

ABUSE OF RIGHTS II – WHA: THE ELEPHANT ON CLOSER INSPECTION

by Hui Ling McCarthy

In the previous edition of this Review¹, I discussed the doctrine of abuse of rights and its application to the VAT regime, following the ruling of the European Court of Justice in *Halifax*², in which the court set out its two-stage test for determining whether abuse existed³. In certain respects, the ruling created more questions than it answered – the recent reference in *Part Service* (C-425/06) is a perfect example: the Italian Supreme Court requesting clarification on what, exactly, the European Court of Justice meant by “essential” aim. The *Halifax* ruling also caused a great deal of uncertainty as to how the doctrine would be applied by national courts. To this end, we waited with bated breath for the Court of Appeal’s judgment in *WHA Ltd and Another v HM Revenue & Customs*⁴, the first indication of the higher courts’ approach to the question of abuse post-*Halifax*. Released on 17 July 2007, the judgment has generated much excitement (well, excitement for HMRC at any rate and a somewhat more tempered emotion for the rest of us). Although the abuse principle is beginning to take shape, certain areas of the Court of Appeal’s analysis in *WHA* are highly unsatisfactory. So far as prospective VAT planning arrangements are concerned, I would suggest that, although *WHA* might have spelt the end for purely artificial VAT avoidance schemes, planning to minimise VAT is, in itself, most certainly not yet dead.

The Arrangements in WHA

The arrangements at the heart of the appeal purported to have the effect of minimising overall liability to VAT in the context of the supply of repairs and parts, provided pursuant to contracts of motor breakdown insurance (MBI). Insurers would not normally be able to recover VAT charged on vehicle repairs, either because the supply of the repair works would be made to the insured rather than the insurer, or because repairs would be undertaken in the course of making an exempt supply of insurance to the insured. Accordingly, the purpose of the arrangements was twofold: (i) to ensure that the supply of repair services was made to the insurer, yet (ii) in such a manner that they would not comprise transactions made in the course of exempt supplies of insurance. The arrangements involved the reinsurance of a proportion of the liabilities via two Gibraltar-based companies as follows:

- An English company (NIG) issued MBI policies to members of the public.
- NIG reinsured 100% of its liability under the policies with a Gibraltar-based company called Crystal.
- Crystal in turn retroceded 85% of the reinsurance to another Gibraltar-based company, Viscount.
- Viscount contracted with an English company, WHA, to instruct garages to carry out repair works required to be effected under the policies and to pay for those works. On each occasion, the garage responsible for carrying out the works rendered an invoice to WHA, who then rendered an invoice to Viscount.

WHA, Viscount and Crystal formed part of the same group of companies. The claims handling and contracts with the garages for repair works were subcontracted along the chain of companies from (originally) NIG to Crystal to Viscount and finally to WHA.

It was common ground that VAT was payable on the invoice rendered by the garage to WHA. The question was whether, at that stage, WHA was able to treat that VAT as input tax. WHA further contended that the invoice it rendered to Viscount was exempt from VAT with the result that WHA would be able to claim a repayment from HMRC of the input tax (because Article 17(3) of the Sixth Directive in part provided that Member States should grant every taxable person the right to a deduction of VAT in respect of any transactions exempted as insurance transactions when the customer was established outside the European Union for VAT purposes. Although part of the European Union – having joined the European Economic Community with the UK in 1973 - Gibraltar is based outside the Customs Union and VAT Area). Alternatively, if WHA was wrong and VAT was chargeable on its invoice to Viscount, then Viscount contended that it would be able to recover as input tax the VAT it incurred in respect of the invoice from WHA (again on the basis of Article 17(3)).

The history of the case before the Court of Appeal

A preliminary hearing took place in 2004 where the companies argued that, assuming the arrangements should be accepted at face value, each element of the scheme was technically correct. The Court of Appeal's interim judgment was released on 14 May 2004 and dealt with the non-abuse issues⁵. On a purely technical analysis, the Court of Appeal found that the arrangements *did* succeed in minimising the overall liability to VAT (in part, because of an inconsistency in the transposition of a particular Community provision into UK law – more on this later). Viscount was entitled to recover as input tax the VAT it paid to WHA (although the court determined that WHA was not entitled to recover the input tax it paid to the garages, on the basis that it had failed to establish that it did not make taxable supplies of services to Viscount).

