[2014] UKUT 0320 (TCC)

Appeal number FTC/65/2013

VAT—Self-billing- failure to complete a self-billing agreement- 4 traders deregistered – whether discretion under regulation 29(2) of VAT Regulations 1995 properly exercised – No – whether assessment to be discharged– Adjourned for further argument

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

G B HOUSLEY LIMITED

Respondent

Tribunal: Mr Justice Warren, Chamber President

Sitting in public in London in the Rolls Building on 4 March 2014

Vinesh Mandalia, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, on behalf of the Appellants
Michael Thomas, counsel, instructed by CCH Taxation Services, on behalf of the Respondent

DECISION

Introduction

1. This is an appeal by the Appellants ("**HMRC**") against a decision of Judge Porter and Susan Stott ("**the Tribunal**") released on 15th February 2013 ("**the Decision**"). The Tribunal allowed the appeal of GB Housley Ltd ("**the Company**"), holding that HMRC had acted unreasonably in not exercising their discretion to accept, in the absence of proper self-billing invoices, alternative evidence in support of input tax deductions claimed by the Company and concluding that the failure to consider the discretion rendered invalid the assessment which had been raised against the Company.

The Legislation

2. The relevant statutory provisions are set out in [6] to [12] of the Decision and are found in section 29 and Schedule 11 VAT Act 1994 ("**VATA 1994**") and in Regulations 13 and 29 of the Regulations.

3. Paragraph 2B Schedule 11 VATA 1994 establishes the self-billing regime. Paragraph 2B essentially provides that where conditions imposed by HMRC, either in regulations or a VAT Notice, are complied with then a taxable person can provide to himself a self-billing invoice which is treated as if it were the VAT invoice which would otherwise be required to be provided by his supplier.

4. The Regulations contain provisions governing the self-billing regime. Regulation 13(3) provides that "a self-billed invoice" which is provided by a taxpayer who is a registered person to himself is treated as a VAT invoice if it complies with both

the conditions set out in Regulation 13(3A) and any further conditions that may be contained in a VAT Notice published by HMRC. A "self-billed invoice" must purport to be a VAT invoice in respect of a Supply of goods and services to him by another registered person.

5. Regulation 13(3A) in turn sets out the three conditions which must be complied with if a self-billed invoice is to be treated as a VAT invoice.

    a. First, it must have been provided pursuant to a prior "self-billing agreement" entered into by the supplier of the goods or services and their recipient which satisfies the requirements in paragraph (3B).

    b. Secondly, it must contain the particulars required under Regulation 14(1) or (2).

    c. Thirdly, it must relate to a supply or supplies made by a supplier who is a taxable person. In that context, section 3 VATA 1994 provides that a person is a taxable person "while he is, or is required to be, registered…".

6. Regulation 13(3B) sets out the conditions for a self-billing agreement. Regulation 13(3C) provides that a self-billing agreement is treated as having expired when the supplier ceases to be registered for VAT.

7. Regulation 29(2) is central to the present appeal. It provides that at the time of claiming deduction of input tax a person shall, in respect of a supply from another taxable person, hold the document which is required to be issued under Regulation 13. In the case of supplies to the Company by the four traders concerned in the

present case, the document is the one which is required under Regulation 13, that is to say either an ordinary VAT invoice from the supplier or a self-billed invoice satisfying the three conditions mentioned above. Regulation 29(2) is subject to this proviso:

> "provided that where the Commissioners so direct, either generally or in relation to particular cases, a claimant shall hold or provide such other evidence of the charge to VAT as the Commissioners may direct."

8. The effect of Regulation 29(2) is that HMRC have a discretion to allow a credit for input tax notwithstanding that the taxable person does not hold a valid tax invoice: see *Kohanzad v Customs and Excise Commissioners* [1994] STC 967 at 969 per Schiemann J, followed in *Best Buys Supplies Ltd v Revenue & Customs Commissioners* [2012] STC 885 at [48].

9. During the course of the proceedings in the Tribunal and before me, complaint has been made about a failure to exercise the discretion conferred by Regulation 29(2). Sometimes what is meant is a failure actually to exercise the discretion in favour of the Company having considered the merits of the case. But sometimes what is meant is a failure to consider whether the discretion should be exercised at all. Thus, a decision not to exercise the discretion on the merits is to be contrasted with a refusal to exercise it. This could occur, for instance, where it is thought that an occasion for its exercise has not arisen, because it is believed, in error, that there is a pre-condition for its exercise which has not been fulfilled. I shall attempt to make clear in which sense I am using the word failure at different points in this Decision.

10. A taxable person has the right to appeal to the First-tier Tribunal in respect of a

refusal by HMRC to exercise their discretion under Regulation 29(2) because this affects the amount of any input tax which may be credited to him: see section 83(1)(c) VATA 1994 and, again, the same page (969) of *Kohanzad* [1994] STC 967 and the same paragraph (48) of *Best Buys Supplies Ltd.* The tribunal exercises a supervisory jurisdiction when hearing such an appeal: it does not exercise an original jurisdiction but asks whether a decision by HMRC not to exercise the discretion in favour of the taxpayer is defensible. In effect, the tribunal should consider whether HMRC have acted in a way in which no reasonable panel of Commissioners could have acted or whether they have taken into account some irrelevant matter or have disregarded something to which they should have given weight. The tribunal should also consider whether HMRC have erred on a point of law. This was the approach adopted by the Court of Appeal in *John Dee Limited v Customs & Excise Commissioners* [1995] STC 941: see at 952 per Neill LJ.

11. Since the tribunal's jurisdiction is only supervisory, it follows that if HMRC have not exercised their discretion properly (including by failing to exercise it at all) the result is that the exercise of the discretion must be revisited. However, there is an exception where HMRC are able to show that, had the discretion been properly exercised, the decision would **inevitably** have been the same: see again *John Dee Ltd* [1995] STC 941 at 952 to 953 and *Best Buy Supplies Ltd* at [50] to [56].

12. Mr Thomas, who appears for the Company, has also referred to the European Union jurisprudence. Chapter 4 of Title X of the Principal VAT Directive (Council Directive 2006/112/EC) sets out the rules governing the exercise of the right of deduction. Article 178 states that, in order to exercise that right, a taxable person must meet certain conditions, including the holding of a valid VAT

invoice. However, Article 180 provides that Member States may authorise a taxable person to make a deduction which is not made in accordance with Article 178. Article 182 provides that Member States shall determine the conditions and detailed rules for applying Article 180. This provision replaces the equivalent rule which was contained in Article 18.3 of the Sixth VAT Directive. The assessment period in the present case falls in part within the Sixth Directive and in part within the Principal Directive.

