



[2014] UKUT 0438 (TCC)
Appeal number: FTC/80/2013

VALUE ADDED TAX - University making exempt supplies of education services – refurbishment of leasehold property – lease of property to trust and underlease to University of property by trust – exercise of option to treat lease and underlease as taxable – whether input tax deductible as related to taxable supply of immovable property – purpose of EU and domestic legislation – whether scheme constitutes abuse of right - appeal allowed

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

BETWEEN:

**THE COMMISSIONERS FOR
HER MAJESTY’S REVENUE AND CUSTOMS**

Appellants

- and -

**UNIVERSITY OF HUDDERSFIELD
HIGHER EDUCATION CORPORATION**

Respondent

**Tribunal: The Hon Mrs Justice Rose DBE
Judge Greg Sinfield**

**Sitting in public at the Royal Courts of Justice, The Rolls Building, Fetter Lane,
London EC4 on 22 and 23 July 2014**

**Peter Mantle, counsel, instructed by the General Counsel and Solicitor to HM
Revenue and Customs for the Appellants**

Paul Lasok QC instructed by KPMG LLP for the Respondent

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DECISION

The appeal of the Appellants, the Commissioners for Her Majesty's Revenue and Customs, IS ALLOWED

REASONS

(a) Background

1. This is an appeal against the decision of the First-tier Tribunal (Judge Demack) released on 29 April 2013 (the '2013 Decision'). In that Decision, the tribunal allowed the appeal by the Respondent ('the University') against the assessment by the Appellants, HMRC, that the University was liable to pay £612,502 of under-declared VAT. That was the amount of input tax paid by the University for the supply of construction services carried out to refurbish a building called East Mill, which was leased to the University. The University had entered into a tax mitigation scheme devised by its accountants which, the University claims, entitled it to deduct that input tax from services it supplied. The issue in the appeal is, broadly, whether that tax mitigation scheme is effective or whether it constitutes an 'abuse of right' within the meaning given to that term by EU law.
2. The 2013 Decision was the second decision taken by Judge Demack in respect of the University's deduction of that input tax. The first decision was taken by the VAT and Duties Tribunal on 16 October 2002 (Case ref MAN/00/263) (the '2002 Decision'). Following the 2002 Decision, Judge Demack referred certain questions to the Court of Justice of the European Communities, later the Court of Justice of the European Union (together the 'CJEU'). The CJEU handed down its judgment in that reference on 21 February 2006 in Case C-223/03 *University of Huddersfield Higher Education Corporation v CCE* [2006] ECR I-1751 ('the CJEU's *University* judgment'). On the same day, the CJEU handed down judgment in two other references from English courts that had been heard at the same time and that raised similar issues. Advocate General Maduro had given a joint opinion on all three cases on 7 April 2005.
3. We will need to consider those three CJEU judgments and Advocate General Maduro's Opinion in more detail later. Here it is enough to say by way of introduction that the CJEU held that the Sixth VAT Directive¹ must be interpreted as precluding any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice.
4. The CJEU also held that an abusive practice exists where two conditions are satisfied:
 - a. first, notwithstanding the formal application of the relevant provisions of the Sixth Directive and of the national legislation transposing it, the transactions concerned result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions; and

¹ Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (OJ 1977 L 145 p. 1), as amended.

- b. secondly, it must be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.
5. Following the CJEU's *University* judgment, these proceedings were stayed pending the decision of the CJEU in another case about abuse of right: Case C-103/09 *HMRC v Weald Leasing Ltd* [2010] ECR I-13589 ('*Weald*'). Judgment was handed down by the CJEU in that case on 22 December 2010. Thereafter these proceedings came back before Judge Demack for him to decide whether the tax mitigation scheme was an abusive practice. He held that it was not.

(b) The facts and the relevant legislative provisions

6. The facts were set out in detail in the 2002 Decision. The University makes supplies of education which are exempt from VAT. It makes a few taxable supplies and under the VAT code it is able to recover a proportion of input tax at its partial exemption recovery rate. In 1996 this rate was 14.56 per cent but it later fell to 6.04 per cent.
7. In 1995, the University wanted to refurbish two Grade II listed derelict mills of which it had bought the leasehold. They were known as East Mill and West Mill and were both situated in Canalside, Huddersfield. The University recognised that if it simply paid a construction company to refurbish the mills, it would have to pay VAT to that company for the refurbishment and would only be able to recover a small proportion of that input VAT. The University sought advice from its accountants KPMG as to how to save tax or defer its liability to pay it. The University dealt with West Mill first, but this appeal is concerned only with the arrangements for East Mill.
8. In order to understand how the scheme was supposed to work, it is necessary to understand the tax regime that applied. At all material times, the VAT Directive in force was the Sixth Directive. The following provisions are relevant.
9. Article 13A(1)(i) provides that Member States must exempt, among other things, university education from VAT.
10. Article 17(2)(a) provides:

‘In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person’.
11. Article 17(5) provides that as regards goods and services to be used by a taxable person both for transactions in respect of which VAT is deductible and for transactions in respect of which it is not, ‘only such proportion of the value added tax shall be deductible as is attributable to the former transactions’. According to the second subparagraph of Article 17(5), ‘this proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person’. The CJEU has interpreted Article 17 as requiring that there be a direct and immediate link between the goods and services on which input tax is paid and the taxable transactions of the taxable person in order for the taxable person to be entitled to make the deduction: see for example Case C-4/94 *BLP Group plc v Commissioners for Customs and Excise* [1995] ECR I-983.

12. Article 13B(b) provides:

“Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse:

(a) ...

(b) the leasing or letting of immovable property ...”

13. Article 13C provides:

“C. Options

Member States may allow taxpayers a right of option for taxation in cases of:

(a) letting and leasing of immovable property;

(b) ...

Member States may restrict the scope of this right of option and shall fix the details of its use.”

14. Since 1 August 1989, the United Kingdom has provided for taxpayers to be able to exercise a right of option so as to treat the supply of land as a taxable rather than an exempt supply. Thus:

- a. Section 31 of the VAT Act provides for supplies set out in Schedule 9 to the Act to be exempt.
- b. Schedule 9 includes the grant of any interest in or right over land other than certain excluded interests.
- c. Section 51 gives effect to Schedule 10 with respect to buildings and land.
- d. Paragraph 2 of Schedule 10 provides that where an election is made in relation to any land, then any grant made in relation to that land by the person who has made that election shall not fall within the exemption in Schedule 9.

