Neutral Citation Number: [2020] EWCA Civ 874

Case No: A3/2019/2181

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
MR JUSTICE HENRY CARR AND JUDGE SINFIELD
UT/JR/2018/001

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 10th July 2020

Before:

LORD JUSTICE LEWISON
LORD JUSTICE NEWEY
and
LORD JUSTICE BAKER

- -

Between:

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellants**
- and -	
NORTHUMBRIA HEALTHCARE NHS FOUNDATION TRUST	**Respondent**

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- -

Peter Mantle (instructed by the **General Counsel and Solicitor to HM Revenue and Customs**) for the **Appellants**
David Scorey QC (instructed by **Deloitte LLP**) for the **Respondent**

Hearing date: 30 June 2020

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Approved Judgment

Covid-19 Protocol: This judgment was handed down remotely by circulation to the parties' representatives by email, release to BAILII and publication on the Courts and Tribunals Judiciary website. The date and time for hand-down is deemed to be 10:30am on Friday 10th July 2020

Lord Justice Lewison:

1. As part of a salary sacrifice scheme, the Northumbria Healthcare NHS Trust ("the Trust") provides its employees with motor cars. The issue on this appeal is whether the Trust is entitled to a refund of the VAT which it incurred when it acquired the cars. The Upper Tribunal ("the UT") (Henry Carr J and Judge Sinfield) held that it was. With the permission of the UT, HMRC appeal. The decision of the UT is at [2019] UKUT 170 (TCC), [2019] STC 1532.

2. The Trust was established under the Health and Social Care (Community Health and Standards) Act 2003. The Trust's statutory activities include the provision of hospital and community health services in North Tyneside and hospital community, health and adult social care services in Northumberland. The carrying out by the Trust of its statutory functions is regarded as a non-business activity for VAT purposes.

3. The Trust offers car leasing to its own employees, employees of a number of other NHS Trusts, and to employees of other public sector organisations under salary sacrifice arrangements. There is a public sector car leasing framework in place which enables the Trust to obtain leased cars on favourable commercial terms. Having leased a car on favourable terms, the Trust then enters into a back-to-back lease of the same car with one of its employees. Car maintenance and repair is included in the leases offered by the Trust to its employees.

4. The Trust provides the car leasing services to other entities under the brand "NHS Fleet Solutions". The Trust currently has approximately 21,000 vehicles within NHS Fleet Solutions and makes supplies to employees of about 170 public sector organisations.

5. Where the Trust leases a car to another NHS Trust in the same divisional VAT registration, an employee of that other NHS Trust is regarded, for VAT purposes, as an employee of the Trust and the same VAT treatment applies.

6. As part of the arrangements, the employees who lease cars from the Trust under the car scheme are entitled to use the cars for the term of the lease. They may use them for private use in addition to using them in the course of their employment activities with the Trust, although the Trust cannot compel their use for the latter purpose. When employees use the cars in the course of their employment, they are reimbursed for their mileage costs by the Trust.

7. The Trust's claim to a refund of VAT which it incurred on the acquisition of cars is made under section 41 (3) of the Value Added Tax Act 1994 ("VATA"). This is a domestic provision which does not owe its origin to EU law. The purpose underlying the enactment of section 41 was to encourage public authorities to "outsource" the provision of services. When they perform services in-house, using their own employees, they incur no VAT. If they were to outsource those services, they would be exposed to having to pay VAT charged by the outside contractor. That was seen as a disincentive to outsourcing the provision of services. Hence the need to provide for a refund of VAT. That sub-section provides:

> "(3) Where VAT is chargeable on the supply of goods or services to a Government department, on the acquisition of any

> goods by a Government department from another member State or on the importation of any goods by a Government department from a place outside the member States and the supply, acquisition or importation is not for the purpose –
>
> (a) of any business carried on by the department, or
>
> (b) of a supply by the department which, by virtue of a direction under section 41A is treated as a supply in the course or furtherance of a business,
>
> then, if and to the extent that the Treasury so direct and subject to subsection (4) below, the Commissioners shall on a claim made by the department at such time and in such form and manner as the Commissioners may determine, refund to it the amount of VAT so chargeable"

8. The Trust counts as a government department: section 41 (6) and (7). The claim under section 41 (3) is not a deduction of input tax. It is a claim for a refund of VAT which is outside the usual method of offsetting input and output tax.

