FISCAL NEUTRALITY – THE BROADER IMPLICATIONS OF SUB ONE

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1. The Decision of the Upper Tier Tribunal in Sub One is meatier than the sandwich which inspired it and, depending upon your tastes, is just as satisfying.

2. In a keenly awaited Decision, the Upper Tier Tribunal rejected a challenge made by more than 1,200 food outlets to the pre-Finance Act 2012 legislation which zero-rated hot takeaway food. The taxpayer's challenge was based upon a number of different grounds. First, that the 1988 Court of Appeal judgment in John Pimblett and Sons Ltd v Commissioners[1] was contrary to EU law and, accordingly, should not be applied by the Tribunal. Second, that the legislation was, in any event, incapable of being construed or applied consistently with the principle of fiscal neutrality. Third, that HMRC itself was liable for the inconsistent decisions that have been made by the courts and tribunals since Pimblett and, finally, that the zero rating legislation was ultra vires the VAT Directives since, following the case of Manfred Bog, HMRC wrongly classifies supplies in the course of catering as supplies of services when they are supplies of goods. A full copy of the judgment can be found here.

Pimblett

3. Pimblett has, for nearly twenty five years, been the seminal case on the interpretation of Note 3(b)(i) to Schedule 8 Part II, which will be instantly recognisable to most practitioners as the provision which defines a "supply in the course of catering" (which is excluded from zero-rating) as including food which has been heated for the purposes of enabling it to be consumed at a temperature above the ambient air temperature.

4. In Pimblett the Court of Appeal determined that, in order to apply Note 3(b)(i) it was necessary to determine the subjective intention of the supplier of the product. As a result, in

1 [1988] STC 258

numerous later cases, successive decisions produced apparently contradictory results based upon the intention of the supplier, such that two identical supplies made by two suppliers possessed of differing motivations, were treated differently.

5. HMRC, represented by Melanie Hall QC, acknowledged that to the extent that the Court of Appeal's Judgment encapsulated a subjective test, which was denied, it was contrary to EU law since it was clear from the Jurisprudence of the CJEU that the test should be objective. [2]

6. An important point of principle was also common ground between the parties, namely that lower courts and tribunals are obliged to depart from the case law of higher courts, even if it would be binding as a matter of domestic law, where this is necessary to apply European law correctly.[3]

7. The Tribunal framed the correct test for the application of Note 3(b)(i), at paragraph 83, as comprising four elements, principal among them being the application of an objective test.

8. An application of the objective test did not cure the Appellant's grievance since, applying that test, its supplies would still be standard rated. Accordingly, the taxpayer contended that the legislation, even read objectively, was in breach of the principle of neutrality since it would result in similar supplies being treated differently.

Fiscal Neutrality

9. Much has been written about fiscal neutrality since the Judgment in Case C-259/10 Rank, so much so that one might even be forgiven for failing to notice that the VAT Directive itself specifically prescribes adherence to the principle in its Seventh Recital.

10. In essence, the principle of neutrality requires, in elegant simplicity, that similar supplies be treated similarly; the complexity derives from determining whether supplies are similar.

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2 Case C-4/94 BLP Group plc v Commissioners of Customs and Excise [1995] ECR I-1001 at [24]

3 This proposition derives clearly from the principles set down by the ECJ in Case 106/77 Amministratrazione delle Finanze dello Stato v Simmenthal SpA [1978] ECR 629 at [24]; was made express, for the first time in Case C-173/09 Georgi Ivanov Elchinov v Natsionalna zdravnoosiguritelna kasa; and, put beyond doubt by the Court in Case C-396/09 Interedil Srl, in liquidation v Fallimento Interedil Srl,Intesa Gestione Crediti SpA

11. The learned Judge considered that the newly framed objective reading of Note 3(b)(i) produced fiscally neutral effects as it would ensure that supplies which are objectively the same are not treated differently merely because of a difference in the subjective intention of the supplier. [4]

12. It followed, therefore, that, leaving aside the manner in which the legislation had been (incorrectly) applied in the wake of Pimblett, the legislation itself was capable of being interpreted and applied in a manner which was not in breach of fiscal neutrality and, accordingly, no breach occurred. The taxpayer then relied upon the extraordinary submission that HMRC itself was responsible for the manner in which the Courts and tribunals had interpreted the provision. I do not use the word "extraordinary" as tending to imply that it is an argument without merit, it is extraordinary only because it was, to the best of the author's knowledge, the first time that such a submission had been made before the Tribunal and, were it to have succeeded, or should it succeed upon an appeal it would lay down a principle of profound implication. Before examining that question it is necessary to take a short jump backwards to examine perhaps the most important part of the Court's judgment.

The Limits of Fiscal Neutrality

13. We have seen above that the Tribunal ultimately decided that the zero-rating legislation was compliant with the principle of fiscal neutrality. My own presentation of the case in this way is, however, a deliberate placing of the cart before the horse since it had first to be considered by the Tribunal whether there was in fact any need for the legislation to comply with principle of fiscal neutrality. Although we know from the Judgment in Rank and others that the provisions of the Sixth Directive are subject to fiscal neutrality there were good grounds for believing that because of the broad discretion afforded to member states in the retention of zero rates that their discretion would permit them to legitimately produce legislation which was not fiscally neutral.