15. However, since 30 November 1994, the United Kingdom has restricted the exercise of that right of option, as envisaged by Article 13C of the Sixth Directive. On that date a new paragraph 2(3A) was inserted into Schedule 10 to the VAT Act by the Value Added Tax (Buildings and Land) Order 1994 (SI 1994/3013) (“the 1994 Order”). The new sub-paragraph provides that an election cannot have the effect of making the supply in relation to the land taxable on or after 30 November 1994 if—

“(a) the person making the grant and the person to whom the grant is made are connected persons; and

(b) either of them is not a fully taxable person.”

16. Further, the 1994 Order added sub-paragraph (8A) to paragraph 3 of Schedule 10 to provide that any question whether a person is connected with another shall be determined in accordance with section 839 of the Income and Corporation Taxes Act 1988. HMRC describe those provisions in Schedule 10 as anti-avoidance provisions. The provisions effectively prevented connected parties within the definition from electing to treat property transactions between them as taxable where either party was exempt or partially exempt. In the case of the University, that ruled out the use of a subsidiary company to achieve tax savings.
17. In the tax mitigation scheme proposed by KPMG, a charitable or discretionary trust was suggested instead of a subsidiary company. That trust could be set up so that it falls outside the definition of a 'connected person' for the purposes of Schedule 10 to the VAT Act.
18. A discretionary trust was established by the University by deed on 17 November 1995 ('the Trust'). The deed was in standard form but provided that the power to appoint and remove trustees be vested in the University. The trustees appointed were three former employees of the University and the beneficiaries were the University, any student from time to time enrolled there and any charity.
19. The Trust was first used in the arrangement regarding the refurbishment of West Mill and then subsequently for a similar arrangement for East Mill. The tribunal found in the 2002 Decision that the sole purpose for the creation of the Trust was to facilitate the tax mitigation scheme suggested by KPMG. The Trust was a shell, having capital of only £10; its only other funds consisted of interest-free loans from the University. The tribunal also found that the Trust was controlled by the University: see paragraph 32 of the 2002 Decision.
20. So far as East Mill was concerned, the tax mitigation scheme operated in the following way.
 - a. On 21 November 1996, the University opted to waive exemption from VAT in relation to East Mill.
 - b. On 22 November 1996, the University granted a taxable, 20 year, full repairing lease of East Mill to the Trust. The initial yearly rent was £12.50.
 - c. The Trust also elected to waive exemption from VAT in relation to East Mill.
 - d. Also on 22 November 1996, the Trust granted a taxable internal repairing underlease of 20 years less 3 days of East Mill to the University at an initial yearly rent of £13.
 - e. The University contracted with a company called University of Huddersfield Properties Ltd ('Properties Ltd') for the refurbishment of East Mill. Properties Ltd was a non-VAT group, wholly-owned subsidiary of the University.
 - f. Properties Ltd was registered for VAT and contracted with the University to refurbish East Mill. Properties Ltd also issued an invoice to the University in the sum of £3.5 million plus VAT of £612,500 for future construction services on East Mill.

- g. Properties Ltd then engaged building contractors at arm's length to provide the necessary construction services for East Mill.
 - h. The University paid the £3.5 million plus £612,500 VAT to Properties Ltd. There was no intention that Properties Ltd would make a profit on the supply.
 - i. The lease and the underlease of East Mill were drawn up so that they could be terminated at any time.
21. When the University came to complete its VAT return, it had a net liability to VAT of over £90,000, disregarding the East Mill arrangement. The University completed its VAT return for the period 01/97 showing a repayment due to it of some £515,000. HMRC unconditionally paid that sum to it.
 22. Work on East Mill was completed by third party contractors on 7 September 1998 and the University occupied the building from that date. Subsequently, the rents due under the lease and the underlease were increased to £400,000 and £415,000 per annum respectively.
 23. In October 1998, HMRC wrote to the University asking for information needed to review the nature of the transactions between the University and the Trust. They asked whether there was a 'commercial purpose' for the grant of the lease and the underlease beyond the deferral or reduction of the VAT. The University wrote back with a purported explanation referring to the 'experience and expertise' in respect of property assets of the distinguished former employees who were acting as trustees. Judge Demack found that there was no evidence whatsoever to show that the University's explanation was genuine. Again, he found that the sole reason for the use of the Trust in relation to East Mill was to facilitate VAT planning and that the sole purpose of the lease and underlease was the same.
 24. Further, the tribunal found that it was the University's intention to obtain an absolute VAT saving by collapsing the arrangements in respect of East Mill after two or three years, or on the date of one of the break clauses in the lease, (that is on the 6th, 10th or 15th anniversaries of the commencement of the term of the lease): see paragraph 50 of the 2002 Decision.
 25. In January 2000, HMRC assessed the University to tax of £612,502 for the period 01/97. They said that in relation to East Mill, the lease and the underlease agreements with the Trust were properly characterised as 'inserted steps' and hence fell to be disregarded when determining the validity of the input tax claims. HMRC's letter went on to say:

"By disregarding the lease and the underlease it follows that the input tax charged to the University by Properties has been treated incorrectly by the University in so far as it has been attributed to taxable supplies and recovered in full."
 26. In other words, HMRC did not regard the input tax on the refurbishment of East Mill as being incurred for the purposes of its taxable supply of the lease of East Mill to the Trust. HMRC offered to discuss with the University how it could attribute part of the input tax under its partial exemption.
 27. The lease and the underlease for East Mill were both terminated on 18 August 2004. As at that date, six years' rent had accrued on both the lease and the

underlease. No money had actually changed hands between the University and the Trust although the sums payable on the lease and the underlease were set out in their respective financial accounts. Further, as we understand it, no output tax charged by the University to the Trust under the lease has in fact been paid over to HMRC, since HMRC at that stage asserted not only that the scheme was an abuse of right but that the lease and underlease did not constitute an economic activity and did not give rise to a taxable supply for VAT purposes.