The held-over part of the appeal concerned the application of the abuse of rights principle, pending the ECJ's ruling in *Halifax*. Lord Neuberger of Abbotsbury delivered the leading judgment with which Lord Justice Latham and Lord Justice Walker concurred without further comment. In September, the companies lodged a petition with the House of Lords for leave to appeal the abuse point, having been refused by the Court of Appeal. In between the two hearings, Lord Neuberger was appointed to the House of Lords (returning temporarily to the Court of Appeal to sit for the second hearing on 20 and 21 June earlier in the year). Bearing this in mind, it will be interesting to see whether permission to appeal to the House of Lords will be granted.

The Court of Appeal's Finding of Abuse

In reaching its conclusion, the Court examined four questions:

1. Was the tax advantage sought “contrary to the purpose” of the provisions of the Sixth Directive?

2. If so, was the “essential aim” of the transactions to obtain a tax advantage?
3. If so, were there any special features that should prevent the principle of abuse from applying?
4. If the principle of abuse did apply, must (and if so, how must) the transactions be redefined?

On the question of abuse, broadly speaking the Court of Appeal held that, although each step of the scheme worked, its overall effect was unacceptable and contrary to the purpose of the Sixth Directive. When evaluating the question of abuse, the transactions had to be examined collectively, not individually. Furthermore, various elements of the scheme were “commercially pointless”. Any reasons for entering into the arrangement other than the purpose of avoiding overall liability to VAT were so minor and unimportant that it could be said that tax avoidance was the “sole purpose” or “essential aim” of both the scheme as a whole and, more precisely, the involvement of Viscount. The Court considered that, having satisfied both limbs of the *Halifax* test, *WHA* had not advanced any other convincing reason as to why the VAT advantage should nevertheless be allowed. The final twist in the Court’s conclusion was that, contrary to previous belief, once a determination of abuse had been reached, it was *not* necessary to settle on a redefinition of the transactions in order to establish the VAT consequences: it was sufficient simply to deny the VAT advantage so claimed without having to reconfigure the arrangements as a preliminary step.

Before discussing the judgment in further detail, I should say that, on the whole, I find the Court’s observations in respect of the “contrary to purpose” test helpful. Combined with the VAT tribunal’s recent decision in *Weald Leasing*⁶, it is also becoming clearer what part “artificiality” plays in finding abuse. However, I find unhelpful the Court’s focus on the companies *change in business practice* when determining the “essential aim” of the arrangements. Moreover, the Court’s conclusions on, in particular, the extension of the abuse principle to domestic legislation (albeit limited) and the question of redefinition are, to my mind at least, unsatisfactory.

Contrary to purpose (the first limb of Halifax)

In determining whether the resulting tax advantage was contrary to the purpose of the Sixth Directive, the Court of Appeal held that the scheme as a whole must be considered and not simply each component separately. This is, in my view, undoubtedly correct: the principle of abuse is an over-arching principle of interpretation – it examines whether the overall result of an arrangement is acceptable in the context of the provisions of the Sixth Directive, notwithstanding that each individual element might work.

Reference was made to the ruling of the European Court of Justice in *Elida Gibbs*⁷ in order to determine the purpose of the VAT provisions with which *WHA* was concerned, namely that the “basic principle of the VAT system is that it is intended only to tax the final consumer” and that “within each country similar goods should bear the same tax burden whatever the length of the production and distribution chain”. Accordingly, the Court accepted HMRC’s argument that “fiscal neutrality requires the conclusion that an insurer,

who provides, in the EU, insurance services which are exempt for VAT purposes, cannot recover input tax attributable to those services.”

In the context of the normal commercial operations of an insurer and a claims handler within the EU, input tax attributable to the cost of the repairs and parts would be irrecoverable. In this instance, the provision of services comprising the claims handling (from WHA to NIG – both suppliers of exempt services) and the supply of repairs and parts (to WHA) were provided in the European Union. This was so, irrespective of the involvement of the two Gibraltar-based companies: the only commercial service provided outside the European Union for VAT purposes was the reinsurance. Accordingly, to the extent that the scheme in question had the effect of making recoverable input tax incurred in the provision of exempt insurance services, the Court held that was contrary to the purposes of the Sixth Directive and the implementing domestic legislation. These commercial operations would ordinarily have resulted in an overall liability to VAT equal to the tax chargeable on the services and not, as resulted from the arrangements, no net liability to VAT whatsoever.