13. Mr Thomas points out that the Court of Justice (formerly called the European Court of Justice and now forming part of the Court of Justice of the European Union) has repeatedly held that the right to deduct input tax is an integral part of the VAT scheme and in principle may not be limited. In this context, he has referred to Case C-438/09 *Dankowski v Dyrektor Izby Skarbowej w Lodzi* [2011] All ER (D) 01 ("***Dankowski***"). At [35] the Court stated that

> "where the competent tax authority has the information necessary to establish that the taxable person is, as a recipient of [relevant] services, liable to VAT, it cannot impose, in relation to the right for that taxable person to deduct input tax, additional conditions which may have the effect of rendering that right ineffective for practical purposes."

14. In that case, the supplier was a taxable person but had failed to register as such. The supplier issued invoices but, under national law, these invoices did not give rise to a right to deduction. They did, however, comply with the requirements of what is now Article 178 of the Principal Directive so that there was no question of the effect of what is now Article 180.

The Facts

15. I take the facts from the Decision. It is not always clear when the Tribunal was

reciting evidence or argument and when it was deciding facts. I will indicate areas of uncertainty or contention as I go along. Evidence was given on behalf of the Company by Mr Burkhill (the managing director of the Company) and Mrs Connoll (the bookkeeper) and on behalf of HMRC by Mr Day, the HMRC officer who had dealt with the Company at all material times. The Tribunal found both Mr Burkhill and Mrs Connoll to be honest and straightforward in giving their evidence and had "no reason to suppose that what they both told us was other than the truth". Although the Tribunal did not expressly make a similar finding in relation to Mr Day, it is clear from the Decision that they regarded him, too, as an honest and helpful witness.

16. At material times, the Company carried on business as a scrap metal dealer from premises at 404-416 Effingham Road, Sheffield, S9 3BQ. It was registered for VAT on 1st April 1973. The business generally operated in this way: a supplier would contact the Company by phone and the Company would offer a price for whatever was for sale. The supplier would be asked for its VAT certificate and would be told that the VAT element of the price would be paid by cheque, the ex-tax price being paid in many cases in cash. I do not understand the Tribunal to have found that this occurred on each and every time a particular supplier contacted the Company; rather, it was done on the first occasion, and once the Company had a copy of the certificate, it did not obtain further copies.

17. After receiving a copy of the VAT certificate the Company would phone the local VAT office to check that the certificate was correct. There was no evidence of such calls having been made other than what Mr Burkhill said. It is not clear whether the Tribunal was intending (in [15] of the Decision) to make a finding

that such calls were in fact made and, if so, whether that was in relation to all suppliers, in particular in relation to the four suppliers relevant to the present appeal.

18. The supplier would bring a load of scrap metal. The buckets would be weighed and the weigh bridge record brought to Mr Burkhill while the driver waited for the invoice to be completed and the money paid. The money (cash) and cheque (for the VAT) would usually be handed to the driver in an envelope.

19. Mr Burkhill produced to the Tribunal VAT certificates (dated as indicated below) for the four suppliers:

    a. Chapeltown Engineering Ltd: 14 March 2007.

    b. Fiadem Ltd: 24 October 2007.

    c. North Lincs Drainage Ltd: 30 October 2000.

    d. Tachman UK Ltd: 27 September 2004.

20. The Tribunal was also provided with sample invoices for each supplier together with bank statements showing, for the samples, the debits for the VAT cheques.

21. Mr Burkhill told the Tribunal (which would appear to have accepted his account) that each year the Company sent a list of its current self-billing suppliers over the previous 12 month period. Mrs Connoll confirmed that she sent such lists to HMRC. Mr Burkhill produced a copy of the list sent on 19 November 2011 of 59 suppliers; that list included the names of the four suppliers relevant to the present

appeal. It strikes me as odd that those names should have been on the list given that the Company had ceased to trade with any of them by August 2008: see the Table below.

22. It was common ground between the parties that

    a. For all the periods between 1st March 2006 and 31st August 2008, the Respondent raised, and then relied upon, self-billing invoices as evidence for the deduction of input tax, for purchases of scrap metal from, among others, the four suppliers which I have just identified.

    b. There were no self-billing agreements in place at the material time between the Company and those four suppliers.

23. The disputed assessment concerns the input tax claimed on self-billing invoices in relation to supplies made to the Company by those four suppliers. It relates to the periods 1 March 2006 to 31 August 2008. The Tribunal recorded at [24] of the Decision various dates concerning the four suppliers as appears from the following table: it is clear from the wording of [24] that the Tribunal accepted the evidence of Mr Day, providing this information.

Name	Date of Registration	Date deregistered	Trade with the Company commenced	Trade with the Company ceased
Chapeltown Engineering	01/03/2007	26/11/2007	13/3/2008	29/08/2008

Fiadem	01/03/2005	25/06/2008	17/7/2008	29/08/2008
North Lincs Drainage	01/10/2000	15/05/2006	02/02/2006	28/03/2007
Tachman UK	01/09/2004	14/02/2008	03/02/2007	27/03/2008

24. It appears, therefore, that two of the suppliers had been deregistered before trading with the Company commenced and that the other two suppliers were deregistered after trading with the Company had commenced, but before the transactions which give rise to some of the input tax claimed by the Company. However, it also appears possible that the de-registrations of the suppliers may have been back-dated. This possibility was mentioned at [27] of the Decision where the Tribunal commented on part of Mr Day's evidence. It was apparent from Mr Day's evidence that there was some sort of ongoing investigation generally into the scrap metal trade; he himself had visited on various dates the addresses of each of the four suppliers (not in all cases in relation to the supplies to the Company), the addresses being those shown on the self-billing invoices prepared by the Company. He discovered that none of the companies had in fact traded from the relevant address. The Tribunal said this:

> "27. Mr Day was unable to explain why, when there appeared to be a specific investigation into scrap metal merchants, it had appeared to take so long to deregister the suppliers. He conceded that there would have been some enquiries made and that the deregistration might then have been back-dated. In

those circumstances, he accepted that it might well have been possible for the Company to ring the local VAT office and receive confirmation that the suppliers were still registered."

25. I will return to the question of when the four suppliers were de-registered later.

26. The Tribunal referred to a number of visits to the Company by HMRC officers over the years. I do not see the relevance of any of that save, perhaps, in relation to the Full Premises Visit on 6 March 2007 as to which the Tribunal recorded this:

> "…..there was nothing fundamental outstanding. The company had by that time been trading with North Lincs for over 12 months and had recorded approximately £454,000 of self-billed purchases with VAT of £79,000. The audit report stated that:-
>
> - All input tax claims were traced to supporting evidence for the period 11-06 and 12.06
> - A random sample of self-billed invoices were traced to the self-billing register.
> - That from the books and records examined, the business is credible, and
> - The records of this business are very well kept."