(c) The case law of the CJEU on abuse of right

28. As we have mentioned, following the 2002 Decision, Judge Demack referred questions to the CJEU. These questions related solely to the issue of whether the lease and underlease constituted an economic activity and whether there was a taxable supply. He did not refer questions about the abuse of right principle, although the tribunal was aware that a reference to the CJEU had been made in another case raising similar issues.
29. In the event, three VAT cases referred by the English courts were considered by the CJEU together:
 - a. The present case which became Case C-223/03 *University of Huddersfield Higher Education Corporation v CCE* [2006] ECR I-1751;
 - b. Case C-255/02 *Halifax plc and others v Commissioners of Customs and Excise* [2006] ECR I-1609 (*'Halifax'*); and
 - c. Case C-419/02 *BUPA v CCE* [2006] ECR I-1685 (*'BUPA'*) which is not relevant to the issues considered in this case.
30. Halifax plc is a banking company and the vast majority of its supplies are exempt financial services. It wished to construct 'call centres' at four different sites in the United Kingdom on land leased or owned by it. Because it was partially exempt, Halifax would have recovered only 5 per cent of the VAT it paid on the building works. It entered into a scheme which, it was advised, would enable it to recover all the input tax. Halifax loaned money to a special purpose, wholly-owned subsidiary, Leeds Permanent Development Services, (*'Leeds'*) to enable it to buy an interest in the site and to carry out the development work. Leeds agreed to carry out a small amount of work for Halifax at the site and Halifax paid it for that work. Leeds in turn entered into an agreement with another company (*'County Wide'*) under which County Wide agreed to carry out all the construction work at each site – including the small value work that Leeds had agreed to carry out for Halifax. Leeds paid County Wide a large sum in advance of the works (a total of about £48 million for the four sites including some £7 million in VAT). Leeds then accounted for VAT on the basis that, in its relevant financial year, it had made standard rated supplies of the small-value construction work and no exempt supplies. It claimed repayment of VAT of over £7 million on its inputs, which corresponded to the sums charged by County Wide for carrying out the construction works on the sites. County Wide also accounted for VAT on those supplies made to Leeds but would eventually be able to deduct the VAT that the contractors and professionals who actually carried out the building work would charge.
31. HMRC refused Leeds' claim for the repayment of VAT on its inputs and those of County Wide in relation to VAT charged to it by the independent contractors. HMRC argued that there was no supply or economic activity for VAT purposes.

Additionally, HMRC submitted that transactions entered into solely for the purposes of VAT avoidance amount to an ‘abuse of rights’ and should on that account be disregarded for VAT purposes.

Advocate-General Maduro’s Opinion

32. Advocate General Maduro’s Opinion covering all three cases dealt first with the questions concerning whether the transactions involved ‘economic activities’ and ‘supplies’. He advised that the fact that supplies or activities may be undertaken as part of an operation that had been carefully orchestrated in order to create a right to recover input tax did not affect whether the transaction amounted to a ‘supply’ or to ‘economic activity’. To hold otherwise would run counter to the objective character of those concepts; the fact that a supply is made with the sole intention of obtaining a tax advantage is immaterial.

33. Turning to the question of abuse of rights, he reviewed the case law of the CJEU applying this principle in other areas of EU law. He emphasised the objective nature of the concept:

“70. ... When the Court takes the view that an abuse exists whenever the activity at issue cannot possibly have any other purpose or justification than to trigger the application of Community law provisions in a manner contrary to their purpose, that is tantamount, in my view, to adopting an objective criterion for the assessment of the abuse. It is true that those objective elements will reveal that the person or persons engaged in that activity had, most likely, the intention of abusing Community law. But it is not that intention that is decisive for the assessment of the abuse. It is instead the activity itself, objectively considered.”

34. The Court, the Advocate General said, should not search for the elusive subjective intentions of the parties but can infer from the artificial character of the situation to be assessed in the light of objective circumstances that the person who relies on the literal meaning of an EU law provision ‘does not deserve to have that right upheld’. There was no reason, he said, why this principle should not apply to VAT law (emphasis added):

“77. I see no reason, in short, why the VAT rules should not be interpreted in accordance with the general principle of the prohibition of abuse of Community law. It is true that tax law is frequently dominated by legitimate concerns about legal certainty, deriving, in particular, from the need to guarantee the predictability of the financial burden imposed on taxpayers and the principle of no taxation without representation. However, a comparative analysis of the Member States’ legal rules is sufficient to make it clear that such concerns do not exclude the use of certain general provisions and indeterminate concepts in the realm of tax law to prevent illegitimate tax avoidance. ... Legal certainty must be balanced against other values of the legal system. **Tax law should not become a sort of legal ‘wild-west’ in which virtually every sort of opportunistic behaviour has to be tolerated so long as it conforms with a strict formalistic interpretation of the relevant tax provisions and the legislature has not expressly taken measures to prevent such behaviour.**”

35. He then set out the two elements for an abuse as we have already described them, namely first, that the aims and results pursued by the legal provisions formally giving rise to the tax advantage invoked would be frustrated if that right were conferred and, secondly, that the right invoked derives from economic activities for which there is objectively no other explanation than the creation of the right claimed.
36. The Advocate General went on to consider the application of those two elements to an alleged abuse of the VAT provisions conferring a right to deduct input VAT (emphasis in the original):

“92. The present three cases involve an alleged abuse of the Community provisions conferring a right to deduction of input VAT. Under the abuse test described above, it is necessary to determine, in the first place, the purposes and objectives of the provisions of the Sixth Directive governing the right to deduction. The national courts will be then able to establish whether or not, in the cases before them, those purposes would be achieved if the right to deduct or recover input VAT were recognised as being available to the applicants, in the circumstances in which they claim it.

93. It is clear from Article 17(2) of the Sixth Directive, *a contrario*, that where a taxable person makes VAT exempted supplies he has no right to deduct the input VAT paid on goods or services used for those exempt supplies. ... The right of a taxable person to deduct from the output VAT payable the input VAT incurred for making the taxable supplies constitutes a corollary of the principle of neutrality. VAT is, in effect, an indirect general tax on consumption meant to be borne by the individual consumers. Correspondingly the same principle requires that a taxable person *must not* be entitled to deduct or recover the input VAT paid on supplies received for its exempted transactions. As long as no VAT is charged on the goods or services provided by taxable persons, the Sixth Directive necessarily seeks to prevent them from recovering the corresponding input VAT. ...

94. In the three cases under consideration here, however, it appears from the orders for reference that, in practice, taxable persons who, according to the purposes of the VAT system of deduction just described, should not be able to deduct or recover input VAT except on a limited proportion of their inputs, have put into effect schemes that have enabled them to circumvent that result and recover input VAT in full. ...

95. It must be, in any event, the responsibility of the national courts to establish whether recognition of the right to deduct or recover input VAT in favour of the taxable persons claiming it in the present cases is compatible with the purposes and objectives pursued by the relevant provisions of the Sixth Directive, as identified above. If the referring courts find that those purposes are only partially achieved – in so far as the exempted taxable persons are entitled to recover a certain proportion of input VAT incurred – then the provisions of the Sixth Directive governing deduction must be interpreted as conferring the right to recover input VAT, on that proportion, on the taxable persons concerned. This seems to be the situation in the *Halifax* and *Huddersfield* cases, where both those two partially exempted

entities could apparently recover input VAT although only at a limited rate on the applicable pro-rata basis.”

