Neutral Citation Number: [2019] EWCA Civ 554

Case No: A3/2017/2452

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM
UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
(Newey J and Judge Sinfield)
[2017] UKUT 325 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 03/04/2019

Before :

LORD JUSTICE GROSS
LORD JUSTICE PETER JACKSON
and
LADY JUSTICE ROSE

- -

Between :

UMAAD BUTT	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

- -
- -

Rory Mullan and Harriet Brown (acting pro bono under licence from the **Bar Pro Bono Unit**) for the Appellant
Jeremy Benson QC and Karen Robinson at the first hearing, **Sarabjit Singh QC** at the second hearing (instructed by **the General Counsel and Solicitor to HM Revenue and Customs**) for the Respondents

Hearing dates : 12 February 2019 and 25 March 2019

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Approved Judgment

Lady Justice Rose:

1. The Appellant, Mr Umaad Butt appeals against a decision of the Upper Tribunal (Tax and Chancery Chamber) (Newey J and Judge Sinfield) released on 8 August 2017 and reported at [2017] UKUT 325 (TCC). The Upper Tribunal upheld the FTT in dismissing Mr Butt's appeal against the imposition upon him by HMRC of a penalty of £3,137,483 under section 61 of the Value Added Tax Act 1994 ('VATA'). Section 61 is ancillary to section 60 VATA. Together they provide, broadly, that where a company dishonestly evades VAT, it can be subject to a penalty and a director of the company whose dishonesty has been attributed to the company can be made liable to pay the whole or part of that penalty.

2. A penalty was imposed on a company Waterfire Ltd ('Waterfire') after HMRC refused a claim by Waterfire for input tax credit of £6,792,184. The claim was refused on the grounds that the company through its directors knew or ought to have known that the transactions in relation to which input tax was claimed were connected with fraud, namely a missing trader intra-Community ('MTIC') fraud. Mr Butt was one of two directors of Waterfire and owned 50 per cent of the shares in the company.

3. The FTT upheld the imposition of the penalty on Mr Butt and the Upper Tribunal dismissed his appeal. He now appeals to this court with the permission of David Richards LJ on a single point of law. Mr Butt argues that the domestic legislation setting out the circumstances in which a penalty can be imposed does not, on its face, cover Waterfire's situation. The only basis on which HMRC have purported to impose the penalty on Waterfire and hence on Mr Butt is by putting a gloss on the wording of the statute, that gloss arising from the decision of the Court of Justice of the European Union in *Kittel v Belgian State; Belgian State v Recolta Recycling SPRL* (Joined Cases C-439/04 and C-440/04) [2006] ECR I-6161, [2008] STC 1537 ('*Kittel*'). Mr Butt argues that it is impermissible as a matter of EU and domestic law to extend the circumstances in which a criminal penalty can be imposed by modifying the wording of the domestic law to be consistent with EU law. A criminal penalty can only be imposed by the clear wording of the domestic legislation. Without that, HMRC do not have power to impose a penalty on Waterfire or Mr Butt.

The legislation

4. Sections 60 and 61 VATA were in force from 1 September 1994 and were repealed on 1 April 2008. Section 60 provided:

> "**60 VAT evasion: conduct involving dishonesty**
>
> (1) In any case where—
>
> (a) for the purpose of evading VAT, a person does any act or omits to take any action, and
>
> (b) his conduct involves dishonesty (whether or not it is such as to give rise to criminal liability),

> he shall be liable, … to a penalty equal to the amount of VAT evaded or, as the case may be, sought to be evaded by his conduct.
>
> (2) The reference in subsection (1)(a) above to evading VAT includes a reference to obtaining any of the following sums—
>
> (a) … ;
>
> (b) a VAT credit;
>
> …
>
> in circumstances where the person concerned is not entitled to that sum.
>
> (3) The reference in subsection (1) above to the amount of VAT evaded or sought to be evaded by a person's conduct shall be construed—
>
> (a) in relation to VAT itself or a VAT credit as a reference to the aggregate of the amount (if any) falsely claimed by way of credit for input tax and the amount (if any) by which output tax was falsely understated;
>
> (b) …
>
> …
>
> (7) On an appeal against an assessment to a penalty under this section, the burden of proof as to the matters specified in subsection (1)(a) and (b) above shall lie upon the Commissioners."