9. The Treasury's direction is dated 2 December 2002 and was published in the London Gazette on 10 January 2003. It is known as the Contracted Out Services Direction ("COSD"). The COSD has four paragraphs and two lists. List 1 sets out the categories of "Government department" which may claim and be paid refunds of VAT. It includes NHS Trusts. List 2 describes the services in respect of which a body in List 1 may claim a refund, subject to the conditions in paragraph 3 of the COSD. At number 26 in List 2 is "Hire of vehicles including repair and maintenance". Paragraph 3 of the COSD states:

> "A tax refund will only be paid if:
>
> (a) either the supply of those services or goods is not for the purpose of:
>
> (i) any business carried on by the department; or (ii) … and (b) the department complies with the requirements of [HMRC] both as to the time, form and manner of making the claim and also on the keeping, preservation and production of records relating to the supply, acquisition or importation in question."

10. Whether the Trust is entitled to a refund in accordance with this scheme requires a broader consideration of the VAT regime.

11. The overarching legal framework relating to VAT is found in Council Directive 2006/112/EC ("the Principal VAT Directive"). Article 2 defines the transactions that are subject to VAT. They include:

> "(a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such

> (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such"

12. One of the key concepts is that of "supply". The supply of a car to the Trust under a lease is one supply, and in principle the supply by the Trust of that car under a lease to another is a second and separate supply. Another of the key concepts is a "taxable person". That expression is defined by article 9 (1):

> "Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.
>
> Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'."

13. Article 13 (1) of the Principal VAT Directive provides:

> "States, regional and local government authorities and other bodies governed by public law shall not be regarded as 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 those activities or transactions.
>
> However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition."

14. The Trust falls within this description, at least when it is carrying out its core purpose of providing healthcare within the NHS. It is not, therefore, a "taxable person" while carrying out those activities. As I understood it, it was common ground that (a) where the Trust leases cars to outside organisations (such as local authorities) it is carrying on the business of doing so and both deducts the input tax attributable to its acquisition of cars so leased, and charges output tax to those organisations on the supply of those cars; and (b) the fact that it carries on that business is of no real consequence in relation to the issues that we have to decide.

15. Because the Trust is not a taxable person in relation to its core activities, it does not have the right to deduct input tax paid on what it acquires under the usual system of offsetting input and output tax. That is why it had recourse to section 41 (3) of VATA. The key question, therefore, is whether the acquisition of the cars by the Trust for the purpose of leasing them to its own employees was for the purpose "of any business carried on" by the Trust, which is the phrase both in section 41 (3) and in COSD. If it was, then the claim to a refund fails.

16. The Principal VAT Directive is implemented in the UK by VATA. Section 4 of that Act provides:

> "(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.
>
> (2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply."

17. It is common ground that in the domestic legislation "business" corresponds to "economic activity" in the Principal VAT Directive. Section 5 of VATA defines what is meant by a supply. The definition encompasses all forms of supply "but not anything done otherwise than for a consideration". The section also empowers the Treasury to make orders further defining what is and is not a supply. Under predecessors of those powers the Treasury made the Value Added Tax (Treatment of Transactions) Order 1992. That order has been referred to as the "De-Supply Order". Article 2 provides:

> "Where an employer gives an employee a choice between—
>
> (a) a particular rate of wages, salary or emoluments, or
>
> (b) in the alternative a lower rate of wages, salary or emoluments and, in addition, the right to the private use of a motor car provided by the employer,
>
> and the employee chooses the alternative described in paragraph (b) above, then the provision to the employee of the right to use the motor car privately shall be treated as neither a supply of goods nor a supply of services (if it otherwise would be) to the extent only that the consideration for the provision of the motor car for the employee's private use is the difference between the wages, salary or emoluments available to him under paragraphs (a) and (b) of this article."