The CJEU's judgments

37. The CJEU delivered separate judgments in the cases referred. In the *University* judgment, the CJEU dealt with the points about ‘economic activity’ and ‘supply’, which were the only issues raised by the questions that had been referred by the tribunal. It held that the fact that the transaction concerned is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity. However, the CJEU, unbidden, did refer to abuse of rights:

“50 ... transactions of the kind at issue in the main proceedings are supplies of goods or services and an economic activity within the meaning of ... the Sixth Directive, provided that they satisfy the objective criteria on which those concepts are based.

51 Whilst it is true that those criteria are not satisfied where tax is evaded, for example by means of untruthful tax returns or the issue of improper invoices, the fact nevertheless remains that the question whether the transaction concerned is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity.

52 In that context, it must however be noted that, as is clear from paragraph 85 of the judgment of today’s date in Case C-255/02 *Halifax and Others* [2006] ECR I-1609, the Sixth Directive precludes any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice.”

38. The *Halifax* judgment was the only one in which the CJEU dealt substantively with the issue, holding that the principle of prohibiting abusive practices also applies to the sphere of VAT. The CJEU observed that preventing possible tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive. The CJEU referred to the need to balance that principle against the need for legal certainty, particularly in the case of rules liable to entail financial consequences. The CJEU also referred to the entitlement of taxpayers to structure their business so as to pay less rather than more VAT: (citations omitted)

“73. Moreover, it is clear from the case-law that a trader’s choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system (...). Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the highest amount of VAT. On the contrary, as the Advocate General observed in point 85 of his Opinion, taxpayers may choose to structure their business so as to limit their tax liability.”

39. The CJEU then set out the two elements which must be satisfied for an abuse of rights to be established.

“74 In view of the foregoing considerations, it would appear that, in the sphere of VAT, an abusive practice can be found to exist only if, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

75 Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.”

40. The CJEU went on to give some guidance to the national court in its task of considering the first element of the test. The Court said: (citations omitted)

“78 In that connection, it must be borne in mind that the deduction system under the Sixth Directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (...).

79 According to settled case-law, ... Article 17(2), (3) and (5) of the Sixth Directive must be interpreted as meaning that, in principle, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (...).

80 To allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules.”

41. Finally, the CJEU discussed the response of the national court when a finding of abuse has been made. The Court held that where an abusive practice exists, the national court must redefine the transactions involved so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice. The tax consequences that flow from that redefinition should then be the tax consequences that apply. Thus, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been

exercised abusively. However, they must also subtract any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess.

42. Following the CJEU's judgments, the domestic proceedings in which the *Halifax* and *BUPA* case questions had been referred settled without the need for further domestic court decisions applying the abuse of right principle to the facts of those cases.

The Weald case

43. It is important to understand the factual basis on which the CJEU arrived at its conclusion in the later case of *Weald*. That case concerned the Churchill group of companies which predominantly supplies insurance services exempt from VAT. They have an input VAT recovery rate of about 1 per cent. Weald Leasing was a member of the Churchill group. Its trading activity consisted in purchasing office equipment and leasing it out. Another company, Suas, was a company owned by a VAT consultant to the Churchill group and his wife. It was not part of the Churchill group. Its only significant trading activity was leasing assets from Weald Leasing and then subleasing them to Churchill. When Churchill needed new equipment, the equipment was purchased by Weald Leasing which leased it to Suas which in turn subleased it to Churchill.

44. The CJEU described the implications of this as follows:

“13 By resorting to that series of transactions, [Churchill] avoided having to purchase outright the equipment they needed or to pay in a single sum the total amount of non-deductible VAT on those purchases.

14 The aim of those transactions was to divide and spread the payment of that amount in order to defer the Churchill Group's VAT liability.

15 [Churchill] were not immediately liable for the non-deductible VAT on the total cost of the equipment purchased, but on the amount of rent relating to that equipment, spread over the term of the leasing agreements.”

45. The tax liability challenged by HMRC was that of Weald Leasing not that of Churchill itself. HMRC raised VAT assessments disallowing the deduction by Weald Leasing of the input VAT paid on the assets leased to Suas between two dates on the ground that the transactions in issue constituted an abuse of rights. Questions were referred to the CJEU by the Court of Appeal of England and Wales.

46. The questions referred focused on the reference in the CJEU's case law on abuse of right to transactions which are not carried out in the context of the participants' normal commercial operations. The CJEU paraphrased the questions it had been asked as follows:

“25 ... the national court asks, in essence, whether the fact that an undertaking resorts to asset leasing transactions such as those at issue in the

main proceedings, involving an intermediate third party company, instead of purchasing assets outright, results in the accrual of a tax advantage the grant of which is contrary to the purpose of the Sixth Directive and whether, if that undertaking does not engage in leasing transactions in the context of its normal commercial operations, resort to such transactions constitutes an abusive practice.”

47. In answer to those questions, the CJEU said: (emphasis added)

“31 As regards the main proceedings, the decision making the reference states that **the essential aim of the leasing transactions at issue in the main proceedings was to obtain a tax advantage, namely spreading the payment of the VAT on the purchases in question, so as to defer the Churchill Group’s VAT liability.**

32 However, before it can be concluded that there was an abusive practice, it must also be the case that, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and the national legislation transposing it, that tax advantage is contrary to the purpose of those provisions.

33 In that regard, it should be pointed out that the leasing transactions come within the scope of the Sixth Directive and that the tax advantage that could arise through recourse to such transactions does not, in itself, constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of that directive and the national legislation transposing it.

34 A taxable person cannot be criticised for choosing a leasing transaction which procures him an advantage consisting, as is apparent from the decision making the reference, in spreading the payment of his tax liability, rather than a purchase transaction which does not procure him any such advantage, provided that the VAT on that leasing transaction is duly and fully paid.

35 It is not disputed that that is the position as regards the VAT on the leasing transactions at issue in the main proceedings and that, for each of those transactions, the companies concerned have paid the correct amount of output VAT and deducted, when they could, the correct amount of input VAT.

36 In fact, if Weald Leasing was entitled to deduct VAT on the assets it purchased, it was because it carried on, not insurance business, but leasing activities subject to, and not exempt from, VAT.

37 Likewise, [Churchill] did not deduct the VAT on the rentals paid to Suas, because 99% of it was irrecoverable.

38 Furthermore, resort to a leasing transaction in respect of an asset does not automatically mean that the amount of VAT on that transaction will be less than would have been paid if the asset had been purchased.”

