[2017] UKUT 467 (TCC)

Appeal number: UT/2015/0098

Value Added Tax - Purchase of Apple iPhones by Appellant without receiving VAT invoice - Whether HMRC's refusal to accept other evidence, in the absence of valid VAT invoices, to constitute sufficient evidence of the supply of the phones to the Appellant was reasonable – approach to be adopted by First-tier Tribunal in such appeals – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

SCANDICO LTD **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: MRS JUSTICE ROSE, CHAMBER PRESIDENT
JUDGE CHARLES HELLIER

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 13 October 2017

James Pickup QC instructed by Smith and Williamson, Solicitors for the Appellant

Jessica Simor QC and Howard Watkinson, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

1. This is an appeal against the decision of the First-tier Tribunal (Tax Chamber) (Judge Howard Nowlan and Mrs Sonia Gable) [2015] UKFTT 0036 (TC) dismissing the challenge by the Appellant ('Scandico') to the decision of the Respondents, HMRC, to disallow an input deduction of the VAT paid by Scandico on iPhones it acquired in the United Kingdom and then sold on, mainly to customers elsewhere in Europe.

2. Scandico is a phone trader specialising in acquiring newly issued iPhones in the United Kingdom and selling them to customers in other countries where stocks of that particular model of phone have not yet been released for sale in Apple's retail stores. The policy of Apple is to prevent the sale of phones to traders who might sell them on in this way. Apple therefore generally refuses to sell phones through its ordinary retail stores to phone traders and limits the number of phones that any single person can purchase to two phones. Scandico engaged individuals referred to as "runners", provided them with cash and instructed each of them to buy two phones on as many occasions as they could manage. The runners would hand the phones and the till receipts from the Apple store to a 'head' runner who would then pass them to Scandico. The runners were paid a small monthly stipend. The phones commanded a considerable premium in the export markets among those keen to have that model of phone before it was officially released in their territory. Sales of the phones to customers outside the United Kingdom attracted no VAT. There were some sales of phones by Scandico to other UK traders but these were also not subject to VAT because of the operation of the reverse charge mechanism which imposed liability to VAT on the purchaser.

3. Scandico sought to recover the VAT that had been charged on the retail sales by Apple as recorded in the till receipts. Initially HMRC accepted the reclaims for VAT. However, over the months of January and February 2011 approximately 7000 phones were purchased and in the light of this increased turnover HMRC conducted an extended verification. The outcome of the extended verification was recorded in the three decisions challenged by Scandico, set out in three letters from the HMRC Higher Officer, Ms Roberts:

> (1) A letter dated 4 November 2011 in which HMRC informed Scandico that the amount shown as input tax in its VAT return for 1 January 2011 to 31 January 2011 was being amended by being reduced by £292,078.13.
>
> (2) A letter dated 18 May 2012 in which HMRC informed Scandico that the amount shown as input tax in its VAT return for 1 February 2011 to 28 February 2011 was being reduced by £297,874.
>
> (3) A letter dated 30 September 2014 in which HMRC confirmed those reduced amounts.

4. The 4 November letter explained the reason for the amendment as follows. First it explained that a taxable person has the right to deduct the VAT incurred on goods and services if certain conditions are met. These include that there has been an actual supply of goods or services taking place in the United Kingdom; that the supply was

made to the person claiming the deduction; and that the recipient intends to use the goods or services for the purposes of his business. It followed, the letter went on, that input tax may be allowed only where those conditions have been met, whether or not a valid VAT invoice is held. The letter continued:

> "As discussed at my visit to your premises on 10th May 2011, Apple till receipts which you have provided to support the claimed input tax do not constitute proper tax invoices because they do not contain all of the required information, each iPhone purchased is in excess of £250 (inclusive of VAT), which is the limit for which a simplified VAT invoice can be used in relation to [a claim for] input tax deduction; so proper documentary evidence in relation to the supplies is not held by [Scandico]. However, as [Scandico] has not produced any records or documentation that enables HMRC to examine an audit trail to confirm that it had received the taxable supplies as described on the till receipts it has not incurred the right to deduct in the first place."

5. Ms Roberts concluded in her 4 November letter "I would like to point out that I would be happy to consider any further evidence you have in support of the above, should this be made available to me".

6. On 9 November 2011 Scandico lodged an appeal at the First-tier tribunal against the decision contained in the 4 November 2011 letter. In the grounds of appeal Scandico contended that it had produced satisfactory evidence to show that it had received taxable supplies. It had produced invoices together with evidence of payment showing that the products were purchased by its employees. Scandico at that stage also contended that its purchases "were supported by full VAT invoices" but argued in the alternative that HMRC "should have allowed the Appellant the right to deduct on the basis of the invoices which were produced together with the other evidence which the Appellant has produced".

7. Ms Roberts' 18 May 2012 letter was in very similar terms to the 4 November 2011 letter but related to Scandico's February VAT return. Scandico lodged an appeal to the First-tier tribunal against the decision in that letter on 23 May 2012 in the same terms as the earlier appeal.

8. In a letter dated 21 November 2012, Scandico wrote to HMRC asking for clarification of some of the matters included in HMRC's statement of case in response to the notices of appeal. In reply, in their letter dated 14 December 2012, HMRC stated that:

(1) they accepted that the Apple till receipts were evidence of taxable supplies made by a taxable person in the course of a business. But it was not accepted that the receipts constituted sufficient evidence that the supplies were made to Scandico.

(2) HMRC had no reason to doubt that Apple had accounted for the output tax generated by the supplies.