5. Section 61 VATA provided:

> "**61 VAT evasion: liability of directors etc**
>
> (1) Where it appears to the Commissioners—
>
> (a) that a body corporate is liable to a penalty under section 60, and
>
> (b) that the conduct giving rise to that penalty is, in whole or in part, attributable to the dishonesty of a person who is, or at the material time was, a director or managing officer of the body corporate (a "named officer"),
>
> the Commissioners may serve a notice under this section on the body corporate and on the named officer.
>
> (2) A notice under this section shall state—

> (a) the amount of the penalty referred to in subsection (1)(a) above ("the basic penalty"), and
>
> (b) that the Commissioners propose, in accordance with this section, to recover from the named officer such portion (which may be the whole) of the basic penalty as is specified in the notice.
>
> (3) Where a notice is served under this section, the portion of the basic penalty specified in the notice shall be recoverable from the named officer as if he were personally liable under section 60 to a penalty which corresponds to that portion; and the amount of that penalty may be assessed and notified to him accordingly under section 76."

6. It is common ground in the present appeal that the VAT evasion for which Waterfire was made liable under section 60 took the form of seeking to obtain a VAT credit when it was not entitled to that credit and so was alleged to fall within section 60(2)(b). The basic penalty imposed on Waterfire was the amount of the tax it had sought to evade by claiming the VAT credit, that is £6,792,184. The penalty imposed on Mr Butt was calculated as 50 per cent of the penalty imposed on Waterfire after that penalty was reduced by 10 per cent.

7. The term "VAT credit" is defined in section 25 VATA. That section provides that a taxable person must account for and pay VAT by reference to its prescribed accounting periods. Section 25 then goes on:

> "(2) Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.
>
> (3) If either no output tax is due at the end of the period, or the amount of the credit exceeds that of the output tax then, … the amount of the credit or, as the case may be, the amount of the excess shall be paid to the taxable person by the Commissioners; and an amount which is due under this subsection is referred to in this Act as a "VAT credit"."

8. Section 26 VATA sets out what input tax is allowable under section 25:

> "(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.
>
> (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

> (a) taxable supplies;
>
> (b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;
>
> (c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection."

9. Section 26(3) and (4) then provide for the kinds of regulations that the Commissioners may make "for securing a fair and reasonable attribution of input tax to supplies" within subsection (2). Regulations have been made by the Commissioners for the purposes of section 26 but none of those regulations is relevant to the issues raised by this appeal.

MTIC frauds and the judgments in *Kittel* and *Mobilx*

10. The courts have on many occasions had to describe what is involved in an "MTIC fraud". The FTT in this case reproduced the explanation in *Red 12 Trading Ltd v The Commissioners for HM Revenue and Customs* [2009] EWHC 2563 (Ch) at [2] – [7] and I do not need to repeat that explanation here. There is no doubt that MTIC frauds became widespread throughout the EU. They threatened a serious diminution in public revenues if national tax authorities could not resist paying an input tax credit claimed by a company which was a link in the chain of the fraud but which was able to present genuine invoices showing that it had paid VAT to its supplier on the supply of the goods which it had sold on.

11. The Court of Justice of the European Union ('CJEU' or 'the Court') addressed this issue in *Optigen Ltd and others v Customs and Excise Commissioners* (Joined Cases C-354/03, C-355/03 and C-484/03) [2006] Ch 218, ('*Optigen*'), a reference from the English High Court. In that case the Commissioners refused claims for a deduction of input tax amounting to about £23.7 million on purchases of microprocessors. The question referred by the High Court stated that the circumstances of the case involved an innocent trader. HMRC nevertheless refused input tax deduction on the ground that the participants in an MTIC fraud had no genuine business motive but only the aim of misappropriating VAT funds. The result was, HMRC argued, that all the transactions comprising the chain were not part of an economic activity and fell entirely outside the VAT system. The Court was therefore asked whether in relation to such a trader's acquisition and sale of goods the trader was a "taxable person acting as such" or whether he was carrying on "an economic activity" or receiving and making a "supply of goods" as those terms were used in the Sixth Council Directive 77/388/EEC ('the Sixth Directive').

12. The CJEU in *Optigen* referred to its earlier case law confirming that the definitions and terms used in the Sixth Directive "are all objective in nature and apply without regard to the purpose or results of the transactions concerned" (see [44]). An obligation on the tax authorities to take account of the intention of a trader of which the taxable person had no knowledge and no means of knowledge would be contrary to the objectives of the common system of VAT and of ensuring legal certainty and facilitating the application of VAT. The CJEU therefore held:

> "51. It follows that transactions such as those at issue, which are not themselves vitiated by VAT fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of articles 2(1), 4 and 5(1) of the Sixth Directive, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge".

13. The CJEU's decision in *Optigen* begged a very important question and it was that question which then shortly after went to the Court in *Kittel*. In *Kittel* the Belgian tax authorities had refused to allow deduction of input tax on the ground that the taxpayer had knowingly participated in an MTIC fraud. Advocate General Ruiz-Jarabo Colomer described intra-Community trade as "fertile ground for VAT evasion" and said that the arrangements made by those operating MTIC frauds were "as fanciful and complicated as the imaginations of the people who think them up": see [27] and [34]. He confirmed his view that *Optigen* was correct and that the principle of neutrality which governs the general organisation of VAT precludes any distinction between lawful and unlawful transactions. An innocent trader does not therefore lose its right to deduct because of fraud elsewhere in the chain of supply, even if domestic legislation provided (as Belgian law did) that its contract of sale was void. However, where the taxable person itself participates in the fraud then, the Advocate General said, it would be contrary to the most basic logic to tolerate the deceitful conduct and leave it free of legal penalty.