27. Relevant to the present appeal to the Upper Tribunal are a number of letters between HMRC and the Company during the course of 2008 and 2009 which I need to consider. They were considered by the Tribunal in [29] of the Decision.

28. I can start with a letter from Mr Day to the Company dated 22 October 2008 referring to his visit the day before. He referred to the four suppliers shown in the Company's record as having made supplies to the Company. Mr Day considered the invoices to be invalid for the reasons which he set out. Although the Tribunal did not record the detail, it is apparent from the letter that Mr Day relied on a

number of factors. They can be summarised as follows (although not every feature applied in every case):

a. Supplier deregistered (all cases, although not all supplies post-deregistration in some cases).

b. Address on self-billed invoice incorrect: the supplier (other than North Lincs Drainage Ltd) had not, according to Mr Day's enquiries, operated from the address shown. However, even in the case of North Lincs Drainage Ltd, the Tribunal recorded at [26] that Mr Day had subsequently visited the address on the self-billed invoices and discovered that it had not traded from that address.

c. No other documentary evidence provided (*ie* to demonstrate supply made or made by a taxable person).

d. The Company had not visited any of the premises of the supplier (all cases).

e. The goods were not believed by the Company to have been stolen (all cases).

29. In the letter, Mr Day referred the Company to the HMRC guidance "VAT Strategy: Input Tax deduction without a valid VAT invoice Statement of Practice – March 2007". As the Tribunal recorded, Mr Day advised the Company that it should obtain "valid evidence to reclaim the amounts shown in your records" and that "if satisfactory evidence could not be obtained, paragraphs 17 onwards of the

Statement of Practice should be followed" pointing out that "this should be done if you wish HM Revenue & Customs to consider exercising its discretion in allowing your input claims".

30. Paragraphs 17 and onwards of the Statement of Practice explained how HMRC would exercise their discretion where a taxpayer held an invalid invoice. In the present case, the Company

> "would need to be able to answer most of the questions at Appendix 2 satisfactorily. In most cases, this will be little more than providing alternative evidence to show that the supply of goods or services has been made (this has always been HMRC's policy)."

31. There are 6 questions set out in Appendix 2. I do not propose to set them out verbatim. The list is expressed not to be exhaustive; additional questions might be asked in individual cases. It is clear that Mr Day did not regard the information which he did have on 22 October 2008 as providing answers to those questions; the Tribunal did not suggest otherwise and for my part I think it is clear that he was entitled to take the view which he did. Mr Day allowed the Company 21 days for such information to be provided.

32. Mr Day also drew attention in his letter dated 22 October 2008 to the fact that the Company had not followed self-billing procedures in obtaining self-billing agreements for its suppliers. The Tribunal did not comment on this. It is clear that the Company did not in fact enter into any self-billing agreements and thus failed to satisfy the statutory requirements for self-billing: see paragraph 5 above. It is not entirely clear whether this reference to self-billing, appearing at the end of the letter, formed part of Mr Day's reasons for considering the invoices to be invalid. The Tribunal did not express a view about this either.

33. Paragraph 5 of the Statement of Practice appeared in a section headed "The 'right to deduct' principles". It stated that a business has incurred input tax if the following conditions are met:

    a. there has actually been a supply of goods or services;

    b. that supply takes place in the UK;

    c. it is taxable at a positive rate of VAT;

    d. the supplier is a taxable person, *ie* someone either registered for VAT in the UK, or required to be registered;

    e. the supply is made to the person claiming the deduction; and

    f. the recipient is a taxable person at the time the tax was incurred.

34. The Tribunal recorded that Mr Day was referred in cross-examination to paragraph 5 and asked if the Company had met all of the conditions referred to. His reply was that all the conditions had been met. The Decision does not record any more detail than that about this line of questioning. In context, however, I think that the Tribunal saw Mr Day as accepting that, in relation to each and every one of the invalid invoices giving rise to the Company's claim to deduct input tax in respect of supplies by the four suppliers, the relevant supplier was, at the time of each supply, a taxable person.

35. Given that each supplier had been deregistered either before the first supply by it to the Company or during the period of such supplies, I do not understand how Mr

Day's answer can be rendered consistent with the fact of deregistration. If a supplier is a taxable person, it is obliged to be registered. It may be in default in applying for registration and various consequences will flow from that. But if a person is already registered, I am unclear what power HMRC has to deregister it unless HMRC consider that that person has ceased to be a taxable person. This may explain why Mr Mandalia, who appears for HMRC, told me that HMRC do not now accept that any of the suppliers was a taxable person after deregistration and say that Mr Day was therefore wrong to accept that all of the conditions of paragraph 5 were satisfied. The first time this was asserted on behalf of HMRC was, however, at the hearing before me: up until then, there had been no suggestion that the four suppliers were not taxable persons. The Tribunal made no express finding about this, no doubt because it had never been suggested that the four suppliers were not taxable persons. It is not a matter on which I have sufficient evidence to make any finding of fact, although if it is the case that the supplies in relation to which input tax is now claimed as a deduction were in fact made by the four suppliers as the invoices would suggest, the level of supply would suggest that the suppliers' turnovers were above the registration threshold and that they ought therefore to have been registered.

36. On 13 November 2011, Mr Day wrote to Mr Housley. He referred to a VAT visit on 6 March 2007 which had been relied on by Mr Housley. He wrote:

> "The fact that the issues I have raised were not highlighted during an earlier visit is not a guarantee that HM Revenue & Customs was satisfied with your input claims. A VAT inspection is not an audit of all aspects of your business; a VAT inspector often selects specific areas for analysis."

Under the heading "VAT Certificates", he wrote:

> "If you are able to provide any further evidence to support your input tax claims, I will allow until 04/12/2008 for this information to be received".

37. On 18 March 2009, Mr Day wrote to the Company following some correspondence over the previous months which I do not need to go into. Mr Day reiterated his conclusion that the relevant invoices were invalid for the reasons which he had previously given and which I have summarised above. He stated that he had attempted to visit the premises relevant to North Lincs Drainage Ltd and Tachman UK Ltd, concluding that they did not operate from the address shown on the self-billed invoice. Mr Day was clearly alive to the existence of the discretion for HMRC to allow deduction notwithstanding the absence of an invoice. He wrote, clearly with the Statement of Practice in mind:

> "You have had the opportunity to provide further information which might permit me to exercise discretion in allowing these claims.
>
> In final conclusion, I do not consider that I can exercise discretion and will therefore be issuing an assessment……".