Artificiality and the contrary to purpose Test

My initial feeling was that the Court had construed the “contrary to purpose” test too broadly. Can it really be said that if an insurer, who provides in the European Union insurance services which are exempt for VAT purposes, attempts to recover input tax attributable to those services, he will always be acting contrary to the purpose of the Sixth Directive, whatever the circumstances – notwithstanding that the insurer might be acting to the letter of the Directive and may simply be taking advantage of a lacuna in the provisions by means of entirely genuine arrangements? On reflection, I do believe that this first limb of *Halifax* is as straightforward as that. The Advocate General in *Halifax* determined that the purpose and objectives of the Community rules were to be compared with the purpose and results achieved by the activity at issue. Therefore, where the purpose of the Community rules is that VAT should be non-recoverable, but the net result of an arrangement is the recovery of VAT, there is a conflict. The result is that the first limb is satisfied, even if the arrangements themselves are not artificial. So, an *absence* of artificiality is not sufficient to prevent arrangements from being contrary to the purpose of the Sixth Directive.

In my view artificiality has its place in the contrary to purpose test as follows: whereas on the one hand the absence of artificiality will not save a scheme from being contrary to the purpose of Community law, on the other hand, the *existence* of artificiality will bring a scheme within the confines of the first limb where otherwise it may not have been. Take, for example, the VAT tribunal’s decision in *Weald Leasing*⁸: nothing in the Sixth Directive (either expressly or by implication) showed that an exempt trader may not defer or spread the burden of input tax by leasing (accordingly, a commercial decision to lease rather than to purchase outright would not, on its own, be contrary to the purpose of the Sixth Directive). However, artificially suppressed rents *would have* resulted in a tax advantage contrary to the purpose of the directive.

An *absence* of artificiality is therefore only material in connection with the essential aim test, so far as VAT is concerned. This is predominantly where the analysis in direct tax cases on abuse (such as *Cadbury Schweppes*⁹) becomes relevant to VAT.

Essential Aim (the second limb of Halifax)

The Court of Appeal proceeded on the basis that establishing “the essential aim of the transactions concerned” was not substantially different from the “sole purpose” test also envisaged by the European Court of Justice in *Halifax* and was content to leave to another day the debate as to whether the former could conceivably be a looser requirement.

Revisiting the findings of the VAT tribunal, the Court agreed with HMRC that, judged objectively, the purpose of the transactions (in particular the imposition of the two Gibraltar-based companies) had been to obtain a tax advantage, namely the recovery of input VAT paid by WHA to avoid a net liability to VAT. The Court considered that the minutes of various meetings between Crystal and Viscount, as well as the fact that all companies involved in the arrangements were 100% members of the same group, were relevant objective factors in determining the essential aim of the transactions. Even assuming the conceivably stricter “sole purpose” test, the Court concluded that collateral or otherwise minor commercial benefits derived from adopting the arrangements could be ignored.

There is, however, a potential deficiency in the Court’s analysis at this point (although perhaps not in its conclusion): in establishing the essential aim of the transactions, the Court’s focus was very much on whether there was a commercial justification for the group’s *change in business practice*, as opposed to a justification for the arrangements *standing alone*. However, the European Court of Justice’s reference to a taxable person’s “normal commercial operations” is to be assessed *objectively*. In other words, in my view the comparison is to be made between, in this case, the arrangements of the insurer who is the subject of the appeal and the “normal commercial operations” of insurers collectively, and not between that particular insurer’s operations before and after adopting the arrangements in question. It would make a nonsense of the test and lead to a potential distortion of competition if one trader was precluded from altering its commercial practice during the course of its business, but another could commence trading adopting the disputed practice from the outset. That a taxpayer’s structuring of his supply is merely unusual or even abnormal is not sufficient for a finding of abuse.

The Court considered that, in one sense, the purpose of the arrangements was to enable NIG to perform and reinsure its liabilities. In my view, the fact that the group had not previously sought to reinsure its liabilities is not a sufficient reason *by itself* for rejecting this as a commercial justification. However, the VAT tribunal had previously found (and the Court of Appeal agreed) that, given the 100% ownership structure of the group, the reinsurance was itself of no real value, other than enabling WHA to reclaim input VAT. This is key: the group was not simply exercising its freedom to structure its business operations as it chose, because the relevant components (included to bring about the required VAT consequence) in fact formed no part of its genuine business activity at all. As the European Court of Justice confirmed in *Halifax*, the purely artificial nature of transactions may be taken into account when determining the essential aim. This is effectively where the *Cadbury Schweppes* analysis comes in – simply because a taxpayer might have an avowed purpose or intention of benefiting from a tax advantage, provided that the arrangements comprise part of his genuine business activity, there should be no abuse, as the essential aim test is not met.