14. The Advocate General approached the matter on the basis of the abuse of rights doctrine that had been established by the CJEU in *Halifax plc v Customs and Excise Comrs* (Joined Cases C-255/02 & C-223/03) [2006] STC 919, [2006] Ch 387 ('*Halifax*'). That case held that prevention of tax evasion is an objective recognised and encouraged by the Sixth Directive. Taxable persons must not be allowed to rely on the Community VAT provisions in order to obtain an advantage which is contrary to their purposes. He took the view that the Sixth Directive demanded that the trader lose his right to deduct if he knowingly participates in fraudulent schemes of this kind. His opinion was that where the taxable person knowingly participates in a fraudulent operation planned for the sole purpose of reducing the tax burden, he commits an abuse of rights and the VAT system requires that he lose the right to deduct.

15. The Court in *Kittel* again stressed that the right to deduct tax is an integral part of the VAT scheme and in principle may not be limited. There is no general distinction between lawful and unlawful transactions. But the Court went on:

> "53. By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where the tax is evaded by the taxable person himself (see *Halifax plc v*

> *Customs and Excise Comrs* (Case C-255/02) [2006] STC 919, [2006] Ch 387, para 59).
>
> 54. As the court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends (see, inter alia, Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).
>
> 55. Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 24; Case C-110/94 *INZO* [1996] ECR I-857, paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).
>
> 56. In the same way, the taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.
>
> 57. That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.
>
> 58. In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.
>
> 59. Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'."

16. The CJEU in *Kittel* thus also based its decision on *Halifax* as establishing the proposition that the objective criteria for the elements of the VAT regime are not met where tax is evaded by the taxable person himself. In *Halifax* the Court was considering to what extent the member states' tax authorities can refuse to recognise

for VAT purposes a transaction which is an abusive practice because it is a transaction carried out not in the context of normal commercial operations but solely for the purpose of obtaining advantages provided for by Community law. The Court recognised the need to balance the objective of preventing possible tax evasion, avoidance and abuse with the requirement that Community legislation must be certain and its application foreseeable; requirements of legal certainty that must be observed all the more strictly in the case of rules liable to entail financial consequences. The Court held (at [74] and [75] of *Halifax*):

> "… in the sphere of VAT an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of the tax advantage the grant of which would be contrary to the purpose of those provisions.
>
> Secondly, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. … the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages."

17. The CJEU said that it is for the national court to determine the real substance and significance of the transactions concerned: "In doing so, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden.": (see [81]). The Court also said that it is only in the absence of fraud or abuse that the right to deduct, once it has arisen, is retained.

18. I note that in [93] of *Halifax*, the Court said that a finding of abusive practice must not lead to a penalty, since a clear and unambiguous legal basis would be necessary for that. The abuse leads rather to an obligation to repay because the input tax refund was not due. They cited for that proposition the judgment in *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* (Case C-110/99) [2000] ECR I-11595 para 56. That case concerned the right of Emsland-Stärke to non-differentiated export refunds. Goods had been exported to Switzerland resulting in the grant of an export refund to Emsland-Stärke but the goods were immediately transported back to Germany unaltered. The German authorities demanded repayment of the export refund. Emsland-Stärke argued that the obligation to repay constituted a penalty and the finding of abuse did not provide an adequate legal basis for that. The Court dismissed this argument:

> "56. Contrary to the assertions of Emsland-Stärke, the obligation to repay refunds received in the event that the two constituent elements of an abuse are established would not breach the principle of lawfulness. The obligation to repay is not a penalty for which a clear and unambiguous legal basis would be necessary but simply the consequence of a finding that the conditions required to obtain the advantage derived

> from the Community rules were created artificially, thereby rendering the refunds granted undue payments and thus justifying the obligation to repay them."

19. The principal domestic authority in this area is *Mobilx Ltd (in Administration) v HMRC* [2010] EWCA Civ 517 ('*Mobilx*'). The three appeals disposed of in *Mobilx* were the first cases to reach the Court of Appeal following the CJEU's *Kittel* judgment. The main issue in the appeals was the degree of actual or constructive knowledge which traders needed to have in order for the *Kittel* test to be satisfied and input tax deduction refused. That is not an issue in Mr Butt's appeal since, as I describe below, he accepts the FTT's finding that he had actual knowledge that the chain of transactions in which Waterfire was a link were fraudulent MTIC transactions.