(3) HMRC accepted that the payroll records provided by Scandico were evidence that Scandico employed the runners but this was not evidence that the purchases were made by or on behalf of Scandico.

(4) HMRC accepted that Scandico had provided evidence of the onward supply of the phones.

9. In her 30 September 2014 letter confirming the previous two decisions, Ms Roberts said:

> "Having reviewed the witness statements and other documents supplied I am not satisfied that this is sufficient to provide an audit trail to confirm that [Scandico] had received the taxable supplies as described on the till receipts. Therefore I am still not satisfied that [Scandico] has incurred the right to deduct input tax."

10. Scandico lodged an appeal against that letter on 8 October 2014 in the same terms as the two earlier appeals. All three appeals were consolidated. The appeals are brought under section 83(1)(c) of the Value Added Tax Act 1994 which provides that an appeal shall lie to the tribunal with respect to "the amount of any input tax which may be credited to a person".

The EU and domestic law on evidencing entitlement to input tax credit

11. According to the Sixth VAT Directive (Directive 77/388/EEC of 17 May 1977) the right of a taxpayer to deduct input tax could be exercised by holding a VAT invoice drawn up in accordance with Article 22(3) of that Directive. Article 22(3)(c) conferred on Member States the power to determine the criteria for considering whether a document 'serves as an invoice'. Article 22(8) of the Sixth VAT Directive also provided that Member States could impose other obligations "which they deem necessary for the correct levying and collection of tax and for the prevention of fraud". The power for Member States to specify the contents of a VAT invoice was superseded by the Invoicing Directive (Directive 2001/115 of 20 December 2001) which amended the Sixth VAT Directive to introduce a harmonised list of the particulars that must appear in VAT invoices. That list included the VAT number of the customer and the full name and address of the customer.

12. These provisions of the Sixth VAT Directive as amended by the Invoicing Directive were replaced by the Principal VAT Directive (Directive 2006/112/EC of 28 November 2006) ('PVD'). Under the Chapter headed "Rules Governing the Exercise of the Right of Deduction", Article 178 PVD provided at the relevant time:

> "**Article 178**
>
> In order to exercise the right of deduction, a taxable person must meet the following conditions:

(a) for the purposes of deductions pursuant to Article 168(a), in respect of the supply of goods or services, he must hold an invoice drawn up in accordance with Articles 220 to 236 and Articles 238, 239 and 240;"

13. Article 180 PVD provided that Member States may authorise a taxable person to make a deduction which he has not made in accordance with Article 178. Article 182 provided that Member States shall determine the conditions and detailed rules for applying Article 180.

14. The obligation on suppliers to provide a VAT invoice was imposed by Article 220 PVD and the details of what information must be included in a VAT invoice were set out in Article 226, including the full name and address of the customer and the customer's VAT identification number. It was common ground before us, as it had been before the FTT, that the till receipts given by Apple to the runners did not constitute compliant VAT invoices.

15. So far as the relevant domestic legislation is concerned, input tax in relation to a taxable person is defined by section 24(1) of the Value Added Tax Act 1994 ('VATA') as including VAT on the supply to him of any goods or services, being goods or services used or to be used for the purpose of any business carried on or to be carried on by him. Section 24(6)(a) (as amended) provides for the making of regulations:

"… for VAT on the supply of goods or services to a taxable person … to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents or other information as may be specified in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases."

16. Regulations have been made for this purpose, namely the VAT Regulations 1995 (SI 1995/2518):

(1) Regulation 13 provides that where a registered person makes a taxable supply in the United Kingdom to a taxable person he shall provide that person with a VAT invoice.

(2) Regulation 14 specifies what must be included in a VAT invoice, including the date of issue of the document, the name, address and registration number of the supplier, the name and address of the person to whom the goods or services are supplied, a description sufficient to identify the goods, the rate of VAT and the amount payable excluding VAT and then the total amount of VAT chargeable.

(3) There is a relaxation of the rules stipulating the contents of a VAT invoice in a case where the consideration for a supply does not exceed £250 and the supply is a domestic one. In such a case, the VAT invoice that the registered person is required to provide need only contain a more limited

amount of information which does not include the name and address of the person to whom the goods are supplied: see regulation 16A.

(4) Regulation 29(2) deals with claims for input tax. It provides that at the time of claiming deduction of input tax in a VAT return a person shall, if the claim is in respect of a supply from another taxable person, hold a VAT invoice which is required to be provided under regulation 13.

(5) There is a proviso to regulation 29(2) which allows the deduction of input tax to be made without a VAT invoice:

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

17. Thus, Articles 180 and 182 PVD empower the Member State to allow a deduction of input tax to be made in accordance with conditions set by that Member State and, in the United Kingdom, regulation 29(2) of the VAT Regulations 1995 confers on the Commissioners a discretion in a particular case to direct that a deduction can be made in the absence of a VAT invoice if the taxpayer provides such evidence of the charge to VAT as HMRC may direct.