48. The CJEU went on to consider the issues of abuse of right that might arise from the interposition of Suas in the transaction chain. In particular, the CJEU considered whether rentals under the leasing agreements were set at an unusually low level and, if so, whether the involvement of Suas (a company outside the Churchill group) prevented HMRC from applying anti-avoidance provisions. These provisions allowed HMRC to direct that open market values are to be used where supplies for less than the market value were made between connected persons, one of whom was not entitled to recover input tax in full.
49. It is important therefore to recognise that the *Weald* case was based on a factual position which was different in important respects from the current case. It was not suggested that the purpose of the leasing arrangement was anything more than allowing the Churchill group to spread the payment of irrecoverable input tax over the period of the lease rather than having to pay it in one lump sum as it would have done if it had purchased the equipment outright. This is clear also from the Opinion of Advocate General Mazák (delivered on 26 October 2010) when he referred to Weald Leasing's submissions distinguishing the facts of *Weald* from the facts of the present case (footnotes omitted):

“17 Weald Leasing claims that in the context of VAT, one of the tax advantages of leasing for exempt or partly exempt traders is the ability to spread irrecoverable input tax over the duration of the lease. However, this tax advantage is not, of itself, sufficient to render the transactions abusive as it is simply the fiscal effect of their choice which is specifically contemplated by the Sixth Directive. It is not abusive as it has not been obtained wrongfully. In particular, there was no attempt by [Churchill] to recover any more input tax than that to which they are entitled. Whilst Weald Leasing obtained a cash flow advantage there was no outright saving of tax and nor was such a saving intended. According to Weald Leasing this is a key distinguishing feature between the present case and *University of Huddersfield* as the only element of the leasing arrangements which might be regarded as potentially abusive is the level of the rentals. ...”

50. The Advocate General's opinion on the point was as follows: (footnotes omitted and emphasis added)

“20. In my view, ... a trader is free, in principle, to choose whether to purchase or lease assets/equipment for use in the course of its business. Moreover, the fact that an exempt trader chooses to enter into a leasing arrangement in respect of assets/equipment rather than purchase them outright in order to benefit from a more favourable treatment under VAT legislation, by deferring its VAT burden is not, in itself, sufficient to support the finding that an abuse of that legislation has occurred. Where a trader chooses to lease equipment it pays VAT on the periodic rental payments made over the duration of the lease rather than a once-off payment of VAT on the purchase of that equipment. I consider that such a transaction is not in itself contrary to the purpose of the Sixth Directive and the national legislation transposing it. In my view, the transaction does not necessarily infringe the principle of fiscal neutrality. As Weald Leasing and the Commission indicated, the lease rather than the purchase of equipment does

not in itself result in the trader paying less VAT or **deducting more VAT than that to which a trader is entitled. Thus while there may be cash flow advantages for the trader, there is no inherent VAT saving in leasing rather than purchasing equipment.**

21. I consider that the setting-up and use of a wholly owned or ‘captive’ subsidiary, in this case Weald Leasing, which for VAT purposes is a separate or independent taxpayer, with the sole purpose of obtaining a VAT advantage in the form of a deferral of VAT is not per se abusive, as such an advantage could be obtained by entering into an arm’s length leasing arrangement with an unrelated third party. Thus, the adoption of an asset leasing structure involving an unrelated third party or a wholly owned subsidiary which is independently registered for VAT by a largely exempt trader instead of purchasing assets outright in order to defer the payment of irrecoverable tax does not in itself give rise to a tax advantage which is contrary to the purpose of the Sixth Directive. Where, however, the rental payments under the leasing arrangements are set at artificially low levels, which do not reflect open market conditions, thereby in turn artificially reducing the amount of VAT payable, that part of the transaction relating to the level of payments rather than the lease itself would, in my view, be contrary to the purpose of the Sixth Directive and the national legislation transposing it.”

51. He advised that the lease arrangement was not of itself an abuse of right although he recognised that it was “a purely artificial structure”.

(d) The tribunal’s 2013 Decision

52. In the decision under appeal, Judge Demack summarised the facts he had found in the 2002 Decision. Those facts are not challenged by the parties before us. We note here that HMRC accepts that the terms of the lease and underlease were commercial terms in the sense that the rent payable was a market rent and there was nothing unusual about the other provisions of the leases.

53. The tribunal set out the arguments of the parties at length on each of the issues in the case. At paragraphs 135 onwards, the judge set out his conclusions. The tribunal accepted the University’s argument that until the leases were collapsed, it was not possible to tell whether the tax mitigation scheme in this case would give rise to an absolute tax advantage or would turn out only to have deferred the liability. This was because he considered that if the leases were allowed to run long enough for the University to charge output tax on the lease equal to the amount of the input tax deducted in 01/97 then that would mean that the effect of the tax mitigation scheme was a deferral of tax only. He held that, according to *Weald*, such a deferral of liability should not be treated as an accrual of a tax advantage contrary to the purposes of the Sixth Directive. The judge held that the *Weald* judgment could not be distinguished and that it was authority for the proposition that where a lease/leaseback arrangement is used by an exempt/partially exempt trader to obtain an upfront tax advantage that was not an abuse of right.

54. He held therefore that it was only in 2004 when the University collapsed the leases that it was possible to assess whether there had been an absolute tax advantage since ‘it was not until then that HMRC were in a position to assess, and only in whatever redefined sum they calculated taking into account the tax the University had by then paid’. Although he had found that it was the University’s intention from the outset to make an absolute tax saving, that actual saving did not occur until 2004.
55. He also rejected HMRC’s argument that the use of the trust which was not strictly a connected person within the relevant statutory definition was an abuse of right. He accepted that the exercise of the option to tax amounted to the obtaining of a tax advantage, but held that it was an advantage entirely consistent with the domestic legislation in point. Parliament had carefully decided how far it was going to narrow the option to waive exemption; it decided to go so far but no further. When Parliament has carefully defined how to remove the option there was no scope for a purposive construction of the legislation that overrode Parliament’s choice.

