[2019] UKFTT 410 (TC)

TC07225

Appeal number: TC/2014/05260

VALUE ADDED TAX – VAT grouping legislation – art 11 of the VAT Directive – section 43A of VATA – 'body corporate' as an eligibility criterion – partnership not eligible for participation – CJEU decision in* Larentia + Minerva *– breach of EU principle of fiscal neutrality – relevant EU provision has no direct effect – whether conforming construction possible to go with 'the grain of the legislation' – whether distinction to be drawn for a Scottish partnership – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BAILLIE GIFFORD & CO	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE HEIDI POON

Sitting in public at George House, Edinburgh on 16 and 17 April 2018

Written submissions for the Appellant on 24 January 2019 and for the Respondents on 14 February 2019 by Directions issued on 18 December 2018

Andrew Hitchmough QC and Emma Pearce, Counsel, instructed by KPMG LLP, for the Appellant

Elisabeth Roxburgh, Advocate, instructed by the Office of Advocate General, for the Respondents

DECISION

Introduction

1. The appellant, Baillie Gifford & Co ('BG&Co') appeals against the decision dated 21 February 2014 as upheld in a further decision of the respondents ('HMRC') on review dated 29 August 2014, which refused the appellant's application to form a VAT group with it as the representative member under s 43 of the Value Added Tax Act 1994 ('VATA').

2. The principal reason for the refusal is that the appellant, as a Scottish partnership, is not a 'body corporate' for the purposes of s 43A of VATA. Consequently, it fails to meet the statutory eligibility criterion to form a VAT group.

3. The issue in this appeal is whether conforming construction can be applied to the existing domestic legislation on VAT grouping following the judgment of the Court of Justice of the European Union ('CJEU') in *Larentia + Minerva* as referenced in the Annex.

Legislative Framework

European Union Directives

4. The relevant EU legislation is contained in the EC Council Directive 2006/112/EC ('**the VAT Directive**' also '**the 2006 Directive**') of 28 November 2006 under Title III for 'Taxable Persons'. Excerpts of the relevant articles material to this appeal are the following:

> **Article 9**
>
> 1. 'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purposes or results of that activity.
>
> …
>
> **Article 10**
>
> The condition in Article 9(1) that the economic activity be conducted 'independently' shall exclude employed and other persons from VAT in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability.
>
> **Article 11**
>
> After consulting the advisory committee on value added tax (hereafter, the 'VAT Committee'), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.

> A Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision.

5. Article 11 of the VAT Directive is the successor to what was contained in Article 4(4) of the Sixth Council Directive 77/388/EEC (‘**the Sixth Directive**’) of 17 May 1977. (The Sixth Directive was repealed by the VAT Directive with effect from 1 January 2007). Instances of case law being referred to in this decision concern the interpretation of Article 4 of the Sixth Directive, of which the relevant provisions are the following:

> **Taxable Persons**
>
> **Article 4**
>
> (1) ‘Taxable person’ shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.
>
> […]
>
> (4) The use of the word ‘independently’ in paragraph 1 shall exclude employed and other persons from the tax in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and employer’s liability. [first sub-para]
>
> Subject to the consultations provided for in Article 29, each Member State may treat as a single taxable person persons established in the territory of the country who, while legally independent, are closely bound to one another by financial, economic and organisational links. [second sub-para]
>
> A Member State, exercising the option provided for in the second subparagraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision …[1] [third sub-para]

European Communities Act 1972 (‘ECA 1972’)

6. The ECA 1972 provides for the Community (now Union) Treaties to be incorporated into domestic law. In so far as the European Treaties have been subsequently modified, the ECA 1972 has been amended to incorporate the modifications under the Single European Act, and the Masstricht, Amsterdam, Nice and Lisbon Treaties.

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[1] The third subparagraph of art 4(4) was inserted by Directive 2006/69, to provide in similar terms to the second paragraph of art 11 of the VAT Directive. At [42] of *L+M*, the court notes that even before the entry into force of the third subparagraph, member states could still have taken ‘equivalent effective measures’ against tax evasion and avoidance, that being an objective recognised and encouraged by the Sixth Directive in the absence of express powers granted by the EU legislature; see for example, *Halifax plc v Customs and Excise Comrs* (Case C-255/02) [2006] STC 919.

7. Section 2 of the ECA 1972 provides for the implementation and application of EU law arising from the Treaties, secondary legislation and the case law of the Court of Justice in the British courts, and sub-section 2(1) states as follows:

> **2 General implementation of Treaties**
>
> (1) All such rights, powers, liabilities, obligations and restrictions from time to time created or arising by or under the Treaties, and all such remedies and procedures from time to time provided for by or under the Treaties, as in accordance with the Treaties are without further enactment to be given legal effect or used in the United Kingdom shall be recognised and available in law, and be enforced, allowed and followed accordingly; and the expression 'enforceable EU right' and similar expressions shall be read as referring to one to which this subsection applies.

Value Added Tax Act 1994

8. The UK has exercised the option contained in Article 11 of the VAT Directive to allow VAT grouping by the enactment of ss 43 and 44 of VATA, of which sub-s 43(1) provides as follows:

> **43 Groups of companies**
>
> (1) Where under sections 43A to 43D any bodies corporate are treated as members of a group, any business carried on by a member of the group shall be treated as carried on by the representative member, and –
>
> (a) any supply of goods or services by a member of the group to another member of the group shall be disregarded; and
>
> (b) any supply which is a supply to which paragraph (a) above does not apply and is a supply of goods or services by or to a member of the group shall be treated as a supply by or to the representative member; and
>
> (c) any VAT paid or payable by a member of the group on the acquisition of goods from another member State or on the importation of goods from a place outside the member State shall be treated as paid or payable by the representative member …
>
> […]
>
> (9) Schedule 9A (which makes proviso for ensuring that this section is not used for tax avoidance) shall have effect.

9. Section 43A VATA contains the criteria of eligibility to form a VAT group:

> **43A Groups: eligibility**
>
> (1) Two or more bodies corporate are eligible to be treated as members of a group if each is established or has a fixed establishment in the United Kingdom and –
>
> (a) one of them controls each of the others,
>
> (b) one person (whether a body corporate or an individual) controls all of them, or

(c) two or more individuals carrying on a business in partnership control all of them.

(2) For the purposes of this section a body corporate shall be taken to control another body corporate if it is empowered by statute to control that body's activities or if it is that body's holding company within the meaning of section 1159 of and Schedule 6 to the Companies Act 2006.

(3) For the purposes of this section an individual or individuals shall be taken to control a body corporate if he or they, were he or they a company, would be that body's holding company within the meaning of those provisions.

10. With effect from 22 July 2004, (by insertion of FA 2004 s 20(1)), the Treasury is provided with the power to make modifications to s 43A requirements under s 43AA as follows:

43AA Power to alter eligibility for grouping

(1) The Treasury may by order provide for section 43A to have effect with specific modifications in relation to a specified class of person.

(2) An order under subsection (1) may, in particular –

(a) make provision by reference to generally accepted accounting practice;

(b) define generally accepted accounting practice for that purpose by reference to a specified document or instrument …

[…]

(3) An order under subsection (1) may also, in particular, make provision by reference to –

(a) the nature of a person;

(b) past or intended future activities of a person;

(c) the relationship between a number of persons;

(d) the effect of including a person within a group or of excluding a person from a group.

(4) An order under subsection (1) may –

(a) make provision which applies generally or only in specified circumstances;

(b) make different provision for different circumstances;

(c) include supplementary, incidental, consequential or transitional provision.

11. The procedure to form a VAT group by application is provided under s 43B:

43B Groups: applications

(1) This section applies where an application is made to the Commissioners for two or more bodies corporate, which are eligible by virtue of section 43A, to be treated as members of a group.

[...]

> (5) The Commissioners may refuse an application, within the period of 90 days starting with the day on which it was received by them, if it appears to them –
>
> (a) … that the bodies corporate are not eligible by virtue of section 43A to be treated as members of a group
>
> (b) in the case of an application such as is mentioned in subsection (2)(a) above, that the body corporate is not eligible by virtue of section 43A to be treated as a member of the group, or
>
> (c) in any case, that refusal of the application is necessary for the protection of the revenue.
>
> (6) If the Commissioners refuse an application it shall be taken never to have been granted.

12. An appeal against the Commissioners' decision on an application under s 43B VATA is brought under the terms of s 83 VATA, of which sub-s 83(1)(k) specifies the right to appeal against 'the refusal of an application such as is mentioned in section 43B(1) or (2)'.

13. Anti-avoidance provisions within VATA include:

(1) Schedule 1 provides against business-splitting, and for the Commissioners to make a direction for a named person to be treated as a single taxable person carrying on the business activities as specified in the direction.

(2) Schedule 9A (as mentioned under s 43(9)) provides against the use of VAT grouping for the avoidance of tax, and confers the Commissioners with a range of powers to make directions where 'a relevant event has occurred'.

Value Added Tax (Groups: eligibility) Order 2004

14. The Value Added Tax (Groups: eligibility) Order (SI 2004/1931) ('the Order') was the first exercise of the Treasury's power under s 43AA of VATA to modify the eligibility requirements to form a VAT group, and comes into force from 1 August 2004. Relevant excerpts of the Order are as follows:

> **Modification regarding section 43A of the Value Added Tax Act 1994**
>
> **2.** A body corporate that is a specified body is eligible to be treated as a member of a group if, in addition to satisfying the conditions set out in section 43A(1)(2) of the Value Added Tax Act 1994 ("the Act"), it satisfies both the benefits condition and the consolidated accounts condition.
>
> **Specific bodies**
>
> **3. –** (1) A body corporate to which this article applies is a specified body for the purposes of this Order if it carries on a relevant business activity and –
>
> (a) the value of the group's supplies in the year ending has exceeded £10 million; or

(b) there are reasonable grounds for believing that the value of the group's supplies in the year then beginning will exceed that amount.

[…]

(3) Subject to paragraph (4), this article applies to a body corporate which, at any time when the relevant business activity is being carried on –

(a) is not a wholly-owned subsidiary of a person who controls all of the other members of the group (or, where the person is or will be a member of the group, all of the other members apart from himself);

(b) is managed, directly or indirectly, in respect of the business activity concerned, by a third party in the course or furtherance of a business carried on by him; or

(c) is the sole general partner of a limited partnership.

[…]

Interpretation etc.

7. – (1) In determining –

(a) the value of the supplies made by a body corporate that is the sole general partner of a limited partnership ('a general partner');

(b)-(d) […]

articles 3(1) and (2), 4(1), 5 and 6 shall apply as if references to the body or specified body, as the case requires, are references to the limited partnership.

(2) – (4) […]

(5) Any reference in this Order to a person controlling a body corporate includes a reference to his controlling the body together with one or more other individuals with whom he is carrying on a business in partnership.

15. The Order is, in effect, a specific anti-avoidance measure and imposes additional conditions on eligibility requirements to form a VAT group, taking into account the 'relevant business activities', 'the benefits condition', and 'the consolidated accounts condition' of the applicant group members.