20. Moses LJ with whose judgment Carnwath LJ and Sir John Chadwick agreed, noted at [29] of *Mobilx* that the CJEU in *Optigen* had rejected the contention that the fact that transactions of innocent parties formed part of a series of transactions with a fraudulent objective meant that those transactions could not be regarded as economic activities. The CJEU had also rejected the United Kingdom's arguments that the unlawful transactions fell outside the scope of VAT completely. He said:

> "30. … By its rejection of the United Kingdom argument, the Court [in *Optigen*] made clear that the reason why fraud vitiates a transaction is not because it makes the transaction unlawful but rather because where a person commits fraud he will not be able to establish that the objective criteria which determine the scope of VAT and the right to deduct have been met."

21. After setting out the relevant passages from *Kittel*, Moses LJ noted in [36] of his judgment that the reference in [54] of the *Kittel* judgment to four previous decisions reinforces the proposition that "fraudulent tax evasion falls outwith the scope of VAT and thus the scope of the right to deduct input tax". Fraudulent evasion of tax does not meet the objective criteria, such as whether the activity is 'economic activity' or a taxable person is 'acting as such' by which the scope of VAT and the right to deduct are identified. He described the effect of *Kittel* as extending the principle that the objective criteria are not met where tax is evaded beyond evasion by the taxable person himself to the position of those who knew or should have known that by their purchase they were taking part in a fraudulent chain of transactions. Once such traders are treated as participants, their transactions also do not meet the objective criteria determining the scope of the right to deduct.

22. Moses LJ rejected the traders' contention that the principles enunciated by the CJEU in *Kittel* could not be applied as part of UK domestic law without specific legislation. He held that the *Kittel* principle does not depend on any national measure. The objective criteria which form the basis of the concepts used in the EU measures also form the basis of the concepts in VATA. Moses LJ emphasised that it is the obligation of domestic courts to interpret VATA in the light of the wording and purpose of the Sixth Directive. He referred to the judgment of Arden LJ in *Revenue and Customs Comrs v IDT Card Services Ireland Ltd* [2006] EWCA Civ 29, [2006] STC 1252 ('*IDT*') acknowledging that the application of the *Marleasing* principle may result in the imposition of a civil liability where such a liability would not

otherwise have been imposed under domestic law. Since in relation to the right to deduct input tax, the Community and domestic law "are one and the same", there can be no objection to the approach adopted in *Kittel*.

23. More recently, the CJEU has moved away from describing the *Halifax* abuse of rights principle as deriving from the meaning of the EU instrument and hence as requiring a conforming interpretation to be made of the relevant domestic legislation. In the VAT sphere there was always a risk of proving too much; if transactions forming part of an MTIC fraud chain were not "economic activity" or the fraudster was not a "taxable person acting as such" what would that mean for the output VAT that had been accounted for to the tax authorities by suppliers in the chain? There have been two cases in which national courts faced with similar questions as were raised in *Mobilx* have referred questions to the CJEU. The first is *Staatssecretaris van Financiën v Schoenimport 'Italmoda' Mariano Previti vof and Turbu.com BV and Turbu.com Mobile Phone's BV v Staatssecretaris van Financiën* (Joined Cases C-131/13, C-163/13 and C-164/13) judgment of 18 December 2014 ECLI:EU:C:2014:245 ('*Italmoda*'). In that case the Dutch tax authorities had refused Italmoda a tax credit on the grounds that it was involved in fraudulent evasion of VAT. The question arose in the Supreme Court of the Netherlands whether credit could be refused when the right of deduction was not subject under Netherlands law to the condition that the taxable person must not have deliberately participated in VAT evasion. The Netherlands Government argued that there were no lacunae in Netherlands law with regard to the transposition of the Sixth Directive and that the prevention of fraud applies as a general principle of law in the application of the national provisions transposing that Directive. The Court agreed, holding that even if there were no national provisions to which a conforming interpretation could be given, the tax authorities could still refuse the credit. The Court held that the effect on Italmoda of the application of *Halifax* and *Kittel* was not inconsistent with the principle that directives do not have horizontal effect: [55]. There is a separate principle that rules of EU law cannot be relied on for abusive or fraudulent ends. The Court went on: (citations omitted)

> "57 Accordingly, in so far as abusive or fraudulent acts cannot form the basis of a right under EU law, the refusal of a benefit under, in this case, the Sixth Directive does not amount to imposing an obligation on the individual concerned under that directive, but is merely the consequence of the finding that the objective conditions required for obtaining the advantage sought, under the directive as regards that right, have, in fact, not been satisfied (…).
>
> 58 Consequently, the present case concerns rather the impossibility for the taxable person to claim a right under the Sixth Directive, the objective criteria for the granting of which have not been satisfied either because of fraud affecting the transaction carried out by the taxable person itself or because of the fraudulent nature of a chain of transactions as a whole, in which that taxable person participated, as has been stated in paragraph 50 of the present judgment.

