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WHEN IS A SUPPLY NOT A SUPPLY? *HALIFAX PLC V COMMISSIONERS OF CUSTOMS & EXCISE*

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1 Introduction[2]

Question: "When is a supply not a taxable supply for value added tax purposes?"

Answer: "When it is made for the purpose of tax avoidance."[3]

The answer was given by His Honour Stephen Oliver QC, President of the United Kingdom VAT and Duties Tribunal, in the Decision of the London Tribunal on March 1st 2001 in *Halifax plc v Commissioners of Customs & Excise*.

The United Kingdom tax world has been stunned by this decision, which rests on no United Kingdom or EC authority, which, in my view, runs counter to the views of Lord Hoffmann, one of the most influential judges of the House of Lords and the Privy Council, and which appears to be inspired by a mistaken

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2 It is only right that I make a declaration of interest. I am representing a taxpayer in litigation pending before the London Value Added Tax Tribunal in which the Commissioners of Customs and Excise have now indicated they will rely on the *Halifax* decision. It is sometimes difficult for Counsel for a litigant to write an academic article. For, wearing his wig, he must not advance any argument adverse to the interests of his client while, wearing his mortar board, he must fairly evaluate the position. In this case, I have no such difficulty, as, in my opinion, be it right or wrong, the decision in *Halifax* is misconceived.

3 Or, on one interpretation of the Decision, when it would result in a leakage of tax.

view of certain United Kingdom judicial decisions on direct taxation.

The proposition advanced by counsel for the Commissioners of Customs & Excise ("Customs"), which the Tribunal accepted, was:

> "a transaction entered into solely for the purposes of value added tax avoidance is neither itself a "supply" nor a step taken in the course of furtherance of an "economic activity" as those terms in the Sixth Directive (and the equivalent terms in the Value Added Tax Act 1994) are properly to be interpreted."[4]

In this article, I submit, with respect, that the proposition is not only unsupported by authority, but is wrong.

The Tribunal also expressed some interesting and, in my view erroneous, views, on the principle of fiscal neutrality in value added tax.[5]

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4 There is a difference in the wording of the United Kingdom Value Added Tax Act 1994 and the Sixth Directive. The Value Added Tax Act section 4(1) provides: "VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him". The Sixth Directive Article 2 provides: "The following shall be subject to value added tax: 1 the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such ..." The House of Lords held in *Institute of Chartered Accountants in England and Wales v Customs and Excise Commissioners* [1999] STC 398, in the context of a dispute as to whether the Institute was carrying out licensing activities in the course or furtherance of a business, that the "1994 Act must so far as possible be construed so as to give effect to the Sixth Directive (see *Marleasing SA v La Comercial Internacional de Alimentacion SA* (Case C-106/89)[1990] ECR 4135). It does not seem to me that there is any difficulty here in doing that and one would expect the same result to follow from the application of either approach": per Lord Slynn.

5 These are discussed at 10 below.

2 The Facts

The following diagram may make the case easier to understand.

Halifax (makes 95% exempt supplies)

sells property to

Developments contracts for building services with **Country Wide**

sells property post refurbishment to

subcontracts building services to unconnected contractors

Investments

Leases property to Halifax

Halifax plc is a bank which makes largely exempt supplies. It was intending to refurbish various properties ("the Sites") which it owned for its own use. If it simply refurbished the Sites itself, it would have recovered only about 5% of the input tax. A strategy was therefore devised whereby, taking the Halifax group as a whole, 100% of the input tax could, it was considered, be recovered. This involved the use of three other English companies, Developments, Country Wide and Investments, of each of which Halifax was the 100% parent. It is not clear whether they were created for the purposes of the scheme. Halifax, Developments and Country Wide each had separate value added tax registrations, that is, although they formed part of a commercial group, they did not form part of the same value added tax group.[6] Investments had no value added tax registration. It planned to make only exempt supplies.

Halifax granted long leases of various sites to Developments for a premium, which appears to have been on arms' length terms. Developments funded the purchase price by issuing a debenture to Halifax. During Development's first "partial exemption year"[7] (Year 1) it purported to make to Halifax taxable supplies of building services of small value. It also refurbished the properties, contracting for building services to be supplied by Country Wide, which in turn

6 See the United Kingdom Value Added Tax Act 1994 section 43, authorised by the Sixth Directive Article 4.4 paragraph 2.

7 See below.

subcontracted to obtain such services from non-connected builders.[8] It ensured that the properties were not "capital goods". In Development's second "partial exemption year", it sold the properties to Investments. Investments then leased them to Halifax. Each of Developments, Country Wide and Investments were to make a profit from entering into the arrangements. Developments and Country Wide did indeed make such a profit.

Country Wide retained the services of various unconnected main contractors and professionals, to which the Tribunal referred collectively as "the arm's length builders". A number of the relevant agreements were apparently accompanied by separate agreements to which Halifax was a party and under which the arm's length builder warranted to Halifax that he would carry out the duties and obligations on his part to be performed under and in connection with his appointment.

It was admitted that "Halifax's sole purpose in arranging the insertion of [Developments] and [Country Wide] between itself and the arms' length construction contractors was to procure (in group terms) the recovery of substantially all the value added tax on the construction works, when otherwise most of that value added tax would have been irrecoverable."[9]

3 The Strategy

The basis of the value added tax strategy was that:

(a) Developments recovered all input tax on building services in Year 1, because the only supplies it made in that year were standard-rated, and that there was no clawback of such input tax as the result of later developments, in particular the subsequent sale of its interest in the properties.

(b) Developments charged no value added tax on the sale to Investments in Year 2 (because the supply was exempt); and

(c) Investments charged no value added tax to Halifax (because it made only

8 It is not explained in the Decision why Developments did not simply contract with such builders directly and why the interposition of Country Wide was considered necessary. In the case of one of the Sites, Halifax had already entered into an arm's length agreement with a contractor for development works. This was novated so that Country Wide replaced Halifax.

9 See paragraph 23 of the Decision.

exempt supplies).

The overall result, if the strategy was successful, was that value added tax recovery, taking the group as a whole, was increased from 5% to 100%.

Customs seem to have agreed with Halifax that, subject to the points argued before the Tribunal, the strategy worked. That is a matter on which I make no comment.

4 Contentions

4.1 The Novel Contentions

Customs claimed that the result was:

> Developments made no supplies of construction works to Halifax
>
> Developments obtained no supplies of construction works from Country Wide
>
> on the proper analysis of the arrangements as a whole, Halifax received supplies from the arms' length builders and not from Developments and could recover only the normal partial exemption recovery percentage of the input tax.[10]

The alternative bases for reaching this result were:

> a transaction entered into solely for the purposes of value added tax avoidance was neither itself a "supply" nor a step taken in the course of furtherance of an "economic activity" as those terms in the Sixth Directive (and the equivalent terms in the Value Added Tax Act 1994) are properly to be interpreted.
>
> transactions entered into solely for the purpose of value added tax avoidance should, in accordance with the general principle of EC law preventing "abuse of rights", be disregarded and, instead, the terms of the Sixth Directive (and, here, the provisions of the Value Added Tax Act 1994, which implement the Directive) be applied to the true nature of the transactions in issue.

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10 This third contention would arise only if the first two were successful, but would then be favourable to Halifax. See 16 below.

> The reality of the arrangements, whichever approach be adopted, was that the only true supplies of construction services were those provided by the arms' length builders etc. and those supplies were made direct to Halifax.[11]

The Tribunal accepted the first and third of these bases. This meant that it was not necessary for it to adjudicate on the second. It therefore declined to do so but noted that "The Appellants gained no rights from the scheme adopted as The Halifax's solution. Consequentially they had no rights to abuse. For that reason the Commissioners' second argument that the transactions comprised in the scheme should, in accordance with EC "abuse of right" principle, be disregarded does not arise." While this is in my view correct, it is so tersely expressed as to be almost incomprehensible to one not acquainted with all the complex arguments. It is beyond the scope of this article.

4.2 Effects of Decisions Appealed Against

As the Tribunal stated, at paragraph 25 of the Decision:

> "The effect of the Commissioners' decisions, if correct, can be summarized as follows:
>
> - Developments made no supplies of construction works to Halifax under the Agreements for Works dated 29th February 2000 and 13th March 2000. No output tax is therefore due from Developments.
>
> - Developments obtained no supplies of construction works from Country Wide under either the First or the Second Country Wide Agreements. No output tax is, therefore, due from Country Wide and Developments incurred no input tax which it can recover.
>
> - Halifax incurred no input tax under either of the Agreements for Works which it can recover.
>
> - On the proper analysis of the arrangements as a whole Halifax received supplies from the arm's length builders and not from Developments; it could recover the tax shown on the invoices applying its normal partial exemption recovery percentage."

11 See paragraph 25 of the Decision.

4.3 Comment

Two points should be made. Firstly, on the particular facts of this tax planning scheme, the Customs obtained the desired result by ignoring the supplies from Developments to Halifax and from Country Wide to Developments. Ignoring the contention that the supplies in fact made by the third party contractors were in fact made to Halifax, the result was that Country Wide bore input tax which it was unable to recover, because it was not incurred for the purpose of making a taxable supply. The same result would have followed, with more economy, had one simply disregarded the supplies made by Developments to Halifax, although the loss would, of course, have been borne by Developments rather than by Country Wide.