38. A formal assessment followed in due course on 25 March 2009.

39. Whether Mr Day acted in a way which is not open to challenge is something I will need to look at later. But what is apparent from this letter is that he was aware that HMRC had a discretion and that he decided that it should not be exercised in the Company's favour. He was not, at this stage, suggesting that, because there were no self-billing agreements, a necessary pre-condition for the exercise of the discretion had not been fulfilled so that there was, as yet, no discretion for him to exercise. Rather, he was saying that he had requested further evidence which would justify the exercise of the discretion but none had been provided. I reject Mr Thomas' submission that Mr Day failed, at this stage, to consider on behalf of

HMRC the exercise of the discretion vested in them: he did consider it, but decided on his view of the merits not to exercise it.

40. It should, however, be noted that, on any view, some trades with North Lincs Drainage Ltd and Tachman UK Ltd were effected at a time when the supplier was still registered for VAT. It is not clear that Mr Day took that into account when refusing to exercise the discretion altogether including in relation to periods when the supplier was in fact still registered.

41. On 8 May 2009 (some weeks after the assessment had been issued), the Company's accountants, Hart Shaw, wrote to HMRC expressing their disagreement with the decision (presumably a reference to the non-exercise of the discretion in the Company's favour and/or the making of the assessment) and asking for a review of the case by an independent officer. They wrote that "Our reasons for this appeal are as follows" and there followed 7 numbered paragraphs, the first 6 with their own headings. It is not at all clear what the actual reasons for the appeal were although the Tribunal attempted a summary at the last bullet point in [29] of the Decision. I think it helpful to provide a summary of the 7 paragraphs under each heading:

    a. Basis of assessment:

        Hart Shaw stated that HMRC were maintaining that the self-billing invoices were invalid because (i) there was no self-billing agreement and (ii) the Company did not obtain additional documentary evidence as to the "creditability" of the suppliers.

b. Self billing: it was accepted that there were no self-billing agreements in place but it was noted that self-billed invoices had been consistently used. It is not clear whether this was a reference to the four suppliers or to suppliers generally. Reference was made to the numerous inspection visits over the years and to correspondence about self-billing arrangements (although the most recent letter referred to was as long ago as March 1998 with no mention being made of the introduction of the requirement for there to be a self-billing agreement in 2003).

c. Additional information: the Company had relied on suppliers lists and VAT registration numbers/certificates.

d. Suppliers lists: lists had been sent regularly to HMRC for checking and approval. Reference was made to letters showing that lists were issued by the Company but those were as long ago as 1996 and 1998.

e. VAT registration numbers/certificates: the Company had always maintained a suppliers register which included details of VAT registration numbers and copy certificates. The register had been regularly reviewed/checked during HMRC inspection visits. There was never an indication that there was any weakness in the accountancy/compliance system.

f. Application of Disallowed Input VAT: the 6th paragraph rehearses the trading dates with each of the four suppliers and the fact of their de-registration. In relation to Tachman UK Ltd, it was pointed out that the majority of the invoices were created whilst it was still registered.

Referring to further checks which had been carried out in relation to North Lincs Drainage Ltd and Tachman UK Ltd when they were registered it was stated "then this would have been an over-riding factor in treating the supplier as credible".

g. The 7th paragraph refers to the regular HMRC inspections of the Company's financial records and business activities. It was asserted that from the information contained in electronic records provided in relation to the previous 3 years and from correspondence,

> "it is obvious that HMRC have a detailed knowledge of our client's financial systems. In all of the above, there is a consistent reference to self-billing, but at no point over a 35 year period have HMRC communicated any weakness in this system, until October 2008."

42. The requested review was carried out by Mrs Thomas who wrote to Hart Shaw with her conclusions on 2 June 2009. She set out the relevant parts of the Statement of Practice and referred to a number of tribunal decisions to show that the absence of a self-billing agreement resulted in the purported invoices being invalid. She concluded:

> "In view of the above, I agree that [Mr Day] was correct in disallowing this input tax and raising the assessment on 25 March 2009…."

43. It is apparent from her letter that Mrs Thomas based her conclusion on the absence of a self-billing agreement. It was on that basis that she concluded that the self-billed invoices were invalid. She was correct to reach that conclusion. But what she did not do – at least, her letter makes no mention of it – was to go on to the next stage and ask herself whether the discretion to allow the input tax deduction should be exercised. Mr Day had declined to exercise that discretion in

the Company's favour, as I have explained, but Mrs Thomas did not express a view one way or the other. If by referring to the invalidity of the invoices Mrs Thomas was intending to indicate that, quite apart from the formal invalidity of the invoices, the discretion to allow deduction of input tax was not to be exercised in favour of the Company, she did not give any reason for such a refusal other than the absence of a self-billing agreement.

44. Hart Shaw responded on 25 June 2009. They asked Mrs Thomas to reconsider her decision. In a lengthy letter, they raised a number of issues which were relevant to the exercise of the discretion, repeating matters which had already been raised with Mr Day. In particular, they noted that North Lincs Drainage Ltd must have been deregistered at the time of a compliance visit on 6 March 2007, noting that this was not drawn to the attention of the Company at the time of the visit. They consider this to be an important point because, if the supplier had been identified as deregistered, the Company would have been made aware of potential fraud emerging in the scrap metal market thus limiting its financial risk. They also drew attention to the fact that two of the suppliers were in fact registered when some of the trades were entered into. They identified evidence of supplies having taken place. This is the evidence recited in the last bullet point of [29] of the Decision:

    a. financial accounts and gross returns of the Company;

    b. cash book records;

    c. bank accounts details;

    d. weigh tickets and self-billing invoices;

e. suppliers register; and

f. the regular compliance visits by HMRC.

The Tribunal noted that Mr Day confirmed in cross-examination that he had seen all of these documents.

45. Hart Shaw enclosed with their letter a set of answers to the standard questions set out in Appendix 2 to the Statement of Practice.

46. Mrs Thomas replied to that letter, informing Hart Shaw that there was no mechanism for a reviewing officer to undertake a further review. New or further information should be referred to the original decision maker.

47. Hart Shaw duly wrote to Mr Day on 10 July 2009. Their letter repeated much of the contents of the letter which they had written to Mrs Thomas following her review and attached the same sheet of answers under Appendix 2 to the Statement of Practice. As to that, they described their letter to Mrs Thomas as "providing new information and suggesting areas that had not been considered as part of the review". That appears to me to be an acknowledgment that they had provided further information such as Mr Day had requested in his letter of 22 October 2008 but which was not in his possession at the time of his original decision not to exercise the discretion.

