

LONDON TRIBUNAL CENTRE

WEALD LEASING LIMITED

Appellant

- and -

**COMMISSIONERS FOR HM REVENUE
AND CUSTOMS**

Respondents

**Tribunal: THEODORE WALLACE (Chairman)
K GODDARD MBE
CYRIL SHAW FCA**

Sitting in public in London on 26-31 January, 1 and 7-9 February 2005 and 21-22 September 2006

Hugh McKay (in 2005 only) and **Nicola Shaw**, instructed by **Mark Buffery FCA**, for the Appellant

Melanie Hall QC, Raymond Hill and **Ben Lask**, for the Respondents

DECISION

1. This is an appeal against assessments disallowing input tax on goods purchased by the Appellant (“Weald”) and leased to Suas Ltd which in turn leased them to two companies which were associated with Weald but were part of a separate VAT group making exempt supplies of insurance. Following the decision of the Court of Justice in *Halifax plc v. Customs and Excise Commissioners (Case C-255/02)* [2006] Ch. 387; [2006] STC 919 it involves the applicability of the doctrine of abuse of rights. The first appeal is against assessments for periods 10/00 to 10/02 totalling £1,298,008; the original appeal (LON/03/43) against the assessment for period 10/00 was consolidated with the appeals 03/195, 03/528 and 03/694 in respect of periods 01/00 to 10/02. The second appeal (LON/04/2399) is against assessments and further assessments totalling £488,422 for periods 01/02 to 10/04 raised on the basis that the original assessments were too low because the arrangements constituted an abuse of rights. The appeals were heard together and were described as the preferred assessments which totalled £1,786,430. All of the assessments carry interest under Section 74 of the VAT Act 1994 limited to 3 years.
2. The assessments were made on the basis that artificial transactions entered into for the purpose of avoiding VAT do not constitute economic activities and do not give rise to a right to input tax following the decision in *Halifax Plc and others v Customs and Excise Commissioners* [2001] V&DR 73. Alternative protective assessments for periods 01/02 and 04/02 and for 01/03 to 10/04 totalling £710,624 were raised on the basis that the arrangements involved an abuse of rights. The appeals against these protective assessments (LON/04/2408) were stood over by direction on 24 January 2005 pending the appeals against the preferred assessments. In addition, Customs asked in paragraph 25A of the Statement of Case as amended by leave on 24 January 2005 for a direction under section 84(5) of the VAT Act 1994 increasing the preferred assessments for periods 10/00 to 10/01 by £201,709 on the basis that, if the Tribunal accepts the argument as to abuse of rights, the preferred assessments were too low. These could not be covered by protective assessments because of the time limit under section 73(6).
3. The Tribunal did not reach a conclusion before the release of the Advocate General’s opinion in *Halifax* and decided to relist the appeal for submissions following the judgment of the Court of Justice on 21 February 2006 (Case C-255/02). Both parties submitted further skeleton arguments. Customs abandoned the submissions based on the proposition that the leasing transactions were not economic activities and relied solely on abuse of rights.
4. In outline, Churchill Accident Repair Centre (“CARC”) and Churchill Management Ltd (“CML”) were part of the Churchill VAT group which made predominantly exempt supplies of insurance. Purchases by CARC and CML

gave rise to an input tax recovery of less than 1 per cent. Weald, which was a subsidiary of CML but was not part of the VAT group, bought goods which it leased to Suas Ltd (“Suas”). Suas, which was not an associated company, leased the goods to CARC and CML making a small profit. The rents charged to Suas were 10 per cent or less per year of the cost of the assets. The money needed to buy the leased goods was lent to Weald by companies in the Churchill group. In its VAT returns Weald claimed input tax on the purchases and accounted for output tax on the rents charged by it to Suas. Suas in turn charged VAT to CARC and CML the input tax on which was largely irrecoverable by the Churchill VAT group. Weald did not pay interest on the loans but it surrendered to other group companies the corporation tax losses incurred by it arising out of capital allowances on the purchases of the leased assets.

The witnesses

5. Five witnesses were called by the Appellant, confirming witness statements and being cross-examined:

John Brendan O’Roarke, managing director of the Churchill Insurance Group plc and a director of Weald, Churchill Insurance Co Ltd, CML and CARC;

Stephen Nicholas Hardy, ACA, finance director of Churchill Insurance Group plc (“the Churchill group” or “the group”) from May 2000;

Simon Boddy, ACA, finance manager in the group finance department;

Mark Buffery, FCA, director of Suas, and VAT Consultant to the Churchill group from 1995;

James Andrew Marshall Edmunds, solicitor, of Beaumont & Son, who gave expert evidence.

John Gaskell, a Customs officer, was called by Customs and was briefly cross-examined;

Statements by four Customs Officers, Christopher Birch, Peter Knight, Nicholas Dean–Webb and Lynne Howes, were accepted without cross-examination.