18. The role of the tribunal on an appeal against a refusal to allow a deduction in circumstances where HMRC has rejected alternative evidence supporting a claim that input tax was incurred was discussed in *Kohanzad v Customs and Excise Commissioners* [1994] STC 967 ('*Kohanzad*'). In that case the Commissioners had conceded before the tribunal that they had a discretion to accept a claim for input tax credit in the absence of VAT invoices. The taxpayer was unable to provide any documentation to support the claim for credit. The taxpayer had produced purchase invoices and contended that in respect of accounting periods before and after those in dispute, the Commissioners had accepted his purchase invoices without question. He submitted that the Commissioners had acted unreasonably in refusing to allow any credit for input tax. An appeal against the decision was dismissed by the VAT Tribunal and the further appeal was also dismissed by Schiemann J sitting in the High Court, Crown Office List. Schiemann J held that the effect of the provision in the VAT Regulations 1985 (which was the predecessor to regulation 29(2) of the 1995 Regulations) was that prima facie a registered taxable person is not entitled to any credit in respect of input tax unless at the time of claiming such a credit he holds a tax invoice in relation to that supply. The second effect of the provision was that the Commissioners have a discretion to allow credit for input tax, notwithstanding that the registered taxable person does not hold such a tax invoice. They had exercised that discretion against the taxpayer. The jurisdiction under which the tribunal could review that decision was the provision in the VAT Act 1983 drafted in the same terms as section 83(1)(c) VATA.

19. Schiemann J went on to say:

> "It is established that the tribunal, when it is considering a case where the commissioners have a discretion, exercises a supervisory

> jurisdiction over the exercise by the commissioners of that discretion. It is not an original discretion of the tribunal, it is one where it sees whether the commissioners have exercised their discretion in a defensible manner. That is the accepted law in this branch of the court's jurisdiction, and it has recently been decided that the supervisory jurisdiction is to be exercised in relation to materials which were before the commissioners, rather than in relation to later material."

20. The judge cited a number of cases in support of that principle including *Customs and Exercise Commissioners v Peachtree Enterprises Ltd* [1994] STC 747.

21. More recently the supervisory nature of the tribunal's jurisdiction in these circumstances was reiterated by the Upper Tribunal in *Best Buys Supplies Ltd v HMRC* [2011] UKUT 497 (TCC) ('*Best Buys*'). The Upper Tribunal confirmed the test in *Kohanzad*, stating that although the jurisdiction of the First-tier tribunal was appellate since the appeal was made under section 83(1)(c), the tribunal could not substitute its own decision for that of HMRC but could only decide whether the discretion had been exercised reasonably by HMRC: see paragraph 49 of the judgment in *Best Buys*.

The proceedings before the First-tier Tribunal

22. It is apparent from how this case was presented to and decided by the FTT that despite the decision in *Kohanzad*, a practice has grown up whereby the tribunal seized with an appeal such as this is invited both by HMRC and by the taxpayer to approach its task in two stages. The first stage is for the tribunal to consider whether in fact the taxpayer made taxable supplies. If he did not, then the appeal fails because the exercise of HMRC's discretion whether to accept alternative evidence is irrelevant if there is no entitlement to deduct the input tax. If the tribunal holds that there was a taxable supply then it will go on to consider the second stage, namely whether, nonetheless, HMRC acted reasonably in refusing to accept the alternative evidence. The appeal will fail if the tribunal upholds that exercise of discretion by HMRC, applying the *Kohanzad* test.

23. The hearing before the FTT in this case lasted for four days during which evidence was heard by the FTT from four witnesses, one of whom gave evidence through an interpreter via a video link. At the start of the judgment, after describing the nature of Scandico's business, the FTT referred to the possible application of section 47(2A) VATA. That provides:

> "Where, in the case of any supply of goods … goods are supplied through an agent who acts in his own name, the supply shall be treated both as a supply to the agent and as a supply by the agent."

24. The FTT said:

> "6. The Appellant's initial contentions had been entirely along the lines that HMRC's decision not to accept the alternative evidence of

the claimed supply had been unreasonable. We made it clear at an early point in the hearing, however, that it seemed to us that the simpler basis on which the Appellant appeared to be unable to claim an input deduction was that under section 47(2A) VAT Act 1994 where supplies had been made by Apple to agents for an undisclosed principal, the supplies were deemed for VAT purposes to be by Apple to the individuals who had purchased the iPhones in the Apple stores, with those individuals then being deemed to supply the phones to the Appellant, on whose behalf they had been purchased. … It therefore appeared that since a VAT input deduction could plainly not flow through those deemed transactions involving non-registered individuals, the Appellant's claim had to fail."

25. The FTT therefore considered that the first issue before it was whether section 47(2A) applied because if it did, the appeal should be dismissed because that meant that there was in fact no taxable supply by Apple to Scandico of the iPhones and so no possible claim to deduct VAT.

26. As the point about section 47(2A) was not one on which the parties had focused their submissions, the FTT accepted that it should look more generally at the evidence as to whether there had been a supply of the phones to Scandico:

> "10. Both parties were also agreed that, in addition to our considering the reasonableness of HMRC's three decisions (most obviously the last of the three), we should also decide independently whether we concluded that there had actually been taxable supplies from Apple to the Appellant, as that was a further and separate pre-condition to sustaining an input deduction. In regard to this issue it was accepted by the Respondents that we could and should address this on the basis of all the information, including that that emerged during the hearing and that we were not restricted, in deciding this issue, to pay regard only to the information possessed by HMRC when the various decisions, and in particular the third decision, were made."

27. The FTT clearly felt some unease at the way they were being asked to approach the case by the parties as they said later in the judgment:

> "95. In deference to the request by both parties, we will reach a decision in relation to both the issues that we have indicated, though we actually consider that the question of whether we now conclude, on the basis of all the evidence, that there was a taxable supply, is not particularly relevant to this decision."