48. Mr Day replied on 17 July 2009 in response, as he put it, to the request that he reconsider his decision. I should here set out what the Tribunal had to say about this letter (the relevant passages of the letter appearing in what the Tribunal said):

"29…….

There was some ambivalence expressed by Mr Day as to his view of the exercise of HMRC's discretion. In his letter of 17 July 2009 addressed to Hart Shaw Mr Day wrote:

> 'I consider that had self-billing been in place that you may be in a position to contend that HMRC should exercise its discretion in allowing the input claims for the two suppliers for some of their trading period with G B Housley Ltd'.

On page 2 of the letter he added

> 'You asked me to consider the HMRC Statement of Practice (Input Tax Deduction) and mentioned a significant volume of goods purchased over a period of 2 years and 7 months. I have not disputed the existence of the goods supplied and accept that your client purchased the goods in connection with the making of his taxable supplies. I accept that all the conditions (para 5- a to g) (see above) have been met.
>
> I have read the complete appendix 2 and consider, that despite the inadequacy in your clients' self-billing system, the information is insufficient for HMRC to exercise discretion.
>
> Further, it should be noted that input tax deduction has been disallowed as your client failed to correctly operate the self-billing procedure. Consequently it would be inappropriate for HMRC to consider applying its discretion under the Statement of Practice'.

31. Mr Day indicated at the hearing, and in correspondence with Hart Shaw, that he would have considered exercising the discretion, but that the Company had failed to produce any further information in spite of saying that it was in possession of the information. Hart Shaw had indicted that they could produce all the appropriate evidence, but that it would be a mammoth task.

32. Mr Mandalia asked Mr Day in re-examining to confirm whether he had received any further evidence at all and Mr Day said he had not. We have concluded from the evidence that Mr Day had seen most of the documentation on his visits but that he had not had any evidence specifically sent to him for the purposes of this appeal. Mr Edwards [who appeared for the Company] commented that the omission to provide further evidence was because Mr Day had made it clear, that as there was no self-billing agreement, that HMRC could not consider an application for discretion and that there was therefore little point in going to the trouble of producing it. We are also satisfied that Mr Day did not consider exercising the discretion because he considered all of the appeal invoices were invalid because no self- billing agreement was in place."

49. The paragraph immediately before the one first quoted by the Tribunal read as follows:

> "I have examined correspondence between you and Mrs Thomas … and consider that the issue of correct self-billing procedure is central to this case; I also take account of your acknowledgement that as there were no self-billing agreements in place that the VAT invoices are annulled."

50. Reading the first paragraph quoted by the Tribunal in the context of the preceding paragraph which I have just quoted, it is apparent that Mr Day regarded non-registration as an important matter: if there had been self-billing agreements in place, then the Company might have been able to contend that the input tax claims in respect of trades while the suppliers were registered should be allowed. The implication of that, it seems to me, is that the Company would not have been able to make such a contention in relation to trades after deregistration.

51. The Tribunal did not refer to a passage of the letter a little further on:

> "Had self billing agreement been set up (particularly in the cases of North Lincs Drainage Limited and Tachman UK Limited) then your client could, to some extent, have relied on the suppliers' responsibility in informing your client of his VAT registration cessation.
>
> I conclude that as the conditions were not met, the input tax is not recoverable."

52. It seems to me to be clear from those paragraphs that Mr Day, who had by then discussed the matter with his colleagues, was taking the view that the discretion could not be exercised because there were no self-billing agreements in place. This is confirmed by the passage quoted by the Tribunal: "Consequently it would be inappropriate for HMRC to consider applying its discretion under the Statement of Practice". It is perhaps not entirely clear whether he was saying that

a pre-condition for the exercise of the discretion had not arisen because there were no self-billing agreements or that the absence of such agreements was a compelling reason, on the facts overall, for refusing actually to exercise it in favour of the Company. There may have been a lack of clarity of expression or thinking or both, although it should be noted that, if Mr Day's view was that a pre-condition had not been met, it would be hard to see how he could have allowed input tax to be deducted in respect of trades with registered traders in the absence of self-billing agreements with them.

The Tribunal's decision

53. The Tribunal allowed the Company's appeal. It is to be noted that Mr Mandalia had submitted that the Company's case was untenable because, as it had not had self-billing agreements in place, Regulation 29 (2) could not be called in aid. That, as a matter of law, was held to be wrong. Clearly, the Tribunal was correct in rejecting the submission: the discretion under Rule 29(2) is capable of exercise in appropriate cases. The Tribunal stated that Mr Day was also of the opinion that Rule 29(2) could not be invoked because there were no self-billing agreements in place. Although Mr Day did not refer in his letters to Rule 29(2), I agree with the Tribunal's conclusion. The proper reading of his letter dated 17 July 2009 is that the discretion to allow deduction of input tax was not available in the absence of self-billing agreements. The fact that Mr Mandalia was able to make the submission which he did indicates that that was HMRC's view, making it unsurprising that, after consultation with colleagues, Mr Day took the same approach.

54. Although the Decision does address (see most parts of [49] to [58]) the exercise of the discretion on its merits, the analysis is not, in all respects, satisfactory. For instance,

    a. There is no finding that the deregistration was backdated; all the Tribunal said was that the dates for the deregistrations "may have been back-dated". There is no indication of the extent of the backdating which there may have been.

    b. The Tribunal held that Mr Burkhill spoke to the local VAT Office which confirmed the registration. There is no finding and, so far as I am aware, there was no evidence about when Mr Burkhill spoke to the VAT Office in relation to each of the four suppliers. In relation to North Lincs Drainage and Tachman UK, it is likely that this was before deregistration took place since Mr Housley's evidence (see [15] of the Decision) was that the call to the Office was made after receiving a copy of the VAT certificate, which would have been (see [14] of the Decision) before the first supply was made and paid for. In any case, so far as I can see, Mr Burkhill's evidence, as recorded in [15] was that the phone call was to check that "the certificate was correct". There is no finding about what was said during the phone call and nothing to show that confirmation was sought that the registration was still in place rather than that the certificate was correct historically.

    c. The Tribunal referred to *Dankowski* and to the passage on which Mr Thomas relied. At [50] of the Decision the Tribunal found as a fact that

the local VAT office had advised the Company that the VAT registrations were correct and then went on to say that

> "in the light of *Boguslaw Juliusz Dankowski* there was no prospect, on that basis, of HMRC establishing that the invoices were invalid."