(e) Our findings as to errors in the 2013 Decision

56. We have concluded that the tribunal’s reasoning in the 2013 Decision was flawed in a number of important aspects and cannot stand.
57. First, the tribunal was wrong to hold that *Weald* could not be distinguished. Advocate General Mazák clearly distinguished the facts of *Weald* from the facts of the present case on the basis that the scheme in *Weald*, although entirely artificial, did not have the effect, and was not intended to have the effect, of enabling a partially exempt person (Churchill in that case) to recover input tax to a greater extent than it was generally allowed. The CJEU in its judgment in *Weald* also made clear that Churchill was not purporting to deduct more than 1 per cent of the tax. The aim of the scheme in *Weald* was merely to spread the irrecoverable tax over the longer period of the lease.
58. *Weald* is not authority for the proposition that where a tax mitigation scheme is devised to create an absolute entitlement to deduct input tax but also generates a liability to account for output tax, one must wait to see how much output tax is in fact accounted for before the scheme runs its course. On the contrary, the CJEU, in discussing the redefinition exercise in *Halifax* clearly envisaged that output tax may need to be refunded to the taxable person once the abusive practice has been set aside. This is inconsistent with the idea that a scheme cannot be an abuse unless and until it appears that the output tax accounted for is less than the input tax deduction claimed by the taxable person. There is no suggestion in *Weald* that the CJEU was overturning that aspect of *Halifax*.
59. In our judgment, the tribunal failed to give proper weight to its finding in the 2002 Decision, at [50], that the tax mitigation scheme for the refurbishment of East Mill was intended not only to defer the time at which the University incurred irrecoverable VAT but also to enable the University to obtain an absolute VAT saving by collapsing the VAT arrangements in respect of East Mill before the irrecoverable VAT incurred on the leases exceeded the input tax on the construction work. This was a finding based on objectively ascertained facts arising from the nature of the Trust and the series of transactions comprising the scheme. Given that finding, which was clearly right and has not

been challenged, the tribunal was wrong to regard the case as the same as *Weald* which concerned only a deferment of payment of irrecoverable input tax. The tribunal recorded, at [104] of the 2013 Decision, that Mr Lasok QC appearing for the University, had accepted that if the University and the Trust had attempted to obtain an absolute saving, it would have been abusive since that was not consistent with the legislation.

60. Secondly, we consider that the tribunal was wrong to separate the collapse of the leases in 2004 from the tax mitigation scheme as a whole and to focus on that event as the event that gave rise to the tax advantage. Mr Mantle appearing for HMRC helpfully referred us to the judgment of Lord Reed in *WHA Limited and another v HMRC* [2013] UKSC 24. Lord Reed emphasised the importance of looking at the transaction in question as a whole.

“26 As this court has recently observed (*Her Majesty's Revenue and Customs v Aimia Coalition Loyalty UK Limited* [2013] UKSC 15, para 68), decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another. It is therefore necessary to begin by considering carefully the facts of the present case. As was also noted in the *Aimia* case at para 38, the case-law of the Court of Justice indicates that, when determining the relevant supply in which a taxable person engages, regard must be had to all the circumstances in which the transaction in question takes place. Furthermore, as Lord Walker explained in *Aimia* at paras 114-115, in cases where a scheme operates through a construct of contractual relationships, as in the present case, it is necessary to look at the matter as a whole in order to determine its economic reality. Accordingly, although the transaction of particular importance is that between the garage and WHA, it has to be understood in the wider context of the arrangements between the insured, NIG, Crystal, Viscount, WHA and the garage.”

61. It is therefore wrong as a matter of principle to focus on the collapse of the leases rather than considering them as part and parcel of the overall tax mitigation scheme. It does not make sense to try to identify whether there was a commercial purpose to the termination of the leases in 2004 once it has been conceded that there is no commercial purpose to the overall tax mitigation scheme. If the leases were created purely for the purpose of generating a tax advantage, as the judge found, then the termination of the leases cannot have a different purpose.
62. Further, the tribunal's approach assumes the answer to the question that is being considered. It assumes that the output tax charged to the Trust by the University pursuant to the lease is legitimately incurred and so properly falls to be accounted for by the University to HMRC. But whether that is indeed the case depends on whether the lease is part of an arrangement which is an abuse of right and whether it should therefore be disregarded on the redefinition of the University's tax position.
63. It is true that the CJEU in the *University* judgment held that the supply of the lease and underlease were taxable supplies, regardless of the motive. However, the CJEU made it clear that this was subject to the unasked question in that reference, namely whether the transaction was an abuse of right. If the

transaction looked at as a whole is an abuse of right and if the consequences of redefinition are that the lease is disregarded, that means that no output tax is generated. The CJEU's comments on redefinition in *Halifax* clearly envisage that redefinition may result in output tax for which the taxable person 'was artificially liable under a scheme' having to be unwound. It is not right to assume, as the tribunal seems to have done, that because the lease apparently gave rise to taxable supplies on which output tax was charged, it was not possible to work out what the tax advantage was until the lease was terminated. That ignores the possibility that the lease is part of the abuse of right and should be disregarded on redefinition.

64. Treating the collapse of the leases as the point at which the tax advantage accrues also generates a difficulty that cannot be easily overcome. What power does HMRC have to collect tax in 2004? Mr Lasok said that HMRC can 'assess the tax advantage' at the point when the leases are terminated. In the 2013 Decision, the tribunal accepted this, rejecting the problem that HMRC submitted was created by the University's approach:

"149. I am as puzzled as Dr Lasok by HMRC's claim that they would have been out of time to assess for tax had they waited until 2004 when the University collapsed the leases. In my judgment, they could then have calculated the absolute tax saving made, and assessed accordingly. It follows that again I do not accept that the amount that HMRC could properly claim was the amount of the University's input tax deduction in 1997."

65. We do not see what power HMRC could exercise in 2004 to assess tax on the absolute saving made. HMRC's powers are to assess input and output tax. They do not have a broader power to assess any tax advantage. The power in section 73 of the VAT Act to make an assessment using 'best judgment' arises only 'where it appears to the Commissioners that such returns are incomplete or incorrect' and is subject to a time limit which, in 2004, was three years. On the hypothesis posed by the tribunal, however, there was nothing incomplete or incorrect about the claim for recovery of input tax in 01/97 – it was only later in 2004 that, on that argument, some of the input tax became irrecoverable.
66. In our judgment, the difficulty posed by HMRC cannot so easily be brushed aside and is another indication that the tribunal's approach is wrong. Mr Lasok argued that if the law is defective in failing to provide a mechanism for HMRC to collect the tax in this situation then so be it; that cannot affect the proper application of the abuse of right principle. However, we note that the discussion by the CJEU in *Halifax* of the principle of abuse of right was couched in terms referring to the right or entitlement to deduct input tax:

"83 Finally, it must be borne in mind that the right of deduction provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. It must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (...).