16. The Order was made to prevent the misuse of the VAT grouping rules whereby a large company as a purchaser of services form a VAT group with a supplier that is run by, or for the benefit, of a third party. For example, a bank as an exempt service provider cannot reclaim its VAT on purchases from its IT provider. The bank might seek to form a VAT group with its IT supplier by meeting the s 43A eligibility test through holding sufficient 'A' shares which confer voting rights with no management input, while the third-party supplier would hold 'B' shares carrying the right to nearly all the profits, dividends, assets on winding up, and would run the business. By forming

a VAT group with its IT supplier, the bank would avoid the VAT on the IT services bought.

17. The Explanatory Note (not part of the Order) states that article 2 of the Order modifies the eligibility rules in s 43A of VATA by imposing additional conditions, whereby if a body corporate is a 'specified body' as defined in article 3, then it may only join a VAT group if, beside satisfying the existing s 43A test of 'control', it meets the benefits condition under article 5, and the consolidated accounts condition under article 6.

Companies Act 2006 ('CA 2006')

18. The VAT grouping eligibility test refers to the control test under s 1159 of CA 2006, which defines:

> **1159 Meaning of 'subsidiary' etc**
>
> (1) A company is a 'subsidiary' of another company, its 'holding company', if that other company –
>
> (a) holds a majority of the voting rights in it, or
>
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
>
> (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it,
>
> or if it is a subsidiary of a company that is itself a subsidiary of that other company.
>
> (2) A company is a 'wholly-owned subsidiary' of another company if it has no members except that other and that other's wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries.
>
> (3) Schedule 6 contains provisions explaining expressions used in this section and otherwise supplementing this section.
>
> (4) In this section and that Schedule [6] 'company' includes any body corporate.

19. Schedule 6 to CA 2006 contains the 'Supplementary Provisions' in relation to the 'Meaning of "Subsidiary"', of which para 2 defines:

> **Voting rights in a company**
>
> …[as] the rights conferred on shareholders in respect of their shares or, in the case of a company not having a share capital, on members, to vote at general meetings of the company on all, or substantially all, matters.

20. Section 1173 of CA 2006 for 'Minor definitions', so far as relevant, states:

> (1) …
>
> 'body corporate' and 'corporation' include a body incorporated outside the United Kingdom, but do not include –
>
> (a) a corporation sole, or

(b) a partnership that, whether or not a legal person, is not regarded as a body corporate under the law by which it is governed; …'

Partnership Act 1890 ('PA 1890')

21. The relevant provisions for the purposes of this appeal are the following:

> **4 Meaning of firm**
>
> (1) Persons who have entered into partnership with one another are for the purposes of this Act called collectively a firm, and the name under which their business is carried on is called the firm-name.
>
> (2) In Scotland a firm is a legal person distinct from the partners of whom it is composed but an individual partner may be charged on a decree or diligence directed against the firm, and on payment of debts is entitled to relief pro rata from the firm and its other members.
>
> […]
>
> **9 Liability of partners**
>
> Every partner in a firm is liable jointly with other partners, and in Scotland severally also, for all debts and obligations of the firm incurred while he is a partner; and after his death his estate is also severally liable in a due course of administration for such debts and obligations, so far as they remain unsatisfied, but subject in England or Ireland to the prior payment of his separate debts.

Case Law

22. The references of the authorities referred to in this decision are set out in the Annex.

The Facts

23. The Tribunal is not required to embark on a fact-finding exercise. The facts of this appeal are not in issue, and the parties lodged a Statement of Agreed Facts.

24. For the appellant, Mr Barry Coghill as Head of Finance at Baillie Gifford & Co, lodged a witness statement. He was not called to give evidence upon the lodgement of the Statement of Agreed Facts. From these statements and the documents bundle, the relevant facts are as follows.

The group structure

25. The appellant was founded in 1908 as a Scottish Partnership under the Partnership Act 1890. It is common ground that the appellant is not a body corporate.

26. The appellant is the sole shareholder in:

(a) Baillie Gifford & Co Limited ('**BG Ltd'**), a private company limited by shares, incorporated on 8 October 1979;

(b) Baillie Gifford Savings Management Limited ('**BG Savings**'), a private company limited by shares, incorporated on 18 December 1991;

(c) Baillie Gifford Life Limited (‘**BG Life**’), a private company limited by shares, incorporated on 22 January 1998.

27. BG Ltd, BG Savings, and BG Life are referred to as the ‘subsidiaries’ and are all registered in Scotland. The appellant together with its subsidiaries are referred to as ‘the BG Group’.

28. As the sole shareholder of each of the subsidiaries, the appellant exercises control of the subsidiaries through its voting rights, which enable the appellant to appoint and remove directors and otherwise to convene and vote at general meetings.

The BG Group’s business

29. The appellant is in the business of providing investment management services. It analyses and monitors the assets, and effects the purchase and sale of securities and other investments. The appellant provides its investment management services to third parties, such as large pension schemes, and to BG Ltd and BG Life.

30. BG Ltd acts as an Authorised Corporate Director (‘ACD’) of Open Ended Investment Companies (‘OEICs’), a Unit Trust Manager, an Alternative Investment Fund Manager, and a provider of regulated investment management services.

31. BG Life is a regulated entity which issues life assurance products.

32. BG Savings is a saving scheme administrator of investment trust share plans and ISAs. It also provides marketing, sales, and administration services to BG Ltd.

33. BG Savings, in turn, receives marketing and corporate administration services, together with office facilities and various related services (IT, systems and maintenance) from the appellant.

34. Some of the services provided by the appellant to its subsidiaries are standard rated for VAT purposes, and others are exempt.

35. It is common ground that due to regulatory requirements governing financial services and investments providers, the group’s business cannot be provided solely through the structure of a partnership. Some financial services can only be undertaken through a corporate vehicle. Further, the provision of life assurance products is required to be undertaken by a separate entity from the appellant.

VAT registration history and VAT group application

36. The appellant and BG Life have been separately registered for VAT, each having its own VAT registration number.

37. On 12 November 2013, BG Savings became registered for VAT. BG Ltd was not registered for VAT at the time.

38. From 1 July 2014, BG Savings and BG Ltd have been granted a VAT group registration.

39. Also on 12 November 2013, the appellant's accountants, KPMG LLP ('KPMG') applied on its behalf to form a VAT group, with the appellant as its representative member, and its three subsidiaries as its members.

40. If the appellant were allowed to enter into a VAT group with the subsidiaries, it would mean that VAT would not be chargeable on transactions between the appellant and the subsidiaries.

41. In the absence of VAT grouping, the VAT due on intra-group supplies, to the extent that it is irrecoverable, represents an artificial cost to the business operated by the group. The level of such costs is not a matter for determination by the Tribunal.

HMRC's refusal decision

42. By letter dated 21 February 2014, HMRC refused the VAT grouping application. The main aspect to the refusal decision concerns the issue that BG&Co (the appellant) is not a 'body corporate'. The decision referred to the explanatory notes under s 1173(1)(b) of CA 2006: 'a partnership, whether or not a legal person is excluded from being regarded as a body corporate'. Section 1488 of CA 2006 further clarifies that 'corporations sole' and 'partnerships', while being legal persons, are not regarded as bodies corporate. In conclusion, while HMRC accept that a Scottish partnership is distinct from other partnerships, in that it is a legal person in its own right, it is not a body corporate, which makes it ineligible for registration to form a VAT group.

43. On 21 March 2014, KPMG requested a review of the decision. It contended that BG&Co meets the criterion in HMRC's guidance manual on eligibility for VAT group treatment, wherein a corporation is defined as: 'a group of people authorised by law to act as an individual, and having its own power, duties and liabilities' (para 3.4.3 of HMRC's guidance volume VI-28, replaced by VATREG09050).

44. On 29 August 2014, HMRC notified the appellant of its review decision, which upheld the refusal of its application.

Appeal and application to stay

45. On 26 September 2014, the appellant notified its appeal against the decision to the Tribunal. The notice of appeal included an application for Tribunal directions for the appeal to stand over, pending the decisions of CJEU in *Larentia + Minerva* (Case C-108/14) and in *Marenave Schiffart* (Case C-109/14). (The two cases were jointly considered; henceforth '*L+M*'.)

46. On 8 December 2014, the Tribunal issued directions for the appeal to be stood over until 60 days after the release of the CJEU decision in *L+M*.

47. On 16 July 2015, the CJEU decision *L+M* was released.

48. On 27 November 2015, KPMG applied for a further stay of the proceedings in anticipation that HMRC would 'in due course, publish their revised policy on the issues', and that the appeal could be resolved without recourse to the Tribunal.

49. On 14 January 2016, HMRC published 'Revenue and Customs Brief 3 (2016): review of VAT grouping provisions following the *Larentia + Minerva* and *Marenave* (C-108/14 and C-109/14) and *Skandia* (C-713) judgments'. The Brief stated: 'As a result of this judgment the government expects to make changes to UK law and VAT grouping provisions'.

50. In spring 2016, HMRC launched a 12-week written consultation on 'the policy options and proposals' to 'determine the final shape of VAT grouping provisions'.

51. On 27 May 2016, KPMG applied for a further stay in anticipation of policy revision in respect of VAT grouping.

52. HMRC launched a further consultation on 5 December 2016 by publishing the consultation document entitled 'Scope of VAT Grouping', with the closing date for comments being 27 February 2017. The appellant took part in this consultation.

53. By letter dated 21 January 2017, the Tribunal informed the appellant that the stay on the proceedings had expired, and the case proceeded under the standard category, with the appellant being given leave to amend its grounds of appeal to incorporate the CJEU's decision in *L+M*.

54. In December 2017, HMRC published the 'Summary of responses' on the consultation on 'Scope of VAT Grouping', of which the government's response at para 2.12 is: 'Any expansion of grouping would need to be supported by robust anti-avoidance measures', which the government will ensure are 'considered alongside any VAT grouping changes' and 'to avoid further complexity for taxpayers'.

Post-hearing Directions

55. As a preliminary matter, the Tribunal issued Directions on 18 December 2018 to invite sequential written submissions from the parties on the courts' obligations to apply a conforming interpretation in a situation where the implementation of the EU Directive provision in question under art 11 of the VAT Directive is not mandatory: whether to permit VAT grouping in its territory is an option that a member state can exercise, and has a margin of discretion as to how to exercise the option. The Tribunal is grateful for the parties' clear and detailed submissions, which are incorporated into their respective arguments as appropriate.

The enactment of the Finance Act 2019

56. A copy of the draft provisions for the Finance Bill 2019 accompanies the appellant's written submissions. The Bill has since been enacted as the Finance Act 2019 ('FA 2019') on receiving Royal Assent on 12 February 2019.

57. By provisions under s 53 and Sch 18, paras 1 and 2 of FA 2019, amendments have been made to s 43A of VATA to the eligibility criteria for VAT grouping. The relevant legislation for the purposes of this appeal remains the version of the legislation that was in force when the VAT group application was made on 12 November 2013.

The Appellant's Case

58. For the appellant, Mr Hitchmough submits that:

(1) UK law on VAT grouping would be in breach of EU law (including the principles of equal treatment and fiscal neutrality) if it were to restrict VAT grouping to bodies corporate.

(2) UK legislation can and should be given a conforming construction, with the result that Scottish partnerships (such as the appellant) can form a VAT group.