As to that, the invoices clearly were invalid, there being no self-billing agreement and this is so regardless of whether the VAT registrations were correct. Presumably what the Tribunal meant was that there was no prospect, in the light of *Dankowski*, that it would be proper for HMRC to refuse to exercise its discretion; but that conclusion does not follow since, as I have pointed out, *Dankowski* was concerned with invoices which did comply with what is now Article 178 of the Principal Directive. I will return to this aspect later.

d. At [53], the Tribunal referred to Regulations 13 and 14. A self-billed invoice had to comply with the requirements of Regulation 14 and in addition to be backed up by a self-billing agreement. As was correctly observed, if the invoice is non-compliant, HMRC has a discretion under Regulation 29(2) so that the absence of a self-billing agreement is not fatal. Next, at [55] (there is no [54]), the Tribunal said "We fail to see how an invoice, which is otherwise compliant, cannot be considered an invoice". These paragraphs taken together appear to be suggesting that, if the only non-compliance with the statutory requirement is the absence of a self-billing agreement, then the taxpayer is entitled nonetheless to deduct. If that is what is being said, it is clearly wrong since, if it were right, it would make the requirement to have a self-billing agreement otiose. But if

that is not what is being said, it is not at all clear what the Tribunal was intending to say when it said that it failed to see how an invoice which was otherwise compliant cannot be considered an invoice. In any case, the question whether a non-compliant invoice can be treated as an invoice does not arise. The question, rather, is what evidence HMRC can reasonably expect to be provided with before exercising its discretion under Regulation 29(2).

e. As to that, it does not follow from the (correct) conclusion that HMRC has a discretion to allow deduction of input tax where there has been a failure to comply with the statutory requirements, that there is sufficient evidence for the purposes of Regulation 29(2) to make it unreasonable for HMRC to refuse to exercise the discretion in favour of the taxpayer whenever an invoice would be compliant if there had been a self-billing agreement. An invoice which does not comply with the statutory requirements is not of itself evidence of a taxable supply.

f. Further, for an invoice to be fully compliant, it has to satisfy the conditions of Regulation 14. One of those conditions is that the invoice states the name, address and registration number of the supplier. Once the supplier had been deregistered, this requirement could not be complied with since it would not have a registration number. It does not appear to me to be correct, subject to the back-dating point, for the Tribunal to have held, as it did at [52] of the Decision, that there was no error on the face of the invoices at least in respect of periods after deregistration. It was also wrong, for the same reason, to say, as the Tribunal does say in [56], that

Mr Day could not deny the validity of the invoices other than for lack of a self-billing invoice.

g. At [56] of the Decision the Tribunal, referred to Rule 29(2) and the proviso. It stated:

> "There is no doubt that the company held such other evidence of the charge to VAT. HMRC was fully aware that the Company was self-billing as evidenced by the many visits and the notes arising there from. Further, Mr Day conceded that he had seen most of the necessary documents. In fact, he can not deny the validity of the invoices, other than for the lack of the self-billing agreement, as he appears to have allowed all the other invoices. The invoices contained all the necessary information under regulation 14 and the legislation."

h. It is not clear whether what follows after the first sentence were merely examples of "such other evidence" or whether what follows was intended to be an exhaustive catalogue of that evidence. Since no other evidence is identified, I do not consider that the Company can rely on this finding to uphold the Tribunal's conclusions insofar as it goes beyond what is expressly identified later in [56]. The point is made by Mr Mandalia that, even if the Company had this evidence, it was never supplied to HMRC nor placed before the Tribunal. I accept that point, save to the extent of what is expressly identified later in [56].

i. As to that, the Tribunal noted that HMRC were aware that the Company was self-billing as evidenced by many visits and notes of visits. That is no doubt the case, but I do not see how it is relevant to the proviso to Rule 29(2): it is not, I consider, evidence of the charge to VAT incurred by the Company although it may be a factor to be taken into account in the

exercise of the discretion.

j. The Tribunal appears to be relying on the fact that there were many visits by HMRC to the Company over the years. However, as Mr Day explained to the Company in his letter dated 13 November 2008 (see paragraph 36 above), an inspection is not an audit and it does not follow from the fact of an inspection that HMRC will have learned of facts relevant to the exercise of discretion later on. In any case, Mr Day asked for all relevant further information in his letter dated 22 October 2008, but was not given it before he had decided to raise the assessment. To the extent that it was not supplied, it does not assist the Company to assert that HMRC saw the relevant paperwork on earlier inspections. It is one thing to see documents and to be given information at an inspection visit; it is another to have the documentation and information in hand when it comes to exercising the discretion. In any case, the Tribunal does not identify what facts were established on the visits (other than the fact of self-billing) as evidence of the charge to VAT referred to in the proviso to Rule 29(2).

k. The Tribunal also stated in [56] that Mr Day conceded that he had seen most of the necessary documents. This concession, it is to be noted, was made during the course of cross-examination. That is not actually quite what he conceded which is more accurately recorded at [30] of the Decision. The concession was that the conditions set out in paragraph 5 of the Practice Statement were satisfied; it was not that he had seen most of the necessary documents. In any case, there is again some lack of clarity in that the Tribunal did not state as of what date the concession was made

or as of what date Mr Day is said to have seen most of the necessary documents. Mr Day is not recorded by the Tribunal as conceding that he accepted at any time before the tribunal hearing that the conditions were fulfilled still less is he to be taken as accepting that he had seen most of the relevant documents at the times when he refused to allow the deduction of the input tax.

55. At [58] of the Decision, the Tribunal rejected HMRC's argument that HMRC's decision would inevitably have been the same because the four suppliers had been deregistered. It decided that the Company was entitled to rely on the advice from the local VAT Office, stating that it was not satisfied that the four suppliers were necessarily deregistered at the time of the phone requests made by the Company.

56. The Tribunal held as follows at [59] of the Decision:

> "We are satisfied that HMRC made no attempt to consider the discretion having decided that the lack of a self-billing agreement was critical. We therefore allow the appeal as HMRC have acted unreasonably in not exercising its discretion and we agree with Mr Edwards' submission that the failure of the officer to consider the discretion renders the assessment invalid *per se*."

57. It is, again, not entirely clear precisely what the Tribunal was saying here. The paragraph, which contains the central conclusion, starts with a holding that HMRC did not consider the exercise of the discretion, having made an (incorrect) decision about the consequence of the absence of a self-billing agreement. It was this central finding that vitiated the decision not to exercise the discretion in favour of the Company so that the Tribunal "therefore" allowed the appeal. And so too, it was the failure to consider the discretion which rendered, in the Tribunal's view, the assessment invalid *per se*.