So far as the essential aim test is concerned, taxpayers are at something of a disadvantage from the outset. Although the test is supposedly determined objectively (theoretically ignoring a taxpayer's subjective intentions) this is incredibly difficult to do – especially if HMRC have obtained full disclosure from the taxpayer in advance of the hearing and, on the day, produce document after document, minute after minute detailing the potential VAT saving a change in business practice might achieve. If amongst those papers there is a brief mention of some other spurious commercial benefit to the new arrangements, this is hardly likely to alter a tribunal's perception in favour of the taxpayer.

To establish a genuine commercial purpose convincingly, evidence of the commercial *results* achieved by an arrangement is invaluable. For example, a tribunal might not attribute much weight to a set of minutes outlining a hypothetical financing benefit (other than a VAT saving) derived from a series of transactions yet to be implemented; but if these minutes were corroborated by documentary evidence of genuine commercial results actually achieved following implementation, the weight of this combined evidence would be far more powerful. A genuine financing benefit might result in, say, a reduction in bank borrowings the following year, which would be reflected in that year's annual accounts: these would provide the requisite objective evidence of an essential aim other than the obtaining of a tax advantage.

Should HMRC's case on abuse otherwise fail?

Having concluded that the two limbs of the *Halifax* test had been satisfied, the Court of Appeal then considered a number of other arguments advanced on behalf of the companies as to why HMRC's case on abuse should otherwise fail; all of which were rejected.

- (i) ***A taxpayer's entitlement to minimise his liability to VAT.*** The Court of Appeal drew a distinction between a taxpayer's reliance on wholly artificial and ingenious steps included purely to obtain a tax advantage (namely the insertion of Viscount and the claims handling chain) as opposed to his entitlement to choose the least-taxed route out of a number of options properly available to him.
- (ii) ***Legal certainty.*** The Court of Appeal concluded that the need for legal certainty was not an additional hurdle for HMRC to overcome, once the *Halifax* test has been satisfied. Although not entirely clear from the Court's judgment, it appears that the companies advanced their argument on legal certainty on the basis of paragraph 72 of the ECJ's judgment in *Halifax* – where rules are liable to entail financial consequences, those concerned must know precisely the extent of the obligations imposed on them. However, in *Kofoed*¹⁰, the European Court of Justice approached legal certainty in the context of abuse from another direction, ruling that the principle precludes directives themselves from being able to create obligations for individuals and accordingly cannot be relied upon against individuals by Member States, without the necessary implementing legislation. As the doctrine of abuse is simply a principle of interpretation of Community law (it is certainly not a general anti-avoidance rule), it follows that it must need an applicable directive onto which to latch. I suggest that legal certainty *can*, therefore, represent an additional hurdle in cases (such as *WHA*) where the results of the transposition of Community law to domestic law are not sufficiently clear and precise, so do not afford the persons affected by them the

opportunity to know the full extent of their rights and obligations; this point is developed in (v) below.