28. However, the FTT recorded what Scandico had said about the significance of a finding as to whether there had been a taxable supply:

> “99 … The Appellant’s representative suggested that if we reached this conclusion, the Appellant would be able to revert to HMRC, asking them to reconsider the input deduction issue. That may or may not be so, and is of no concern of ours. The only observations that we would make are that section 47(2A) still appears to bar the entitlement to an input deduction and, quite apart from that, our conclusion on the supply issue does not necessarily mean that it would cease to be reasonable for HMRC to reject the alternative evidence.”

29. On the issue whether there had been a taxable supply to Scandico, the FTT described the evidence that it had heard from Mr Shabbir Dharas the owner of Scandico and some of the runners and head runners. They set out in detail their findings as to how the business operated. The FTT commented (paragraph 43) that there were several features of the administration of the business that they considered had not been convincingly explained to them. The FTT discussed what happened to the phones once they had been collected by the head runners, how and where they were stored and how and where they were sold on either for export or to UK customers. At paragraphs 53 onwards the FTT described the significance of the IMEI numbers, that is the individual number which identifies a particular phone. The IMEI number of each phone was printed on the till receipt and the FTT considered whether and how lists of these numbers were collated by Scandico when the phones were stored in its warehouse.

30. In its reasoning dismissing the appeal, the FTT first concluded that because of the application of section 47(2A) there was no taxable supply and hence no entitlement on the part of Scandico to deduct the input tax. The FTT then considered whether there was a taxable supply to Scandico ignoring section 47(2A) and held that there was. The evidence contained, they said, “a number of troubling oddities” for example that the runners were only paid such a small amount for their work and further, there was a total absence of documentation in relation to very large amounts of cash collected from a money exchange business and then distributed first to the head runners and then to the individual runners - parts of the arrangements operated by Scandico did not really make sense. Despite this, the FTT was still inclined to accept on the balance of probability that the evidence given to them was true because the underlying business model did make sense:

> “111. On balance, therefore, we conclude, and we repeat that we find this conclusion irrelevant, that the iPhones were purchased on behalf of the Appellant as the Appellant contended, through the activity of the runners.”

31. The FTT recognised that the relevant issue for them was whether HMRC’s decision not to accept the Apple store till receipts as evidence of the taxable supplies to Scandico had been unreasonable. The FTT noted that the parties accepted that that issue had to be addressed by looking only at the information that the case officer had before her on the occasion of each of the decisions and not by reference to information that emerged about the nature of the supply during the hearing. The FTT

analysed the decision that the case officer had taken as recorded in the three decision letters:

> "117. The Appellant's representative contended that the case officer's decision had been that there had in fact been no relevant supply. We disagree with that. As she said when questioned during the hearing, she did not reach any decision either to the effect that there had or had not been a taxable supply from Apple to the Appellant. Her decision was essentially in relation to the burden of proof, namely that in the absence of an audit trail, in other words any documentary corroboration whatsoever of the oral claim as to how the phones had been purchased and delivered to Maina [*the freight forwarder*] or the Appellant's warehouse, she was not satisfied that it was appropriate to accept the alternative evidence of the supply."

32. The FTT referred to the authorities that make it clear that there needs to be something quite seriously deficient in the case officer's conclusion before the FTT could decide it was unreasonable; the question was not whether the FTT might have reached a different conclusion.

33. The FTT noted that there was no suggestion there was any fraud against HMRC. On the contrary, Apple had plainly accounted for the VAT and, on the assumption that the phones were either sold to non-UK customers for delivery abroad or that the sales were to domestic customers subject to the reverse charge mechanism, the VAT would ordinarily have been due to be repaid to Scandico. However, the FTT accepted that the case officer was "certainly entitled to be extremely cautious" when considering the alternative evidence put forward by Scandico in the absence of any valid VAT invoices. The FTT described again the oddity of the lack of documentary evidence supporting some of the stages of the arrangements put in place by Scandico and more generally the gaps in the explanation as to how the business operated. They held:

> "129. Our decision is that, when HMRC were considering the adequacy of secondary evidence, and there were all the gaps and uncertainties in the evidence that we have now listed, and no documentary evidence to confirm any audit trail of the goods, we cannot conclude that the case officer's three decisions were in any way unreasonable."

34. Finally, the FTT considered whether section 47(2A) was in conformity with Article 14.2(c) of the PVD. They concluded that if the issue had arisen for decision they would have referred a question to the Court of Justice of the European Union. However, as they had decided that the case officer's refusal to accept the alternative evidence was reasonable, there was no need to resolve the more difficult legal point.

35. The FTT granted permission to appeal in a decision dated 14 July 2015.

The appeal before us

36. There were two points raised in Scandico's amended grounds of appeal. The first was that the FTT had erred in concluding that section 47(2A) applied because, having found that the runners were employees of Scandico (a fact that was not in dispute before it), the FTT could not also find that they were agents for the purposes of section 47(2A).

37. The second ground of appeal was that, having found that there was a supply as contended by Scandico, then, since section 47(2A) does not apply as a matter of law, the FTT should have upheld the appeal. The grounds of appeal assert that since section 83(1)(c) VATA provides a right of appeal in respect of the amount of any input tax which may be credited to a person, "the matter before the FTT was thus the amount (if any) of tax which could be credited or deducted, not the basis on which the decision refusing the input tax deduction claim had been taken by HMRC". Scandico asserted that having appealed HMRC's decision to the FTT, Scandico's inability to establish the supply by reference to VAT invoices had been superseded by the exploration of the issue before the FTT and the FTT's findings of fact on the basis of the evidence before it. Having established that there was a taxable supply on the facts (putting aside the section 47(2A) point), the FTT should have upheld the appeal.