58. But what then of the words "as HMRC have acted unreasonably in not exercising its discretion"? On one view, the Tribunal is simply saying that, in failing to consider the exercise of its discretion, HMRC were acting unreasonably; the Tribunal was reflecting the language of the authorities which show the need to demonstrate unreasonable conduct on the part of a decision maker when it comes to challenging the decision. Thus in the present case it was necessary to show that Mr Day was acting unreasonably in refusing to consider the exercise of his discretion. In effect, "in not exercising" means "in not considering whether or not to exercise". On another view, the Tribunal was actually saying that, if Mr Day had considered whether or not to exercise the discretion and had decided not to do so on the merits of the case, he would have been acting unreasonably. But on its own finding that Mr Day had not considered the exercise of the discretion, so this latter view cannot be right.

The arguments and discussion

59. In the light of what I have said so far, I can take the arguments on the appeal comparatively swiftly. But before I address them, I must say something about what decision was being challenged. Mr Day made two relevant decisions. The first appears from his letter dated 18 March 2009 which resulted in the assessment. For the reasons which I have already given, I am of the view that that decision was not based on the proposition that it was simply not open to him to exercise the discretion in the absence of self-billing agreements. Rather, it was a decision not to exercise the discretion in favour of the Company in relation to which no doubt the absence of self-billing agreements was a factor (properly I might add) taken into account. The second exercise of discretion appears from Mr

Day's letter dated 19 July 2009 when he reconsidered his decision in the light of Hart Shaw's letter, concluding that input tax was not recoverable, essentially because self-billing agreements were not in place. The Tribunal's focus was on the second exercise of the discretion; it does not appear to have addressed whether, on the first occasion, Mr Day exercised the discretion or whether, on information which he then had, he acted unreasonably.

60. It has not been suggested that Mr Day did not have power to reconsider the exercise of the discretion and I proceed on the basis that he could do so. But here it is necessary to draw some distinctions. Mr Day might have taken any one of the following courses:

    a. He might have refused to reconsider the case, taking the view that he had made a decision on the information before him in March 2009 after having given the Company the opportunity to comply with the Statement of Practice. A challenge to that refusal could be made but it is not entirely clear whether it should be by way of judicial review or whether it should be by way of appeal against the assessment. I add that the exercise of the discretion in March by refusing to allow the deduction of input tax would remain a matter open to appeal on a challenge to the assessment. But the merits of that appeal would turn on the reasonableness or otherwise of Mr Day's exercise of the discretion on the information available to him.

    b. He could do what he actually did, which was to reconsider the matter. Having decided to reconsider the matter, it would not be open to HMRC (and they have not sought to do so) to argue that it would have been

reasonable not to reconsider the matter (leaving the Company to an appeal against the original decision) and that, therefore, an incorrect decision on that reconsideration can be ignored. Instead, it was correct, in my view, for the Tribunal to consider whether Mr Day had acted unreasonably in relation to the exercise of the power under Rule 29(2) in refusing to allow the deduction of input tax in July 2009.

61. There are three grounds of appeal as set out in Mr Mandalia's skeleton argument. They are formulated slightly differently from the formal Grounds of Appeal. Both he and Mr Thomas have addressed the arguments as formulated in the skeleton argument. The three grounds are these:

    a. The Tribunal erred in law in its decision to "allow the appeal as HMRC have acted unreasonably in not exercising its discretion….rendering the assessment invalid per se".

    b. The decision of the Tribunal that "HMRC made no attempt to consider the discretion, having decided that the lack of a self-billing agreement was critical" and that the Commissioners have acted "unreasonably in not exercising their discretion" is perverse, unsupported and against the weight of the evidence;

    c. It was not open to the Tribunal upon the evidence before it, or on the primary facts found by the Tribunal, to reject the proposition that HMRC's decision would inevitably have been the same had they reasonably exercised their discretion.

62. These grounds are all closely related; I propose to consider them all together.

63. For reasons which I have already given, I consider that Mr Day did exercise a discretion when he refused to allow the deduction of input tax in March 2009. He was, I consider, clearly addressing the facts and making a decision on the merits. He did not, at that stage, take the view that no occasion for consideration of the exercise of the discretion had arisen. It might be said that he exercised his discretion unreasonably, but that is far from clear given the evidence which he had at the time (in contrast with what is, or might be made, available today).

64. Mr Mandalia submits that HMRC did exercise their discretion. For reasons already given, I agree that Mr Day did so in March 2009. But the submission goes, too, to the events in July 2009. In support of his contention, he notes that supplies by other suppliers without self-billing arrangements were accepted so that HMRC must have exercised a discretion in relation to them. That may be true; but even if it is, it does not follow that Mr Day exercised any discretion in relation to the four deregistered suppliers. Indeed, the submission is contrary to the finding of the Tribunal in [59] of the Decision.

65. In my judgment, it is not right for me to interfere with the Tribunal's finding that Mr Day made no attempt to consider the exercise of the discretion (*ie* under Regulation 29(2)) when he came to reconsider his decision in July 2009. I have already addressed at length the correspondence and other material which justifies that decision. But even if he did consider the exercise of the discretion, it is clear that his refusal to exercise it in the Company's favour was based almost entirely on the absence of any self-billing agreement. Although Mr Mandalia now seeks

to draw the distinction between a case where the trader is registered and one where he is not, that was not a distinction much relied on by Mr Day in July 2009 or indeed by Mr Mandalia before the Tribunal. At best from HMRC's point of view, too much weight has been placed on the absence of any self-billing agreement. No apparent weight has been attached to the other factors on which the Company has relied; that may be justifiable on the basis of a lack of evidence. This is a matter which I will come back too later in the context of HMRC's submission that their decision would have been exactly the same even if they had exercised this discretion properly.

66. It follows from what I have said that the discretion must be exercised afresh unless either (i) HMRC can demonstrate that their decision would inevitably have been the same in July 2009, when Mr Day refused to allow the deduction of input tax, had he applied the correct principles or (ii) the Company can demonstrate that no reasonable body of Commissioners could conclude other than that deduction of the input tax should be allowed. In relation to (i), I say July 2009 rather than any later date because that is the date as of which it is being asked whether the exercise of the discretion would have been the same. In contrast, if HMRC are now to exercise their discretion afresh, it should be exercised on the basis of all of the material provided to them by the time of the exercise of the discretion.

67. As to (i), it is, in my judgment, far from clear to me that, if this matter were to be reconsidered by HMRC, their decision would necessarily be to refuse to allow the deduction of the input tax. If nothing else, the appeal to the First-tier Tribunal and now to the Upper Tribunal has clarified factors which should play a part in the decision-making process and has identified factual areas where further elucidation

may be necessary, in particular in relation to the back-dating of the deregistrations before a decision is made.