Secondly, it is not at first blush obvious why Customs went on to contend that the arm's length builders made supplies to Halifax. This was quite unnecessary. Moreover, given that the Halifax group had lost on the first three bullet points set out at 4.2, the establishment of the fourth was actually in Halifax's interests, as it could at least recover 5% input tax. It is therefore not that surprising that the Tribunal should have upheld this contention too, far removed as it was from reality, as there would have been no one to argue against it.

4.4 Short statement of contentions

The Tribunal set out briefly at paragraphs 24 Bis and 25 Bis of the Decision the main opposing contentions:

> "24. The case for the Appellants, put positively, was that all the transactions forming part of the arrangements with which these appeals are concerned were genuine; they resulted in supplies that had genuinely been made. The supplies of the arm's length builders self-evidently served commercial purposes. So also did Country Wide's supplies of construction services and Investments supplies of construction services and land. Each of those two companies and Investments were to earn profits from their participation in the arrangements. Those factors formed part of the commercial considerations behind the arrangements. The Appellants accepted that the arrangements had been structured so as to achieve an advantageous fiscal result. But, it was argued, the VAT system imposed a charge to tax on a transaction by transaction basis; genuine transactions such as these could not be disregarded for any reason.

> 25. The Commissioners' first submission was that a transaction entered into solely for the purposes of VAT avoidance was neither itself a "supply" nor a step taken in the course or furtherance of an "economic activity" as those terms in the Sixth Directive (and the equivalent terms in the VAT Act 1994) are properly to be interpreted. The application of this principle of interpretation to the present arrangements meant that [Developments] undertakings to The Halifax in the Agreements for Works did not count as supplies; nor did [Country Wide's] undertakings to [Developments] in the First and Second [Country Wide] Agreements. The Commissioners' second submission was that transactions entered into solely for the purpose of VAT avoidance should, in accordance with the general principle of EC law preventing "abuse of rights", be disregarded and, instead, the terms of the Sixth Directive (and, here, the provisions of the VAT Act 1994 which implement the Directive) be applied to the true nature of the transactions in issue. The reality of the arrangements, whichever approach be adopted, was that the only true supplies of construction services were those provided by the arm's length builders etc. and those supplies were made direct to The Halifax."

5 What is Meant by "Tax Avoidance"?

5.1 The Tribunal's Approach

If the Tribunal had proceeded logically, it would perhaps first have asked whether either of the Commissioner's propositions was well founded and, if so, what was meant by "tax avoidance" *within the meaning of such proposition*. But, consistently with the rest of the Decision, which was highly economical with logic, it took a different approach:

> "39. Common to both arguments advanced for the Commissioners is the proposition that the transactions comprised in the solution were steps in a tax avoidance scheme and, viewing them individually and collectively, those transactions had no business or economic function other than to facilitate the solution to The Halifax's partial exemption problem. Before addressing the arguments on their merits, we shall start by setting out our understanding of the concept of "tax avoidance" in the Sixth Directive."

The Tribunal[12] relied on the decision of the ECJ in *Direct Cosmetics Ltd v Customs and Excise Commissioners* [1988] STC 540.[13] In that case the question was whether the United Kingdom, having been authorised, pursuant to Article 27(1) of the Sixth Directive, to adopt a measure of national law derogating from Article 11A(1)(a) of the Directive, could apply that measure to, *inter alios*, a taxpayer who had been accepted as carrying on business without any intention to evade or to avoid Value Added Tax and whose method of trading had evolved solely on account of commercial considerations.

Article 27(1) 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 ..."

The ECJ decided that it could. The key passage in its judgment[14] reads:

> "20. The concept of tax avoidance as expressed in Art 27.1 of the Sixth Directive is a concept of Community law. Hence the definition of that concept is not left to the discretion of the member states.
>
> 21. The wording of Article 27, in all the language versions, draws a distinction between the concept of avoidance, which represents a purely objective phenomenon, and that of evasion, which involves an element of intent.
>
> 22. That distinction is confirmed by the historical background to Article 27. Whilst the Second Council Directive on value added tax of 11 April 1967 (EC Council Directive 67/228) referred exclusively to the concept of 'fraud', the Sixth Directive mentions in addition the concept of tax avoidance. This means that the legislature intended to introduce a new element in relation to the pre-existing concept of tax evasion. That element lies in the inherently objective nature of tax avoidance; intention on the part of the taxpayer, which constitutes an essential element of evasion, is not required as a condition for the existence of avoidance.

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12 At paragraph 39 of the Decision.

13 This is in fact Case 138/86. The Decision erroneously refers to it as Case 5/984, which appears to be a slip for Case 5/84 of the same name, reported at [1985] STC 479.

14 Cited at paragraph 39 of the Tribunal Decision.

> 23. That interpretation is in conformity with the principle governing the system of value added tax according to which the factors which may lead to distortions of competition at national and Community level are to be eliminated and a tax which is as neutral as possible and covers all the stages of production and distribution is to be imposed. The title of the Sixth Directive, refers to a 'uniform basis of assessment' of value added tax. Furthermore, the second recital in the preamble to the Directive refers to 'a basis of assessment determined in a uniform manner according to Community rules' and the ninth recital specifies that 'the taxable base must be harmonised so that the application of the Community rate ... leads to comparable results in all the Member States'. It follows that the system of value added tax is concerned principally with objective effects, whatever the intentions of the taxable person may be.
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> 24. The answer to the first question must therefore be that Art 27(1) of the Sixth Directive permits the adoption of a measure derogating from the basic rule set out in Art 11(A)(1)(a) of that Directive even where the taxable person carries on business, not with any intention of obtaining a tax advantage but for commercial reasons."

While some of the reasoning of the Court is, from a United Kingdom perspective, open to criticism, the actual decision is a perfectly sensible one. The Article 27(1) procedure is there to allow "tax leakage" to be stopped and to iron out kinks in the uniformity of the application of value added tax. The tax leakage is still there whether the conditions for it arose naturally or were deliberately created with a view to securing a tax advantage.

5.2 A Linguistic Difficulty: "Tax Avoidance" and "Tax Evasion"

I have said that the reasoning is open to criticism. Continental lawyers do not always distinguish as clearly as do British lawyers between:

(a) "evasion", which nowadays is used in the United Kingdom to refer to deliberate and fraudulent steps with the purpose of ensuring that tax which is legally due is not paid, and

(b) "avoidance" which is used only where steps are taken with the motive of ensuring that no liability to tax shall arise.

This difference is no doubt partly attributable to the comparative richness of the

English language in terms of vocabulary.[15] It may also reflect the United Kingdom culture in which tax evasion is totally unacceptable but tax avoidance is either admired or, at least, understood, if not totally appreciated. Yet even in the United Kingdom, it is only comparatively recently that the present usage has become standardised in the United Kingdom. One can find dicta in older judicial decisions where "evasion" is sometimes loosely used to mean what would now be termed "avoidance". Indeed, one can find United Kingdom lawyers, such as some criminal practitioners, who even nowadays do not always keep the distinction clear.

Modern United Kingdom authorities have gone further and sub-classify cases where a tax advantage is deliberately obtained as "tax avoidance" or "tax mitigation". The most famous classification is that of Lord Nolan in *Inland Revenue Commissioners v Willoughby*[16] where he characterises tax avoidance as "a course of action designed to conflict with or defeat the evident intention of Parliament". Consequently, the acceptance of an offer of freedom from tax which Parliament has deliberately made cannot be tax avoidance.

To us in the United Kingdom, it may appear surprising that the ECJ should not have seen that there was any middle course between fiscal fraud and objective leakage of tax. Yet when one considers the European background, it is not so surprising, any more than that "avoidance" should have been used to refer to an objective leakage of tax.

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15 Take, for example, an otherwise very sophisticated language such as French. The highly respected Larousse Unabridged French-English, English - French Dictionary translates "tax avoidance" as "évasion fiscal" and "évasion fiscal" as "tax evasion"! For a case in which the United Kingdom alleged that an authorisation (pursuant to Article 27(1) of the Sixth Directive) had been mistranslated, see *Direct Cosmetics Ltd v Customs and Excise Commissioners* [1988] STC 540 at paragraph 23 of the Report of the Judge Rapporteur (C N Kakouris): "As for the terminology used in the decision of authorisation, the United Kingdom submits that it contains a mistranslation inasmuch as the expression 'tax evasion' in the English version corresponds to the French 'fraude' whereas the expression 'evasion fiscale' is correctly translated in English by the expression 'tax avoidance'." See also the Opinion of Advocate General Da Cruz Vilaça at paragraph 85 onwards.

Consider also the French Livre des Procédures Fiscales, Article 64 "Procédure de Répression des Abus de Droit" which seems, at the beginning, to be concerned with fraud or "actes qui dissimulent la portée véritable d'un contract" (documents/actions which conceal the true meaning of a contract) but when it says that the means of concealment include "clauses ... c) ... qui permettent d'éviter .... le paiement des taxes (clauses which allow the evasion? avoidance? avoision? of taxes) it, wanders ambiguously into the sphere of tax avoidance. The ambiguity of the provision is all the more striking when one considers its penal consequences: see *Code Général des Impôts* article 1729.1.