18. The argument for the Trust, which the UT accepted, was that since the provision of cars by the Trust to its employees was not a supply it could not be an economic activity; because an economic activity requires a supply of goods or services. As the UT put it at [33]:

> "We take the view that provision of the cars by the Trust to the employees under the salary sacrifice scheme cannot be regarded as a supply of services because it has been de-supplied by the De-Supply Order. It follows that the leasing of the cars by the Trust cannot be an economic activity because that requires a supply of services. Since the effect of the De-Supply Order is that any "business" or "economic activity" relating to the Car Scheme is ignored for VAT purposes, the Trust is deemed to be, or reverts to being, a purely non-business operation. In those circumstances, the terms of section 41(3)(a) VATA94 are deemed to be satisfied pursuant to the De-Supply order."

19. Mr Mantle, on behalf of HMRC, says that that is wrong. He accepts that the effect of the De-Supply Order is that the provision of the cars is not a supply. But he argues that the concepts of "supply" and "business" (or "economic activity"), while related, are distinct concepts. It is not a precondition of economic activity that supplies have actually taken place.

20. The De-Supply Order says that the provision of a car as part of a salary sacrifice scheme is not to be "treated as" a supply. This form of words is a more modern form of deeming provision: Bennion on Statutory Interpretation para 7.18; *R (Charlesworth) v Crossrail Ltd* [2019] EWCA Civ 1118, [2020] RVR 17. The first point to note is that the only thing that is to be treated as not being a supply is the provision by the employer to the employee of the right to use the car. The acquisition of the car by the employer is not within the scope of the De-Supply Order. That acquisition remains a supply for the purposes of VAT.

21. The effect of a deeming provision on the wider context in which it is enacted depends on the proper interpretation of the deeming provision. The most recent authoritative consideration of the principles applicable to deeming provisions of this kind is the decision of the Supreme Court in *Fowler v HMRC* [2020] UKSC 22, [2020] 1 WLR 2227. Lord Briggs said at [27]:

> "There are useful but not conclusive dicta in reported authorities about the way in which, in general, statutory deeming provisions ought to be interpreted and applied. They are not conclusive because they may fairly be said to point in different directions, even if not actually contradictory. The relevant dicta are mainly collected in a summary by Lord Walker of Gestingthorpe JSC in *DCC Holdings (UK) Ltd v Revenue and Customs Comrs* [2011] 1 WLR 44, paras 37–39, collected from *Inland Revenue Comrs v Metrolands (Property Finance) Ltd* [1981] 1 WLR 637, *Marshall v Kerr* [1995] 1 AC 148 and *Jenks v Dickinson* [1997] STC 853. They include the following guidance, which has remained consistent over many years:
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> (1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.

> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
>
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real. As Lord Asquith memorably put it in *East End Dwellings Co Ltd v Finsbury Borough Council* [1952] AC 109, 133:
>
> "The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs.""

22. The deeming provision in this case does not merely say that the provision of the car to an employee is not a supply for consideration. It says that there is no supply at all. If the provision of the car to the employee is not to be treated as a supply, then in the fictional world there is no supply when the car is provided. It is that fictional world which we must consider.