14. The case of Talacre Beach Caravan Sales Ltd v Customs and Excise Commissioners[5] was considered by some at the time of its release to be somewhat of an anomaly. In that case the ECJ decided that a single supply for VAT purposes could be taxable at two different rates. This conclusion derived from the fact that Article 28(2)(a) of the Sixth Directive – which allows member states to retain zero-rates in respect of specific items – only permitted the retention

4 Paragraph 83
5 [2006] ECR I-6269

of a zero-rate for caravans but not their contents. In light of the fact that the zero-rating of the contents was, in effect, not permitted by the Directive, zero-rating could not be achieved through the 'back door' of composite supply.

15. In the author's view, as the debate on fiscal neutrality develops over the coming months and years we may see the Judgment in Talacre attain a higher level of fame or notoriety, again, depending upon your perspective.

16. Another key piece of the Tribunal's careful analysis was Idéal Tourisme SA v Belgian State [6]which considered circumstances that would appear on all fours with the issue now before the Tribunal. In that case the Kingdom of Belgium had applied a zero-rate to international air transport but applied a 6% rate to international land transport such that, in accordance with Article 28(3)(b) the Directive permitted the retention of only the former. Predictably, a supplier of international land transport, namely bus services, objected to this seemingly discriminatory treatment. Though seemingly acknowledging that a breach of equal treatment arose (of which fiscal neutrality is but one aspect) the Court held that the Kingdom of Belgium would not be authorised to extend to land transport the zero-rating applied to air transport, even if the difference in treatment infringed the Community principle of equal treatment.

17. The combined effect of Talacre and Idéal Tourisme would appear to be clear authority for the proposition that even if Note 3(b)(i) produced an effect which was in breach of fiscal neutrality this was permissible as it was merely the effect of complying with the constraints of the zero-rating provisions provided by the Directive itself. As we already know, however, the Tribunal seems not to have taken this view.

18. The taxpayer relied upon two different Judgments in order to rebut the presumption that would appear to arise by virtue of Talacre and Idéal Tourisme, namely Commission v France[7] and Marks & Spencer II[8].

19. Marks & Spencer II related to the Commissioners' defence that the taxpayer would be unjustly enriched if it were to be repaid the VAT for which it accounted on the sale of teacakes. The taxpayer sought to argue that the application of the unjust enrichment rules to payment traders and not repayment traders was a breach of equal treatment. First, however it

6 Case C-36/99, [2000] ECR I-6049
7 Case C-481/98, [2001] ECR I-3369,
8 Case C-309/06 Marks & Spencer plc v Revenue and Customs Commissioners [2008] ECR I-2283

needed to wield the sword of equal treatment which it could do only if European Law rights were invoked. The ECJ, applying Talacre, concluded that the taxpayer did not have any directly effective right to zero-rating and held that the zero-rating provided for by Article 28(2)(a) permitted the "optional maintenance of the previous status quo" and was therefore "merely framed by the Sixth Directive". The Court cited Talacre and Idéal Tourisme (or, at least, aspects of them) with approval but went on to hold that the maintenance of zero rates is permissible only in so far as it complies with, inter alia, the principle of fiscal neutrality.

20. It would appear that the Tribunal perceived there to be a conflict between these authorities and resolved this apparent conflict as follows. Whilst the Tribunal accepted that it is for UK to determine the boundary between zero-rated supplies and standard-rated supplies and that the principle of fiscal neutrality cannot be relied upon as depriving the UK of this discretion. However, it did not follow that the UK can draw the line in such a way as to discriminate between objectively similar supplies. In the Judgment's key line the Tribunal concluded that "the maintenance of the exemption is only permissible in so far as it complies with the principle of fiscal neutrality."

21. As we have seen already, however, success on this argument did not avail Sub One anything since it was ultimately decided that – on an objective reading - the legislation did not in fact breach the fiscal neutrality principle.

"Pimblett's Progeny"

22. So, the legislation was, when properly interpreted, consistent with the requirements of fiscal neutrality but Sub One had nonetheless endured over a decade under the subjective test laid down in Pimblett. The progeny to which the Tribunal referred were some twenty-three cases which had been decided in the wake of Pimblett, no fewer than six of which concerned supplies of toasted sandwiches and similar products by competitors of Subway's 1,200 franchisees.

23. It was common ground between the parties that, in certain circumstances, an agency of the State can be held accountable for an action or inaction which is the cause of that State's failure to fulfil obligations arising under the VAT Directive. Indeed it is clear from Commission v Italy[9] that even a constitutionally independent institution such as a court can be held liable

9 Case C-129/00

on this basis.

24. The taxpayer did not – at least in these proceedings - attempt to hold the State liable for the Courts' actions in the post-Pimblett years rather it went one step further, and according to the Tribunal, one step too far, by claiming that HMRC have a duty to ensure that the law is correctly applied by courts and tribunals including a duty to appeal adverse decisions. The Tribunal concluded that HMRC's action or inaction was not the cause of the breach of fiscal neutrality on the facts of the case but it appears to have contemplated the possibility of a legal basis for establishing such a breach.

25. It begs a fascinating question: Is HMRC required to adhere to the law as promulgated by the national courts in much the same way as any other litigant or does it have an obligation, independent of the courts, to ensure that EU law is correctly applied? By engaging in an analysis of the facts – upon which it was found to be clear that no breach arose – the Tribunal does appear to have proceeded on the basis of the latter position.

26. Much like the meatball sub, for something of such substance it is surprisingly easily digested and there is little doubt but that the parties will be back for more.

Melanie Hall QC represented HM Revenue & Customs.
Junior counsel were Ewan West and Owain Thomas.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

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