59. The substantive arguments in relation to the submission that UK law is incompatible with EU law over the VAT grouping rules are as follows:

(a) The principle of equal treatment requires persons to be treated equally in respect of their EU rights.

(b) The principle of fiscal neutrality is a sub-set of the principle of equal treatment. It precludes treating similar (and therefore competing) economic transactions differently for VAT purposes.

(c) The appellant contends that the UK VAT grouping legislation breaches both of these fundamental principles for the reasons given (in relation to German law) by Advocate General ('AG') Megozzi and the CJEU in *L+M*.

(d) Following *L+M*, it is clear that the literal terms of the UK legislation, in limiting the application of VAT grouping to particular legal entities (namely, bodies corporate), amount to an unjustifiable restriction which is contrary to EU law, in particular the principles of equal treatment and fiscal neutrality.

(e) Such a restriction would not infringe EU law if it were justified as necessary and appropriate to prevent abuse. The appellant contends that there is no such justification, nor has any such justification been advanced by HMRC in the context of these proceedings or otherwise.

(f) Contrary to HMRC's case (para 16 of the Statement of Case) there is no requirement for further evidence to demonstrate that these fundamental principles are 'engaged on the facts'. That these principles are engaged follows inevitably from the conclusions of both the AG and the CJEU in *L+M*.

(g) Furthermore, it is an obvious result of the restriction in UK legislation that the appellant's competitors can enjoy the commercial advantage of VAT grouping, whilst the appellant cannot.

(h) In any event, HMRC appear to acknowledge that UK legislation on VAT grouping is in breach of EU law: they have held a consultation on changing VAT grouping legislation in the light of *L+M*.

60. The substantive arguments in support of the need for a conforming construction are as follows:

(a) It is clearly stated in *L+M* that Article 4(4) was not capable of having direct effect.

(b) It follows that the appellant can only rely upon Article 11 of the VAT Directive in so far as it is possible to construe domestic law in accordance with EU law, a process known as 'conforming construction' or the *Marleasing* principle.

(c) The appellant contends that a conforming construction that permits a Scottish partnership (which is not a body corporate) to form part of a VAT group is perfectly possible in this case.

(d) UK courts are required to interpret UK legislation so far as possible in conformity with the requirements of EU law: 'any enactment passed or to be passed … shall be construed and have effect subject to' the UK's EU treaty obligations incorporated into UK law (see ss 2(1) and 2(4) of ECA 1972).

(e) The approach to be adopted when construing legislation in conformity with EU law was summarised and applied by the English courts in *Prudential* and *Vodafone 2*: the obligation on the courts in this respect is described as 'both broad and far-reaching', and the approach is described by Lord Sumption in *FII* as a 'highly muscular approach'.

61. Concerning the issue whether a conforming construction that enables a Scottish partnership to form a VAT group would 'go with the grain' of the VAT grouping legislation, it is submitted that:

(a) HMRC do not argue that the restriction to bodies corporate is a cardinal feature of domestic legislation, and they are right not to do so, for it is not a fundamental feature.

(b) By contrast, the conditions in domestic legislation stipulating the requisite degree of control do constitute a cardinal feature, and reflect the requirements in Article 11 in respect of 'closely bound to one another by financial, economic and organisation links'.

(c) Furthermore, the restriction of grouping to bodies corporate is *not* required in order to apply the provisions relating to control. HMRC's acceptance that the control criterion is met here is unsurprising. The appellant meets the tests in CA 2006 s 1159 and Schedule 6 readily.

(d) The extension of VAT grouping to Scottish partnerships does not interfere with other fundamental features of the domestic legislation, such as administrative simplification and the abolition of artificial charges to VAT. Indeed, conforming construction would further rather than undermine these objectives.

(e) Nor would it cause problems with the application of the anti-avoidance provisions in VATA, Schedule 1, para 2 or Schedule 9A.

(f) It is noteworthy that the UK law under consideration is similar to the German law at issue in *L+M*. AG Mengozzi nevertheless accepted (in terms) that the German legislation in question could be construed in a manner compatible with EU law without going against the grain of that legislation.

(g) It is also noteworthy that LLPs are in many respects similar to Scottish partnerships and the inclusion of LLPs in VAT grouping does not appear to have given rise to any practical issues. It is highly likely that the inclusion of a Scottish partnership in a VAT group would be equally unproblematic.

62. In his written submissions, Mr Hitchmough refers to the (then) draft legislation published on 6 July 2018 to amend s 43A VATA, and submits that it would enable Scottish partnerships to be members of a VAT group as detailed below (italics original):

(a) The proposed legislation allows partnerships carried on by '*relevant persons'* (which expressly include individuals and Scottish partnerships) and a UK body or bodies corporate to join a VAT group whether the partnership controls the UK body or bodies corporate.

(b) The proposed test to determine whether or not a partnership controls a body corporate is whether the partnership '*would were it a company, be the UK body corporate's holding company* ... [where] *"holding company" has the meaning given by section 1159 of, and Schedule 6 to, the Companies Act 2006*'.

(c) The existing control test under s 43A of VATA to determine whether one body corporate (A Co) controls another is '*if* [A Co] *is empowered by statute to control that body's activities or if* [A Co] *is that body's holding company within the meaning of section 1159 of and Schedule 6 to the Companies Act 2006*'.

(d) It is common ground that the appellant meets the requirements of the *existing* control test (in that it controls the bodies corporate in the proposed VAT group as if it were their holding company); it must follow that the appellant meets the requirements of the new control test.

(e) The proposed new legislation expressly permits Scottish partnerships to form VAT groups: Finance Bill 2019, clause 53 and section 18.

(f) Any decision by the Tribunal in the appellant's favour (regarding the period running from the date of its original application) will have a very limited effect beyond this particular appellant: the decision would only be relevant to any Scottish partnership which meets the existing control test and has an outstanding application to form a VAT group before the Finance Bill 2019 ('the Bill') receives Royal Assent.

HMRC's case

63. For the respondents, Ms Roxburgh's submissions have two main aspects:

(1) Whether a Scottish partnership is a body corporate;

(2) Whether a 'conforming interpretation' is possible in the instant case.

64. It is submitted that a Scottish partnership is not a body corporate:

(a) The Court is to identify the ordinary meaning of language in the general context of the statute: *R (ex p Spath Homes Ltd)* at 396-398. Words

which have a technical legal meaning will usually be given that meaning: *MacMillan* at [54].

(b) As a matter of the general law, a Scottish partnership is not a body corporate. Whilst it possesses many of the privileges that the law confers on a body corporate, such as separate legal personality, it does not have all of the necessary attributes. In particular, the partners of a Scottish partnership remain jointly and severally liable for its obligations.

(c) In *Forsyth v Hare* Lord Medwyn observed at page 47 that a Scottish partnership is 'a quasi corporation, possessing many, but not all the privileges which law confers upon a duly constituted corporation'.

(d) Section 43A(2) provides that a body corporate controls another body corporate where it is empowered to do so by statute or where it is a holding company in terms of CA 2006. The reference to CA 2006 demonstrates that the intention of Parliament was that bodies corporate would be defined in the manner consonant with CA 2006 provisions.

(e) Section 43A(1)(c) refers to ownership of the bodies corporate within the group by a partnership. If partnerships came within the definition of bodies corporate, then this sub-para would be otiose. If the reference were to English partnerships alone, one would expect to see this stated in terms.

(f) The heading to section 43 of VATA is 'Groups of companies'. The heading of a section, and side-notes or marginal notes are part of the Act and provide an approximation of what is permissible to consider as the purpose of a section.

65. The respondents submit that it is not possible to apply a conforming interpretation to the VAT grouping provisions to enable a Scottish partnership to be given VAT grouping treatment. In fact, the member states which have introduced the VAT grouping regime are still in the process of ascertaining what it means in terms of legislative changes after the decision in *L+M*:

(a) Article 11 of the VAT Directive enables member states to exercise the option to provide for VAT grouping. Article 11 does not have direct effect. The member states have a discretion in implementing its terms (see *L+M* at [46]).

(b) The UK has introduced a voluntary grouping regime. In doing so, it has restricted eligibility to bodies corporate.

(c) Following *L+M*, it is accepted by HMRC that s 43A VATA as presently enacted, is not compliant by restricting eligibility to bodies corporate. Such a restriction can only be justified where it is necessary to prevent abuse of the tax system.

(d) VAT grouping is currently implemented in 16 member states. In 2009, the European Commission issued a Communication on VAT grouping (COM/2009/0325 final). That communication expressed the view that only taxable persons could be members of VAT groups. The decision in *L+M* is inconsistent with elements of that communication (VAT Expert Group, VEG No 070, taxud.c.1 (2018) 1668166-EN).

(e) The UK launched a consultation on 5 December 2016 to discuss options with stakeholders, which may result in legislative change.

(f) Other member states within a VAT grouping regime are likewise considering the consequences of *L+M*. Further work is being undertaken to clarify the meaning of Article 11: (i) the seminar in Dublin in September 2016 and (ii) the VAT Expert Group in 19 March 2018.

66. In terms of substantive arguments against conforming interpretation, it is submitted that the conforming interpretation suggested by the appellant is to replace the reference to 'body corporate' in s 43A VATA with a reference to 'body'. The respondents submit that the following difficulties are inherent in this approach:

(1) Firstly, the matter of legal certainty –

(a) The proposed interpretation fails to provide sufficient certainty as to when non-corporate bodies could come within a VAT group. The current legislation provides legal certainty through the concept of control as determined by reference to tests in CA 2006.

(b) The proposed alteration lacks the equivalent certainty: there would be no basis for saying when a non-corporate body could be controlled by another member of the group.

(2) Secondly, the proposed alteration will amount to 'judicial legislation'–

(a) Any attempt to set out the new terms for membership of bodies other than bodies corporate would extend beyond the interpretation of the section into the realms of judicial legislation.

(b) The tests set down by Parliament for inclusion in a VAT group are a fundamental feature of the legislation. There is a carefully calibrated scheme in place to determine whether entities are 'closely bound to each other by financial, economic and organisation links'.

(c) Anti-avoidance legislation has been enacted to target bodies corporate alone.

(d) The proposed alteration goes against the grain of that legislation.

(e) Any alteration to the entities eligible to be included in a VAT group will require detailed revisals to the VAT grouping rules in place, and of the particular avoidance risks that each entity presents. There will also be a requirement for equivalence in respect of the tests applicable.

(3) Thirdly, there is doubt as to the alteration being conforming interpretation –

(a) Any interpretation is only 'conforming' if it is compliant with EU law. The proposed interpretation would limit inclusion in a VAT group to those categorised as 'bodies', and it is not clear what entities would fall within this definition. It is clear, however, it would not include individuals.

(b) Ultimately, a conclusion regarding which entities can be included in a VAT group will be linked to the conclusions reached regarding the anti-avoidance measures available.

(4) Fourthly, any conforming interpretation would have to relate to the 'control tests' that would enable the legislation to define entities are 'closely bound to each other by financial, economic and organisational links'.

67. Ms Roxburgh's responses to aspects of Mr Hitchmough's written submissions are as follows:

(1) The appellant has to satisfy the Tribunal that the legislation can be interpreted in a way which conforms with the relevant provision of EU law. It is not enough to say, as the appellant does, that it would come within any conforming interpretation. A conforming interpretation needs to eliminate the incompatibility. A conforming interpretation which would benefit only some of those affected by the incompatibility would itself be a breach of the principle of fiscal neutrality.

