

DCM (Optical Holdings) Ltd (Appellant) v Commissioners for His Majesty's Revenue and Customs (Respondent) (Scotland) [2022] UKSC [26] On appeal from: [2020] CSIH 60

Date: 12 October 2022

Justices

Lord Reed (President), Lord Hodge (Deputy President), Lord Sales, Lord Hamblen, Lord Stephens

Background to the Appeal

DCM is a VAT-registered business principally specialising in the sale of dispensed spectacles and laser eye surgery under the name Optical Express.

VAT operates in large measure by self-assessment, with taxable persons submitting periodic self-assessment returns to His Majesty's Revenue and Customs ("HMRC"). DCM is a "partially exempt" person for VAT purposes, as it makes both supplies on which VAT is chargeable (such as the supply of frames and lenses) and supplies which are exempt from VAT (such as dispensing services). Where a taxable person makes both taxable and exempt supplies, section 19(4) of the Value Added Tax Act 1994 ("VATA") provides that the consideration (which was, in DCM's case, the price paid for its goods and services) should be apportioned between the taxable and exempt elements.

The first issue before the Supreme Court concerns an assessment issued to DCM by HMRC on 20 October 2005 which was disputed in relation to under-declared output VAT (the VAT on DCM's sales) for accounting periods from October 2002 to July 2003. When faced with an incomplete or incorrect VAT return, section 73 of VATA empowers HMRC to make an assessment of the VAT due not later than whichever is the later of (a) two years after the end of the accounting period; or (b) one year after evidence of facts comes to HMRC's knowledge which is, in HMRC's opinion, sufficient to justify making the assessment. DCM argued that HMRC knew that "something was wrong" with its apportionment method by January 2004 and, from then, had one year to make their assessment. This meant that they were out of time to do so for the relevant accounting periods by October 2005, making their purported assessment invalid ("**time bar challenge**").

Where VAT is charged to a taxable person on goods and services that it purchases, it is possible for that person to reclaim it as input VAT by setting it off against its output VAT. Under section 25(3) of VATA, if there is no output VAT or the amount of input VAT exceeds its output VAT, then the amount of the excess must be paid to the taxable person by HMRC as a VAT credit. The second issue before the Supreme Court concerns disputed decisions by which HMRC reduced the VAT credits which DCM had submitted in its returns. DCM argued that HMRC did not have the power to make the relevant reductions as section 25(3) of VATA mandated HMRC to pay DCM the VAT credits which it claimed ("**vires challenge**").

DCM was unsuccessful in both of its challenges before the First-Tier Tribunal, although the Upper Tribunal allowed the time bar challenge. The Inner House of the Court of Session allowed HMRC's appeal on the time bar challenge and dismissed DCM's appeal on the vires challenge.

Judgment

The Supreme Court unanimously rejects the appeal. Lord Hodge gives the judgment, with which Lord Reed, Lord Sales, Lord Hamblen and Lord Stephens agree.

Reasons for the Judgment

The time bar challenge

It was common ground between the parties that “knowledge” in section 73 of VATA meant actual, rather than constructive, knowledge (constructive knowledge being knowledge which HMRC did not, in fact, have, but which they could have had if they had taken the necessary steps to acquire it) [18].

The Supreme Court holds that, when considering section 73 of VATA, a court must first decide what were the facts which, in HMRC’s opinion, justified the making of the particular assessment and then determine when the last piece of evidence of those facts was communicated to HMRC. It is from this date that the period of one year begins to run [18-20]. HMRC obtained the last pieces of evidence relevant to the assessment of October 2005 (including, for the first time, from DCM’s VAT account) on 31 August and 1 September 2005, before which time HMRC did not have evidence of facts sufficient to justify that assessment. It was then that the clock began to run. The Supreme Court therefore dismisses DCM’s time bar challenge as HMRC were not out of time to make that particular assessment [21-22].

The vires challenge

HMRC’s powers are set out in statute either expressly or by implication [29], [33].

It was common ground that HMRC have both a power and a duty to conduct a reasonable and proportionate investigation into the validity of VAT credit claims. That being accepted, the Supreme Court finds that the question becomes whether HMRC have the power to give effect to the result of this verification process by refusing to pay a claim [30-31]. There is no express power to refuse to pay a claim so any power to do so, if it exists, must arise by implication [29].

The Supreme Court finds that it is implicit in section 25(3) of VATA that the obligation on HMRC to pay a VAT credit arises only once it is established by the verification process that the VAT credit is due: the obligation to pay does not depend solely on the say-so of the taxable person [32]. The existence of a power and duty to verify and, where justified, refuse to pay a claimed VAT credit is not inconsistent with the statutory provisions of VATA, and is implicit in HMRC’s duty to “be responsible for the collection and management of VAT,” as set out in paragraph 1 of Schedule 11 to VATA. The implied power is consistent with the purpose of ensuring that the taxable person pays the right amount of VAT or receives the right amount of VAT credit [33], [41-43].

The implied power is also consistent with the principle of fiscal neutrality, which underpins VAT jurisprudence and tasks HMRC with verifying a taxable person’s claims and refusing to pay sums which are not due [34], [37]. It does not involve unjustified discrimination between payment traders and repayment traders [36-39].

The Supreme Court therefore dismisses DCM’s vires challenge as HMRC did have the power to make the relevant reductions [46].

References in square brackets are to paragraphs in the judgment

Note

This summary is provided to assist in understanding the Court’s decision. It does not form part of the reasons for the decision. The full judgment of the Court is the only authoritative document. Judgments are public documents and are available online. [Decided cases](#)