16 [1997] STC 995

5.3 " 'Tax Avoidance' in the Sixth Directive"

The Tribunal decided that the *Direct Cosmetics* decision was authority for the meaning of "the concept of "tax avoidance" in the Sixth Directive".[17] Yet it is plainly an authority only on the interpretation of Article 27(1) and that interpretation is based on a purposive construction of that provision. When the ECJ said in paragraph 20 of the Judgment "The concept of tax avoidance as expressed in Art 27(1) of the Sixth Directive is a concept of Community law", it meant simply that "tax avoidance" in Article 27(1) had to be construed as part of Community law, just as must the rest of the Sixth Directive. That is a trite proposition and would perhaps not have been restated, had not the Commission argued the contrary in earlier proceedings: see *Direct Cosmetics Ltd v Customs and Excise Commissioners* [1985] STC 479(Case ECJ 5/84).

Hence the definition of that concept is not left to the discretion of the member states. The term "tax avoidance" as such does not appear anywhere else in the Directive.[18] However, Articles 13, 14, 15, 28c and 28k, which deal with exemptions, refer to "avoidance".[19] Article 13 A. 1 provides:

> "A. Exemptions for certain activities in the public interest
>
> 1 Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any possible evasion, avoidance or abuse ..."

17 See paragraph 39 of the Decision, where "Schedule" is a misprint for "Directive".

18 Except in the penultimate recital, which provides: "Whereas Member States should be able, within certain limits and subject to certain conditions, to take or retain special measures derogating from this Directive in order to simplify the levying of tax or to avoid fraud or tax avoidance".

19 Of course, there are other places in the Directive where the possibility of avoidance is probably in the legislator's mind. See, for example, the Opinion of Advocate General Da Cruz Vilaça in *Direct Cosmetics Ltd v Customs and Excise Commissioners* (ECJ Case 138/86) [1988] STC 540: "44. Moreover, the Sixth Directive permitted the adoption of certain machinery designed to deal with situations which are particularly complex or which involve a risk of tax avoidance enabling part of the taxable amount to escape taxation. 45. Thus, the second paragraph of Art 4(4), widening the definition of taxable person in Art 4(1), permits the member states to treat 'as a single taxable person persons established in the territory of the country who, while legally independent, are closely bound to one another by financial, economic and organisational links'." This provision is not, of course, concerned exclusively with avoidance.

Article 14.1 provides:

> "Exemptions on importation
>
> 1 Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemption and of preventing any possible evasion, avoidance or abuse ..."

Article 15 provides:

> "Exemption of exports from the Community and like transactions and international transport
>
> Without prejudice to other Community provisions Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of such exemptions and of preventing any evasion, avoidance or abuse ..."

Article 28c provides:

> "Exemptions
>
> A Exempt supplies of goods
>
> Without prejudice to other Community provisions and subject to conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions provided for below and preventing any evasion, avoidance or abuse, Member States shall exempt ...
>
> ...
>
> B Exempt intra-Community acquisitions of goods
>
> Without prejudice to other Community provisions and subject to conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions provided for below and preventing any evasion, avoidance or abuse, Member States shall exempt ..."
>
> ...

> D Exempt importation of goods
>
> Where goods dispatched or transported from a third territory are imported into a Member State other than that of arrival of the dispatch or transport, Member States shall exempt such imports where the supply of such goods by the importer as defined in Article 21(2) is exempt in accordance with paragraph A.
>
> Member States shall lay down the conditions governing this exemption with a view to ensuring its correct and straightforward application and preventing any evasion, avoidance or abuse."

Article 28k contained provisions relating to duty-free exemptions which expired on 30th June 1999. After authorising Member States to make the exemptions, it provided:

> "5 Member States shall take the measures necessary to ensure the correct and straightforward application of the exemptions provided for in this Article and to prevent any evasion, avoidance or abuse."

The way in which "evasion, avoidance or abuse" are lumped together in every case does not suggest that the legislator was considering at all carefully what he meant by "avoidance". I would fully expect each and every one of these articles to be interpreted, as was "avoidance" in the context of Article 27(1), as meaning that a Member State can or should take appropriate measures to prevent distortions resulting in a leakage of value added tax, no matter what the intention of the taxpayers who would benefit if no such measures were taken. That, however, results from the purpose of the provisions in question and not because (a) there is a general concept of "avoidance" in the Sixth Directive and (b) it is an objective one.

5.4 Which Test of "Tax Avoidance" did the Tribunal Apply?

The Tribunal concluded:[20]

> "Our task, therefore, is to identify what the solution was designed to achieve and to examine the steps taken in implementation of the solution and from those to conclude, one way or the other, whether those factors possess the inherently objective characteristics of tax avoidance."

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20 At paragraph 39 of the Decision.

The reader might well be forgiven for being puzzled at this conclusion. The Tribunal had cited *Direct Cosmetics*, where the ECJ laid down a wholly objective test. Yet the reference to "what the solution was designed to achieve" would appear to import subjective notions of motive, purpose and/or intention. Then again, as a matter of grammar, it appears that the only factors the Tribunal should take into account are the steps actually taken, which would appear to preclude any reference to intention. This is bolstered up by the reference to "the inherently objective characteristics of tax avoidance".

What is the more surprising about the apparent decision that "tax avoidance" is an objective concept is that it may well have been unnecessary, in that there was ample evidence on which the Tribunal could in this case have concluded that there was subjective tax avoidance. Halifax had clearly admitted that the scheme was set up in order to secure a value added tax advantage in the shape of recovery of a greater proportion of input tax. Once the Tribunal had concluded that, objectively, there was a leakage of tax, it was arguably open to it to conclude that seeking to obtain that advantage *did* defeat the evident intention of Parliament, which was that input tax should not be recoverable in so far as attributable to supplies used for the purpose of making exempt supplies.

The Tribunal went on to conclude[21] "that the scheme implementing the solution and every step and every transaction involved in it were "tax avoidance" in the sense contemplated by the Sixth Directive". One bizarre piece of reasoning was "if the scheme works it will "cause distortions of competition at National and Community level" : see paragraph 23 of *Direct Cosmetics*. This follows from the fact that The Halifax's "competitors" who do not adopt an avoidance scheme having similar effect will be at a disadvantage in economic terms as compared with The Halifax." Halifax's competitors were, of course, just as able to implement the scheme as was Halifax. See further 10 below.

5.5 "Tax Avoidance" in United Kingdom Law

Although the Tribunal had been considering the position under the Sixth Directive, it also expressed the view that the transactions "were 'tax avoidance'" in the United Kingdom sense of that expression as explained by Lord Nolan in *Inland Revenue Commissioners v Willoughby* (HL) [1997] STC 995 at 1003h. By entering into the scheme The Halifax and the other participating companies reduced the incidence of value added tax "without incurring the economic consequences that Parliament intended to be suffered by a taxpayer qualifying for such reduction in "its tax burden". No explanation is given for this conclusion. The quotation from Lord Nolan was, in the context, inept. His Lordship had in

21 At paragraph 42 of the Decision.

mind at this point in his speech cases such as *Commissioner of Inland Revenue v Challenge Corp Ltd* [1986] STC 548, [1987] AC 155, (PC) and *Ensign Tankers (Leasing) Ltd v Stokes* [1992] STC 226 (HL) where the question was whether a taxpayer had actually incurred expenditure (resulting in the one case in a trading loss and in the other of the acquisition of plant and machinery qualifying for capital allowances). More apt was the test propounded later in the speech: was this a "course of action designed to conflict with or defeat the evident intention of Parliament"?

6 Purposive Construction

The Tribunal remarked uncontroversially:[22]

> "It is well established that a purposive construction must be given to EC legislation. It necessarily follows that UK legislation (the VAT Act 1994) which implements EC legislation must be construed in conformity with EC law: see *Marleasing* [1990] ECR 1-4135 at 4159. It is therefore necessary to identify the purpose of the Sixth Directive since this governs both the Directive and the VAT Act 1994."

It then added, most surprisingly:

> "Nor is there any real dispute that the scheme comprised in the solution adopted by The Halifax was designed to achieve a result that violated the purposes of the Sixth Directive."

Given that it is scarcely credible that the experienced Leading Counsel who appeared for Halifax should have made such a concession, one wonders whether this is perhaps the Tribunal's gloss on some rather more innocent remark.

7 Halifax's Submission

The Tribunal then stated[23] Halifax's position:

> "The legal basis for the Appellants' argument on the construction of the Sixth Directive was that a taxable person's purposes in entering into a

22 At paragraph 46 of the Decision.

23 At paragraph 47 of the Decision.

transaction is immaterial to the question of whether that transaction amounts to a supply or whether the person in question has carried out an economic activity. The aim or purpose for which the transaction (or series of transactions) were carried out is not in point: see cases such as *Customs and Excise Commissioners v Robert Gordon's College* [1995] STC 1093, *BLP Group Plc v Customs and Excise Commissioners* (Case C4/94) [1995] STC 424 and *Customs and Excise Commissioners v Thorn Materials Supply Ltd* [1998] STC 725. If supplies are not genuine they can properly be disregarded for all VAT purposes; if, on the other hand, they have genuinely been made, they must be given their due tax consequences and if the authorities want to deny these, they must seek a change in the law."

8 United Kingdom Direct Tax Authorities

8.1 The Tribunal's Inspiration

While accepting[24] that the transactions were genuine, the Tribunal nevertheless rejected these submissions.

It observed:[25]

> "Were this a matter of UK law alone, the transactions comprised in The Halifax's tax avoidance solution would not, we think, be classed as taxable supplies. This is because they would not have been made in the course or furtherance of the businesses of either [Developments] or [Country Wide]. The House of Lords in *FA & A B Ltd v Lupton* [1972] AC 634 concluded that if the sole object of a transaction was tax avoidance, it was not a trading transaction for purposes of tax on corporate profits. That was so even if, as here, there was a profit built into the scheme: see *Thomson v Gurneville Securities* [1972] AC 661. A similar robust approach would, we think, be applied where the issues concerned businesses as distinct from trades."