(2) In determining whether a conforming interpretation is possible, the court must not cross over into the territory of judicial legislation. A conforming interpretation must not distort or undermine a fundamental feature of the legislation.

(3) The CJEU recognises that member states can restrict the entities which can enter into a VAT group where such restrictions are necessary to prevent abusive practices or behaviour, or to combat tax evasion or avoidance. The present provision restricts membership of VAT groups to bodies corporate. A conclusion regarding which other entities can be included in a VAT group will be linked to the potential for avoidance and the anti-avoidance measures available. Arrival at a compliant interpretation will therefore require an evaluation of competing alternatives. That strongly suggests that the alterations required are properly for Parliament to make and that a conforming construction is not possible.

(4) The proposed amendments set out in the Bill provide for individuals and partnerships to be 'treated' as members of a VAT group if specified criteria are met. Two points can be made in that regard. First, being 'treated' as a member is not the same as being a member of a VAT group. Secondly, only individuals and partnerships can be treated as members. This means that other entities, such as unincorporated associations, remain outside the scope of the provision.

(5) The provisions in the Bill do not show the complete picture. Anti-avoidance provisions in place relating to the current provision will require to be amended to prevent misuse of the new criteria.

Discussion

68. The central issue in this appeal is whether conforming interpretation can be applied to the existing UK VAT grouping legislation to the extent that the appellant, which is not a 'body corporate' for the purposes of the legislation, can form a VAT group as proposed.

69. The drafting of this decision coincided with the enactment of FA 2019 on 12 February 2019, and the amendments to s 43 VATA have the effect of widening the eligibility for VAT grouping to individuals and partnerships. The appellant, under the

amended provision for s 43 VATA, is eligible to form a VAT group. Consequently, the effect of this decision is most likely to be limited to this particular appellant, and concerns chiefly the outstanding VAT group application made on 12 November 2013 and the financial implications that follow therefrom.

70. The relevant statute for the purposes of this appeal remains the version of s 43 VATA before the enacted amendments in February 2019. The appellant's case is staked on the ruling of the CJEU in *L+M*. In view of the submissions made by the parties, it is necessary to set out aspects of the facts, the AG's Opinion ('AGO'), and the judgment of the CJEU in *L+M* in some detail, before considering the substantive issue in this appeal.

The case of L + M

71. In *L+M*, the group in question had two holding companies, with Larentia and Minerva mbH &Co KG ('L&M')[2] as the limited partner, and GmbH &Co KG (a limited liability company) as the general partner. L&M held 98% of the shares in two subsidiaries, which were constituted in the form of limited partnerships, each operating a vessel. As the management holding company, L&M also provided the subsidiaries with administrative and business services for remuneration.

72. In respect of the services subject to VAT, L&M deducted in full the input VAT paid in procuring capital from a third party, which was used to fund the acquisition of its shareholdings in the subsidiaries and its services, in particular administrative and consultancy services.

73. The German court referred three questions to the CJEU, the second and third of which are directly relevant to this appeal:

> '(2) Does the provision on the consolidation of several persons into a single taxable person in the second subparagraph of art 4(4) of the Sixth Directive preclude national legislation under which –
>
> (i) only a legal person, but not a partnership, can be integrated into the undertaking of another taxable person, (a so-called 'Organträger' (controlling company)); and
>
> (ii) requires that this legal person 'is integrated into the undertaking of the Organträger' in financial, economic and organisational terms (in the sense of a relationship of control and subordination)?
>
> (3) If the second question is answered in the affirmative: can a taxable person rely directly on the second sub-para of art 4(4) of the Sixth Directive?'[3]

[2] 'L&M' is used to refer to the entity, as distinguished from the case '*L+M*', which also incorporates the reference considered by the CJEU in the case of *Finanzamt Hamburg-Mitte v Marenave Schiffahrts AG* (C-109/14). The facts related here are confined to L&M.

[3] AGO at [10] and CJEU at [11]

The scope of the second sub-para of art 4(4) of the Sixth Directive

74. The second question from the referring court in *L+M* was recast by AG Mengozzi at [56] into two separate issues: the 'legal personality' and 'control relationship' points for ease of reference:

> (1) *the 'legal personality' point* – whether the second sub-para of art 4(4) of the Sixth Directive precludes a member state from limiting the formation of VAT groups to entities having legal personality, to the exclusion of partnerships such as the subsidiaries of the two holding companies in *L+M*.
>
> (2) *the 'control relationship' point* – whether a member state may require the relationship between the members of the VAT group to be a relationship of control and subordination by which the 'subordinate' entities are integrated into the controlling company.

The 'legal personality' point

75. The AG's interpretation of art 4(4) of the Sixth Directive as applying to 'persons' and not 'legal persons' is the cornerstone of his analysis on the 'legal personality' point, and is contained at [57] to [64] as summarised below:

> (1) In German law, a trade or profession is not exercised independently if a legal person is integrated in financial, economic or organisational terms into the undertaking of the controlling company.
>
> (2) In German law, partnerships may be the controlling bodies of the tax entity, such partnerships, in particular limited partnerships, have no legal personality, and could not be controlled and could not therefore participate in a VAT group as it exists in Germany.
>
> (3) The wording of the second sub-para of art 4(4) of the Sixth Directive, mentions that '*persons*' may be treated as a single taxable person.
>
> (4) In *Commission v Ireland* the court contrasted the second sub-para of art 4(4) of the Sixth Directive, with art 11 of the 2006 VAT Directive, which reproduced the similar wording of the Sixth Directive. The court concluded that the wording of art 11 did not preclude a member state from providing that non-taxable persons may individually be included in a VAT group.
>
> (5) It follows from *Commission v Ireland,* that the scope of the second sub-para of art 4(4) is not limited to a specific form of company or to a member of a VAT group having legal personality.
>
> (6) Certain provisions of the Sixth Directive refer to 'legal persons', which indicates that the EU legislature did not intend to limit the scope of art 4 to entities having legal personality; at [62].
>
> (7) The AG considers that the scope *ratione personae* of the second sub-para of art 4(4) extends to all persons. There is nothing in the Sixth Directive to permit the exclusion of partnerships from participation in a VAT group.

76. However, the finding as to what the EU legislature intended does not, of itself, answer the referred question, since VAT grouping is not mandated for implementation. On the contrary, a member state can choose to exercise the option to permit VAT

grouping in its territory. Therefore, to answer the question, AG Mengozzi assesses whether the Sixth Directive precludes a member state from limiting the eligibility of the 'persons' when it exercises the option to permit VAT grouping.

77. The question calls for a 'nuanced response' as given by the AG at [66] to [74]:

(1) In *Commission v Finland* and *Commission v Sweden* (both on 25 April 2013, unreported), the CJEU stated that art 11 of the 2006 Directive does not stipulate that the member states are able to impose other conditions on economic operators in order to form a VAT group, such as carrying out a certain type of activity or being part of a particular sector of activity.

(2) Nevertheless, the court recognised that on the basis of the objectives of art 11, it is possible for member states to restrict the application of the scheme as provided under art 11 and be compliant with EU law.

(3) The court therefore rejected the allegations that Sweden and Finland had failed to fulfil their obligations. It held that the Commission had failed to show that the restriction of the application of the VAT group scheme in Sweden and Finland, 'motivated by the goal of preventing tax evasion and avoidance in accordance with the second paragraph of art 11' was contrary to EU law.

(4) The AG considered the case law (*Commission v Sweden* and *v Finland*) can be applied to the Sixth Directive, and that a margin of discretion is conferred on the member states when they exercise the option, although that margin of discretion is subject to the pursuit of the objectives of art 4(4) in compliance with EU law.

(5) In practice, the AG considered that the restrictions on the scheme provided for in the second sub-para of art 4(4) '*must be necessary and appropriate for*' the objectives of preventing: (a) abusive practices or conduct, or (ii) tax evasion and avoidance, in compliance with EU law, in particular, the principle of fiscal neutrality.

(6) In the case of *L+M*, in order to be regarded as legitimate, the restriction to exclude partnerships from participation in a VAT group, must be justifiable on the basis of the objectives pursued by art 4(4), having due regard to the principle of fiscal neutrality.

(7) The AG made two additional observations at [76] to [78]:

(a) The objectives of preventing tax evasion or avoidance set out in the second para of art 11 of the 2006 Directive were adopted by the legislature by means of introducing a *third* sub-para in art 4(4) of the Sixth Directive, which expressly recognises that member states, having exercised the option to permit VAT grouping, 'may adopt any measures needed to prevent tax evasion or avoidance' through the use of the second sub-para of art 4(4).

(b) The case of *L+M* (with the relevant tax year being 2005) was well before the date of adoption of the 2006 Directive, but it does not mean that prior to the entry of the 2006 Directive, member states were

unable to adopt measures available to them in pursuing such objectives in the exercise of the option under art 4(4) of the Sixth Directive.

78. The AG's conclusions on the point of 'legal personality' are at [80] to [84]:

(1) It is not obvious that a distinction based on legal form or on the existence or non-existence of legal personality of undertakings is necessary and appropriate in order to prevent tax evasion and avoidance.

(2) Such a distinction is contrary to the principle of fiscal neutrality. VAT grouping may entail cash flow advantages to its members. Depriving economic operators of those advantages by reason of the legal form of one of its operators amounts to a difference in treatment of similar transactions.

(3) 'The characteristic of the taxable person is precisely the economic activity and not the legal form' (at [82]).

(4) Consequently, the AG proposed the answer to the 'legal personality' point as follows:

> '… the second subparagraph of art 4(4) of the Sixth Directive precludes a member state, in the exercise of the option available under that provision, from making the formation of a VAT group subject to the condition that all the members of that group must have legal personality, unless that condition is justified by the prevention of abusive practices or tax evasion or avoidance, having due regard to the principle of fiscal neutrality, this being a matter which must be determined by the referring court.'

The 'control relationship' point

79. For close financial, economic and organisational links, the settled German law requires the existence of a relationship of control and subordination between the controlling company and the controlled entity as the 'subordinate person', whereby:

(1) Financial integration exists if the controlling company is financially involved in the controlled company in such a way that it can impose its will by a majority vote in the general meeting.

(2) Economic integration exists if the controlled company appears as a component of the controlling company in the latter's structure.

(3) Organisational integration exists if the controlling company, in conjunction with financial integration, controls the day-to-day business management of the subsidiary, governing the subsidiary by its management method and imposing its will on the controlled.

80. At [90] of the AGO, it is stated that the 'existence of "close" financial, economic and organisational links does not necessarily mean either the integration of a member into the undertaking of another member of the VAT group, or a relationship of control and subordination between those members'. In its associated footnote, the AG observed that the adverb 'closely' use in the second sub-para of art 4(4) of the Sixth Directive to describe the links between the entities concerned replaced the adverb 'organically' previously used.