38. In their response to the grounds of appeal, HMRC stated that they do not contest Ground 1. They agree that section 47(2A) does not apply in this case because the runners were employees and could not also be agents for the purposes of that section. However, HMRC contend that the runners were in fact the recipients of the taxable supplies of the iPhones and not Scandico. As to Ground 2, HMRC object to this ground because it involves, they say, a 'complete volte face' by Scandico. HMRC submitted that the appeal had proceeded before the FTT with the agreement of both parties and like similar appeals in the past, on the basis of the two stage approach. That two stage approach involved the tribunal considering whether there was in fact a taxable supply and only if the FTT concluded that there was, then going on to consider whether HMRC had acted reasonably in rejecting alternative evidence. Scandico was now arguing that the first stage was determinative of the appeal whichever way it was decided and not only if the conclusion was that there was no taxable supply.

The correct approach to appeals of this kind

39. The role of the First-tier tribunal is to examine a decision that HMRC have taken and decide whether that decision was right or wrong. Sometimes the test that is applied in examining HMRC's decision is a full merits appeal. Sometimes it is a review as to whether the decision fell within the reasonable bounds of HMRC's discretion. We have considered carefully the precise content of the decision that the case officer made in this case. Mr Pickup argued that the decision letters showed that she had in fact decided that there had been no taxable supply from Apple to Scandico. We do not agree that that is the correct reading of the letters although we accept that the letters could have been better worded to make this clear. We agree with the conclusion arrived at by the FTT in paragraph 117 of its judgment that in this case

HMRC have not taken a decision about whether there was a taxable supply of the phones to Scandico. What the case officer decided is that, in the absence of VAT invoices from Apple to Scandico, there was not enough information provided by Scandico for HMRC to decide whether there has been a taxable supply or not. HMRC has therefore exercised the discretion conferred on it by regulation 29(2) of the VAT Regulations 1995 by declining to direct that the alternative evidence that Scandico provided should be treated as sufficient evidence of the supply of the iPhones to Scandico. That is the decision which has been taken by HMRC and hence it is the decision that can be appealed and it is the decision that the tribunal should address.

40. In these circumstances we firmly disapprove of the two stage approach which the parties in this case encouraged the FTT to adopt and which has, we understand, been adopted in similar cases. We regard the two stage approach as seriously flawed both in juridical and practical terms.

41. Mr Pickup submitted that the fact that the appeal is brought under section 83(1)(c) VATA means that the issue before the tribunal is the broad issue of the amount of input tax which may be credited to Scandico. That, he said, requires or entitles the tribunal to examine all issues which go to that question, including here whether there has in fact been a taxable supply to Scandico. We do not agree. This confusion arises from the fact that the result of HMRC's exercise of discretion in these circumstances is to disallow the deduction. But the refusal to allow a deduction of input tax is the potential result of two different decisions. The first is a decision that for some reason, for example that there has been no taxable supply or that the supply is exempt, the taxpayer is not entitled to input tax credit. The second decision is that HMRC is not satisfied on the evidence presented to it that there has been a taxable supply. Although both kinds of decision lead to the same result - the refusal of input tax deduction – they are different decisions. The fact that the challenge to both kinds of decision comes to the tribunal through section 83(1)(c) VATA does not, in our judgment, expand the jurisdiction of the tribunal to consider a decision that has not in fact been made by HMRC.

42. The practical difficulties that arise from this two stage approach are that the evidence before the tribunal directed at answering the first question may be very different in scope and nature from the evidence that was before the caseworker when the decision was taken. This then puts the tribunal in the uncomfortable position of first considering a larger pool of more up-to-date evidence including the evidence of witnesses who are called to be cross-examined. Then if the tribunal concludes that there has been a taxable supply, it must put out of its mind all that evidence, go back to the evidence that was before the caseworker and consider whether it was reasonable or not for the caseworker to reject the alternative evidence of supply as being insufficient. There was some dispute between the parties in this appeal as to whether there was material before the FTT that had not been placed before the HMRC case officer, at least by the time she took her confirmatory decision in September 2014. In the present case, the FTT did conscientiously turn its mind to the distinction between evidence that had been before the case officer and the evidence given in the hearing. But there is no doubt that the two stage approach generates a perception of unfairness as it has done in the present case where the taxpayer manages to establish

that there was a taxable supply and yet the result of the hearing is that the appeal is dismissed and he is not entitled to make the deduction because the decision of the caseworker is upheld.

43. In appeals of this kind, the First-tier tribunal should address only the decision which is before it, namely HMRC's decision that, in the absence of the VAT receipts, they were not prepared to exercise their discretion to accept the alternative evidence provided by the taxpayer as to whether there had been a taxable supply. The test that the First-tier tribunal applies in reviewing that decision is the test set out in *Kohanzad*.

44. We therefore decline to express any view on whether there was a taxable supply in this case. There has been no decision one way or the other by HMRC and it is not the task of either the First-tier Tribunal or the Upper Tribunal to arrive at a decision on that point, however much the parties may ask it to do so or however useful such a decision would be. The task of the tribunal is not as Mr Pickup variously put it to "fill in the gaps" or "complete the picture" in order to come to a conclusion, for the first time, as to whether all the substantive requirements for deduction are met.

45. Scandico relied on a line of decisions of the European Court which Mr Pickup submitted were authority for the proposition that once all the substantive requirements for the exercise of the right to deduct are met, then there can be no justification for refusing the right to deduct unless there is some suggestion that the transactions are connected to the fraudulent evasion of VAT. Mr Pickup argues that once the tribunal has decided the taxable supply issue in the taxpayer's favour then the question of the reasonableness or unreasonableness of the case officer's decision drops out of the picture.