68. As to (ii), it is, in my judgment, also far from clear to me that the only reasonable decision which HMRC could make would be to allow the deduction of the input tax. I do not consider that the findings of the Tribunal compel them to make such a decision. In the first place, given the decision of the Tribunal that HMRC had not even considered the exercise of their discretion, many of their findings were unnecessary to their decision and may simply be *obiter*. But that point apart, I have identified at paragraph 54 above a number of unsatisfactory aspects of the Decision. I do not consider that the Decision can be taken as making clear findings which bind HMRC when it comes, if it comes, to considering how to exercise their discretion.

69. Quite apart from that, it seems to me that the Tribunal approached the whole question of reasonableness in the light of their reading of *Dankowski* so that, provided that HMRC were satisfied that input tax had been paid to a taxable person, they should allow deduction. *Dankowski* is a decision to the effect that a Member State cannot impose extra conditions over and above those laid down in the relevant Directive for the deductibility of input tax which would render the right given by the Directive ineffective for practical purposes. But where the Directive itself lays down conditions for deductibility, the issue is different. The Directive itself gives no right to deduction when those conditions are not fulfilled. Instead, Member States are permitted to determine the conditions and procedures under which deduction is permissible where deduction is not in conformity with the express provisions of the Directive: see Article 18(3) of the Sixth Directive

and Article 180 of the Principal Directive. The right to deduct in accordance with the relevant Directive is one thing: national legislation cannot be allowed to stand if it would, for practical purposes, render that right ineffective (save in special cases, such as the prevention of fraud in a proportionate manner). But where the relevant Directive itself lays down conditions under which that right can be exercised, it would not, in my view, be right to conclude that national legislation or administrative practice (justified by reference to what it now Article 180 of the Principal Directive) must always allow that right to be exercised notwithstanding non-compliance with the conditions but subject only to the same exceptions as would justify a derogation from the right to deduct.

70. No doubt, in laying down its national procedures, a Member State should take account of the fundamental principles of the EU VAT legislation but the Member State is not thereby compelled to adopt a system under which a taxpayer is to have a right to deduct whenever he can prove that he has paid input tax in relation to a supply by a taxable person.

71. I do not doubt that the scheme of the UK self-billing legislation, and in particular the provisions of Regulations 13 and 14, is compliant with EU law in that it does not impose disproportionate requirements as to the conditions to be met to obtain a deduction in the absence of a valid invoice. In particular, the proviso to Regulation 29(2) provides a mechanism to ensure that, in appropriate cases, a deduction can be obtained notwithstanding non-compliance with the statutory conditions. In exercising their discretion, HMRC are permitted, in my view, to take a wider view of the purpose of the discretion than simply giving effect, so far as possible, to the fundamental principle that a taxable person has a right to deduct

input tax in respect of supplies from another taxable person. As the Tribunal has observed in *UDL Construction PLC v CCER* [195] V&DR 396, the self-billing system can be seen "as a gross violation of the integrity of the VAT system. ….. It goes without saying that such a dangerous procedure should be strictly controlled and policed." In my view, HMRC is entitled to take account of that when considering whether to exercise its discretion under Regulation 29(2). In that context, it will be permissible to take into account, among other matters, (i) the consequences (and the dangers) of there being no self-billing agreement and (ii) the fact of deregistration (with a more thorough assessment of when the deregistration took place); and in relation to that, it may be relevant to bear in mind that had there been any self-billing agreement in place with any of the four suppliers, such an agreement would be treated as terminated on deregistration.

72. There is one other point which I need to come back to. It relates to Mr Day's acceptance that the four suppliers were taxable persons. If and when it comes to a re-exercise of HMRC's discretion, then it will, I consider, be open to HMRC to revisit the question whether the four suppliers were or were not taxable persons; they are not bound by Mr Day's apparent concession and the Tribunal made no finding that they were.

73. It follows from this discussion that the Tribunal were correct to decide that HMRC did not properly exercise their discretion through Mr Day when he refused to allow the deduction of input tax in July 2009. It is not, in my judgment, clear how he would have exercised his discretion had he adopted the correct approach to the exercise of the discretion. Accordingly, the discretion must be exercised afresh, which is a matter for HMRC, not for the First-tier Tribunal or the Upper

Tribunal.

74. It does not necessarily follow from this conclusion that the assessment should be discharged at this stage. Whether the assessment is to be discharged may be a matter of some importance since it has been suggested that HMRC would be out of time to make a new assessment even were they able properly to refuse to exercise their discretion to allow deduction of the input tax. If this case concerned only the exercise (or rather non-exercise) of the discretion in July 2009, there would be some force in the argument that the Company's appeal should be allowed and the assessment therefore be discharged. But it does not concern only that exercise of the discretion. It also concerns the exercise of the discretion in March 2009 following which the assessment was made. The Tribunal has not decided, and I am not in a position to decide – indeed it has not been argued – that the exercise of the refusal to exercise the discretion in March 2009 was invalid. If it was not invalid, then it may well be that the assessment should stand. The basis for that is as follows:

    a. Mr Day validly exercised the discretion n March 2009;

    b. The assessment was therefore validly raised;

    c. HMRC agreed to reconsider the exercise of the discretion but that did not of itself render the assessment a nullity;

    d. If, on reconsideration of the exercise of the discretion, HMRC decide to allow deduction of the input tax, the assessment will be discharged to give effect to that decision;

e. But if, on reconsideration of the exercise of the discretion, HMRC validly decide not to allow deduction, the assessment remains a perfectly valid assessment.

Conclusions

75. I have not heard any argument on this potentially important point. I make no criticism of that since it comes into focus only as result of my decision in relation to the exercise of the discretion. I do not, therefore, propose to decide it in this Decision. For the present, I confine myself to affirming the Tribunal's decision that the failure of HMRC to consider exercising its discretion in July 2009, having embarked upon a review, was not reasonable. But if that is wrong in the sense that Mr Day did exercise the discretion, his decision was nonetheless flawed for the reasons which I have given. HMRC should now exercise, or re-exercise as the case may be, their discretion to determine whether the Company should be allowed to deduct the relevant input tax, in the light of the totality of the evidence available at the time of the exercise of the discretion.

76. A further hearing should be fixed to determine whether or not, in the absence of agreement, the assessment should be discharged. However, that may not be necessary if the Company accepts that HMRC would not be out of time for making a further assessment if they refuse to exercise their discretion in the Company's favour. It may be sensible to await the decision of HMRC on their reconsideration of the exercise of the discretion since, if the decision is to allow the deduction of input tax, a mechanism must be found to ensure that the deduction is recognised which may simply be by discharging the assessment.

Mr Justice Warren
Chamber President

Release Date: 10 July 2014