Sub-One – The Court of Appeal

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On 10 June the Court of Appeal published its decision in *Sub-One v HMRC* [2014] EWCA Civ 773. The issue will be familiar to all readers and this note cannot purport to provide a comprehensive analysis of all of the arguments – indeed the Court of Appeal noted that it had been presented with eleven volumes of legislation and case law in order to enable it reach a conclusion on an ostensibly straight-forward issue. This note will attempt to set out some of the most interesting issues in the appeal – and those with the broadest implication.

In an article I wrote on the Upper Tribunal decision in October 2012 I set out in some detail the arguments being made by the parties. Those arguments have not changed significantly since then.

At its core, this is a case about fiscal neutrality. The arguments being made by Sub-One were as follows.

First, the legislation which applied the zero-rate to hot food other than that which has been heated for the purposes of enabling it to be consumed above ambient air temperature, had been construed in accordance with the court of Appeal Judgment in Pimblett as importing a subjective test. Pimblett required that one must look at the subjective intention of the supplier. The Court of Appeal agreed.

Second, BLP requires that one must not look at the subjective intention of the supplier but rather at the objective nature of the supply. In consequence, Pimblett was wrongly decided. HMRC did not cavil with this submission.

Third, that the subjective test implied into the relevant statutory exclusion was the only way in which this legislation could be read and it was not possible to read the legislation as permitting of an objective analysis. In consequence, the exclusion from the zero-rate was ineffective. The Court of Appeal disagreed with this contention. The Court reiterated the summary of the relevant principles to be extracted from the case law as regards the limits of the principle of conforming interpretation as contained in the Judgment in *Vodafone 2 v Revenue & Customs Commissioners* [2009] STC 1480. Ultimately, the court concluded that applying these principles it

was possible to read the legislation as importing an objective test. In this regard, McCombe LJ, delivering the judgment of the Court, was particularly influenced by a question put by Briggs LJ to Melanie Hall QC for HMRC as to whether *"the deal"* was that *"the supplier was selling and the customer was buying a sandwich which could be eaten 'hot'."* McCombe LJ then held that:

"This approach to the matter searches for the assumed common intention of the supplier and the consumer as to whether it is a term of the bargain that the product will be supplied in order to be eaten hot. By this entirely objective enquiry [i.e. what was 'the deal'] the court derives the terms of the bargain from what each party to the contract says and does…"

In other words, the test is no longer what was the supplier's purpose in heating the food but rather was the objective reality that this was food which was being sold hot in order to be eaten hot. Not for the last time in the Judgment, McCombe LJ confessed that his mind had waivered as to the correct answer to this aspect of the case and it is easy to see how this would be so. For my part, I would respectfully offer the observation that the test applied by the Court is not obviously objective to me. In essence the court has crafted an objective way of elucidating the subjective intentions of the parties and, in particular, the supplier.

The argument as to the requirements of an objective analysis is, in essence, (though not expressed in this way in the Judgment) that a slice of quiche that is fortuitously hot because the quiche has just come out of the oven is precisely the same as a slice of quiche which is reheated to the same temperature two hours later. The Court, however, appears to have accepted HMRC's submission that *"heated-to-order food meets a different consumer need to food which is fortuitously hot…"* i.e. that the supply of quiche which is fortuitiously hot is an objectively different supply to the sale of that same slice of quiche heated for consumption. There is, I think one would have to agree, a very fine line between this objective approach and considering the subjective intention of the supplier in heating the quiche. It was, however, a fine line which the Court recognised as having been correctly drawn by HMRC.

Having lost on this point the Appellant then has to accept that, during the entire period, its own supplies ought properly to have been liable to VAT at the standard rate and, one would have thought, that therefore its claim for repayment of output tax must fail but this is where the case gets even more interesting. Sub One argued that the principle of fiscal neutrality, nonetheless, entitled it to a repayment. This was the fourth issue.

The first matter that had to be considered under this argument was whether or not the principle of fiscal neutrality applied at all to the domestic provisions introduced pursuant to the standstill provisions in what is no now article 110 RVD. HMRC argued, inter alia, that provided there were clearly defined social reasons for excluding certain supplies from the zero-rate, it was nothing to the point that those supplies might otherwise be similar to supplies which were in fact zero-rated. The Upper Tribunal and the Court of Appeal disagreed, both holding that in retaining the zero-rate pursuant to article 110 the State could only do so provided that it was complying with the principle of fiscal neutrality.

It is important to note that the Court of Appeal expressly rejected the notion that the Court of Justice decision in *Deutsche Bank* [2012] STC 1951, compelled a different answer to that reached by the Upper Tribunal. There the Court of Justice held (and has since reaffirmed) that the principle of fiscal neutrality:

"cannot extend the scope of an exemption in the absence of clear wording to that effect. That condition is not a rule of primary law which can condition the validity of an exemption, but a principle of interpretation, to be applied concurrently with the principle of strict interpretation of exemptions."

However, the Court of Appeal held that this case was concerned with a "black letter line" setting the boundaries of an exemption to be found in the Directive itself and not with the issue as to a differentiation in treatment between traders supplying similar goods within the same national exemption category.

Having concluded that the principle of fiscal neutrality was of application in the sphere of zero-rates and that the 'subs' being supplied were similar to other products to which the zero-rate had historically been (incorrectly) applied, the Court went on to consider the implication of its finding of this breach of fiscal neutrality noting that this breach of fiscal neutrality arose out of the application of the legislation and not the legislation itself (which was capable of being read as importing an objective test).

For the second time, the learned Judge declared that he did not find the answer to this question straightforward. Ultimately, the Court concluded that the Appellant had no remedy because the illegality of the treatment of the similar products provided an absolute answer. As the Court of Justice stated in Rank:

"…the principle of equal treatment must be reconciled with the principle of legality, according to which a person may not rely, in support of his claim, on an unlawful act in favour of a third party…"

In a slightly unusual twist the Court also based its conclusions on this point an a concession apparently made by the taxpayer at the hearing that if the cases decided in favour of persons making supplies similar to those of the Appellant were wrongly decided then HMRC should succeed.

It is interesting that the Court records in a footnote the time at which this concession was made because it might seem to be one which was at odds with the Appellant's position in the hearing.

In light of the Court twice having gone to the trouble of recording its hesitancy in reaching particular conclusions – and notwithstanding its decision that a reference to the Court of Justice was not necessary – one would have thought that a further appeal to the Supreme Court is a distinct possibility.

Melanie Hall QC and Ewan West represented HMRC.

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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