- (iii) ***Inconsistency between the technical analysis and the case for abuse.*** Simply because, on a step-by-step analysis of the scheme, it had been established that WHA was obliged to charge output tax for the supplies it made to Viscount, the Court did not consider itself precluded from reaching a conclusion on the question of abuse that was inconsistent with that finding. The question of abuse required examining the effect of the scheme as a whole: the net tax advantage derived from the arrangements viewed collectively.
- (iv) ***The principle of freedom of establishment.*** In this instance, the Court held that their finding of abuse did not offend against the principle of freedom of establishment because the group was not impermissibly penalised for exercising its freedom to set up Viscount in Gibraltar. Unlike in *Cadbury Schweppes*, it was not the establishing of Viscount in Gibraltar that was allegedly abusive, but the involvement of Viscount in the scheme that was the artificial contrivance. There is a danger, however, that HMRC may seek to generalise the Court's conclusion on this point too far. It is certainly not the case that conduct amounting to a legitimate exercise of freedom of establishment is an abuse of the provisions of the Sixth Directive, simply because the taxpayer concerned benefits from a more favourable VAT regime. There must still be an element of artificiality (as the ECJ ruled in *Cadbury Schweppes*) amongst the arrangements. Either the establishment itself must be artificial in the sense that it is fictitious (*Cadbury Schweppes*) or the economic activities in which that establishment purportedly participates must be artificial in the sense that they are "commercially pointless" (*WHA*).
- (v) ***Reliance on domestic (as opposed to Community) legislation.*** The Court of Appeal rejected the companies' argument that because the success of the scheme depended on provisions of domestic rather than Community law, the doctrine of abuse (as a principle of Community law) could not apply. The Court acknowledged that Viscount was able to recover input tax paid by WHA, not because of the provisions of the Sixth Directive¹¹ or the Thirteenth Directive, but only because of provisions of national law¹² which imperfectly transposed the Directives. However, it went on to determine that the domestic legislation in question had been enacted with the *intention* to give effect to the provisions of the Directives and that was sufficient for the principle of abuse to encompass the relevant domestic provisions. In my view, this conclusion is highly unsatisfactory. In its preliminary judgment concerning the technical merits of the arrangements, the Court of Appeal concluded that domestic legislation went *further than is envisaged by the Sixth Directive* in permitting persons based outside the Community to reclaim VAT, so that Viscount could rely on a specific provision of domestic law in order to recover the input tax it paid to WHA. Herein lies the problem: following *Halifax*, it is quite clear that the doctrine of abuse governs *the interpretation of Community law*¹³ - once again, it is not a GAAR. Accordingly, where the Court is *not* required to interpret Community law, it is difficult to see on what basis the abuse principle can apply. It is trite law that, just as directives do not have horizontal effect, in addition, they do not have direct effect against individuals (in this case, the taxpayers, as set out in (ii) above)¹⁴. Accordingly, the principle of

direct effect surely cannot cure the incorrect transposition of Community law here. One option open to the Court would have been to impose a “directive-compliant” interpretation of national law on the companies¹⁵. However, the Court of Appeal expressly disclaimed this option at paragraph 142 of their preliminary judgment. It would be highly contradictory to attempt to reinstate it here. Unlike various other Member States (for example, Greece), the UK has not enacted its own national provisions prohibiting abuse. Furthermore, the doctrine is not recognised as part of the UK’s notion of purposive construction and no domestic anti-avoidance principles exist to cure similar defects in domestic legislation (as demonstrated by Lord Hoffman’s speech in *MacNiven (Inspector of Taxes) v. Westmoreland Investments Ltd*¹⁶ and more recently by Henderson J’s observation in *HMRC v D’Arcy*¹⁷). In the absence of a provision or general principle prohibiting abuse *in domestic law*, an extension of the Community law principle of abuse is unjustified¹⁸. Put simply, so far as the UK is concerned, it cannot be said to be an abuse of Community law to take advantage of a domestic loophole – however ‘well-intended’ the Parliamentary draftsman’s efforts to correctly enact the equivalent domestic provision¹⁹. In my view, the fact that the abusive nature of a particular scheme should be determined by considering the scheme as a whole does not save the analysis: how can it be said that a taxpayer has improperly or fraudulently taken advantage of provisions of Community law if domestic law (namely Regulations 186 and 190 of the Value Added Tax Regulations 1995, SI 1999/3121) in part permits him to do so?

- (vi) ***The doctrine of abuse should not be invoked to put right an oversight in the drafting of national legislature.*** The Court of Appeal considered that (although essentially a permutation of the companies’ fifth argument) there was some merit in this point. Nevertheless, they rejected it for the same reasons. However, the ECJ’s ruling in *Kofoed* suggests that the Community doctrine of abuse cannot be extended to correct such domestic defects in the absence of an equivalent national anti-abuse measure. It will be interesting to see whether the House of Lords grants the companies permission to appeal, given that the ruling in *Kofoed* was released on 5 July 2007 – post-dating the hearing on the question of abuse in *WHA*, but preceding the release of the Court of Appeal’s judgment.
- (vii) ***The genuineness of the individual steps comprising the scheme.*** The fact that the tribunal found that each individual step comprising the scheme was a genuine transaction did not preclude a finding of abuse: the Court of Appeal held that this was entirely consistent with the ECJ’s ruling in *Halifax* where the fact that a transaction was entered into for the purposes of tax avoidance did not prevent it from being a genuine supply for VAT purposes. Such transactions, although genuine, were nevertheless outside the range of the companies’ normal commercial operations.
- (viii) ***Subjective motive.*** The fact that the subjective motive of the parties to the scheme was irrelevant did not assist the companies in this case: the inclusion of Viscount as a retrocedent (given the tribunal’s conclusion that this was “commercially pointless”) coupled with the claims handling chain were objective factors demonstrating that the essential aim of the transactions was to minimise overall liability to VAT.