23. Mr Mantle stressed the need to discern the limited purpose of the deeming provision (as Lord Briggs' proposition (2) requires). That purpose, he said, was simply to prevent the charging of output tax on the provision or leasing of a car by an employer to an employee as part of a salary sacrifice scheme. In the alternative its purpose was to preclude the charging of output tax on the supply of the car by the employer; and the deduction of input tax on the antecedent supply of the car to the employer. The De-Supply Order could have provided that the provision of the car was not to count as an economic activity (or as part of a business) but it did not. The concept of a supply and the concept of economic activity, though related, were distinct concepts. Although the De-Supply Order only deemed the provision of the car by the employer to the employee as not being a supply, the consequence was that under section 26 of VATA the employer was not entitled to deduct input tax on the antecedent supply of the car to him, because it was not a supply with a sufficient link to the making of a taxable supply. Section 24 only permits the deduction of input tax on goods or services "used or to be used for the purpose of any business carried on or to be carried on by" the taxable person. Section 26 allows deduction of input tax in relation to taxable supplies made by a taxable person in the course of his business. The effect of the UT's decision was that a car leased by the Trust to an employee enters final consumption without having borne any VAT. That is an unjust and anomalous result, which in accordance with Lord Briggs' proposition (4) ought to be avoided. The language of the De-Supply Order is not so clear as to compel that result. Section 41 (3) was not designed to apply in such a situation.

24. The question whether a taxable person would have been entitled to deduct input tax on the antecedent supply of a car to him does not arise for decision in this appeal. I therefore express no concluded view on the point. But there are four observations that I wish to make. First, the Value Added Tax (Input Tax) Order 1992 (referred to as the Blocking Order) which purports to exclude the right to deduct input tax on the antecedent supply in almost all cases would, on this analysis, have been largely redundant. Second, the Blocking Order expressly permits the deduction of 50 per cent

of input tax where the antecedent supply to the employer consists of a lease. It is hard to see how that can be justified if there is no sufficient link between that supply and the subsequent provision of the car to an employee (which is deemed not to be a supply at all). Third, if the analysis is correct, it must be because the consequences of the deeming provision must be tracked though the general VAT regime. Fourth, if section 24 does not permit the deduction of input tax, it must be because the provision of the car by an employer to an employee does not count as carrying on a business (i.e. is not an economic activity). The upshot is, in my judgment, that this argument reinforces the Trust's position, that the acquisition of a car in order to provide that car to an employee is not an acquisition for the purposes of a business; and hence qualifies for a refund of VAT.

25. In *Wakefield College v HMRC* [2018] EWCA Civ 952, [2018] STC 1170 this court held at [52]:

> "Whether there is a supply of goods or services for consideration for the purposes of art 2 and whether that supply constitutes economic activity within art 9 are separate questions. A supply for consideration is a necessary but not sufficient condition for an economic activity."

26. At first blush that appears to be strong support for the Trust's case. If a supply for consideration is a *necessary* condition for an economic activity, and there is no supply, it must follow that there is no economic activity. The court went on to say at [53]:

> "Having concluded that the supply is made for consideration within the meaning of art 2, the court must address whether the supply constitutes an economic activity for the purposes of the definition of 'taxable person' in art 9."

27. Inherent in that way of putting the point is that if the court had concluded that there was no supply made for consideration, there would have been no need to consider the question of economic activity.

28. That view seems to me to be supported by the case law of the CJEU. In (Case C-520/14) *Geemente Borsele v Staatssecretaris van Financiën* [2016] STC 1570 Advocate-General Kokott said at [32]:

> "The Kingdom of the Netherlands is right to say that an economic activity within the meaning of art 9(1) of the VAT Directive cannot be said to exist where an activity does not correspond to any of the various chargeable events defined in art 2 of the VAT Directive. The court's repeated references to the chargeable events defined in art 2 of the VAT Directive when interpreting art 9 of that directive must also be understood in this way."