46. One of the primary authorities on which Scandico relied was Case C-285/11 *Bonik EOOD v Bulgarian Tax Authority* ECLI:EU:C:2012:774. That case concerned a refusal by the Bulgarian tax authority to allow the taxpayer to deduct VAT on supplies of wheat he had acquired. Bonik had in its possession VAT invoices issued to it by its immediate suppliers and relating to the purchases. However, the tax authority decided that it was unable to establish that the taxpayer's suppliers had themselves actually acquired the wheat that they said they had sold on to the taxpayer. The tax authority therefore concluded that no actual supplies had been made to Bonik: see paragraph 15 of the judgment. The Varna Administrative Court held the tax authorities were not entitled to refuse input tax credit on the basis that a preceding supply had not taken place, if there was evidence that Bonik had itself paid input tax on the supplies and then sold the goods on to its own customers. The European Court interpreted the questions referred to it as asking whether the PVD must be interpreted as meaning that a taxable person must not be refused the VAT credit on the grounds that in view of factors relating to transactions upstream of that supply, the supply is considered not actually to have taken place. In its judgment, the Court emphasised that the right to reclaim input tax is a fundamental feature of the VAT system and must not be limited by Member States. The Court held (paragraph 28) that the question whether the VAT payable on the prior or subsequent sales of the goods concerned has or has not been paid to the public purse is irrelevant to the right of the taxable person to deduct input VAT. The relevant issue was thus only whether the

supplies to Bonik had in fact been made and whether Bonik had used them for the purposes of its taxed transactions. This was a question for the national court to assess. No issue arose in relation to the absence of a compliant invoice.

47. We do not see how *Bonik* assists Scandico. Certainly, the Court refers to the overall assessment to be carried out by the national court in order to establish, having regard to all the facts and circumstances of the case, whether Bonik was entitled to deduct the input tax. But those comments were made in the context first of contrasting that role with the role of the European Court which could not carry out such a factual assessment and secondly in the context where there had been a finding by the tax authority that, despite Bonik being able to produce tax invoices, in fact no supply had taken place. We certainly do not read the case as authority for an obligation on the Member States to provide a forum for a full merits assessment of whether a supply has taken place in the absence of any decision on that point by the tax authority, nor as authority for the proposition that once the substantive conditions for deduction have been met, the Member State must permit the exercise of that right even in the absence of a compliant invoice.

48. Mr Pickup also relied on Case C-518/14 *Senatex GmbH v Finanzamt Hannover-Nord* ECLI:EU:C:2016:691. In that case the relevant German legislation provided that a taxpayer could correct or supplement a VAT invoice which contained missing or inaccurate information but also provided that the invoice would only take effect to enable the taxpayer to deduct input VAT in the period in which the corrected invoice was transmitted, not in the period when the original defective invoice was issued. The European Court held that the failure to allow the correction to operate retrospectively was in effect a disproportionate penalty for the failure to comply with formal requirements. This went further than was necessary to ensure the correct collection of VAT and to prevent evasion, the only purposes for which the Member State is entitled under the PVD to impose additional formal requirements. Scandico relied particularly on the comments of Advocate General Bot in his Opinion in *Senatex* where he said that the rules requiring the taxable person to hold an invoice drawn up in accordance with the Directive are described as "formal conditions" by the Court and do not constitute conditions to be fulfilled in order for the right to deduct VAT to arise. The Advocate General said at paragraph 44 that the principle of VAT neutrality requires deduction of input tax to be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements.

49. The European Court in *Senatex* declined to answer an additional question, namely whether national legislation would be compliant with EU law if it withheld the right to deduct VAT where the correction of an invoice took place **after** the tax authority had adopted a decision refusing the deduction VAT. That question did not arise on the facts of that case because the tax authority had agreed to accept the invoice corrections.

50. Again, we do not accept that *Senatex* is relevant to the present appeal – though it might have been if the additional question had been answered. We understand that Scandico went back to Apple to ask for VAT invoices to be provided to it for the phones but that request was refused. The provision of additional, alternative evidence

is not the same as the correction or completion of a VAT invoice. We do not accept that the Advocate General's emphasis on the importance of fiscal neutrality means that the FTT was either required to consider if there had been a taxable supply in this case or to allow Scandico's appeal if it found on the facts that there had been. Nor, even though the Court described the holding of an invoice as a formal rather than a substantive requirement of the right to deduct, does it set at nought a condition for the exercise of that right that in the absence of an invoice the taxpayer must satisfy the national authorities of the existence of the right to deduct.

51. Other cases on which Scandico relies are those where the European Court has considered the extent of the power conferred on the Member States to set criteria for input tax deduction or to impose additional formalities in various situations. These included the following:

(1) Cases 123 & 330/87 *Jeunehomme v Belgium* [1988] ECR 4517 which concerned a reference from a Brussels court of questions raised in proceedings brought by the taxpayer who was a dealer in second-hand cars. It was alleged in those proceedings by the tax authority that the invoices issued by the supplier of certain cars to Ms Jeunehomme were defective in a number of ways. Belgian law stipulated the specific items which must appear on invoices to ensure payment of VAT. Those requirements went beyond what was permitted by Articles 18(1)(a) and Article 22(3)(a) and (b) of the Sixth VAT Directive. The Court held that Member States were able to provide for the inclusion of additional information on the VAT invoice to ensure the correct levying of VAT and to permit supervision by the tax authorities. However, any additional requirements must be limited to what is necessary for those purposes and must not "render the exercise of the right to deduction practically impossible or excessively difficult.".