> 59 In such a situation, however, express authorisation cannot be required in order for the national authorities and courts to be able to refuse a benefit under the common system of VAT, as that consequence must be regarded as being inherent in the system."

24. The Court therefore concluded that the refusal of the VAT credit was not dependent on there being some wording in the Dutch domestic law that could be given a conforming interpretation to bring about that result. The same answer was given to questions referred by the Irish Supreme Court in *Cussens and others v Brosnan* (Case C-251/16) judgment of 22 November 2017 ECLI:EU:C:2017:881 [2018] STC 1957 ('*Cussens*'). The CJEU restated one of the questions referred as asking "whether the principle that abusive practices are prohibited must be interpreted as being capable, regardless of a national measure giving effect to it in the domestic legal order, of being applied directly in order to refuse to exempt sales of immovable goods, such as the sales at issue in the main proceedings, from VAT.": [25]. The CJEU drew a distinction between directives which do not have horizontal direct effect and the effect of settled case law, holding that the principle that abusive practices are prohibited, as applied to the sphere of VAT by the case-law stemming from the judgment in *Halifax*, "displays the general, comprehensive character which is naturally inherent in general principles of EU law": ([31]). The principle could therefore be relied on against a taxable person to refuse him a right to exemption from VAT, even in the absence of provisions of national law providing for such refusal.

25. Another question referred to the CJEU in *Cussens* was whether, as the transactions at issue in the main proceedings were carried out before the judgment in *Halifax* was delivered, the application of the abuse of rights principle was consistent with the principles of legal certainty and of the protection of legitimate expectations and, in particular, whether the principle had a sufficiently clear and precise content. The Court held that there was no issue with retrospectivity where the law derived from the rulings of the Court:

> "41 The interpretation which the Court, in the exercise of the jurisdiction conferred upon it by Article 267 TFEU, gives to EU law clarifies and defines, where necessary, the meaning and scope of that law as it must be, or ought to have been, understood and applied from the date of its entry into force. It follows that, unless there are truly exceptional circumstances, which is not however claimed to be the case here, EU law as thus interpreted must be applied by the courts even to legal relationships which arose and were established before the judgment ruling on the request for interpretation, provided that in other respects the conditions for bringing a dispute relating to the application of that law before the courts having jurisdiction are satisfied (…)."

26. Since *Halifax* was not one of the exceptional occasions where the CJEU had restricted the temporal effect of its judgment, the Court in *Cussens* held that the principle that abusive practices are prohibited applied directly to refuse exemption from VAT even though the sales concerned were carried out before the judgment in *Halifax* was

delivered. The principles of legal certainty and of the protection of legitimate expectations did not preclude this.

The FTT and UT decisions

27. For the purposes of Mr Butt's appeal, the key findings of the FTT following trial are as follows:

    i) The VAT returns submitted by Waterfire accurately represented taxable supplies which were made during the relevant period, that is to say the mobile phones existed and were bought and sold as reflected in the VAT invoices. The figures in the claim for VAT credit were not wholly concocted: [313] and [322].

    ii) However, there were features of Waterfire's transactions which led to the inescapable conclusion that it was not engaged in a genuine grey market; its transactions were wholly artificial and entered into in order to benefit from fraud: [377].

    iii) Mr Butt had actual knowledge that the transactions of Waterfire were connected to the fraudulent evasion of VAT. By entering into those transactions and making VAT returns which included those artificially contrived transactions, Waterfire had done an act for the purpose of evading VAT and had done so in circumstances where it was not entitled to the sum claimed as it had no right to deduct: "that right having been lost as the transactions fell outwith the scope of VAT by their fraudulent nature and Waterfire's actual knowledge of VAT fraud": [387].

    iv) Waterfire's acts were wholly and obviously dishonest and its directors must have known that its actions were, by ordinary standards, dishonest. Mr Butt had been deliberately dishonest in respect of financial matters: [388] – [391].

28. The first ground of appeal before the Upper Tribunal was the ground of appeal raised by Mr Butt before this court, namely whether the *Kittel* principle can be relied on to penalise a UK taxpayer in the absence of specific legislation. Mr Butt did not challenge HMRC's reliance on the *Kittel* principle to refuse Waterfire's VAT credit. He challenged the extent to which it can be used in addition to impose penalties under sections 60 and 61 VATA.

29. The Upper Tribunal held that that challenge was unsustainable given that sections 60 and 61 VATA were enacted before Waterfire incurred the VAT which it later sought to deduct and in the light of Moses LJ's statements in *Mobilx* that the *Kittel* principle does not require the introduction of further domestic legislation because Community law and domestic law are the same: see [27]. There was no need to adopt a conforming interpretation in order to apply section 60 VATA because the only issue was whether the statutory criteria of section 61 were fulfilled. The FTT had found that they were and the Upper Tribunal concluded that they were entitled to do so. The Tribunal held further that there was a clear and unambiguous legal basis for the imposition of a penalty in section 60: see [37].