Basic facts

6. Weald was incorporated on 16 April 1997 as a wholly owned subsidiary of CML and commenced trading on 17 June 1997, its principal activity being the ownership and leasing of fixed assets; it was independently registered for VAT. CML was at all material times a subsidiary of Churchill Insurance

Group plc, the ultimate parent of which was the Credit Suisse Group, Switzerland. On 1 September 2003 the Royal Bank of Scotland group acquired the Churchill group, including Weald, from Credit Suisse.

7. The Churchill group included Churchill Insurance Co Ltd (“CIC”), which was authorised to write general insurance in the UK, and CML, which provided administration and management services to CIC and ancillary products and services to CIC’s customers. CARC was a subsidiary of CML; it was established in 1995 to repair vehicles for CIC. The representative member of the VAT group was another subsidiary of Credit Suisse, Winterthur Financial Services UK Ltd. There were other companies in the Churchill group and the VAT group, however they were not directly relevant to the appeal. The establishment of CML and its subsidiaries was designed to ensure that the regulated insurance companies did not breach section 16 of the Insurance Companies Act 1982.
8. The accounts of Weald for its initial period to 31 December 1997 showed turnover from operating leases of £84,444 and a loss of £190,172, after depreciation, audit fees and interest of £44,457. There were no other expenses, the directors’ emoluments being paid by CML. Tangible fixed assets cost £2,162,666 made up of body shop equipment, computer equipment, motor vehicles and office furniture and equipment; depreciation charged was £226,194, calculated on an expected useful life of 4 years for assets other than the vehicles for which the expected life was 3 years. £2,120,822 was shown as owed to group undertakings and £249,097 as bank overdraft.
9. Weald’s accounts to December 2001, covering a substantial proportion of the original assessments, showed turnover of £1,652,015 and a loss on ordinary activities before taxation of £2,336,699 with a credit of £695,321 for compensation for tax losses surrendered to group companies. Tangible assets at cost were £21,572,218 with additions during the year of £8,464,787 and disposals of £210,548. Accumulated depreciation was £9,467,429, the charge for the year being £3,997,739. £20,059,934 was owed to group undertakings on which no interest was paid. Debtors at £2,708,115 included £1,773,155 corporation tax recoverable and trade debtors of £613,520. The accounts for 2002 showed additions of only £152,314. Accumulated losses to 31 December 2002 were £6,691,617.
10. Suas was incorporated in 1995. Mr Buffery has been the sole director throughout. He holds 50 per cent of the shares, his wife holding the balance.
11. The accounts of Suas for 1997 showed turnover of £103,558, all from operating leases, and cost of sales of £94,335, being rentals on operating leases. Net assets were £19,284. The abbreviated accounts for 2001 showed net assets of £106,212. Turnover was not given but the profit for the year was £26,046.

12. On 22 November 1996 Churchill House Ltd, a subsidiary of CML, had granted a 25 year lease on a property, in respect of which it had opted for tax, to Suas which in turn granted a 25 year sublease to CML.
13. A draft dated 25 April 1997 of a letter sent by Mr Boddy to John Timmis, a director of CIC, CML, CARC and also of Weald, referred to “the possibility of using Weald Leasing as a vehicle for recovering VAT on fixed assets that we will buy in the future.” The draft letter referred to “Mark Buffery’s papers”. A scheme was outlined with assets being bought by Weald which would lease it on an operating lease to Suas which would lease on to a Churchill company. After a period of two years for fast depreciating assets and four or five years for other assets the lease would be terminated and the asset sold to the user. Rental levels and the sale price would be as low as possible. A monthly rental of 1/60th of 125 per cent of asset value was suggested for an asset lasting five years, with a sale price equal to three months’ rent. The letter said that computer equipment worth more than £50,000 would not be included, unless the supplier broke down the invoice into smaller components, since such assets would fall into the capital goods scheme and would have to be leased for at least five years. Fixtures and fittings could only be included if there was an interest in the relevant property. All other assets could be included. A calculation based on purchases of £100,000 worth of assets monthly for two years showed a saving in net present value terms of around £150,000 based on the asset being sold after 15 months. It showed the rent paid by and to Suas as being the same.
14. In 1997 CIC was one of the largest general insurance companies in the UK and was expanding rapidly; gross premiums written rose by 22 per cent in the year.
15. On 29 May 1997 an inter-office memo from Mr Boddy to John Battley of CARC stated,

“With a view to reducing our VAT costs, we have set up a separate company I would like purchases of all assets from now on, which are authorised by yourself, to be invoiced to Weald Leasing Ltd ...”

It stated that motor vehicles would still be purchased through CML. The memo referred to a meeting on 30 May with “our VAT Consultant”, in fact Mr Buffery. A further memo on the same date to Steve Richards of the IT department said that to ensure that no item exceeded £50,000 suppliers should be asked to break down their invoices as far as possible.