(2) Case C-85/95 *John Reisdorf v Finanzamt Koln-West* [1996] ECR I-6257 where the Court held that in the absence of specific rules governing proof of the right to deduct input tax, Member States have the power to require production of the original invoice in order to establish that right, as well as the power, where a taxable person no longer holds the original, to admit other evidence that the transaction in respect of which the deduction is claimed actually took place.

(3) Case C-90/02 *Finanzamt Gummersbach v Bockemühl* [2004] ECR I-3303 where the Court held that only Article 18(1)(d) of the Sixth VAT Directive applied to the reverse charge procedure applicable in that case and that the power conferred by that provision on the Member States to add formal requirements could only be exercised in so far as their imposition did not make it practically impossible or excessively difficult to exercise the right to deduct.

(4) Case C-590/13 *Idexx Laboratoires Italia Srl v Agenzia delle Entrate* ECLI:EU:C:2014:2429 where the European Court held that where the tax authority has the information necessary to establish that the substantive requirements have been satisfied, it cannot impose additional conditions which may have the effect of rendering that right ineffective for practical purposes. Similarly, in Case C-110/98 *Gabalfrisa SL and others v Agencia Estatal de*

Administración Tributaria [2000] ECR I-1577 the Court condemned a number of formal hurdles that Spanish legislation had created because they went beyond what was necessary to attain the objectives of ensuring the correct levying and collection of tax and preventing fraud.

(5) Case C-18/13 *Maks Pen EOOD v Direktor na Direktsia* ECLI:EU: C:2014:69 [2014] All ER (D) 226 where the European Court held that if the conditions of entitlement to deduct were fulfilled, the deduction could not in principle be refused. However, it was open to national courts and tax authorities to refuse the deduction if it was shown in the light of objective evidence that the right was being relied on for fraudulent or abusive ends. Further, where new facts relating to the existence of fraud or abuse were relied on for the first time by the tax authorities on an appeal before the national court, the national court could of its own motion investigate the matter if that was how it would deal with an analogous point arising under domestic law.

52. None of these cases assists Scandico in this appeal. They do not say anything about the situation that has arisen here, where the national tax authority does not have sufficient information before it to decide whether the substantive requirements are satisfied. We agree with HMRC's submission that these cases do not undermine the position arrived at in EU law and domestic law that where the taxpayer cannot produce a VAT invoice to support its claim to deduct input tax, the tax authority has a discretion whether to accept alternative evidence as satisfying it that a taxable supply has taken place entitling the taxpayer to the credit. They do not establish the proposition for which Scandico contended, that the only circumstance in which a taxable person can be refused the right of deduction is if he knew or ought to have known that he was participating in an evasion of VAT by the supplier.

53. We do not consider that there is an inconsistency between the obligation on Member States to allow input tax deduction when the substantive requirements have been satisfied on the one hand and the discretion conferred on HMRC by regulation 29(2) to decline to accept alternative evidence in a particular case on the other hand. It is true that the European Court and the Advocates General have emphasised in the cases we have cited that the Member State must not place additional obstacles in the taxpayer's path when the substantive requirements for deduction have been fulfilled. But that discretion on the part of the tax authority where the taxpayer cannot produce a compliant VAT invoice is clearly contemplated by the Directives. Provided that HMRC focus on the relevant question, namely has the taxpayer established that the substantive conditions for deduction are in place, the exercise of that discretion does not, in our judgment, amount to the imposition of an additional formal requirement. In a case where HMRC have taken a decision that they are or are not satisfied, the tribunal will examine that decision and decide whether that decision was reasonable.

54. The most relevant case to which we were referred is the decision of the European Court in Case C-271/12 *Petroma Transport SA and others v Belgium* ECLI:EU:C:2013:297. There the taxpayer had submitted VAT invoices which were incomplete and could not be shown to correspond to actual services. The tax authority therefore disallowed the deductions because the company had failed to comply with the domestic statutory requirements. Subsequently additional information was

provided by the taxpayer but was not accepted by the tax authority as a sufficient basis to allow the deduction of the various VAT amounts. The Court in its judgment reiterated principles that have been set out in many previous cases, some of which we have described earlier; namely that:

5 (i) the right to deduct VAT is a fundamental principle of the common system of VAT which cannot be limited and must be exercised immediately in respect of all the taxes charged on input transactions;

(ii) every taxable person is therefore entitled to deduct the amounts invoiced as VAT for services rendered to him so far as such services are then used for the
10 purposes of his taxable transactions;

(iii) formerly the Sixth VAT Directive and now the PVD provides that the taxable person must hold an invoice drawn up in accordance with the provisions of that Directive;

(iv) although Member States are empowered to impose other obligations which
15 they deem necessary, any such requirements must be limited to what is necessary and must not make the exercise of the right to deduct practically impossible or excessively difficult;

(v) any additional requirements imposed by the Member State must not include conditions relating to the content of invoices beyond those expressly laid down
20 in the PVD.