84 However, as the Court has already had occasion to observe, it is only in the absence of fraud or abuse, and subject to adjustments which may be made in accordance with the conditions laid down in Article 20 of the Sixth Directive, that the right to deduct, once it has arisen, is retained (...)

85 Accordingly, the answer to be given to the second question must be that the Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input VAT where the transactions from which that right derives constitute an abusive practice.”

67. That passage, together with the passage to which we have already referred in which the CJEU envisages that output tax wrongly accounted for will need to be refunded following redefinition, shows in our judgment that the University’s suggested approach of leaving the entitlement to deduct intact and trying to claw back the tax at some later point is not what EU law requires.

(f) Application of the abuse of right principle to the present case

68. Having concluded that the tribunal erred in its approach to the University’s tax saving arrangement, we turn to consider whether the tax mitigation scheme used by the University was an abuse of right, applying the CJEU’s case law.

69. It is accepted by the University that the second criterion laid down in *Halifax* is satisfied here because there are sufficient objective factors showing that the essential aim of the transactions concerned was to obtain a tax advantage. There was no other commercial purpose to the lease and underlease arrangement entered into between the University and the Trust other than to bring about the claimed tax saving. It is conceded therefore that the second element of the *Halifax* test is satisfied here.

70. The questions we must therefore address are whether there was a tax advantage accruing to the University from the arrangements and whether the grant of that advantage would be contrary to the purposes of the Sixth Directive provisions.

71. When the transaction is looked at as a whole, the answers to these two questions are clear. The tax advantage that the arrangements were intended to confer on the University was the ability to claim that the refurbishment work was directly and immediately linked not to the University’s general supplies most of which were exempt supplies, but to the supply of the lease which the University had opted to treat as a taxable supply. This enabled the University, it claimed, to recover 100 per cent of the input tax rather than only a small proportion of it. We find that this is a tax advantage that accrued to the University when it claimed the input deduction for the period 01/97, as it was entitled to do under the strict wording of the provisions.

72. As to whether this advantage was contrary to the purposes of the VAT legislation, HMRC put its case two ways. The first way related to a purpose which can be expressed as ensuring that taxpayers making exempt supplies are not permitted to recover input tax on supplies that are, in reality, directly and immediately linked to those exempt supplies. The second focuses on the use of the Trust by the University as the vehicle for the tax saving arrangement. That purpose could be expressed as ensuring that taxpayers do not frustrate the tax avoidance provisions of the VAT Act aimed at preventing connected persons from electing to waive exempt status for supplies of immovable property between them when one of them is exempt or partially exempt.

73. The first purpose was the purpose enunciated by Advocate General Maduro and the CJEU in the *Halifax* case. In paragraph 93 of his Opinion, quoted above, the Advocate General stated that the principles behind the Sixth Directive require

‘that a taxable person *must not* be entitled to deduct or recover the input VAT paid on supplies received for its exempted transactions’. The Court also said that to allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, they only make exempt supplies ‘would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules’.

74. This is clear guidance, in our judgment, that the tax mitigation scheme devised for the University should be regarded as an abuse. It is an artificial attempt to create a taxable supply which does not have any function other than to enable the deduction of input tax. The University had no need to enter into the lease and underlease in order to use East Mill for its general activities since it already had a lease entitling it to occupy the premises. Once refurbished, East Mill was going to be used for the general activities of the University and those activities are primarily exempt supplies. To allow the University to rely on the lease of East Mill to the Trust as the provision of a taxable supply would be contrary to the purposes of the Sixth Directive as described by Advocate General Maduro and the CJEU in *Halifax*.
75. We therefore hold that the tax mitigation scheme was an abuse of right.
76. The second purpose relied on by HMRC as being undermined by the tax saving arrangement is the purpose of preventing tax avoidance by connected persons. Article 13B(b) of the Sixth Directive requires Member States to exempt certain supplies, including supplies of immovable property, subject to conditions that ensure the correct and straightforward application of the exemptions and prevent any possible evasion, avoidance or abuse. The Member State is empowered by Article 13C to allow taxpayers a right to opt for taxation for leases of land. That provision also empowers the Member State to restrict the scope of this right of option and to fix the details of its use.
77. HMRC submit that the new paragraphs 2(3A) and 3(8A) inserted into Schedule 10 to the VAT Act were intended to prevent connected persons from making the kind of arrangements used in this case. There are features of the Trust which show that the University controlled it and the tribunal so found in the 2002 Decision at [32]. The fact that the University found a way round the definition in section 839 of the Income and Corporation Taxes Act 1988 by using a trust rather than a subsidiary company is a technical device which undermines the purpose of the tax avoidance provision and should amount to an abuse.
78. Although we see some force in Mr Mantle’s arguments, we also see some formidable obstacles to HMRC’s case on this ground for the finding of abuse.
79. First, we doubt whether preventing the circumvention of anti-avoidance measures can properly be described as a separate purpose pursued by the Sixth Directive and the VAT regime in general. It seems to us that the anti-avoidance measures introduced into Schedule 10 are ancillary provisions supporting the purpose we have identified in relation to the first ground, that is to stop exempt or partially exempt taxpayers claiming an entitlement to deduct input tax by waiving exemption to create a taxable supply. To hold that an arrangement which circumvents an anti-avoidance provision enacted by a Member State is, of itself, contrary to the purpose of the VAT regime and hence potentially an abuse of right, risks expanding the principle of abuse beyond the scope currently

described by the CJEU. It would in effect enable the Member State to rely on the principle to close any loop-hole found in anti-avoidance measures by asserting that use of the loop-hole was contrary to a general purpose of ensuring anti-avoidance.

80. Mr Mantle drew our attention to the Opinion of Advocate General Mazák in *Weald*. In that case, Weald Leasing argued that HMRC's complaint was not really about the use of a leasing mechanism instead of an outright purchase but the interposition of Suas with the possibility that the hire payments for the equipment were artificially low. Suas did not fall within the definition of connected persons for the purposes of the anti-avoidance provisions in paragraph 1(1) of Schedule 6 to the VAT Act (which empowered HMRC to substitute the open market value for the value paid for taxable supplies between connected persons). Weald Leasing argued that the abuse principle only applies to tax advantages which are contrary to EU law provisions and not to attempts to circumvent domestic law. The Advocate General rejected this argument: (footnotes omitted)

“24. I consider that Weald Leasing's submission cannot be accepted. It would appear from the file before the Court, and subject to verification by the referring court, that paragraph 1, Schedule 6, of the VAT Act 1994 was enacted pursuant to a derogation under Article 27 of the Sixth Directive. In my view, provisions of national legislation which were adopted in accordance with the derogations laid down in Article 27 of the Sixth Directive form an integral part of the national VAT system, are binding on a taxable person under national law and may be relied upon by the tax authorities of a Member State before the national courts against that person. For the purposes of the application by the national courts of the abuse principle as laid down in *Halifax*, any distinction between national provisions which implement the provisions of the Sixth Directive and those which were adopted in full compliance with a derogation permitted under that directive is, in my view, contrived and tends to undermine the integrity of the national VAT system and indirectly the EU VAT system.”