Mr Butt's ground of appeal

30. It was common ground before us that the penalty under section 60 VATA is criminal for the purposes of the ECHR, see *Han and Yau v HMCE* [2001] EWCA Civ 1048, [2001] 1 WLR 2253. It follows from this that it is also criminal for the purposes of EU law and in particular the Charter of Fundamental Rights of the European Union ('the EU Charter'). Mr Mullan, appearing with Ms Brown for Mr Butt, relies in particular on article 49 of the EU Charter:

> "**Principles of legality and proportionality of criminal offences and penalties**
>
> 1. No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national law or international law at the time when it was committed. Nor shall a heavier penalty be imposed than that which was applicable at the time the criminal offence was committed. If, subsequent to the commission of a criminal offence, the law provides for a lighter penalty, that penalty shall be applicable.
>
> 2. This Article shall not prejudice the trial and punishment of any person for any act or omission which, at the time when it was committed, was criminal according to the general principles recognised by the community of nations.
>
> 3. The severity of penalties must not be disproportionate to the criminal offence."

31. Mr Butt fully accepts the findings of dishonesty made against him. Mr Mullan began his cogent and well-presented submissions by emphasising that Mr Butt's fraudulent activity should not colour our conclusions. The unmeritorious are entitled to have their human rights respected and upheld just as much as the meritorious. Indeed, they may be in greater need of the court's protection against the power of the executive than those whose behaviour is beyond reproach.

32. Mr Butt did not pursue a point on retrospectivity along the lines that the *Kittel* judgment post-dated the 04/06 accounting period in respect of which the penalty had been imposed on Waterfire. Rather he relied on the principle of certainty that is embodied in article 7 ECHR and article 49 of the EU Charter, as applied by the CJEU in the case law that I describe below.

33. Mr Butt accepts that the concepts used in sections 24 to 26 must be interpreted in the light of *Kittel* and *Halifax* so that HMRC is justified in refusing the VAT credit. That is what was decided by the Court of Appeal in *Mobilx*. He argues that the same interpretation cannot be given where the application of a criminal sanction is involved. He submits that an essential step in establishing Waterfire's liability to a penalty under section 60 is to show that it did in fact evade tax. The method of tax evasion relied on by HMRC here was the method in section 60(2)(b), namely by claiming a VAT credit to which Waterfire was not entitled. In order to decide whether Waterfire was entitled to the VAT credit of £6,792,184, one must look at the

earlier provisions of VATA governing claims for deduction or repayment of input tax. Sections 24 and 25 VATA do not restrict the right to deduct because of any connection with fraudulent activity. The only exception to the right to deduct input tax actually incurred (that is input tax which is not entirely fictitious) is set out in section 26A. Section 26A VATA was inserted by the Finance Act 2002 with effect for supplies made after 31 December 2002. That exception is where the taxable person has not paid the consideration for the supply to which the input tax relates and the consideration is still unpaid at the end of six months. That did not apply here. In order therefore to establish that Waterfire was not entitled to claim the VAT credit HMRC must rely not on the wording of the statutory provisions but on the CJEU's decision in *Kittel* and its earlier judgments together with the Court of Appeal's decision in *Mobilx*. That, Mr Mullan submits, is impermissible because of the EU law principle that the process of conforming interpretation cannot be used to impose a criminal liability; specific domestic legislation is required for that.

34. Mr Mullan relies particularly on the case of *Procura della Repubblica v X* (Joined Cases C-74/95 and C-129/95) [1996] ECR I-6629 ('*Procura della Repubblica*'). That was a preliminary reference on the interpretation of a Council Directive to protect the health and safety of workers using display screens. The questions referred arose in criminal proceedings against X for an alleged breach of an Italian legislative decree which implemented the provisions of the Directive in Italian law. The Italian decree defined a "worker" in a particular way and imposed criminal penalties on employers who fail to comply with its provisions. The question referred by the Italian court was whether the interpretation of the term 'worker' in the decree should be affected by the apparently wider definition of 'worker' given in the Directive so that X might be criminally liable for failing to provide safe conditions for someone who fell within the Directive definition of 'worker' but outside the Italian decree's definition of that term. The Court said:

