* transitional period, *the very creation* of such a period cannot be for precisely the reason Lord Scott gives at para 21 of his judgment – that it is not the function of judges to legislate. In the Court of Appeal in the *Fleming* case ([2006] STC 864), Ward and Hallett LJJ determined that the reasoning in paragraph 41 of *Grundig* only applied where it is the *inadequacy* of an existing transitional period that is the issue, and I would respectfully concur with that approach.

Yet the essential *ratio* of Lord Neuberger's leading judgment is not disrupted by squabbles concerning whether there is a difference in principle – constitutional or otherwise – between the two cases. The importance of *Fleming* lies in the affirmation of the principles of legitimate expectation and effectiveness as ensuring that Community rights are transparent and not capriciously determined. As Lord Neuberger explained, the stipulation of a prior transitional period would be a 'hypothetical' solution to the problem since a retrospective transitional period created by the disapplication of Regulation 29(1A) – even one of a year in duration – would come to an end many years before it had even become clear that the absence of a transitional period meant that there had been a breach of Community law

principles (paras 85-86). This would simply be to pay "lip service" to the principles of effectiveness and legitimate expectation. Following *Marks and Spencer II* (at para 39) for a limitation period to be valid then it must be fixed in advance, and therefore so too must any adequate transitional period[2].

2 For interesting recent applications of ***Fleming and Conde Nast*** see:

Marks & Spencer plc v Revenue and Customs Commissioners (sub now Marks & Spencer plc v Halsey (Inspecter of Taxes) [2009] SFTD 1 (Avery-Jones and Gammie QC presiding) (para 48 – Lord Neuberger's analysis of the European Jurisprudence at para 78 ***Fleming***; see also CofA decision at [2007] EWCA Civ 117);

Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners [2008] EWHC 2893 (Ch) [2009] STC 254 (Henderson J – para 143: *"The basic principles which should guide the national court are not in doubt. If at all possible, the offending national legislation should be construed or interpreted so as to make it 'conform to the superior order of EU law', to use the vivid phrase of Lord Walker of Gestingthorpe in Fleming (t/a Bodycraft)…"*; [2008] STC 2391 (CofA decision pending).

Vodafone 2 v Revenue and Customs Commissioners (No 2) [2008] EWHC 1569 (Ch) (Evans-Lombe J, paras 80 – 87; see also CofA decision at [2009] EWCA Civ 446)