81. The AG's comments on the 'control relationship' as required by German law to establish close financial, economic and organisational links continued at [90] to [100]:

> (1) Of the 16 member states which had taken the option to allow VAT grouping, only 4 (including Germany) required such links of integration and of subordination.
>
> (2) The CJEU in *Ampliscientifica* rejected the argument put forward by the Austrian government that 'the existence of a relationship of subordination is inherent in the condition of "close links"' under the second sub-para of art 4(4), since it is precisely the existence of such a relationship between natural persons and their employer (i.e. in terms of control and subordination) which prevents them from being treated as persons liable to VAT under the first sub-para of art 4(4).
>
> (3) The requirement for a relationship of control and subordination constitutes 'additional conditions' to those laid down by the second sub-para of art 4(4), and therefore these additional conditions must be justified in terms of preventing abuse or tax evasion or avoidance.
>
> (4) Following the CJEU's reason in *Commission v Sweden*, 'such an additional condition is not in itself incompatible' with the second sub-para of art 4(4).
>
> (5) The AG nevertheless expressed reservation about such a national measure at [99]:
>
>> 'I am nevertheless uncertain whether a national measure which requires such an intensity of links between persons to form a single taxable person does not go beyond what is necessary to attain those objectives. … it is difficult to understand, in general, why the pursuit of the abovementioned objectives would make necessary a relationship of control and subordination … in order to satisfy the condition relating to the existence of close financial, economic and organisational links. Whilst the existence of such a relationship of control and subordination … is undoubtedly a sufficient condition … I doubt whether it is strictly necessary.'

Whether second sub-para of art 4(4) has direct effect

82. The third question referred by the German court concerned whether the second sub-para of art 4(4) has direct effect. According to settled law, and wherever provisions of the Sixth and the VAT Directives appear, the prerequisite for a relevant provision to be directly effective is:

> '[104] … so far as its subject-matter is concerned, be considered to be unconditional and sufficiently precise as to permit an individual to rely on it before the national courts with a view to opposing the application of national legislation which is incompatible with that article.'

83. For an EU Directive provision to have direct effect, the prerequisite is that the provision is 'unconditional and sufficiently precise'. AG Mengozzi continued by clarifying that a provision is not precluded from being directly effective in the following situations:

(1) A provision of a directive giving member states a choice does not necessarily render it impossible to have direct effect; at [106].

(2) The existence of discretion on the part of the member states in implementing provisions of the Sixth Directive does not in itself eliminate the possibility of recognising the direct effect of some of those provisions; at [107].

(3) The CJEU has ruled that where member states have a discretion as regards laying down the conditions for the application of certain *exemptions* provided for by the Sixth Directive, it does not prevent individuals from relying on a Directive provision directly, especially where national provisions are incompatible with that directive, in particular, with the principle of fiscal neutrality; at [108], see *Linneweber* and *JP Morgan Fleming*.

(4) The fact that in the exercise of the option available under art 4(4) a member state retains 'a certain margin of discretion' does not mean that individuals are deprived of the right to rely directly on the provisions of that article before the national court; at [109].

(5) However, 'the substantive condition under the second subparagraph of Article 4(4) of the Sixth Directive that the financial, economic and organisational links between several persons must be "close" in order for them to form a single taxable person undoubtedly needs to be specified at national level'; at [112].

(6) That being the case, the second sub-para of art 4(4) of the Sixth Directive does not have direct effect; at [113].

(7) It will still be for the referring court to determine whether national law can be interpreted, as far as possible, in a manner consistent with EU law; at [114].

84. AG Mengozzi then made the following observations of the German legislation for VAT grouping:

(1) A German tax court attempted to give such a consistent interpretation, holding that partnerships 'with a capital-based structure', like the limited partnerships in the main proceedings, might come within the scope of *ratione personae* as provided in the national legislation; at [115].

(2) At least as regards persons capable of participating in a VAT group, it is suggested that 'an interpretation in conformity with EU law is certainly feasible, without, however, leading to a *contra legem* interpretation'; at [116].

(3) Having declared that the second sub-para of art 4(4) does not have direct effect, the AG stated that it is for the referring court, 'as far as possible, to interpret its national legislation in conformity with that provision of the Sixth Directive'; at [120].

The CJEU ruling in L+M

85. The CJEU followed closely AG Mengozzi's Opinion, but went further in considering the restriction placed by Germany in its VAT grouping legislation. The pronouncement by the CJEU as respects the eligibility of partnerships to participate in VAT grouping is instructive for present purposes:

> '[37] … the second subparagraph of art 4(4) of the Sixth Directive, which refers to "persons" does not exclude, of itself, from its scope of application entities which, like the limited partnerships at issue in the main proceedings, do not have legal personality.
>
> [38] Nor does [it] … expressly provide for the possibility for member states to impose other conditions on economic operators in order to form a VAT group … in particular, the possibility for member states to *insist that only entities having legal personality may be members* of a VAT group.' (emphasis added)

86. The court then considered at [39] whether 'the margin of discretion' accorded to the member states in exercising the option to permit VAT grouping in their territory, nevertheless, 'allows them to exclude entities which do not have legal personality' from participating in VAT grouping in their domestic legislation. In doing so, the court stated at [40] the aims and objectives of the second sub-para of art 4(4) as follows:

> 'It is apparent from the Commission Proposal (COM (73) 950 final) which resulted in the adoption of the Sixth Directive that the EU legislature … intended, either in the interests of simplifying administration or with a view to combating abuses such as [business-splitting or] … to treat as taxable persons those whose "independence" is purely a legal technicality [*Commission v Sweden*].'

87. In *Commission v Sweden*, the CJEU considered the first para of art 11 in the 2006 Directive, and held that in the context of their margin of discretion:

> '… [the member states] were entitled to make the application of the VAT group scheme subject to certain restrictions provided that they fall within the objectives of that directive to prevent abusive practices and behaviour or to combat tax evasion or tax avoidance [paras 38, 39 of *Commission v Sweden*].'

88. Applying *Commission v Sweden*, the CJEU in *L+M* concluded that it is for the referring court to determine whether the measure in domestic law, whereby entities lacking legal personality are excluded from the benefit of the VAT group scheme, 'constitutes a measure which is necessary and appropriate for attaining objectives' of the Directive, namely: 'to prevent abusive practices or behaviour or to combat tax evasion or tax avoidance' (at [43]).

89. The CJEU's ruling on the second question as referred in *L+M* is at [46]:

> '… the second subparagraph of art 4(4) of the Sixth Directive must be interpreted as precluding national legislation which reserves the right to form a VAT group, as laid down by that provision, solely to entities with legal personality and linked to the controlling company of that group in a relationship of subordination, except where those two requirements constitute measures which are appropriate and necessary in order to achieve the objectives seeking to prevent abusive practices or behaviour or to combat tax evasion and tax avoidance, which it is for the referring court to determine.'

90. Concerning whether the second sub-para of art 4(4) of the Sixth Directive has direct effect, the CJEU held at [50] and in accordance with the AG's opinion, that:

> '… the formation of a VAT group is subject to the existence of close financial, economic and organisational links between the persons concerned needs to be specified at national level. That article is thus conditional in as much as it involves the application of national provisions determining the actual scope of such links.'

The implications of the CJEU ruling in L+M

91. VAT grouping is provided as an option under the relevant directive, and as such the member states enjoy a margin of discretion in deciding whether to exercise the option, and how to implement the scheme if the option is exercised. The UK has exercised the option to permit VAT grouping, and relevant provisions under section 43 *et al* of VATA are referable to art 11 of the VAT Directive, being the successor provision of art 4(4) of the Sixth Directive.

92. The ruling by the CJEU in *L+M* has two significant aspects that enable the appellant to state its case in front of this Tribunal in reliance thereon. First, it is the ruling that the 'legal personality' point breaches the EU principle of fiscal neutrality. Secondly, it is the ruling that the second sub-para of art 4(4) of the Sixth Directive (and by corollary art 11 of the VAT Directive) has no direct effect. The consequences of the CJEU ruling for the UK VAT grouping legislation are two-fold as explained below.

The breach of the principle of fiscal neutrality

93. The principle of fiscal neutrality is stated in *Ampliscientifica* at [25] as follows:

> '… the principle of fiscal neutrality is a fundamental principle of the common system of VAT … which precludes, on the one hand, treating similar goods, which are thus in competition with each other, differently for VAT purposes … and, on the other hand, treating similar economic transactions, which are therefore in competition with each other, differently for VAT purposes …'

94. The appellant's submissions have included the principle of equal treatment as being breached. Within the sphere of VAT, the effect of equal treatment is effectively encapsulated into the principle of fiscal neutrality, as explicated by the AG in *Compass Contract* at [55]:

> 'The principle of fiscal neutrality is simply the translation into the sphere of VAT of the principle of equal treatment. The latter applies not only between competing traders but also between traders who are not necessarily in competition with each other but are nevertheless in a similar situation in other respects, which brings the analysis back to equal treatment.'

95. In the light of fiscal neutrality, the primary focus is on the economic effect of a provision on the transaction or supply in question. In the present case, the focus is on the appellant as an economic operator within the investment sector and being placed at a disadvantage in comparison with its competitors which are eligible to participate in VAT grouping. In the light of equal treatment, the focus is on the appellant's position along with other 'persons' who are similarly affected by not being able to participate in VAT grouping due to the legal form in which the traders choose to operate.

96. As illustrated by *Gregg*, while a provision may seem to concern 'equal treatment' as regards the '*persons*', the ultimate analysis in the context of a VAT provision is to assess the breach in the light of the principle of fiscal neutrality. For this reason and for present purposes, I confine my consideration to whether the principle of fiscal neutrality is breached in the UK VAT grouping legislation.

97. In *Gregg*, Mr and Mrs Gregg operated a nursing home business as a partnership in Northern Ireland and applied to register for VAT. HMRC refused the application as the business activity is exempt for VAT purposes. Mr and Mrs Gregg appealed, relying on *Bulthuis-Griffioen*, which held that the VAT exemption laid down in art 13A(1)(b) and (g) of the Sixth Directive applies only to activities carried on by legal persons. In other words, the Greggs argued that as 'natural persons' running a nursing home, the partnership was not within the scope of exemption activities.

98. The UK tribunal in *Gregg* made a reference to the CJEU on the interpretation of the relevant article provisions in the Sixth Directive as regards whether these provisions pertain only to 'legal persons'. The CJEU's ruling in this respect is as follows:

> '[19] That interpretation, to the effect that the terms "establishment" and "organisation" do not refer only to legal persons, is, in particular, consistent with the principle of fiscal neutrality inherent in the common system of VAT …
>
> [20] The principle of fiscal neutrality precludes, inter alia, economic operators carrying on the same activities from being treated differently as far as the levying of VAT is concerned. It follows that that principle would be frustrated if the possibility of relying on the benefit of the exemption provided for activities carried on by the establishments or organisations referred to in art 13A(1)(b) and (g) was dependent on the legal form in which the taxable person carried on his activity.'

99. The ruling in *Gregg* is to say that the benefit of exemption provided for in the Sixth Directive is referential to the nature of the supply in question, and not dependent on the legal form in which the economic activities are operated.

100. Similarly, the CJEU ruling in *L+M* is to find that the benefit of VAT grouping is not referential to the legal form in which a trader chooses to operate. At [62] of the AGO, it is clearly stated that if the EU legislature had intended to restrict VAT grouping to 'legal persons' only, it would have used 'legal persons' in the second sub-para of art 4(4) of the Sixth Directive, as is used expressly for arts 28a to 28c in the Sixth Directive.