> "24. It is true that the national court must apply its domestic law as far as possible in the light of the wording and the purpose of the Directive so as to achieve the result it seeks to achieve … However, that obligation on the national court to refer to the content of the Directive when interpreting the relevant rules of its national law is not unlimited, particularly where such interpretation would have the effect, on the basis of the Directive and independently of legislation adopted for its implementation, of determining or aggravating the liability in criminal law of persons who act in contravention of its provisions (see in particular Case 80/86 *Kolpinghuis Nijmegen* [1987] ECR 3969, para 13).
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> 25. More specifically, in a case such as that in the main proceedings, which concerns the extent of liability in criminal law arising under legislation adopted for the specific purpose of implementing a directive, the principle that a provision of the criminal law may not be applied extensively to the detriment of the defendant, which is the corollary of the principle of legality in relation to crime and punishment and more generally of the principle of legal certainty, precludes bringing criminal

> proceedings in respect of conduct not clearly defined as culpable by law. That principle, which is one of the general legal principles underlying the constitutional traditions common to the Member States, has also been enshrined in various international treaties, in particular in Article 7 of the Convention for the Protection of Human Rights and Fundamental Freedoms (see, inter alia, the judgments of the European Court of Human Rights in *Kokkinakis v Greece*, 25 May 1993, Series A, No 260-A, paragraph 52, and in *S. W. v United Kingdom and C. R. v United Kingdom*, 22 November 1995, Series A, No 335-B, paragraph 35, and No 335-C, paragraph 33).
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> 26. The national court must therefore ensure that that principle is observed when interpreting, in the light of the wording and the purpose of the Directive, the national legislation adopted in order to implement it."

35. The CJEU therefore declined to answer the question about the scope of the term "worker" in the Directive, since even if it bore a wider meaning than that set out in the Italian decree, that could not affect the progress of the criminal prosecution against X in the context of which the questions had been referred.

36. Advocate General Ruiz-Jarabo Colomer's opinion in *Procura della Repubblica* was also that the Italian law had defined precisely the conduct that it wanted to punish by criminal sanction. Any lacuna in that implementation could not be rectified by means of an interpretation of the Italian Decree "which makes it say more than it does, albeit in order to bring it into conformity with the Directive": see [41]. He said:

> "58. The legal basis for the imposition of legal sanctions must thus be clear and unequivocal, that is to say, unambiguous. No doubt a criminal provision also requires interpretation by the courts, but they are not permitted to fill any lacunae in the definitions of offences by resorting to an extensive interpretation.
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> …
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> 63. The principle of legal certainty, when understood in this way, precludes resorting to a Community directive in order to extend the definition of an offence, to the disadvantage of the accused, from situations different from those which strictly match the definition of the punishable acts given by national criminal law."

37. Mr Mullan argued that the principle set out in *Procura della Repubblica* was similar to that established by the House of Lords in *R v Withers* [1975] AC 842 ('*Withers*'). The House of Lords held in *Withers* that the courts do not have power to create new criminal offences, although that does not prevent well established principles being applied to new facts: see *per* Viscount Dilhorne at page 859. As Lord Diplock stated at 862, the law must be administered as it is, not as it ought to be; if what the

defendants had done in that case ought to be made a crime, it was for Parliament to legislate accordingly. Mr Mullan also referred us to the judgment of Arden LJ in *IDT* where she considered the ambit of the *Marleasing* principle in the light of the principle of legal certainty: see [109] onwards. She held that the latter principle was no grounds for objecting to a conforming interpretation of domestic law since it is well known that the provisions of VATA have to be interpreted in conformity with the Sixth Directive. She said further at [111] that such a conforming interpretation "might result in the imposition of a civil liability where it would not otherwise have been imposed under domestic law". Mr Mullan relies on her inclusion of the word 'civil' there as showing that Arden LJ was acknowledging the distinction between civil and criminal liability that is made in the case law on which he relied.

Discussion

38. Following the hearing of the appeal, the Court invited further submissions from the parties about how the principle in *Procura della Repubblica* applied where the EU law relied on to interpret domestic legislation was found not in an unimplemented or wrongly implemented directive but in a judgment of the CJEU. Judgments of the Court are, currently, binding on UK courts according to section 3 of the European Communities Act 1972. There is no doubt that judgments of the European Court can have the effect of imposing obligations on individuals in member states in so far as they change the previously recognised meaning of the EU concepts or legislation on which the Court rules. We received skeleton arguments from Mr Mullan on behalf of Mr Butt and from Sarabjit Singh QC on behalf of HMRC and a short further hearing was held. Both counsel agreed that the principle applies just as much to a judgment of the CJEU as it applies to unimplemented directives and that there was no distinction to be drawn between the present case and *Procura della Repubblica* on that basis.