29. The court specifically approved that point at [21]:

> "As the Advocate General stated at point 32 of her opinion, an activity can be regarded as an economic activity within the meaning of art 9(1) of the VAT Directive *only* where the activity corresponds to one of the chargeable events defined in art 2 of that directive." (Emphasis added)

30. In (Case C-28/16) *MVM Magyar Villamos Művek Zrt v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság* [2017] STC 452 the question before the CJEU was whether a holding company which played an active part in the management of its subsidiaries, but which did not pass on the costs of services in relation to its active holding activities, could be regarded as a taxable person. Because of the definition of "taxable person" that raised the question whether it was carrying on an economic activity. In the course of its reasoning the CJEU stated at [33]:

> "… it follows from settled case law of the court that the involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity within the meaning of art 9(1) of Directive 2006/112 *where it entails carrying out transactions which are subject to VAT by virtue of art 2 of that directive*, such as the supply by a holding company to its subsidiaries of administrative, financial, commercial and technical services…" (Emphasis added)

31. It would seem to follow that where a company is not carrying out transactions falling within article 2 (i.e. it is neither supplying goods nor services for a consideration) it is not engaged in an economic activity.

32. Mr Mantle, however, originally argued that the making of a supply is not a pre-condition of economic activity. He supported that argument by reference to the decision of the CJEU in (Case C-37/95) *Belgium v Ghent Coal Terminal NV* [1998] STC 260. Ghent Coal Terminal had bought land for the purposes of its business; and carried out improvement works. But it was compelled to exchange that land for other land, with the consequence that it never operated its business from the land that it had acquired. As the order for reference put it:

> "'… the invested goods had been in the normal course of events intended for use in taxable transactions, that the exchange had not been foreseen or planned in advance by the respondent, and that it could not have been avoided by the respondent in the normal course of its business and even constituted economic force majeure for it."

33. The question was whether it was entitled to deduct the input tax that it had paid during the course of the investment works. In stating his opinion Advocate-General Ruiz-Jarabo Colomber said:

> "[38] It is sufficient, then, that the goods or services are acquired and used by an undertaking within the framework of an economic activity for the VAT paid or due to be deductible. Where art 17(2) of the Sixth Directive speaks of 'goods and

> services ... used' for the 'purposes of his taxable transactions', it seeks to emphasise that the use must be specifically aimed at the business activity and not at other activities of a different kind.
>
> [39] That does not mean, however, that the purpose or objective for which the goods acquired or services received are to be used in the normal course must always be achieved in every case. On the contrary, it is perfectly possible that certain business transactions for the realisation of which goods or services were acquired may subsequently be frustrated. The right to deduct the VAT paid does not cease to exist for that reason"

34. At [17] the court held:

> "It follows that a taxable person acting as such is entitled to deduct the VAT payable or paid for goods or services supplied to him for the purpose of investment *work intended to be used in connection with taxable transactions*."

35. Taxable transactions would encompass supplies of goods or services for a consideration. Since the goods in that case were intended for use in connection with taxable transactions, the right to deduct input tax arose immediately. The court went on to hold at [19] that the right to deduct, once it has arisen, remains acquired even if the planned economic activity has not given rise to taxable transactions. It went on to hold at [20]:

> "Likewise, the right to deduct remains acquired where the taxable person has been unable to use the goods or services which gave rise to a deduction in the context of taxable transactions by reason of circumstances beyond his control."

36. In its *dispositif* the court ruled:

> "Article 17 of the Sixth Directive must be construed as allowing a taxable person acting as such to deduct the VAT payable by him on goods or services supplied to him for the purpose of investment work intended to be used in connection with taxable transactions. The right to deduct remains acquired where, by reason of circumstances beyond his control, the taxable person has never made use of those goods or services for the purpose of carrying out taxable transactions."

37. Accordingly, a person may be a taxable person (i.e. carrying on an economic activity) and hence entitled to deduct VAT on goods or services supplied *to* him, if those goods or services are intended to be used in connection with taxable transactions (i.e. supplies of goods or services made *by* him). But if the goods or services supplied to the relevant person are intended to be used in connection with activities that are not supplies (or deemed not to be supplies), I cannot see anything in the *Ghent Coal* case that undermines the Trust's argument. In the course of his oral address Mr Mantle

accepted that under the general legal regime applicable to VAT it was a necessary condition of the carrying on of an economic activity that the person in question either made or intended to make taxable supplies.