101. In *L+M* the restriction to 'legal persons' in the VAT grouping legislation implemented by Germany is found by the AG to breach the principle of fiscal neutrality:

> '[81] … such a distinction is also contrary to the principle of fiscal neutrality since, as the German government acknowledged at the hearing, entities which are individually fully liable to VAT cannot participate in a VAT group solely by reason of their specific legal form.
>
> [82] … Depriving economic operators of those advantages by reason of the legal form through which one of those operators exercise its activity amounts to a difference in treatment of similar transactions, which are therefore in competition with one another, aside from the fact that the

> characteristic of the taxable person is precisely the economic activity and not the legal form.'

102. As a corollary, the VAT grouping legislation implemented in the UK breaches the principle of fiscal neutrality by restricting eligibility to 'bodies corporate'. Consequently, it amounts to a difference in treatment of similar transactions for economic operators adopting different legal forms to carry out their activities.

103. As a matter of fact, the appellant as an economic operator is disadvantaged against its competitors which are eligible to benefit from VAT grouping, simply due to the legal form it has adopted to carry out its economic activities. As the appellant contends, it bears VAT costs of around £250,000 monthly on its supplies to its subsidiaries in consequence of not being able to participate in VAT grouping.

The implications of art 4(4) not having direct effect

104. Section 2 of the ECA 1972 provides for the application of any EU law arising from the Treaties, secondary legislation, and the case law of the Court of Justice in the national courts of the United Kingdom. Subsection 2(1) in effect provides for the direct applicability and the direct effect of EU law without further enactment.

105. If a relevant EU provision has direct effect, it is possible for individuals to rely on the relevant EU provision for enforcement in the UK courts, without prior enactment in domestic legislation of the relevant directive provision. In the words of Arden LJ, '[the] 1972 Act thus contains the mandate for English courts to interpret domestic legislation in accordance with applicable European Union Directives' (*IDT* at [74]).

106. From the *L+M* ruling, it is clear that the existing VAT grouping legislation infringes the principle of fiscal neutrality by excluding the appellant from participating in a VAT group. It is also clear that the second para of art 4(4) does not have direct effect, and by the same reasoning, art 11 of the VAT Directive does not have direct effect either, which means that a party such as the appellant cannot seek to enforce the EU provision directly at national courts. It therefore falls upon the domestic courts such as this Tribunal to interpret the national legislation, so far as possible, in conformity with the fundamental principles in EU law.

107. The parties are agreed that the Tribunal in the present case has a duty to apply conforming interpretation to the existing VAT grouping legislation, and specifically the eligibility provisions under s 43A of VATA. The real issue in this appeal is not whether conforming interpretation should be applied, but the *extent* to which it can be applied. 'So far as possible' implies a limit, and that limit, as acknowledged by AG Mengozzi at [116], is 'without leading to a *contra legem* interpretation'.

The extent of the obligation to apply conforming interpretation

The Marleasing principle

108. The European Court of Justice ('ECJ') in *Marleasing* defined the obligation of the national courts of the member states to interpret domestic law, as far as possible, in conformity to EU law at [8] of the ECJ judgment:

> 'It follows that, in applying national law, whether the provisions in question were adopted before or after the directive, the national court called upon to interpret it is required to do so, as far as possible, in the light of the wording and the purpose of the directive in order to achieve the result pursued by the latter and thereby comply with the third paragraph of Article 189 of the Treaty.'

109. In *Vidal-Hall* a succinct judicial pronouncement as to the extent and limits of the national courts' obligation in applying conforming interpretation is as follows:

> '[86] The *Marleasing* principle is not in doubt. It is that the courts of member states should interpret national law enacted for the purpose of transposing an EU Directive into its law, so far as possible, in the light of the wording and the purpose of the Directive in order to achieve the result sought by the Directive. The critical words (which have been given to some difficulty) are "so far as possible". It is recognised that there are circumstances where it is not possible to interpret domestic legislation compatibly with the corresponding Directive even where there is no doubt that the legislation was intended to implement the Directive. If a national court is unable to rely on the *Marleasing* principle to interpret the national legislation so as to conform with the Directive, the appropriate remedy for an aggrieved person is to claim *Francovich* damages against the state.'

110. The UK courts have seen a close parallel between the *Marleasing* principle and section 3 of the Human Rights Act 1998 ('HRA 1998'). Consequently, the development of the jurisprudence in conforming interpretation has drawn on both streams of authorities, when the UK courts interpret national law in conformity to EU law or to Convention Rights. In *IDT* Arden LJ remarked that any differences in approach between a conforming interpretation to EU law and to Convention Rights are 'more apparent than real' (at [92]).

111. In *IDT*, Arden LJ drew on the House of Lords' decision on s 3 of HRA 1998 in *Ghaidan* to develop the extent of the *Marleasing* principle in the VAT case, which concerned the supply of multi-functional phone cards by IDT (based in Ireland) to distributers and retailers within the UK. Customers who purchased those cards from UK retailers obtained telecommunications services from a company based in Ireland. The UK did not impose VAT on the supply of the phone cards, which was regarded as credit vouchers, and charged VAT on the supply of the telecommunications services. In Ireland, VAT was charged on the supply of the phone cards to non-business users or to traders within Ireland, but avoided double taxation by not imposing VAT when accessing the telecommunications services obtained on redemption of the phone cards.

112. The scheme of supplying phone cards and telecommunication services across the two member states with different treatments for the supplies resulted in the *non-taxation* in Ireland and the UK, on either the sale of the phone cards or on the supply of the underlying telecommunications services.

113. The issue faced by the Court of Appeal in *IDT* is whether the prevention of non-taxation is a general purpose underlying the Sixth Directive, which it held it was (at [95]). The question then arose whether UK law could be construed in such a way as to

conform with the Directive and to impose a charge to VAT on the sale of the phone cards in the UK, which the court held that it could. In reaching this conclusion, Arden LJ set out the approach of the courts:

> '[75] The approach of the English courts when interpreting United Kingdom legislation designed to give effect to Community legislation is to construe the English legislation so far as possible so as to make it compatible with the Community legislation. This is the approach that the English courts adopt to legislation implementing international treaties generally. In addition, when Parliament recently incorporated the European Convention on Human Rights (ECHR) into domestic law, it took the same formula and used it to impose an obligation on English courts to interpret domestic statute law, so far as possible, compatibly with human rights (Human Rights Act 1998, s 3).'

The extent of and the limits to conforming interpretation

114. In relation to the limits to conforming interpretation, Arden LJ referred to *Ghaidan* as the 'judgment authority as to what is "possible" as a matter of statutory interpretation' at [85] in *IDT*:

> 'The similarities in this regard between interpretation under s 3 of the 1998 Act and under the *Marleasing* principle are illustrated by the fact that Lord Steyn traced the origin of the interpretative obligation in s 3 to *Marleasing* case and that both Lord Steyn and Lord Rodger of Earlsferry in their speeches relied on (inter alia) the *Litster* case as demonstrating that the court could read in words in order to interpret legislation under s 3(1) of the 1998 Act. In those circumstances, in my judgment, the guidance given by the House of Lords in that case as to the limits of interpretation can also in general be applied to when the limits of interpretation under the *Marleasing* principle arise for consideration.'

115. In *Ghaidan* the House of Lords in 2004 had to consider the interpretation of the Rent Act 1977 (para 2 of Sch 1) so as to make it compatible with Convention rights. The defendant in *Ghaidan* was the surviving partner in a homosexual relationship, and was placed in a less secure position than a survivor of a heterosexual partnership. As such the defendant's rights under articles 8 and 14 of the Convention on Human Rights were infringed. The appeal by the landlord claimant was dismissed by a majority at the House of Lords (Lord Millett dissenting).

116. Lord Nicholls described the interpretative obligation decreed by s 3 of HRA 1998 as of 'an unusual and far-reaching character' (at [30]); 'that [if] the operation of section 3 should depend critically upon the particular form of words adopted by the parliamentary draftsman … [it] would make the application of section 3 something of a semantic lottery' (at [31]). He continued at [33] by stating the limit in the discharge of this extended interpretative function in the following terms:

> 'The meaning imported by application of section 3 must be compatible with the underlying thrust of the legislation being construed. Words implied must, in the phrase of … Lord Rodger of Earlsferry, "go with the grain of the legislation".'

117. Lord Steyn's speech in *Ghaidan* was accompanied by a study of case law involving the interpretative task under s 3 HRA 1998, which 'reveals that there has sometimes been a tendency to approach the interpretative task under section 3(1) in too literal and technical way' as indicated by the high number of instances of declaration of incompatibility, which, he emphasised, 'must always be an exceptional course':

> '[49] … If the core remedial purpose of section 3(1) is not to be undermined a broader approach is required. That is, of course, not to gainsay the obvious proposition that inherent in the use of the word "possible" in section 3(1) is the idea that there is a Rubicon which courts may not cross. …
>
> [50] Having had the opportunity to reconsider the matter in some depth, I am not disposed to try to formulate precise rules about where section 3 may not be used. Like the proverbial elephant such a case ought generally to be easily identifiable. What is necessary, however, is to emphasise that interpretation under section 3(1) is the prime remedial remedy and that resort to section 4 [a declaration of incompatibility] must always be an exceptional course. In practical effect there is a strong rebuttable presumption in favour of an interpretation consistent with Convention rights.'

118. Lord Rodger's speech in *Ghaidan* contains some memorable dicta on conforming interpretation by drawing parallels with an attempt in emendation of a corrupt text:

> '[122] … The key is that the emendation must start from a careful consideration of the writer's thought. Similarly, the key to what it is possible for the courts to imply into legislation without crossing the border from interpretation to amendment does not lie in the number of words that have to be read in. The key lies in a careful consideration of the essential principles and scope of the legislation being interpreted. If the insertion of one word contradicts those principles or goes beyond the scope of the legislation, it amounts to impermissible amendment. On the other hand, if the implication of a dozen words leaves the essential principles and scope of the legislation intact but allows it to be read in a way which is compatible with Convention rights, the implication is a legitimate exercise of the powers conferred by section 3(1). … what matters is not the number of words *but their effect.* For this reason, *in the Community law context, judges have rightly been concerned with the effect of any proposed implication, but have been relaxed about its exact form….*' (emphasis added)

119. In *Vidal-Hall*, a case where a conforming interpretation was not possible because to do so would be to ignore a cardinal feature of the domestic legislation, the Court of Appeal nevertheless accepted the submission by counsel for the defendant as to the extent in applying the *Marleasing* principle as follows:

> '[89] … there is a greater scope for applying the *Marleasing* principle by reading words in to a national measure (i.e. to expand its potential field of application) or by reading it down (i.e. to narrow its potential field of application) than by disapplying or striking out an incompatible measure. We accept this submission …
>
> [90] But it does not follow that it is never possible to interpret a measure by disapplying or striking down part of it in order to make it compatible

> with the Convention or a Directive. Various interpretative techniques may be deployed in order to eliminate an incompatibility. The relevant question in each case is whether the change brought about by the interpretation alters a fundamental feature of the legislation or is inconsistent with its essential principles or goes against the grain, to use Lord Rodger's memorable phrase. In our view, there is no significance in the interpretative tool that is used. … It will not be possible to interpret domestic legislation, whether by reading in, or reading down or disapplying a provision, if to do so would distort or undermine some important feature of the legislation …'

120. In relation to the limits that conforming interpretation can be applied to a statutory provision, Lord Rodger referred to the case in *In re S*. In that case, the House of Lords reversed the decision of the Court of Appeal for having departed substantially from 'a cardinal principle' of the Children Act 1989, and 'pass[ed] well beyond the boundary of interpretation'. In commenting on *In re S*, Lord Rodger continued by setting the limits to conforming interpretation in the following terms:

> '[115] … in *In re S* … Lord Nicholls made the further point that a departure from a fundamental feature of an Act of Parliament may be more readily treated as crossing the boundary into the realm of amendment where it has important practical repercussions which the court is not equipped to evaluate. It appears to me that difficult questions may also arise where, even if the proposed interpretation does not run counter to any underlying principles of the legislation, it would involve reading into the statute powers or duties with far-reaching practical repercussions of that kind. …'

121. Lord Millett (dissenting) accepted that there is 'a strong adjuration' from Parliament to read and give effect to legislation in a way which is compatible with Convention rights, but highlighted the danger of trespass into judicial legislation:

> '[61] This is a difficult exercise, for it is one which the courts have not hitherto been accustomed to perform, and where they must accordingly establish their own ground rules for the first time. It is also dangerously seductive, for there is bound to be a temptation to apply the section beyond its proper scope and trespass upon the prerogative of Parliament in what will almost invariably be a good cause.'