8.2 Critique

This is a key passage as it reveals the "inspiration" for the rule of EC law which the Tribunal considers it has discovered. The Tribunal has, with respect.

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24 At paragraph 48.

25 At paragraph 49 of the Decision.

misunderstood the *ratio decidendi* of those cases and had overlooked later House of Lords authority which flatly rejects the view espoused by it. Moreover, even if its analysis of them were correct, it has overlooked the vital difference between a "trade" in the context of taxes on income and a "business" in the context of a tax on consumption. In order to make both points, it will be necessary to analyse the United Kingdom direct tax cases in some detail.

8.3 The Dividend Stripping Cases

The cases in question related to dividend stripping tax avoidance schemes, which were very popular until outlawed by Finance Act 1960.[26] The Tribunal Chairman, Stephen Oliver QC, would have been well acquainted with these cases. He represented the tax avoider in *FA & AB Ltd,* while the then head of his distinguished former Chambers represented the Revenue in *Gurneville Securities*.[27] The essence of dividend stripping[28] is that shares in a company replete with distributable profits are sold for a capital sum to a dealer in shares. The dealer then receives an abnormal amount by way of dividend, on which it is taxable as income (although it may receive a tax credit for the whole or part of the tax). It then sells the shares at a loss. If the purchase and sale are in the course of its trade as a dealer in shares, that loss is a trading loss which diminishes its trading profits and/or increases its trading losses. Hence, it is taxable only on its profit overall and, to the extent to which the amount of the dividend exceeds the amount of that profit, it is paid free of tax. In addition, the trader is better off to the extent of any repayable tax credit associated with the dividend.

With respect, the Tribunal misunderstood the effect of the dividend stripping authorities. The point was that in the cases where the taxpayers lost, the shares were not acquired as trading stock in the course of the dealer's trade of dealing in securities. And it is only losses made in the course of a trade which are deductible in computing trading profits. Now it is true that the only reason the dealer entered into these transactions was that they were part of a raid on the Revenue. But it was not that *per se* which meant that they were not transactions

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26 See now the United Kingdom Taxes Act 1988 Part XVIII Tax Avoidance, Chapter I Cancellation of Tax Advantages from Certain Transactions in Securities.

27 By contrast, counsel for Halifax were EC lawyers, rather than tax lawyers, with apparently little or no experience of United Kingdom direct taxes. They must have found this part of the argument very difficult to deal with. One wonders whether they were aware of and cited any of the later direct tax cases, such as *Ensign Tankers*, referred to below.

28 I describe dividend stripping by a sale to a trader. Other forms of dividend stripping, such as the sale to a body which is exempt from tax, were not in point in these cases.

carried out in the course of the taxpayer's trade or that the shares were not trading stock. They were not carried out in the course of the taxpayer's trade because of their nature. Of course, their nature was determined by what were thought to be the necessary requirements for a successful fiscal raid. Hence, on the particular and highly unusual facts, there *was* a causal connection between their being tax motivated and their not being transactions carried out in the course of the taxpayer's trade of dealing in shares.

It is a logically unjustified leap to conclude, as did the Tribunal: "if the sole object of a transaction was tax avoidance, it was not a trading transaction for purposes of tax on corporate profits." That this leap is impermissible is made abundantly clear even by the speeches in *FA & AB Ltd* itself. See per Lord Morris of Borth-y-Guest:

> "But, my Lords, once it is accepted, as it must be, that motive does not and cannot alter or transform the essential and factual nature of a transaction, it must follow that it is the transaction itself and its form and content which is to be examined and considered...
>
> If, therefore, as in my view is clear, the presence of a motive of securing tax recovery does not cause a trading transaction to cease to be one, then reliance on motive must disappear."

Per Lord Guest:

> "In *Harrison* what the House decided by a majority was that the mere fact that a transaction was entered into with the purpose of making a loss and with no hope of making a profit, and with a fiscal motive, did not prevent it from being a trading transaction ..."

Per Viscount Dilhorne:

> "My noble and learned friend Lord Morris of Borth-y-Gest said, at page 234, that it seemed to him that a trading transaction does not cease to be such merely because it is entered into in the confident hope that, under an existing state of the law, some fiscal advantage will result. I respectfully agree with that."

Per Lord Simon of Glaisdale:

> " a share-dealing which is palpably part of the trade of dealing in shares will not cease to be so merely because there is inherent in it an intention

> to obtain a fiscal advantage, or even if that intention conditions the form which such share-dealing takes"

8.4 *Ensign Tankers*

It is striking that the Tribunal did not quote rather more recent English authority. Perhaps the most notable is the House of Lords decision in *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)* [1992] STC 226.[29] The members of the Victory Partnership claimed a first-year capital allowance (deductible in computing their taxable income) of $14,000,000, which they alleged they had expended in acquiring a film for exploitation. Such allowance would be available only if the partnership was carrying on a trade. The partnership claimed that it was carrying on the trade of exploiting the film (by licensing screenings of it). In fact, the Partnership was really only ever at risk for $3,500,000. The Revenue claimed that as the purpose of setting up the partnership was tax avoidance - which could hardly be doubted - the partners were not trading, so that no capital allowance was due. While Stephen Oliver QC would clearly have accepted this argument, it was firmly rejected by the House of Lords. Lord Templeman, who was not known for being soft on tax avoidance, made the position very clear in his speech, with which all the other members of the Appellate Committee agreed:[30]

> "Mr McCall QC for the Crown relied heavily on *FA & AB Ltd v Lupton* because this House held that tax avoidance is not trading. Therefore, Mr McCall submitted, the tax avoidance scheme in the present case is not trading and Victory Partnership did not create any valid claim to a first-year allowance although Victory Partnership incurred expenditure of $3,250,000 in the production of a film. I see the force of the argument. The precedent of *FA & AB Ltd v Lupton* was followed by the Court of Appeal in the instant case. But in dividend-stripping cases the tax avoidance scheme negatives trading because on the true analysis of the transaction the trader does not trade at all. In *FA & AB Ltd v Lupton* where there was neither a profit nor a loss the House did not consider the present situation in which on the true analysis there was trading involving an expenditure of $3,250,000. The financial consequences of the scheme, namely the expenditure by Victory Partnership of $3,250,000 on the making of a film, produce the corresponding fiscal consequence of a

29 This is a case with which Jonathan Peacock QC (as he has since become), counsel for Customs in *Halifax*, would have been well acquainted, as he appeared in it as counsel for the tax avoiders.

30 Lord Templeman had appeared for the tax avoider in *FA and AB*.

> first-year allowance of that sum. The task of the courts is to construe documents and analyse facts and to ensure the taxpayer does not pay too little tax or too much tax but the amount of tax which is consistent with the true effect in law of the taxpayer's activities. Neither the taxpayer nor the Crown should be deprived of the fiscal consequences of the taxpayer's activities properly analysed."

The House of Lords reversed the decision of the Court of Appeal in *Ensign Tankers*. Lord Templeman roundly rejected the heresy, propagated by that Court, that a fiscal motive can turn a trading transaction into a non-trading transaction. In a later passage in his speech he said:

> "Similarly, in the view of Sir Nicolas Browne-Wilkinson V-C ([1991] STC 136 at 149),[31] the taxpayer is deprived of all the beneficial effects of the scheme if the scheme was entered into 'essentially for the purpose of obtaining a fiscal advantage under the guise of a commercial transaction'.
>
> In the view of Sir Nicolas Browne-Wilkinson V-C (at 147) -
>
> > '... if the commissioners find as a fact that the sole object of the transaction was fiscal advantage, that finding can in law only lead to one conclusion, viz that it was not a trading transaction ... if the commissioners find as a fact only that the paramount intention was fiscal advantage ... the commissioners have to weigh the paramount fiscal intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constitutes trading for commercial purposes.'
>
> My Lords, I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal elements. The task of the commissioners is to find the facts and to apply the law, subject to correction by the courts if they misapply the law.[32] The facts are undisputed and the law is clear. Victory Partnership expended capital of $3,250,000 for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and exploiting a commercial film is a trading purpose. By

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31 In the Court of Appeal.

32 If only the Tribunal had simply found the facts and applied the law in *Halifax*, the decision would have been an uncontroversial one and this article would not have been written!

> section 41 of the 1971 [Finance] Act capital expenditure for a trading purpose generates a first-year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. **It is true that Victory Partnership only engaged in the film trade for the fiscal purpose of obtaining a first-year allowance but that does not alter the purpose of the expenditure.**[33] The principles of Ramsay and subsequent authorities do not apply to the expenditure of $3,250,000 because that was real and not magical expenditure by Victory Partnership.
>
> Sir Nicolas Browne-Wilkinson V-C referred to authorities in which intentions sometimes illuminated and sometimes obscured the identification of a trading purpose. But in every case actions speak louder than words and the law must be applied to the facts."