81. The CJEU agreed:

“42. In that context, Weald Leasing's argument that the principle of prohibiting abusive practices does not apply to breach of Paragraph 1 in Schedule 6 to the VAT Act 1994 because that provision is purely a question of national law cannot be accepted, because that provision was adopted on the basis of Article 27 of the Sixth Directive and forms part of the national legislation implementing that directive.”

82. We accept that the fact that the anti-avoidance provisions are found in domestic law rather than in the Sixth Directive itself does not rule out the application of the abuse of right principle in relation to a circumvention of the domestic provision. However, Mr Lasok pointed out certain differences between domestic legislation implementing Article 27 of the Sixth Directive and the domestic legislation at issue in this case. He accepted that Articles 13B and 13C of the Sixth Directive empower Member States to enact anti-avoidance provisions when granting taxpayers the option to waive exemption on supplies of leases. He also accepted that domestic legislation enacted pursuant to those articles must comply with general principles of EU law such as protection of legitimate

expectations and legal certainty: see Cases C-487/01 & C-7/02 *Gemeente Leusden v Staatssecretaris van Financiën* [2004] ECR I-5337. But he argued that in this case there was no material on which a tribunal could arrive at the conclusion that the purpose of paragraphs 2(3A) and 3(8A) of Schedule 10 was to achieve something broader than what it actually achieved. There was no justification for assuming that the purpose of the Treasury in making the 1994 Order, or the purpose of Parliament in approving it, was to prevent waivers of exemption by a wider class of connected persons than are in fact caught by the wording of the 1994 Order properly interpreted. The 1994 Order could have set out a more comprehensive definition of ‘connected persons’ but instead it cross refers to the definition in the Income Taxes Act. HM Treasury and Parliament must be assumed to know what that definition covers and it is common ground that it does not cover the relationship between the University and the Trust in this case. Mr Lasok argued that any supposition of a wider purpose – and hence any assertion that the tax saving arrangement devised here was contrary to such wider purpose – would be pure invention.

83. We agree that it is difficult to see how an English court should approach the issue of working out what the purpose of legislation is if that purpose is something different than ‘the strict formalistic interpretation’ of the provision, to adopt Advocate General Maduro’s phrase. We are familiar with looking at the purpose of legislation as an aid to construction of the words of the statute. But once the words have been interpreted, we are much less accustomed to identifying a purpose which the legislation tried but failed to achieve and with relying on that purpose to repair that failure in the way that the abuse of right doctrine contemplates.
84. If the outcome of this appeal had depended on the second ground relied on by HMRC, we would have sought the parties’ submissions on whether it was appropriate to refer further questions to the CJEU – unpalatable though that would be given that we are already over 15 years away from the period of assessment 01/97.
85. Since we have concluded that the answer on the first ground is clear, we do not need to resolve the questions posed by HMRC’s reliance on the abuse of right principle to extend the scope of paragraph 2(3A) beyond its wording.

(g) Redefinition

86. We turn finally to the question of how we should redefine the tax situation in order to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice. In doing so we reject the procedural point made by Mr Lasok to the effect that the tribunal below had come to a conclusion as to the redefinition of this transaction and HMRC had failed to challenge that in their grounds of appeal. Since the tribunal found that there had been no abuse, it did not have to undertake the redefinition exercise and we do not read the 2013 Decision as including any such redefinition.
87. In the *Halifax* judgment, the CJEU described the redefinition exercise in the following terms:

“93 It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of

that finding, which rendered undue all or part of the deductions of input VAT (see, to that effect, *Emsland Stärke*, paragraph 56).

94 It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

95 In that regard, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been exercised abusively (*Fini H*, paragraph 33).

96 However, they must also subtract therefrom any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess.

97 Similarly, it must allow a taxable person who, in the absence of transactions constituting an abusive practice, would have benefited from the first transaction not constituting such a practice, to deduct, under the deduction rules of the Sixth Directive, the VAT on that input transaction.

98 It follows that the answer to Question 1(b) must be that, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.”

88. In the *Weald* judgment, the CJEU held that the redefinition by the national court ‘must go no further than is necessary for the correct charging of the VAT and the prevention of tax evasion’.

89. Bearing in mind those stipulations we have considered whether the correct redefinition is -

- a. to disregard the exercise by the University and the Trust of their option to waive the exemption for the supply of the lease and underlease but to treat the lease and the underlease as remaining in place; or
- b. to disregard the lease and underlease in their entirety.

90. It might appear that the first option does less violence to the arrangement entered into and therefore goes no further than is necessary. But we have concluded that in fact the second option is the one which results in the correct charging of VAT and the prevention of tax evasion. This is because if the lease and underlease remain in place as an exempt supply of services, then it might be argued by HMRC that the refurbishment work was directly and immediately linked only to that exempt supply and not to the supply of the University’s other services. That might have the result that none of the input VAT is recoverable by the University. If the lease and underlease are disregarded following redefinition then it must be recognised that the refurbishment was undertaken for the University’s general purposes and the University would still be entitled to recover the relevant proportion of tax that it recovers on its general expenditure.

91. We do not see that it is necessary for the correct charging of VAT or to prevent tax evasion to prevent the University from being able to deduct the amount of input tax that it would have deducted if it had not entered into the tax mitigation arrangement. The prevailing situation should therefore be redefined to remove the whole of the tax mitigation scheme and treat the refurbishment as undertaken for the University's general purposes.

Disposition

92. We therefore allow the appeal on the first ground put forward by HMRC because we find that the tax mitigation scheme entered into between the University and the Trust was an abuse of right in so far as it entitled the University to claim a greater deduction of input tax paid on the refurbishment work on East Mill than it would have been entitled to if that refurbishment work had been regarded as directly and immediately linked to its general, largely exempt, supplies.

93. We redefine the tax position by disregarding both the lease by the University to the Trust and the underlease from the Trust to the University. The University is not therefore required to account for any output tax incurred pursuant to the tax mitigation arrangement.

Signed

Mrs Justice Rose DBE

Judge Greg Sinfield

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