122. Counsel for the appellant has included a helpful summary of the principles to be applied by the courts when construing domestic legislation so far as possible in conformity with EU law and is reproduced here. The courts' obligation in this regard:

(1) is not to be constrained by conventional rules of construction (*IDT* [82]);

(2) does not require ambiguity in the legislative language (*Ghaidan* [32]);

(3) is not an exercise in semantics or linguistics (*Ghaidan* [31], [48], [110]);

(4) permits departure from the strict and literal application of the words which the legislature has elected to use (*Ghaidan* [31]);

(5) permits the implication of words necessary to comply with EU law obligations (*IDT* [89]);

(6) accepts that the precise form of the words to be implied does not matter (*IDT* [114], *Vidal-Hall* [90]);

(7) is only constrained to the extent that the meaning should '*go with the grain of the legislation*' and be compatible with the underlying thrust of the legislation being construed (*Ghaidan* [33], *Vidal-Hall* [90]);

(8) must not lead to an interpretation being adopted which is inconsistent with a fundamental or cardinal feature of the national legislation since this would cross the boundary between interpretation and amendment (*IDT* [82], [113], *Vidal-Hall* [90]);

(9) cannot require the courts to make decisions for which they are not equipped or give rise to important practical repercussions which the court is not equipped to evaluate (*IDT* [113]).

Whether a conforming interpretation possible in the instant case

123. Mr Hitchmough's submissions place emphasis on 'the breadth of the obligation' to adopt a conforming interpretation; it is an obligation that has been described as a '*highly muscular*' principle by Lord Sumption at [176] in *FII Group Litigation*; and that the only restriction on the Tribunal's ability to apply such a conforming interpretation would be if it produces a result that frustrates a cardinal feature of the UK VAT legislation.

124. In Lord Rodger's words, the key to what is possible lies in a careful consideration of the essential principles of the legislation – 'the very core and essence, the "pith and substance" of the measure that Parliament had enacted'[4].

125. In performing the duty of interpretation of a domestic provision in conformity with EU law, it seems to me that the process involves the following stages:

(1) The first stage is to discern the objectives and the context of the EU provision in question, namely art 11 of the VAT Directive, to which the domestic measure under s 43 VATA is trying to give effect by Parliament.

(2) The second stage is to identify the 'pith and substance' of the measure enacted by Parliament. The 'cardinal feature' of s 43 VATA is to be found in the statutory wording itself, applying the ordinary rules of construction.

(3) The third stage involves 'emendation' (to use Lord Rodger's analogy) of the statutory wording by reading up or reading down or partial disapplication. The concern at this stage is that the *effect* of the proposed emendation is not *contra legem*: that the conforming interpretation goes with the grain of the legislation.

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[4] Lord Rodger in *Ghaidan* at [111], with the phrase 'pith and substance' being from Lord Watson in *Union Colliery Co of British Columbia Ltd v Bryden* [1899] AC 580, 587.

The objectives and context of the VAT grouping provision

126. In relation to the objectives of the VAT grouping provision, the Advocate General in *Commission v Ireland* cited the explanatory memorandum to the proposal for the Sixth Directive, which states:

> '[38] … in the interests of simplifying administration or of combating abuses [e.g. business-splitting] Member States will not be obliged to treat as taxable persons those whose "independence" is purely a legal technicality …
>
> [39] … in order to understand the purpose of VAT grouping within the context of the broader VAT regime, account needs to be taken of the effect VAT groups have on fiscal neutrality. This entails consideration of the practical effects of registering a VAT group. This is significant, because these effects may well provide the motivation for economic operators to be involved in VAT grouping, provided that they have a choice in this respect under the applicable national legislation.'

127. The task of conforming interpretation is necessarily performed against the backdrop of the EU provision in question. To state the aim of the EU provision in question is essential to a purposive construction of the domestic legislation in conformity thereto. As Lord Oliver of Aylmerton noted in *Litster*, at 557A-B, *Pickstone* had established that:

> '… the greater flexibility available to the court in applying a purposive construction to legislation designed to give effect to the United Kingdom's Treaty obligations to the Community enables the court, where necessary, to supply by implication words appropriate to comply with those obligations …'

128. In summary, the objectives in providing member states with the option to permit VAT grouping include: (a) in the interests of simplifying administration, and (b) combating abuses. In exercising the option, member states need to take into account the effect VAT groups have on fiscal neutrality. A conforming interpretation in the present case involves a purposive construction of the domestic legislation in conformity to the stated purpose of art 11 of the VAT Directive.

The cardinal feature of the eligibility measure for VAT grouping

129. With the purpose of art 11 of the VAT Directive in mind, the second stage in carrying out a conforming interpretation is by examining the statutory wording of s 43A VATA to identify its cardinal feature. From the statutory wording, it is readily discernible that 'control' is the 'pith and substance' of the eligibility provision.

130. Subsection 43A(1) defines the eligibility of two or more bodies corporate to form a VAT group entirely referential to the 'control' exercised on the entities, with three scenarios of control being covered by subsections (1)(a), (b) and (c) as follows:

> (a) one of them *controls* each of the others,
>
> (b) one person (whether body corporate or an individual) *controls* all of them, or
>
> (c) two or more individuals carrying on a business in partnership *control* all of them.

131. The control scenario in (a) applies to a situation where all the entities are bodies corporate, and there is a group structure in place to connect these entities. The situation envisaged is one where, for example, X controls Y, and Y controls Z, all three companies will meet the control test to form a VAT group. If X also controls W, then W can join the VAT group, even though W has no direct connection with Y or Z.

132. The control scenarios in (b) and (c) are similar, in so far as they both envisage a situation where the controlling body is at the apex of the hierarchy, and it is a single controlling body exerting control downwards on *all* the entities seeking to form a VAT group. Scenarios (b) and (c) differ from (a), in that the controlling body does not need to be a body corporate; it can be a natural person (an individual) or a partnership.

133. Subsection 43A (2) gives the definition of 'control', and the relationship of the main clause to its subordinate clauses (i) and (ii) are analysed as follows:

> 'For the purposes of this section (that is the whole of section 43A) –
>
> *a body corporate* shall be taken to control another body corporate
>
> (i) if it is empowered by statute to control that body's activities; or
>
> (ii) if it is that body's *holding company* within the meaning of section 1159 of and Schedule 6 to the Companies Act 2006.' (Italics added)

134. The main clause here is: 'a body corporate shall be taken to control another body corporate'. Subsection (2) therefore focuses on the controlling body as a body corporate, and the control tests under subsection (2) cover the scenarios provided under subsection (1)(a) – where the control is each of the others; and (1)(b) – where the control is by one body corporate of all the others. The subordinate clauses (i) and (ii) define two separate control tests.

135. The first control test under clause (i) is defined by the power to control the *activities* of the subordinate entity. The designation 'if it is empowered by statute' refers to a relevant statute not otherwise specified.

136. The control test under clause (ii) is referential to s 1159 of CA 2006. Section 1159 defines the meaning of a 'subsidiary', whereby a company is a 'subsidiary' of another company, its 'holding company', of that other company if it –

> (a) holds a majority of the voting rights in it, or
>
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
>
> (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it, or
>
> if it is a subsidiary of a company that is itself a subsidiary of that other company.

The use of the connective 'or' within s 1159 means that satisfying any one of the control criteria is sufficient for establishing a holding company and a subsidiary relationship.

137. Subsection 43A(3) maps closely the provision under subsection (2), and states:

> 'For the purposes of this section (that is the whole of section 43A) –
>
> *an individual or individuals* shall be taken to control a body corporate,
>
> (iii) if *he or they, were he or they a company*, would be that body's holding company within the meaning of those provisions.' (Italics added)

Subsection (3) covers the scenarios of control under subsection (1)(b) pertaining to a natural person (an individual), and 1(c) pertaining to a partnership (as individuals). In both scenarios, the controlling body is not a body corporate, but nevertheless exercises its control over *all* of the entities as if – '*he or they, were he or they a company*' – these are the very words contained in the subordinate clause in subsection (3), and designated as clause (iii) here to distinguish from clauses (i) and (ii) above under subsection (2).

138. The use of the subjunctive in clause (iii) within subsection (3) is unmistakable, and of note for present purposes. According to the Oxford English Dictionary, the subjunctive is used 'to express situations which are hypothetical or not yet realised, and typically used for what is imagined, hoped for, demanded, or expected'. In the present context, the meaning of the subjunctive is to connote the hypothetical nature of treating a natural person or a partnership *as if he or they were a company.*

139. Within the statutory context of subsection (3), the use of a control test referable to s 1159 CA2006 necessitates the *deeming* of the controlling body as if he or they were a company. To state what may seem to be obvious, for the sake of using a control test referable to the Companies Act 2006, the deeming of the controlling body (which is non-corporate) *as if he or they were a company* becomes the inevitable consequence.

140. It is accepted that the cardinal feature of the eligibility provision under s 43A VATA, so far as a non-corporate body is concerned, is inextricably tied to the control test as defined by s 1159 CA2006. The control test so employed is the *grain of the legislation*. However, it is also in the essence of subsection (3) to deem the non-corporate controlling body as the holding company for the purposes of applying the control test that is referable to companies only.

141. Furthermore, the subsection (3) eligibility test is restrictive in scope, and applies only to situations where the *controlling* non-corporate body controls *all* the entities seeking to form a VAT group. As it stands, the current deeming of a controlling non-corporate body under subsection (3) is purely for the purpose of establishing the eligibility of the *controlled* entities, and stops short after the eligibility test is performed. The controlling non-corporate body is then excluded from participating in VAT grouping by the essence of the provision under subsection (1) for not being a body-corporate.