38. The cases to which I have referred demonstrate, to my mind, that it is not possible under the general scheme of the VAT legislation to decouple the carrying on of an economic activity from the making of taxable supplies (either actual or intended).

39. In the present case, the language of the De-Supply Order uses an expression ("supply") which has a well-recognised meaning in VAT law. The concept of making a supply for a consideration is an essential element of the carrying on of an economic activity. As Mr Scorey QC put it, by making the De-Supply Order in the form that it did, Parliament chose to effect the change at a structural level. It did so by recharacterising the activity that might otherwise have amounted to the carrying on of an economic activity. It is the inevitable consequence of the absence of supplies that there cannot be the carrying on of an economic activity. That is simply to apply Lord Briggs' proposition (5). I agree.

40. Nor do I accept that this interpretation produces unjust results. As Mr Scorey emphasised the facts of this case are highly unusual. The De-Supply Order applies to all employers whether or not they are taxable persons, and whether or not they make other taxable supplies. It applies in its terms only to the transaction between the employer and employee. It does not apply to the antecedent acquisition of the car by the employer. In some cases, the Blocking Order will preclude (or limit) the deduction of input tax on that acquisition, but that Order does not apply to the Trust in so far as it is not a taxable person. The Trust carries out no relevant economic activity apart from the activities that are deemed not to be supplies. The purpose of section 41 (3) is to give public authorities a specific right to a refund of VAT where they are not charging output tax on supplies and not able to deduct input tax. The fact that in the case of the Trust a car enters final consumption without having borne VAT is simply a consequence of the deeming provision.

41. It is, of course, possible that even if it is not making (or deemed not to be making) these particular supplies, the Trust is nevertheless carrying on a relevant economic activity. The UT were alive to that possibility. At [34] they said:

> "If the Trust's only activity were the provision of cars to employees under the salary sacrifice arrangements, there would be no economic activity as a result of the De-Supply Order. Accordingly, the supplies of the leased and maintained cars to the Trust for the purpose of providing those cars to employees cannot have been for the purpose of any business carried on by the Trust. That is also the position if the Trust's wider activities are taken into account. That is because those other activities of the Trust are not business activities and do not constitute an economic activity."

42. They returned to the point at [38] in which they said:

> "In conclusion, although we accept that an activity that is not a supply may nevertheless be part of a wider economic activity,

> we do not accept that the provision of the cars to employees under the salary sacrifice arrangement in this case was an economic activity in its own right or part of the economic activity of the Trust."

43. It is common ground that in these two paragraphs the UT left out of account the leasing business that the Trust carried on in supplying cars to outsiders (such as local authorities); but it was also common ground that they were right to do so. It is clear from a later part of their decision, dealing with what the position would have been if the De-Supply Order had not applied, that the UT well understood the legal test for deciding whether or not a person carries on an economic activity. Indeed, it is common ground that the UT applied the right legal test. I do not consider that we should or could conclude that in paragraphs [34] and [38] they applied some different test. Accordingly, in my judgment the UT's evaluation of the Trust's overall activities was a question of fact to which they were entitled to come.

44. I mention by way of post-script that Mr Mantle said that the De-Supply Order was contrary to EU law because of the decision of the CJEU in (Case C-40/09) *Astra Zeneca UK Ltd v HMRC* [2010] STC 2298. Why the De-Supply Order has not been revoked in the 10 years that have elapsed since that decision is unexplained. But Mr Mantle accepted that the Trust was entitled to rely on that Order, despite its alleged illegality under EU law. He did at one stage argue that we should interpret the De-Supply Order so as to bring it into conformity, so far as possible, with EU law. But as I see it, that is an impossibility, as I think Mr Mantle ultimately accepted.

45. In short, I consider that the UT were right, for the reasons that they gave. I would dismiss the appeal.

Lord Justice Newey:

46. I agree.

Lord Justice Baker:

47. I also agree.