With respect, the position could hardly be clearer. The acquisition of the property, its refurbishment and its resale at an intended profit amount in law to a trade and those transactions were effected in the course of that trade. Hence, Developments *was* trading. Similarly, contracting to provide building services and providing those services through the agency of subcontractors to make an intended profit is trading. Consequently Country Wide *was* trading. Indeed, I would be amazed if the Inland Revenue Commissioners refused to tax Developments or Country Wide on the profits they made on the grounds that they were not trading profits! It is immaterial in either case that the purpose of carrying on the trade was to help secure a tax advantage for another member of a company in the same group as the company carrying on the trade.

8.5 "Trade" and Business"

I have so far dealt with the question whether Developments and Country Wide were trading. In United Kingdom value added tax law, the question was whether the supplies were made in the course or furtherance of a "business". The Tribunal had added: "A similar robust approach would, we think, be applied where the issues concerned businesses as distinct from trades."

In my view, if the companies were carrying on a trade, they were also carrying on a "business" While "business" is not a technical term of United Kingdom law - it takes its colour from its context - it is clearly wider than "trade". In the United Kingdom value added tax legislation "business" is expressly defined to

33 Emboldening supplied.

include a trade.[34]

Even if the presence of a tax avoidance motive meant that the companies were not carrying on a trade, it by no means follows that they were not carrying on a business. Purpose *is* to an extent relevant in determining whether a person is carrying on a trade. For carrying on an activity in the hope or expectation of profit is the hallmark of a trade.[35] It is the profit motive which determines the commercial nature of the profits and thus, in most systems, brings them within the charge to tax on income, which they would escape were they, say, casual profits arising from the purchase and sale of a capital asset by a private individual. What the United Kingdom direct tax authorities establish is that once that purpose is established, the trade does not cease to be a trade because there is some reason for carrying on the trade beyond the desire to earn profits. That reason might be the avoidance of taxation.[36] The trade might be carried on in performance of a statutory duty.[37] Or the trader might simply enjoy his work and have no need for the profits, which he donates to charity.

Value added tax, by contrast, is a tax on consumption which is only at a technical level levied on the person making the supply and is in reality levied on the recipient of the supply. The motive of the supplier in making the supply should thus in principle make no difference to the taxability of the supply. Any system of tax on consumption, such as value added tax, needs to ascertain who is accountable for the tax and to fix a reference point at which "consumption" occurs. Where "consumption" is literally consumption, as where I enjoy a meal in a restaurant or receive medical treatment, the immediate supplier is the obvious person to make accountable. Where the "consumption" is not literally consumption, as where I buy a painting for my own enjoyment but may give it away, re-sell it, so that my "consumption" is non-exhaustive and others may consume it too, it is feasible to make the last "commercial" supplier to me accountable for the tax. After all, such a person will normally have some degree of organisation which will make it easier both for him to account for the tax and for the liability to account to be enforced.

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34 Value Added Tax Act 1994 section 94(1).

35 I appreciate that this is also true of a profession, but then professional profits are normally taxed in the same way as trading profits and in determining whether a person is carrying on a profession similar, if not identical, considerations are relevant as in determining whether he is carrying on a trade.

36 As in *Ensign Tankers*.

37 *Mersey Docks and Harbour Board v Lucas* (1883) 8 App. Cas. 891; 2 TC 25.

9 Illegal Activities

The Tribunal then went on to consider whether, as a matter of EC law, the same approach was to be applied:

> "50. This brings us to what we see as the central question. Can transactions, such as those that formed part of the scheme comprised in The Halifax's tax avoidance solution, properly be classed as "supplies" effected by a taxable person carrying out an "economic activity", as those expressions are used in the Sixth Directive? The answer depends on the proper construction of those expressions in the context in which they are found; the context is a statutory code designed to impose VAT without producing distortion of competition."

So far, so good. But then, instead of considering the language and purpose of the Sixth Directive, the Tribunal went on to consider[38] "certain activities [which] are excluded from ranking as economic activities with the result that the transactions involved will not qualify as supplies. It rightly pointed out[39] that

> "Unlawful trading activities will be excluded so long as their exclusion will not produce unfair competition between unlawful and lawful activities in the same area of trade. The ECJ in *Mol* (Case 269/86) [1988] ECR 3627 and in *Vereniging Happy Family Rustenburgerstraat* (Case 289/86) [1988] ECR 3655 ruled that trafficking in narcotic drugs was not an economic activity. Because of the total prohibition on trafficking in all Member States, the exclusion of supplies from the ambit of VAT could not put suppliers in a privileged position. By contrast *Fischer* (Case C-283/95) [1988] STC 708 decides that unlicensed gambling transactions can rank as economic activities because to do otherwise would infringe the principle of fiscal neutrality and create unfair competition between unlicensed and licensed gambling sectors."

I do not quarrel with the Tribunal's analysis of these decisions. The European Court of Justice might perhaps have decided (as an English Court would assuredly have decided) that illegal consumption is still consumption; that, while it should not occur, it does occur and that the law should no more blind itself to the fact that it has occurred than it should refuse to admit that a rape has occurred and punish the rapist, (on the grounds that the rape should not have occurred) moreover, that there is no reason why illegal consumption should be encouraged

38 At paragraph 51 of the Decision.

39 At paragraph 52 of the Decision.

by being given immunity from taxation. Rightly or wrongly, the Court did not so decide in *Moll* and *Happy Family* and thus had to find an escape from the apparent consequences of its stance. Hence, the compromise that value added tax is not exigible on supplies of items which are clearly *hors de commerce*.

It is the next part of the Tribunal's reasoning which hardly squares up to Aristotelian standards:

> "The Halifax's tax avoidance scheme contains transactions that have no business purpose and which were inserted solely for tax avoidance reasons. To exclude these from the ranks of economic activities could not possibly create unfair competition. Indeed to allow them to qualify as economic activities would, as we observed in paragraph 42 above, put The Halifax at an unfair advantage over comparable financial institutions that did not adopt such schemes."

The authorities establish that the exception to the rule that illegal supplies are not taxable supplies is where they would otherwise unfairly compete with lawful supplies. To conclude that a lawful supply ceases to be a taxable supply if either

(a) its exclusion "from the ranks of economic activities could not possibly create unfair competition" or

(b) if its non-exclusion would confer on those who made such supplies an unfair advantage over comparable institutions which did not

is in each a complete *non sequitur*.

10 Fiscal Neutrality

The Tribunal had already raised the spectre of unfairness of competition at paragraph 42 of the Decision, commented on at 5.4 above. I shall take a brief detour to lay this spectre. In the European Court of Justice decision in *BLP Group plc v Customs and Excise Commissioners* [1995] STC 424 (Case C-4/94), BLP incurred input tax on taxable supplies made to it for the direct purpose of what was agreed by the parties to be an exemption transaction, namely a sale of shares, and for the indirect purpose of reducing its indebtedness which derived from taxable transactions it had effected. BLP had argued "... in the interests of fiscal neutrality, the focus must be the wider purpose of that supply, namely the discharge of BLP's bank debts. The sale of the shares represents an incidental financial transaction, which was part of BLP's overall strategy in the conduct of

its core business and the making of its taxable supplies of goods or services."[40]

The *ratio* of the Court's judgment is given at paragraph 19 of the Judgment:

> "to give the right to deduct under [Article 17] paragraph 2 [of the Sixth Directive], the goods or services in question must have a direct and immediate link with the taxable transactions, and ... the ultimate aim pursued by the taxable person is irrelevant in this respect."

One of BLP's arguments was: " if, in order to meet its liquidity requirements, it had taken out a bank loan, the VAT on the services of an accountant, required for obtaining that loan, would have been deductible in full. The principle of fiscal neutrality requires that economic decisions should not be influenced by tax factors."[41]

The Court's reply was:

> "25. It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax on the services supplied by accountants or legal advisers for the taxable person's taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. However, that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions.
>
> 26. In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case law of the court, does not have the scope attributed to it by BLP. That the common system of VAT ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way, presupposes that those activities are themselves subject to VAT (see in particular *Rompelman v Minister van Financiën* (Case 268/83)[1985] ECR 655 at 664, para 19)."

40 See paragraph 16 of the Opinion of Advocate General Lenz.

41 See paragraph 15 of the Judgment.

The Opinion of Advocate General Lenz, with whom the Court agreed, is also instructive. First, he explains the legislative and jurisprudential basis for the principle of fiscal neutrality:

> "45. In support of its argument ... BLP further relies on the principle of fiscal neutrality, which it deduces from the recitals in the preamble to the First Directive (see the first to third and eighth recitals. They state essentially that in view of the defects of the VAT legislation 'at present' in force, harmonised rules are to be introduced which will not distort conditions of competition) and the case law, in particular the judgments in *Rompelman v Minister van Financiën* (Case 268/83)[1985] ECR 655 and *Sofitam v Ministre chargé du Budget* (Case C-333/91)[1993] ECR I-3513."

His answer was:

> "47. The objectives of the common system of VAT do not by any means require all forms of raising money to be treated alike. If the harmonisation introduced with that system is intended to prevent distortion of conditions of competition, as is expressed in the recitals to the First Directive, that can only mean that operations of the same type are to be treated in the same way. The taking up of a loan and the selling of an interest in a company are not, however, operations of the same type for the purposes of the VAT system, because that system focuses on transactions and makes a clear distinction between taxable and exempt transactions...
>
> 49. As to the general principle of fiscal neutrality recognised in [the *Rompelman* and *Sofitam]* ... judgments, that principle is mentioned in connection with the observation in *Rompelman* (at 664, para 19) that -
>
> > '... the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities.'
>
> And in *Sofitam* (para 10) that -
>
> > '... the common system of VAT consequently ensures that all economic activities, whatever their purpose or result, provided that they are themselves subject to VAT, are taxed in a wholly neutral way.'