- (ix) ***Minimising liability to Insurance Premium Tax (IPT)***. Finally, the Court dismissed the companies' purported justification that the arrangement was necessary in order for the group to compete with traders established outside the European Union following the introduction of IPT. Increasing profits or avoiding or reducing loss was not by itself a sufficient commercial reason for defeating an abuse claim as that would always be the natural outcome of minimising liability to VAT.

Redefining the transactions

Another of the more surprising elements of the Court's judgment is its conclusion that it was not mandatory to redefine the series of transactions following a finding of abuse. It was enough, or so the Court of Appeal held, simply to neutralise the effects of an abusive scheme merely by removing the purported VAT advantage, provided that the consequences of the scheme in question did not involve further rights of tax authorities to demand tax, rights of taxpayers being over-taxed or rights of any third parties. The Court of Appeal held that because the scheme in question did not compromise any such rights (as the tax due had been fully paid, but not overpaid, and no third party rights needed protection) redefinition had no purpose. As the scheme was abusive (albeit achieving its tax-saving aim at face-value) the outcome was simply that Viscount was not entitled to recover as input tax the VAT it incurred in respect of the invoice from WHA, and that was the end of the matter.

In *Halifax*, the European Court of Justice considered that "transactions involved in an abusive practice *must be redefined* so as to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice." To justify their conclusion that there was no need for redefinition, the Court of Appeal interpreted the mandatory term "*must be redefined*" to mean that the original, abusive transactions could not be permitted to remain, rather than that a counter-factual must be determined. So far as the Court was concerned, redefinition did not present a third hurdle to HMRC once the *Halifax* test had been satisfied. Superficially, this is an attractive conclusion to reach: if a practice is abusive in that it improperly takes advantage of Community law, what could be simpler than removing the advantage, so remedying the abuse?

However, is the Court's conclusion (that the tax position was neutral as regarding the taxpayers', the tax authority's and any third party's rights, so that redefinition would serve no particular purpose) necessarily correct? HMRC's preferred analysis (and indeed the VAT tribunal's approach) was that the garage's supply should be treated as being made to the insured alone. In which case, a VAT registered insured would be able to reclaim the VAT on his bill from the garage. Albeit this redefinition does not confer a VAT advantage on the group (it would be, after all, the insured that would benefit from the VAT repayment), it nevertheless affects both the tax authority's and a third party's rights. Taking this a step further, what if (rather than paying the gross amount of the insured's bill) the insurer agreed with its VAT-registered customers that it would refund an amount net of VAT. Although the insurer's net VAT liability would itself remain unaltered, its net financial position would be as if it had been able to reclaim VAT in respect of its VAT-registered customers. Surely this business model falls within one of the options available to a trader?

By choosing to interpret the ECJ's ruling on redefinition as they did, the Court of Appeal has effectively managed to avoid a number of complicated questions that must surely

arise in due course, the more the principle of abuse is litigated before the domestic courts. For example, if, following a finding of abuse, there are two or more possible ways in which the abusive arrangements can be recharacterised, would it amount to a penalty not to redefine the transactions in the most tax-efficient manner (bearing in mind that the European Court of Justice in *Halifax* ruled that a finding of abuse must not lead to a penalty)? Is there to be a presumption that a taxpayer would always select the most tax-efficient option? In *Cantor Fitzgerald*²⁰, the European Court of Justice ruled that a taxable person with a choice between two transactions could not choose one of them and avail himself of the effects of the other. Although *Cantor Fitzgerald* concerned an entirely different issue, an indirect corollary of the judgment could be that simply denying a trader the most tax-efficient recharacterisation does not automatically equate to a penalty. But even if some readers are inclined to think that, given a choice between two recharacterisations, it is obvious that the most tax-efficient must be selected, how about this: what if there are two options for redefinition, both of which bring about the same VAT consequences for the trader, but one would give the trader a net financial advantage - which does the court choose then? Take HMRC's preferred analysis in the paragraph above, with the modification that the insurer refunds its VAT-registered customers an amount net of the VAT they incurred. The trader's net VAT liability remains unaltered, but not its net financial position, which varies inversely to the amount of output tax HMRC collects. So should HMRC's net VAT position be ignored?