Emendation to give effect to the purpose of the EU provision

142. In these circumstances, the Tribunal considers that a conforming interpretation which goes with the grain of the legislation is by extending the deeming of the *controlling* non-corporate body under subsection (3) *as if he or they were a company* by adding the following words italicised in bold:

'For the purposes of this section, *an individual or individuals* shall be taken to control a body corporate, if he or they, *were he or they a company*, *would be that body's holding company* within the meaning of those provisions, ***and also for the purposes of subsection (1)***.'

143. The kernel of deeming is inherent in subsection (3); by extending the deeming, the integrity of the control test contained within subsection (3) is preserved. At the same time, the very core and essence of the provision under subsection (1) is also preserved.

144. In performing the task of conforming interpretation, the Tribunal is not restricted in the interpretative methods used in arriving at a statutory construction of s 43A that is in conformity with EU law. Statutory deeming is a familiar device in tax legislation. Two common examples in relation to the capital gains tax regime come to mind. The gift of an asset is a deemed disposal for CGT purposes, and triggers a chargeable event. In the sale of an asset to a connected party, the proceeds are deemed to be the open market value, regardless of the fact that the actual consideration may be lower.

145. The cardinal feature of section 43A is the control test. The rationale behind using a control test to establish eligibility reflects Parliament's intention in delineating the scope of the VAT grouping provision, thereby giving effect to the core element in art 11 of the VAT Directive by allowing '*persons ... who, while legally independent, are closely bound to one another by financial, economic and organisational links*' to form a VAT group.

146. The repercussions of extending the deeming need to be evaluated as part of the exercise in conforming construction of s 43A. Neuberger J (as he was then) in *Jenks v Dickinson* observed at 878 the effect of a deeming provision in the following terms:

> '… by its very nature, a deeming provision involves artificial assumptions. It will frequently be difficult or unrealistic to expect the legislature to be able satisfactorily to proscribe the precise limit to the circumstances in which, or the extent to which, the artificial assumptions are to be made. … Accordingly, while the rules of construction … apply equally to a deeming provision it is, at least in some circumstances, rather easier to identify a limitation to the ambit of a deeming provision than it is to the ambit of a provision which is not a deeming provision.'

147. Within section 43A itself, subsections (1)(b) and 1(c) contain two built-in limitations on the extent that subsection (3) can apply.

(1) The first limitation concerns the extent of control exerted by the controlling body, which has to be total to be eligible. Only an individual or a partnership that controls *all* of the corporate entities seeking to form a VAT group meets the eligibility test under subsection (1)(c). The single word 'all' effectively limits the scope of the eligibility test.

(2) The second limitation concerns the direction of control. The extended deeming applies only to the *controlling* body, not to the controlled entities, which have to remain bodies corporate for the purposes of subsection (1).

148. The second limitation means that it would have been impossible to carry out a conforming interpretation if the *controlled* entities were partnerships, as in the case of

L+M. There would have been no way to construe the existing provision under s 43A without going against the grain of the legislation.

149. A third limitation can be implied by reading into the wording of '*one person*' in subsection (1)(b) and '*a business*' in subsection (1)(c). By the use of the singular, the controlling body is envisaged to be one entity. While it is possible to have more than one entity at the apex having an interest in the controlled entities, only one entity will emerge as the controlling entity exercising control in the manner defined by s 1159 of CA2006. If the controlling entity at the apex is also the *only* entity, then the controlled companies are 'wholly-owned' subsidiaries within the meaning of subsection 1159(2):

> 'A company is a "wholly-owned subsidiary" of another company if it has no members except that other and that other's wholly-owned subsidiaries or persons acting on behalf of that other or its wholly-owned subsidiaries.'

150. To limit the repercussions from the extended deeming, the third limitation as implied can be made explicit by adding the wording 'if the body corporate is a "wholly-owned" subsidiary' as follows:

> 'For the purposes of this section, *an individual or individuals* shall be taken to control a body corporate, if he or they, *were he or they a company*, *would be that body's holding company* within the meaning of those provisions, ***and also for the purposes of subsection (1) if the body corporate is a "wholly-owned" subsidiary***.'

151. As a matter of fact, the appellant controls BG Ltd, BG Savings, and BG Life as the sole shareholder in each. It is common ground that the three subsidiaries meet the control test as stipulated under subsection 43A(2), referable to s 1159 of CA 2006. Furthermore, these subsidiaries are wholly-owned within the meaning of subsection 1159(2) as discussed above.

152. I have considered the appellant's submission on limiting a conforming interpretation to Scottish partnerships. I reject this proposed emendation, not only because the existing provision does not lend itself readily to such an interpretation, but also to allow Scottish partnerships to the exclusion of English partnerships is to create a new issue that infringes on the principle of fiscal neutrality in the process of trying to solve one. I understand the proposal is to limit the repercussions that a conforming interpretation may have, and I consider that the narrowing of the scope of the extended deeming can achieve the purpose without creating a new issue in the process.

153. As to the respondents' caution against a conforming interpretation that may result in repercussions that the Tribunal is not equipped to evaluate, it is settled law that there is limitation in construing a deeming provision that the court can be called upon to apply. In *Marshall v Kerr* Lord Browne-Wilkinson cited with approval at 164 Peter Gibson J's leading judgment of the same case in the Court of Appeal:

> '… the correct approach in construing a deeming provision [is] to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the

> statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents flowing from or accompanying that deemed state of affairs, unless prohibited from doing so.'

154. Any conforming interpretation needs to take account of prevention of abuse as a core objective of the VAT Directive. The restriction to 'bodies corporate' for VAT grouping in the existing legislation is a measure against abuse, but it is not the panacea for such prevention: the Order (SI 2004/1931), being the first instance of the Treasury exercising the power conferred under s 43AA of VATA to legislate against abuse of the VAT grouping legislation, is a case in point.

155. While it is true that a deeming provision involves artificial assumptions which may make it difficult 'to proscribe the precise limit' as Neuberger J has observed, there is the judicial safeguard in interpretation, as highlighted in *Jenks v Dickinson*: '[with] a deeming provision it is, at least in some circumstances, rather easier to identify a limitation to the ambit of a deeming provision than it is to the ambit of a provision which is not a deeming provision'.

156. In view of the enactment of FA 2019 with amendments to the VAT grouping legislation, the repercussions of the conforming construction of the predecessor version of s 43A VATA in this Decision are likely to be limited, and restricted to any outstanding VAT grouping applications where the applicants are in a similar position to that of the appellant and its subsidiaries.

Disposition

157. The appeal is accordingly allowed, upon a purposive construction of section 43A of the Value Added Tax Act 1994 in conformity with the principle of fiscal neutrality.

158. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR HEIDI POON

TRIBUNAL JUDGE
RELEASE DATE: 25 JUNE 2019

ANNEX

Case law

The authorities referred to in this decision are listed in the alphabetical order of their short case names:

(1) *Ampliscientifica Srl and another v Ministero dell'Economia e delle Finanze and another* (Case C-162/07) [2011] STC 566 ('***Ampliscientifica***')

(2) *Bulthuis-Griffioen v Inspector de Omzetbelasting* (Case C-453/93) [1995] STC 954 ('***Bulthuis-Griffioen***')

(3) *Compass Contract Services UK Ltd v Revenue and Customs Commissioners* (Case C-38/16) [2017] STC 1358 ('***Compass Contract***')

(4) *European Commission v Finland* (Case C-74/11) (23 April 2013, unreported) ('***Commission v Finland***')

(5) *European Commission v Ireland* (Case C-85/11) [2013] STC 2336 ('***Commission v Ireland***')

(6) *European Commission v Sweden* (Case C-480/10) [unreported in STC] ('***Commission v Sweden***')

(7) *European Commission v United Kingdom* (Case C-86/11) [2013] STC 2076 ('***Commission v UK***')

(8) *Test Claimants in the FII Group Litigation v Revenue and Customs Commissioners* [2012] UKSC 19, [2012] STC 1362 ('***FII Group Litigation***')

(9) *Fleming (trading as Bodycraft) v Revenue and Customs Commissioners* [2008] UKHL 2 ('***Fleming***')

(10)*Francovich v Italian Republic* (Joined cases C-6/90 and C-9/90) [1995] ICR 722 ('***Francovich***')

(11)*Forsyth v Hare* [1834] 12 S 42 ('***Forsyth v Hare***')

(12)*Ghaidan v Godin-Mendoza* [2004] UKHL 30 ('***Ghaidan***')

(13)*Gregg and another v Customs and Excise Commissioners* (Case C-216/97) [1999] STC 934 ('***Gregg***')

(14)*Halifax plc v Customs and Excise Commissioners* (Case C-255/02) [2006] STC 919 ('***Halifax***')

(15)*Revenue and Customs Commissioners v IDT Card Services Ireland Ltd* [2006] EWCA Civ 29 ('***IDT***')

(16)*In re S (Minors) (Care Order: Implementation of Care Plan)* [2002] UKHL 10; [2002] 2 AC 291 ('***In re S***')

(17)*J P Morgan Fleming Claverhouse Investment Trust plc v Revenue and Customs Comrs* (Case C-363/05) [2008] STC 1180 ('***J P Morgan Fleming***')

(18)*Jenks v Dickinson (Inspector of Taxes)* [1997] STC 853 ('***Jenks v Dickinson***')

(19)*Finanzamt Gladbeck v Linneweber; Finanzamt Herne-West v Akritidis* (Joined cases C-453/02 and C-462/02); [2008] STC 1069 ('***Linneweber***')

(20)*Beteiligungsgesellschaft Larentia + Minerva mBH & Co KG v Finanzamt Nordenham; Finanzamt Hamburg-Mitte v Marenave Schiffahrts AG* (Joined cases C-108/14 and C-109/14); [2015] STC 2101 ('***Larentia*** + ***Minerva*** and ***Marenave***' also as '***L+M***')

(21)*Litster v Forth Dry Dock & Engineering Co Ltd* [1990] 1 AC 546 ('***Litster***')

(22)*Macmillan v T Leith Developments Ltd (in receivership and in liquidation)* [2017] SC 642 ('***MacMillan***')

(23)*Marleasing SA v La Commercial International de Alimentactión SA* (Case C-106/89); [1990] ECR I-4135, ECJ ('***Marleasing***')

(24)*Marshall (Inspector of Taxes) v Kerr* [1995] 1 AC 148 ('***Marshall v Kerr***')

(25)*Pickstone v Freemans plc* [1989] AC 66 ('***Pickstone***')

(26)*The Prudential Assurance Company Ltd & Anor v Revenue and Customs Commissioners* [2013] EWHC 3249 (Ch), [2014] STC 1236 ('***Prudential***')

(27)*R v Secretary of State for the Environment, Transport and the Regions, ex p Spath Homes Ltd* [2001] 2 AC 349 ('***R (ex p Spath Homes Ltd)***')

(28)*R (Anderson) v Secretary of State for the Home Department* [2003] 1 AC 837 ('***R (Anderson)***')

(29)*Vidal-Hall and others v Google Inc (Information Commissioner intervening)* [2015] EWCA Civ 311 ('***Vidall-Hall***')

(30)*Vodafone 2 v Revenue and Customs Commissioners (No 2)* [2009] EWCA Civ 446 ('***Vodafone 2***')