> 50. It follows from that context that the principle of fiscal neutrality cannot be considered independently of the 'common system of VAT' and that in its application account must be taken of the extent to which the taxable person's economic activities are 'subject to VAT'."

It is clear on reading these passages that the principle of fiscal neutrality is a very limited one. It certainly does not apply simply where one taxpayer may pay less tax than another because he chooses to arrange his affairs in a certain way, even if that choice is motivated by "tax considerations relating to the VAT system". It certainly does not apply because one taxpayer arranges his affairs in a tax-efficient way and another taxpayer does not, although he might have done. The whole point about competition is the survival of the fittest. If one taxpayer employs cleverer tax advisers than his competitor, the principle of free of competition requires him not to be denied the resultant competitive advantage, any more than if he employs cleverer marketing consultants.

To my mind, what the Court had to say in *BLP* about fiscal neutrality suggests that the decision in *Halifax* was wrong. So too does the Court's views on motive and intention, discussed at 13.5 below.

11 Governmental Functions

11.1 The Tribunal's View

The Tribunal then considered another category of non-supplies:[42]

> "Regulatory activities conducted by an outside body on behalf of the State are another example of activities excluded from the scope of economic activities. That was the effect of the decision of the House of Lords in *Institute of Chartered Accountants in England and Wales v Customs and Excise Commissioners* [1999] STC 398. In that case the Institute's regulatory activities were provided in return for payment by the members of the profession seeking approval. It is not enough, as Lord Slynn observed at page 404, that what was done could be described as an activity "of the professions" for purposes of Article 4.2; so here it is not enough that the construction services described in the First and Second Agreements for Works and in the First and Second [Country Wide] Agreements are "activities of traders and persons supplying services" (see the words of Article 4.2).

42 Paragraph 52 of the Decision.

> 53 The *ICAEW* decision and the other cases cited in Lord Slynn's speech show that, in deciding whether an activity is an economic activity, it is, to use the words of the Advocate General (Lenz) in *Wellcome Trust Ltd* (C- 155/94) [19961 STC 945. "..... the inherent nature of the activity itself that is the vital consideration". The inherent nature of the transactions with which the present appeal is concerned is, taking those transactions collectively and individually, tax avoidance. There was no business purpose. Even the profits allowed to [Developments] and [Country Wide]. which are emphasized in the minutes of the meetings, were (to use Mr Fleming's words referred to in paragraph 33 above) "built into the scheme"; they were not based on any real business activity. Adapting the Sixth Directive terms, The Halifax's tax avoidance activities were, we think, "counter-economic activities".[43] They were, to use the ECJ's words in *Fischer,* supra, at page 722 (paragraph 19), ... "wholly alien to the provisions of the Sixth Directive and do not give rise to any tax debt"..."

11.2 Critique

The *Chartered Accountants* case is light years away from *Halifax*. It was clear that the functions in question were "regulatory functions ... essentially for the protection of members of the public"[44] and that, although supplies were made for a consideration, they were not made in the course or furtherance of a "business" or of an "economic activity". Their Lordships held that the Institute was "carrying out on behalf of the state a regulatory function in each of these three financial areas to ensure that only fit and proper persons are licensed or authorised to carry out the various activities and to monitor what they do. This is essentially a function of the state for the protection of the actual or potential investor, trader and shareholder. It is not in any real sense a trading or commercial activity which might justify it being described as 'economic' and the fact that fees are charged for the granting of the licences (to be assessed overall on a break-even basis) does not convert it into one."

---

43 The phrase "counter-economic activities" is not, of course, found in the Sixth Directive. It is an odd one to coin. What did the Tribunal mean by it? It does not have the same meaning as "activities which are not economic activities". It rather reminds one of "counter-revolutionary activities" or "un-American activities". It is the sort of phrase one would expect to be used by some latter-day Inquisitor General, determined to preserve Orthodoxy against free-thinkers and free-actors. Its use may suggest a great deal about the psychology of the Tribunal and how it perceives its role in society.

44 Per Lord Slynn.

They naturally considered the jurisprudence of the European Court of Justice, and in particular *EC Commission v Netherlands* (Case 235/85)[1987] ECR 1471, where the question arose whether notaries and bailiffs supplying services to third parties in return for fees which they received for their own account, were taxable persons within the meaning of Art 4 of the Sixth Directive. It was held that they were, even if appointed by the state and carrying out functions regulated by the state. The Court held (at 1487, para 8) that the '**scope of the term "economic activities" is very wide, in as much as it covers all the services provided by the liberal professions and that the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or result'.**[45] The Court said (at 1487, para 9):

> 'In view of **the wide definition of the term "economic activities"**,[46] encompassing all the activities of the professions without any reservation in respect of professions regulated by statute, it must be concluded that, in so far as notaries and bailiffs in the Netherlands provide services to private individuals on a permanent basis and in return for remuneration, they carry out an economic activity within the meaning of the Sixth Directive.'

Their Lordships also considered *Ayuntamiento de Sevilla v Recaudadores de las Zonas Primera y Segunda* (Case C-202/90)[1993] STC 659,[1991] ECR I-4247, where the question was whether the activities of tax collectors appointed by local authorities who carried out their activities under the control of the treasury of the authorities who appointed them constituted professional services carried out independently within the meaning of Art 4(1) and (4) of the Sixth Directive. They were paid by a percentage of the sums received and were not employees, but provided their own staff and offices. Their Lordships noted that, although the real question turned on Art 4(5), it was not suggested, it seems, that they were not carrying on an economic activity, even though it was done on behalf of a public authority. Their Lordships concluded that it appeared that in both these cases, the persons concerned were carrying out activities for their own account in the way that professional men ordinarily do, even if the activities were carried out on behalf of the state.

On the other hand, in *Diego Calì & Figli Srl v Servizi Ecologici Porto di Genova SpA (SEPG)*(Case C-343/95)[1997] ECR I-1547 the Court of Justice held that anti-pollution surveillance entrusted by the Port Authority of Genoa to SEPG was an essential function of the state for the protection of the environment and not an

45 Emboldening supplied.

46 Emboldening supplied.

economic activity subject to the Community rules on competition. Similarly, in *SAT Fluggesellschaft GmbH v European Organisation for the Safety of Air Navigation (Eurocontrol)* (Case C-364/92) [1994] ECR I-43 powers were conferred on Eurocontrol by public authority for the exercise of navigation control. The charges collected were the consideration for the obligatory and exclusive use of air navigation control facilities and services. The activities were typically, the Court found, the activities of a public authority and not of an economic nature which fell within the competition provisions of the EC Treaty.

Their Lordships additionally considered an area rather different from both *ICAEW* and *Halifax*, that of the position of a shareholder. They noted that the European Court of Justice held in the *Polysar* case (see [1993] STC 222,[1991] ECR I-3111) that the mere holding of shares in other companies, from which a company received dividends and from which it paid dividends to its own parent company, did not make the *Polysar* case a taxable person for the purposes of Art 4 of the Sixth Directive. It did not follow that the mere acquisition and holding of shares was to be regarded as an 'economic activity', nor did it constitute the exploitation of property. A similar result was reached in *Wellcome Trust Ltd v Customs and Excise Commissioners* (Case C-155/94)[1996] STC 945,[1996] ECR I-3013, where the Court held that the purchase and sale of shares as an investment (which did not involve a commercial share dealing activity and was not the acquisition of shares so as to secure involvement in the management of companies) was not an economic activity. As the Advocate General (Lenz) said ([1996] STC 945 at 955,[1996] ECR I-3013 at 3028, para 39) in deciding whether an activity is an economic activity,**'it is the inherent nature of the activity itself that is the vital consideration'."**[47]

I invite the reader to re-read the quotations above from paragraphs 52 and 53 of the Decision in the light of what was in fact decided and said in *ICAEW*. In *Halifax*, there was no question of Developments or Country Wide carrying on any governmental functions. If *ICAEW* was relevant at all, it was surely to show how wide is the concept of "economic activity", as indicated by the passages I have emboldened in the quotations above from the judgments of the European Court of Justice. In particular, the quotations show the complete irrelevance of motive. It is "the inherent nature of the activity itself that is the vital consideration". One can only gawp in disbelief at the Tribunal's conclusion that "the inherent nature of the transactions with which the present appeal is concerned is, taking those transactions collectively and individually, tax avoidance." To call this conclusion "perverse" would be an understatement. When the European Court of Justice says that "the activity is considered per se and without regard to its purpose or result", it means precisely that.

47 Emboldening supplied.

12 *A Priore* Considerations

Let us leave the Decision of the Tribunal for the moment and considered the matter as if it were *res integra*. What does the Sixth Directive say of "tax avoidance" in the context of "supply" and "economic activity". Nothing! Which makes the Tribunal's decision all the more amazing. Both the ECJ and the United Kingdom authorities show that "supply" is a word of the widest meaning.

The EC First Council Directive of 11th April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (67/227/EEC) recites:

> "Whereas a system of value added tax achieves the highest degree of simplicity and of neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution and the provision of services"

Article 2 provides:

> "The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.
>
> On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components.
>
> The common system of value added tax shall be applied up to and including the retail trade stage."