Conclusion

Although the Court of Appeal's judgment in *WHA* appears to be, superficially at least, very bad news for VAT planning, it is not quite the case that "[t]he unanimous decision of the Court of Appeal gives clear answers to many of the questions being raised by taxpayers and their advisers in abuse cases", as Chris Tailby, the Director of HMRC's Anti-Avoidance Group, wrote in a recent article for *Tax Journal*²¹ (if one assumes that "Will it work?" and "No" are respectively the genre of questions and clear answers Chris Tailby had in mind). As already mentioned, it should be remembered that the VAT tribunal in *WHA* made a number of damaging findings of fact regarding artificiality. I would suggest that, although a powerful weapon against contrived VAT avoidance schemes, there are still generous opportunities to argue that *WHA* can be distinguished in cases on different facts.

¹ *Abuse of Rights – Europe's Legal Elephant*, GITC Review, June 2007

² *Halifax v Customs and Excise Commissioners* (C-255/02) [2006] STC 919

³ At paragraph 86 of the ECJ's judgment in *Halifax*: "... first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. ... the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages."

⁴ [2007] EWCA Civ 278

⁵ [2004] EWCA Civ 559

⁶ V20003 Weald Leasing Limited, VAT Tribunal Decision.

⁷ *Elida Gibbs Ltd v Commissioners of Customs and Excise* (Case C-317/94) [1996] STC 1387

⁸ At paragraphs 135, 136, 142 and 146 of the decision.

⁹ *Cadbury Schweppes plc v Inland Revenue Commissioners* (Case C-196/04), [2006] STC 1908

¹⁰ Case C-321/05 *Kofoed v Skatteminsteriet*, released on 5 July 2007

¹¹ Namely Articles 9(2)(e) and 17(3).

¹² Namely Regulations 186 and 190 of the Value Added Tax Regulations 1995, SI 1999/3121.

¹³ As the Advocate General expressly stated in his opinion and the Commission stated in its written observations in the *Halifax* case (at paragraph 69).

¹⁴ As this would “totally blur the distinction between regulations and directives which the Treaty establishes in Articles 189 and 191”, per Advocate General Slynn in *Case C152/84 Marshall v Southampton and South-West Hampshire Area Health Authority (Teaching)* [1986] ECR 723 at 734. See also *Kofoed*, ECJ at para 42 and the VAT tribunal’s observation in *Weald Leasing* at paragraph 154 that Member States cannot rely on direct effect but must transpose the provisions by domestic legislation. Although contrast this with the position that individuals *can* rely on incorrectly implemented directives against the State, provided that the directive is sufficiently clear and precise (see, for example, *Case C-62/00 Marks & Spencer v C & E Comrs* ECJ, para 25).

¹⁵ As suggested by the ECJ in *Kofoed* at para 45.

¹⁶ [2001] 1 All ER 865 at 884 when he repeated what had been said of a direct taxing statute in *Norglen Limited v Reeds Rains Prudential Limited* [1999] 2 AC 1 at 14, “It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes.”

¹⁷ [2007] EWHC 163 (Ch), para 47, to the effect that unintended gaps occur in a tax system as complicated as that of the UK – well-advised taxpayers are not precluded from taking advantage of them.

¹⁸ It would appear that the ECJ is clear on this point – see *Kofoed* at paragraph 46

¹⁹ Of course, all this may well be academic, if indeed, as the European Commission considers, the Sixth Directive had actually been correctly transposed after all – see para 48 of the Court of Appeal’s judgment.

²⁰ *Case 108/99 CC&E v Cantor Fitzgerald International* [2001] ECR I-7257, ECJ. The ECJ ruled that, although the subletting of property by a tenant for a lower rent or the payment of compensation to the landlord for early termination of a lease (both exempt transactions) would have been comparable in economic impact to the assignment of the original lease for a fee payable by the original tenant, it did not follow that the assignment should have the same VAT treatment.

²¹ *Abuse: WHA Decision Released*, Tax Journal, Issue 896, 7, 30 July 2007.