55. The Court in *Petroma* noted that if incorrect invoices are submitted to the tax authority, they can subsequently be corrected by the taxpayer. If correct invoices are provided before the tax authority concerned has made a decision, the benefit of the right to deduct cannot, in principle, be refused on the ground that the original invoice
25 contained an error. The Court went on:

> "35. However, it must be stated that, with regard to the dispute in the main proceedings, the information necessary to complete and regularise the invoices was submitted after the Tax Authority had adopted its decision to refuse the right to deduct VAT, with the
> 30 result that, before that decision was adopted, the invoices provided to that authority had not yet been rectified to enable it to ensure the correct collection of the VAT and to permit supervision thereof.
>
> 36. Consequently, … the provisions of the Sixth Directive must be interpreted as not precluding national legislation, … under which
> 35 the right to deduct the VAT may be refused to taxable persons who are recipients of services and are in possession of invoices which are incomplete, even if those invoices are supplemented by the provision of information seeking to prove the occurrence, nature and amount of the transactions invoiced after such a refusal decision was
> 40 adopted."

56. In our judgment *Petroma* is authority for the proposition that where the Member State tax authority adopts a decision refusing the right to deduct VAT because the information provided by the taxpayer is incomplete or irregular, the Sixth VAT Directive did not require the tax authority to revisit that decision when further information was provided after the decision has been taken. The position should be no different where the further information is provided to a tribunal in the context of an appeal against the initial refusal. This must apply equally to the PVD as to the Sixth VAT Directive. The fact that the FTT did, despite its misgivings about the relevance of the exercise, actually examine the facts in detail and conclude that there was a supply does not allow Scandico to side step the exercise of HMRC's discretion, or to require that discretion to be exercised by reference to the later information before the FTT.

57. The second question answered by the European Court in *Petroma* is also relevant to this appeal. The national court asked whether, given that the tax authorities had refused to allow the deduction of input tax by the taxpayer who had failed to produce a complete VAT invoice, the Member State was then obliged to refund to the claimant's supplier the VAT that had been accounted for by that supplier. The Court held that the principle of fiscal neutrality did not require such a refund to be made. The Court stated:

> "42 … the exercise of the right to deduct VAT levied on the provisions of services at issue in the main proceedings, to which the recipients of those services would normally have been entitled, was refused due to the absence of certain compulsory particulars on the invoices issued by the service provider.
>
> 43 Since, in the dispute in the main proceedings, it was confirmed that the services subject to VAT were in fact provided, the VAT relating to those transactions was due and was correctly paid to the tax authority. In that context, the principle of fiscal neutrality cannot be invoked to justify the refund of VAT in a situation such as that in the dispute in the main proceedings. Any other interpretation would be liable to encourage situations that may prevent the correct collection of VAT, which Article 22 of the Sixth Directive seeks specifically to avoid.
>
> 44 Therefore, in view of the foregoing, the answer to the second question is that the principle of fiscal neutrality does not preclude the tax authority from refusing to refund the VAT paid by a company providing services, in the case where the exercise of the right to deduct the VAT levied on those services has been denied to the companies receiving those services by reason of the irregularities confirmed in the invoices issued by that service-providing company."

58. *Petroma* confirms, in our view, the distinction that the Court has always drawn between the existence of the right to deduct which arises when the substantive

requirements have been satisfied and the need for the taxpayer to comply with the formal requirements before exercising that right. Fiscal neutrality does not require the Member State to ignore the latter provided that any formal requirements imposed by the Member State in addition to those contemplated in the Directives are within the bounds set by the Court's jurisprudence.

59. We therefore reject the submission that the EU case law indicates that in the present situation, either:

> (1) The Member State is obliged to provide a judicial forum in which the question of whether or not a taxable supply has taken place can be determined even where the tax authority has not made such a determination; or
>
> (2) Scandico can now rely on the findings of the FTT as entitling it to the deduction claimed.

60. In the light of that conclusion we turn to the sole issue which properly arises on this appeal. That is whether the FTT was correct in concluding that the decision of HMRC's case officer that she was not prepared to allow the tax credit on the basis of the information placed before her was reasonable.

61. This part of the FTT's decision is at paragraphs 119 onwards and we have set out the relevant passages earlier in this judgment. The test to be applied as expressed by the FTT in paragraph 119 is the correct test. The analysis in paragraphs 123 to 129 is, in our judgment, fair and unimpeachable. Scandico argue that the deficiencies in the evidence identified by the FTT as having been before the case officer were immaterial and did not relate to the information which is required on a VAT invoice. Mr Pickup referred to Case C-392/09 *Uszodaépítő kft v APEH Központi Hivatal Hatósági Főosztály* [2010] ECR I-8791 and C-438/09 *Dankowski v Dyrektor Izby Skarbowej w Łodzi* [2010] ECR I-14009. In both those cases the European Court stressed that where the tax authority has the information necessary to establish that the taxpayer is liable to VAT, the right to deduct must not be rendered ineffective by the imposition of additional conditions. We do not accept that that is what either HMRC or the FTT was doing here. Scandico should have realised from the outset of their business that they were not going to receive VAT invoices from Apple because their business model depended on Apple not knowing the ultimate destination of the iPhones. They could have set up and operated their business in a way that enabled them to provide HMRC with clear and unequivocal information supporting their entitlement to a deduction. Instead the case officer was fully entitled to conclude on the basis of the evidence before her that she could not be satisfied that the supply of the phones to Scandico for which a credit was claimed had taken place. She was not setting an impossibly high standard for Scandico to meet in order to claim the deduction.

62. There is no basis on which we should interfere with the FTT's conclusion and we therefore dismiss the appeal.

MRS JUSTICE ROSE, CHAMBER PRESIDENT
JUDGE CHARLES HELLIER
RELEASE DATE: 7 December 2017