The Sixth Council Directive of 17th May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes-common system of value added tax: uniform basis of assessment (77/388/EEC) provides:

> "Article 2
>
> The following shall be subject to value added tax:
>
> 1 the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such"

> "Article 4
>
> 1 "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.
>
> 2 The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity."

The phrase in Article 4(1) "whatever the purpose or results of that activity" is telling. It suggests in the clearest terms that a supply does not cease to be a supply because of the purpose, such as the avoidance of taxation, with which it is made.

The tax is a tax on consumption. The tax is in reality borne by the consumer, although the responsibility for payment of the tax to the fiscal authorities rests on the supplier. In the case of some supplies of services, the service is literally consumed by the recipient of the supply and ceases to exist. In other cases, such as the sale of goods, the goods may well continue to exist and thus are capable of being re-supplied. Once, however, the goods have been acquired by a consumer, i.e. a person not carrying on an economic activity, the tax has been paid once and for all. It is similar to excise duty, which is payable once and for all when goods are "realised for consumption", no matter who subsequently actually consumes them.

What is the scope of the requirement that, for a supply to be taxable, it must be made by a person independently carrying on an economic activity? Article 4.1 and 4.2 shows that prima facie this is to be interpreted very widely.

What is the relevance of motive? Prima facie, none. Article 4.1 stresses "whatever the purpose". (These words were conveniently ignored by the Tribunal in *Halifax*.) If there is an economic activity, then purpose is irrelevant.

It is admittedly not enough to take each of the possibilities in Article 4.2 and see if they are satisfied. The words have to be read *eiusdem generis* and in the context of the Sixth Directive. If I paint a picture while on holiday and someone offers me £50 for it, I might literally be a "producer", in the sense that I have produced something. If I house sit for someone while they are on holiday, I have

literally supplied a service. The words "traders" and "professions" colour, but do not totally define the context. In United Kingdom tax law, a trade cannot be carried on except with a view to profit, but it is well established that a "business", the term used to incorporate "economic activity" into United Kingdom law,[48] can.

It is established that the following are not taxable persons. Firstly, employees (and, possibly, quasi-employees) who render services. That is made clear by Article 4.4 of the Sixth Directive:

> "4 The use of the word "independently" in paragraph 1 shall exclude employed and other persons from the tax in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability."

This express exclusion shows how wide indeed the concept of economic activity would otherwise be. Employees render services for a consideration. This is prima facie enough to amount to an "economic activity".

Secondly, certain persons are not taxable persons in so far as they carry on governmental functions. Article 4.5 of the Sixth Directive provides:

> "5 States, regional and local government authorities and other bodies governed by public law shall not be considered taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with these activities or transactions.
>
> However, when they engage in such activities or transactions, they shall be considered taxable persons in respect of these activities or transactions where treatment as non-taxable persons would lead to significant distortions of competition.
>
> In any case, these bodies shall be considered taxable persons in relation to the activities listed in Annex D, provided they are not carried out on such a small scale as to be negligible.

48 See Value Added Tax Act 1994 section 4(1): "VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him."

> Member States may consider activities of these bodies which are exempt under Article 13 or 28 as activities which they engage in as public authorities."

Again, this shows, that "economic activity" is prima facie wide enough to cover state services, the provision of which will not be by way of trade or even commercial. Supplies can be made on a subsidised basis. There is no need for a profit motive. All that matters is that the supply has been effected for a consideration.

Thirdly, "activity" does prima facie import a measure of continuity, so that one-off supplies are unlikely to be made in the course of an economic activity. The wording of Article 4.2 further supports this interpretation:

> "The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity."

Moreover, this impression is confirmed by Article 4.3, which expressly extends the concept to certain occasional transactions. It provides:

> "3 Member States may also treat as a taxable person anyone who carries out, on an occasional basis, a transaction relating to the activities referred to in paragraph 2 and in particular one of the following:
>
> (a) the supply before first occupation of buildings or parts of buildings and the land on which they stand ...
>
> (b) the supply of building land ..."

13 Jurisprudence of The European Court of Justice

13.1 No Authority in Support of Tribunal's View

In brief, there are no decisions of the European Court of Justice which support the proposition that a supply is not a taxable supply for value added tax purposes when it is made for the purpose of tax avoidance. By contrast, there is no shortage of authority that the scope of value added tax is very wide, as is the

scope of "economic activity".

13.2 *EC Commission v United Kingdom* [1999] STC 742 (Case C-359/97),

A recent example is *EC Commission v United Kingdom* [1999] STC 742 (Case C-359/97), where the European Court of Justice held that the United Kingdom had failed to fulfil its obligations under the Sixth Directive in not subjecting to value added tax tolls collected for the use of toll roads and toll bridges. Advocate General Alber said in his Opinion:[49]

> "68. Article 4(2) of the Sixth Directive defines economic activity as 'all activities of producers, traders and persons supplying services'.
>
> 69. The court has consistently held that **the scope of the term 'economic activities' is very wide, and that the term is objective in character, in the sense that the activity is considered per se and without regard to its purpose or results.** (See *EC Commission v Netherlands* (Case 235/85)[1987] ECR 1471, *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën* (Case 348/87)[1989] ECR 1737 at 1752, para 10, and *van Tiem v Staatssecretaris van Financiën* (Case C-186/89)[1993] STC 91 at 106,[1990] ECR I-4363 at 4386, para 17.)
>
> 70. Under this wide definition of economic activity it is not necessary for services to be primarily or exclusively orientated towards the market or economic life. It is sufficient that they are actually connected with economic life in some way or other (See the opinion of the Advocate General (Lenz) of 12th February 1987 in *EC Commission v Netherlands* (Case 235/85)[1987] ECR 1471 at 1481, para 22, and the judgment in that case.). ... **The objective nature of the definition of economic activity also calls for the classification of the activity in this case as an economic one as the activity itself must be considered, regardless of its purpose or result."**

But for the decision of the Tribunal in *Halifax*, one would have thought the position could not be stated more clearly.

13.3 *Sofitam*

In *Sofitam SA (formerly Satam SA) v Ministre chargé du Budget* [1997] STC 226, (Case C-333/91), the question was whether dividends received formed part of "turnover" for the purpose of calculating the deductible proportion of input tax.

49 Emboldening supplied.

The European Court of Justice held[50] that "Since the receipt of dividends is not the consideration for any economic activity within the meaning of the Sixth Directive, it does not fall within the scope of VAT. Consequently, dividends resulting from holdings fall outside the deduction entitlement. Consequently, dividends must be excluded from the calculation of the deductible proportion referred to in Arts 17 and 19 of the Sixth Directive, if the objective of wholly neutral taxation ensured by the common system of VAT is not to be jeopardised." As the Commission put it, in their submission: " ... the income of an undertaking, such as dividends, attendance fees, capital gains on share transfers, constitute consideration for neither a taxable activity nor an exempt activity. As remuneration for a capital investment, that transaction falls outside the scope of VAT."

The Court stated:

> "10. It is settled case law (see, inter alia, *EC Commission v France* (Case 50/87)[1988] ECR 4797 at 4817, para 15) that the deduction system is meant to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures that *all* economic activities, **whatever their purpose or results,**[51] provided they are themselves subject to VAT, are taxed in a wholly neutral way."

The Advocate General Van Gerven commented on nature of economic activity at paragraph 11 of his Opinion:

> "Under Art 4(1) of the [Sixth] Directive a taxable person means 'any person who independently carries out in any place any economic activity specified in para 2, whatever the purpose or results of that activity'. Article 4(2) explains that the economic activities referred to comprise all activities of producers, traders and persons supplying services, in particular the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis. **The court has given the concept of 'exploitation' a wide interpretation:**[52] it includes all transactions, whatever their legal form, by which it is sought to obtain income from the goods in question on a continuing basis (see, inter alia, the judgments in *van Tiem v Staatssecretaris van Financiën*

50 At paragraphs 17 and 18 of the Judgment, given on June 22nd 1993.

51 Both sets of emboldening supplied.

52 Emboldening supplied.

> (Case C-186/89)[1993] STC 91 at 106,[1990] ECR I-4363 at 4386, para 18 and *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen Arnhem* (Case C-60/90)[1993] STC 222 at 238,[1991] ECR I-3111 at 3137, para 12)."

13.4 *Harnas & Helm*

In *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] STC 364 (Case C-80/95), Advocate General Fennelly said:[53]

> "23. It must be recalled, in the first instance, that the court has consistently held that Art 4 of the Sixth Directive confers 'a very wide scope on value added tax (VAT), comprising all stages of production, distribution and the provision of services'(see, inter alia, *van Tiem* [1993] STC 91 at 106,[1990] ECR I-4363 at 4386, para 17 of the judgment). ... I share the view, expressed by the Advocate General (P VerLoren van Themaat) in relation to the concept of a taxable person under Art 4 of [the Second Directive] that **'it is not the aim but rather the nature of the activities in question which is relevant'** when determining what constitutes an economic activity (see *Staatssecretaris van Financiën v Hong Kong Trade Development Council* (Case 89/81)[1982] ECR 1277 at 1293)."[54]

That the aim is the facilitation of tax avoidance is irrelevant.