39. In my judgment, the principle in *Procura della Repubblica* does not preclude the imposition of the penalty on Waterfire and on Mr Butt in this case. Mr Butt's ground of appeal is inconsistent with the way that the CJEU has described how the national courts should apply the *Halifax* principle as further clarified by the Court in *Kittel*, *Italmoda* and *Cussens*. Those cases establish that the fact that the taxpayer fraudulently carried out the transactions in respect of which the VAT credit is claimed does not mean that those transactions are not "economic activity" or that he is not a "taxable person acting as such". It is not the meaning of those specific terms in the Sixth Directive that is affected by the *Halifax* line of cases; the principle is more subtle than that. The abuse of right principle is, according to *Cussens*, "naturally inherent in general principles of EU law" as a free-standing principle that applies irrespective of the ability of the wording of the national provisions to be subjected to a conforming interpretation.

40. The Court has repeatedly held that the refusal to allow a credit does not of itself amount to the imposition of a penalty by the tax authority. The CJEU held in *Emsland-Stärke* that there needs to be a clear and unambiguous basis for imposing a penalty in addition to disallowing the benefit fraudulently claimed. Section 60 provides that clear and unambiguous basis in Mr Butt's case so the court is not having to devise a criminal offence in order to give effect to the wording of a directive. Section 60 provides expressly for the imposition of a penalty where a person dishonestly does an act for the purpose of evading VAT, in Waterfire's case that act

being to claim a VAT credit in circumstances where it was not entitled to that credit. The *Halifax/Kittel* principle means that the circumstances in which Waterfire is not entitled to claim the VAT credit include circumstances where Waterfire knew that the transactions purporting to give rise to the credit were part of an MTIC fraud. The situation here is different from that in *Criminal Proceedings against X* where the national legislation was expressly limited to the import and export of the goods or from that in *Procura della Repubblica* where the definition of 'worker' in the domestic legislation was narrower than that in the relevant directive. Here there is nothing in section 60 which expressly limits the circumstances in which the penalty can be imposed to cases where, for example, the transactions were entirely fictitious.

41. As the Advocate General said in [58] of his Opinion in *Procura della Repubblica*, criminal provisions need to be interpreted by the courts. The potential for the scope of domestic criminal provisions to change as a result of judicial decision making does not render them too uncertain to be enforceable. That is the same whether the judicial decision making is in the domestic courts or in Luxembourg. The CJEU held in *Cussens* that the application by the domestic courts of section 60 to take account of *Halifax* and *Kittel* does not offend against the principles of legal certainty even if it is applied to transactions predating those judgments. EU law has merely clarified and defined the scope of that law as it must be or ought to have been understood and applied from the start. For the same reason, the Upper Tribunal's decision does not offend the principle described by the House of Lords in *Withers*. When a court construes a legislative provision which creates a criminal offence it is not thereby creating a new criminal offence even if that construction changes what was previously thought to be the ambit of the provision.

42. Mr Mullan argues for an interpretation of section 60 which restricts its ambit to the kind of tax evasion where the goods do not in fact exist or the VAT return and input tax claimed are entirely fictitious. However, the abuse principle arises precisely in a situation where all the formalities of the VAT provisions appear to have been fully complied with by the taxpayer so that it appears that the claim to the benefit under the VAT regime is a good claim. The effect of the CJEU's rulings is that, as the Court said in *Halifax* [74], notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, the objective criteria for deduction are not in fact satisfied because the right to deduct is being exercised fraudulently.

43. Mr Mullan drew our attention to sections 69C and 69D VATA, introduced with effect from 16 November 2017 and applicable to transactions entered into after that date. Those provide for the imposition of a penalty on someone who has entered into a transaction connected with the fraudulent evasion of VAT by another person where HMRC has refused to allow a deduction of input tax applying the *Kittel* principle. For these new provisions, for which dishonesty does not have to be proved, the penalty is 30 per cent of the potential lost VAT. I do not accept that the introduction of these provisions indicates that there was something missing from the earlier provisions with which this appeal is concerned.

44. I consider that the Upper Tribunal was right therefore to hold in [27] that no changes were needed to VATA in order for the conditions for the application of sections 60 and 61 to be met in this case.

45. Mr Butt's alternative argument is that *Mobilx* was wrongly decided if the inevitable consequence of reading sections 24 to 26 VATA so as to preclude a VAT credit is that a penalty can be imposed under section 60 when such a VAT credit is claimed. I cannot accept that. The judgments in *Italmoda* and *Cussens* confirmed the correctness of the result achieved by this Court in *Mobilx*.

Conclusion

46. For the reasons given above I would dismiss the appeal.

47. Before concluding, this court wishes warmly to commend Mr Mullan and Ms Brown who appeared on behalf of Mr Butt at a number of interlocutory and substantive hearings including an eight day trial before the FTT, the appeal before the Upper Tribunal and the appeal before us, acting pro bono under licence from the Bar Pro Bono Unit. They argued an interesting point with conspicuous ability and their written and oral submissions were cogent, thorough and very helpful. Mr Butt was indeed fortunate to have the benefit of their representation in this appeal.

Lord Justice Peter Jackson

48. I agree.

Lord Justice Gross

49. I also agree.