13.5 *BLP*

I have referred to the European Court of Justice decision in *BLP Group plc v Customs and Excise Commissioners* [1995] STC 424 (Case C-4/94) at 10 above. Advocate General Lenz, in the context of his discussion of the principle of fiscal neutrality, quotes[55] with approval from the judgment of the European Court of Justice in *Sofitam v Ministre chargé du Budget*[56] at paragraph 10:

> '... the common system of VAT consequently ensures that all economic activities, *whatever their purpose or result*, provided that they are

53 Emboldening supplied.

54 See also paragraph 13 of the Judgment of the Court.

55 At paragraph 49 of his Opinion.

56 (Case C-333/91)[1993] ECR I-3513.

themselves subject to VAT, are taxed in a wholly neutral way.'[57]

In *BLP*, the Court was considering not whether a supply ceased to be a taxable supply because of the motive of the person making it but whether input tax incurred for the purpose of making an exempt supply could nevertheless be recoverable, depending on the motives, intention or ultimate aim of the recipient of the supply. The Court held, at paragraph 19 of the judgment:

> "Paragraph 5 [of Article 17 of the Sixth Directive] lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person 'both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible'. The use in that provision of the words 'for transactions' shows that to give the right to deduct under para 2, the goods or services in question must have a direct and immediate link with the taxable transactions, and that *the ultimate aim pursued by the taxable person is irrelevant in this respect.*"[58]

The Court also held, at paragraph 24 of the judgment:

> "Moreover, if BLP's interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question."

In my opinion, these remarks are equally applicable to the question at issue in the *Halifax* decision. Whether or not a supply is a taxable supply and whether or not it is made in the course of a business/ an economic activity must be in general an objective question and cannot turn on the ulterior motives of the person making the supply.

13.6 *Rompelman* to *Ghent Coal Terminal*

The scope of "economic activity" is so wide that there can be an economic

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57 Italics supplied.

58 Italics supplied.

activity even at a time when no supplies are being made, provided such supplies are intended to be made in future: see *Rompelman v Minister van Financiën* (Case 268/83)[1985] ECR 655, ECJ, and *Lennartz v Finanzamt München III* (Case C-97/90)[1995] STC 514,[1991] ECR I-3795, ECJ. Nor is the position any different if the intended supplies are never in fact made: see *Intercommunale voor Zeewaterontzilting (in liq) ["INZO"] v Belgium* (Case C-110/94)[1996] STC 569,[1996] ECR I-857, ECJ, and *Belgium v Ghent Coal Terminal NV* (Case C-37/95), ECJ.

14 The United Kingdom Authorities

14.1 Dearth of Authority

So far as I am aware, the proposition which the Tribunal accepted has not, before *Halifax*, been advanced anywhere in Europe in the period of more than a quarter of a century since the United Kingdom has been a member of what is now the EC. It has certainly not been advanced in the United Kingdom. One would not therefore expect to find any direct United Kingdom authority on the point. There is, however, indirect authority.

14.2 *Morrison's Academy*

Customs and Excise Commissioners v Morrison's Academy Boarding Houses Association[59] was a case decided by the Inner House of the Court of Session of Scotland.[60] The taxpayer ('the Association') was a charity, the principal objects of which were 'To establish, carry on and maintain ... properly equipped Boarding Houses ... in Scotland ... for the accommodation of resident pupils or scholars at Morrison's Academy' ('the academy'). The terms of the Association's memorandum provided that the income and property of the Association was to be applied solely towards the promotion of its objects and was not to be available for distribution to its members by way of dividend, bonus or otherwise by way of profit. In promotion of its objects the Association owned and operated six boarding houses in which, during the school terms, some 240 pupils of the academy were accommodated. The Association charged fees in respect of the goods and services provided for the pupils accommodated. The Association's affairs were managed so that neither a profit was made nor a loss incurred in the conduct of its activities.

59 [1978] STC.

60 The highest court in Scotland below the House of Lords.

The Association was admittedly a taxable person. There was no argument that it did not make supplies. It contended that it did not make supplies of accommodation to pupils "in the course or furtherance of a business". It argued unsuccessfully:

> "(a) the test of a 'business' is a qualitative test and since the Association did not go out to win custom the test was not satisfied.
>
> (b) in any event there must be a commercial element in a 'business' and there was none present
>
> (c) in any event, profit motive is an essential feature of any form of 'business'"

Lord Emslie said:

> "The definition [of "business"] in s.45(1) [Finance Act 1972] is, however, not unhelpful, for, by providing that 'business' includes any trade, profession or vocation, a clear hint is given that a wide meaning is intended, and I observe that nowhere in Part I of the 1972 [Finance Act] is there any use of the word 'commerce' or 'profit' in association with the word 'business', or otherwise. ... I can discover nothing in the natural meaning of the word 'business' so to restrict its scope and there is nothing in the context of the taxing provisions as a whole to require one to read 'business' in such a narrow way. **The tax is, after all, not a tax on profit or income but on taxable supplies by taxable persons and to make liability to tax depend on the motive with which activities were continuously carried on would lead to the unreasonable result that where two taxable persons make identical taxable supplies in course of carrying on an identical activity or occupation, in which each makes the same loss, or neither a profit nor a loss, and one has sought to make profit and the other has not, only the former would be accountable for value added tax."**[61]

Lord Cameron agreed:

> "The tax with which this appeal is concerned is levied not on the profits and gains of a trade, profession or vocation but on turnover calculated on the value, actual or notional, of the supply of certain goods and services known as 'taxable supplies' which are supplied by the registered

61 Emboldening supplied.

taxpayer. ... **Neither the purpose for which the supplies are made nor the expectation or hope of gain or profit arising therefrom are matters which prima facie are relevant to the issue of liability to tax.** ... Section 2(2) which Lord Emslie has already quoted is silent as to the purpose for which the business is carried on or as to the profit or gain realised or expected from making the taxable supplies. It was powerfully urged by counsel for the Association, however, that having regard to the function and utility of the Association it could not be regarded as carrying on a business ... It was further argued that the conduct of their affairs by the Association did not have the element of commercial character necessary to the carrying on of a business within the context of the relevant section and part of the 1972 Act and, finally, that as it was found that the Association pursued the objective of making neither profit nor loss they were therefore not carrying on a business within the meaning of the 1972 Act. However ingeniously argued I do not however find this contention persuasive and in my opinion the argument put forward by the Crown is correct and in accordance with the proper construction of the taxing provisions of this part of the 1972 Act. The foundation of this contention was that the concept of profit or gain was absent from the meaning of the word 'business' as used in this part of the 1972 Act, and that the word in this context was wide enough to embrace any occupation or function actively pursued with a reasonable and recognisable continuity. This basic contention is in my opinion sound and goes to the root of the case. The legislation under consideration is concerned with the levy of a tax on the value of the supply of certain goods and services called 'taxable supplies' within the United Kingdom and the importation of goods into the United Kingdom (see s.1(1)). The important section for the purpose of this appeal is s.2(2) the terms of which have already been quoted and which I do not repeat."[62]

15 *Reductio ad Absurdum*

One of the Aristotelian principles of reasoning is to posit a proposition and see if it leads to an absurd consequence. If it does, then it must be wrong. Let us consider the absurd consequences which flow from the Tribunal's decision.

The making of a supply is the event which precipitates a charge to value added tax. It is indeed paradoxical that if what would otherwise be a supply is made with the purpose of avoiding liability to value added tax, then no tax is due on

62 Emboldening supplied.

that supply! On closer examination, it will be seen that, while ignoring a supply can, in certain circumstances, such as those of the *Halifax* case, result in more value added tax being paid overall, yet in other cases, less tax would be payable!

Take the facts of the *Direct Cosmetics* case, referred to at 5.1 above. Suppose that Direct Cosmetics had set up its sales system for the avoidance (in the strict sense of the word) of value added tax and not for bona fide commercial reasons. Before the United Kingdom changed the law, there would have been a leakage of value added tax on the mark up of the sales ladies, value added tax being charged only on the consideration given by them to Direct Cosmetics and not on the consideration given to them by their customers. It would follow, on the Tribunal's view, that as the supplies made by Direct Cosmetics were being made for the purpose of tax avoidance, they were not supplies at all. Thus no value added tax at all would have been payable![63] *Quod absurdum est.* The result of the application of the so-called rule is "If you try to avoid paying some value added tax, you will thereby escape liability to pay a lot more"!

16 *Ab Absurdo ad Absurdius*

The Tribunal also decided, ostensibly in reliance on the English decision of the English Queen's Bench Division in *CCE v Reed Personal Services Ltd* [1995] STC 588, that the outside contractors made supplies directly to Halifax! This part of the decision, which is beyond the scope of this article, must, with respect, proceed from a complete misunderstanding of that English authority and the later decision of the House of Lords in *Customs and Excise Commissioners v Redrow Group Plc* [1999] STC 161.

This decision on this point was actually helpful to Halifax, as it at least ensured that it recovered the same proportion of input tax as if the supplies had been made to it directly. Customs had won completely once the Tribunal had decided that Developments and Country Wide made no taxable supplies, as the input tax they suffered was thus totally irrecoverable. The same result would have followed if it had held merely that Developments made no taxable supplies. One is thus left wondering why Customs put the point forward and whether Counsel for Halifax would have argued at all strenuously that it was wrong.

63 Except any input tax suffered by Direct Cosmetics, which would have become irrecoverable.

17 Conclusion

The Tribunal may be likened to the voice of one crying in the wilderness. It is preaching a new gospel which denies taxpayers the power so to arrange their affairs as to be liable to pay the least amount of tax. Whether that gospel will become the orthodox religion of tomorrow or whether it will fall on deaf ears and remain the heresy I believe it to be, only time and the appeal courts will tell.