16. On 2 June 1997 Weald and Suas signed an equipment leasing agreement (reference WLD 1-6/97), the signatories being Mr Timmis and Mr Buffery. This was the first leasing agreement. The equipment was a spraybooth complex and a dust extraction system with a combined quarterly rent totalling £1,794.41 excluding VAT. The date of delivery was 2 June and the location was Hatfield. Rent was payable quarterly in advance by the end of the first

week of the quarters commencing on 1 June, 1 September, 1 December and 1 March. Under clause 1 the time of all payments was of the essence. Under clause 2 the equipment remained in the ownership of the lessor (Weald) and the lessee was not to dispose of it save by way of sublease. Clause 3 provided for Weald to assign warranties or make available their benefit. Under clause 5 the lessor was to maintain the equipment; the lessee was required to make good any damage or loss. Under clause 6 the lessor was entitled to terminate if the lessee failed to pay sums due on time or breached any other term. Under clause 8 the lessee was entitled to terminate at any time by giving 21 days notice in writing and the lessor was entitled to terminate by giving 28 days notice. Clause 10 provided for interest of 4 per cent above base rate on all sums not paid within one month of the due date. Under clause 12 the hire of each item was to be treated as a separate hire contract. The rent was in fact calculated so as to pay back 100 per cent of the cost to Weald in ten years and was therefore only 40 per cent of that suggested in Mr Boddy's draft letter (see paragraph 13 above). The quarterly rent for the dust extraction element was £456.91 excluding VAT; the sum invoiced to the Appellant for supplying and installing the system was £18,276.37 after a discount for early payment but before VAT. The annual rent to Suas was therefore 10 per cent of the cost.

17. The equipment leased to Suas under that agreement was leased by Suas to CARC at a combined quarterly rent of £1,928.99 excluding VAT by an agreement dated 9 June 1997 signed by Mr Buffrey for Suas and by Mr O'Roarke for CARC. The rent was payable quarterly in advance from the date of delivery on 2 June to be paid before the end of the first week of each quarter. The rent charged by Suas was thus 7.5 per cent higher than that charged to it by Weald. Under clause 2 Suas remained the owner. Under clause 4 CARC was obliged to insure the equipment.
18. A schedule of items also to be leased under the terms of the above agreement of 2 June between Weald and Suas was signed on 23 October 1997 for Weald and on 25 November 1997 for Suas. This showed 151 items of office equipment and furniture, the dates of delivery being between 31 May and 19 August, the total initial rent being £31,841.83 and the total quarterly rent being £17,196.72. The leases were to take effect from the delivery date.
19. A substantial number of the items covered by the schedule were subleased by Suas to CML under an agreement signed by Mr O'Roarke for CML also on 23 October 1997. Clause 2.1 provided that the equipment remained in the ownership of Suas. Clause 3.1 provided,

“The Lessor has not inspected the Equipment which has been selected by the Lessee using his own skill and judgment.”

Under clause 4 CML was responsible for insurance. Clause 8 entitled CML to terminate on 28 days notice and Suas to terminate on 21 days notice.

20. When further equipment was leased by Weald to Suas, either a new agreement was signed with similar terms or a schedule of additions to an existing agreement was drawn up. Each agreement was given a reference number with the letters "WLD", the sequential number and the month and year when it was drawn up. The leases prior to the VAT period ending on 31 October 2000 were of course not directly relevant to the input tax on purchases with which the appeals before us are concerned. Agreement reference WLD 11-2/01 with a schedule WLD 11-03/01 was the earliest agreement which covers goods delivered in the assessed periods; the wording was almost identical to that in WLD 1-6/97. WLD 11-2/01 was signed by Mr Timmis and Mr Buffery but was not dated. Schedule 3 contained equipment under descriptions with delivery dates varying from July 2000 to February 2001; most equipment was located at Churchill Court, Bromley, but some was located at Biggin Hill, Romford, Ipswich, Ashton-under-Lyne or Stockton. The total quarterly rent was £20,919.53, varying from £7.75 for two colour monitors to £4,734.53 for two Ultra Net Storage Director 6 systems. Each heading bore a reference number running from 1345 to 1516, but with some gaps. Rent was payable before the end of the second week of each quarter.
21. The equipment covered by agreement WLD 11-2/01 was the subject of a further lease by Suas to CML which was signed by Mr Buffery but was not dated. The rents were 5 per cent higher than that paid by Suas. The delivery dates and locations were the same. Clause 3 recorded that the lessor had not inspected the equipment which had been selected by the lessee. Clause 4 required the lessee to insure.
22. Agreement WLD 12-09/01 between Weald to Suas covered equipment delivered between January 2000 and April 2001.
23. Agreement WLD 15-05/02 with Suas covered equipment delivered between April 2001 and December 2001. Some of those items were leased on by Suas to CARC at an uplift of 5 per cent. It was undated. The initial invoice by Weald to Suas was dated 31 July 2002 being for £320,524.15 plus £56,091.73 VAT. Payment was by the end of the second week in each quarter. Apart from this there was no material difference from the first lease in 1997.
24. When CARC or CML needed new equipment the equipment was selected by a member of the staff of the unit in question, a quotation was obtained from the supplier and a purchase requisition form was sent to the group finance department for authorisation. The form would specify the cost centre for budgeting purposes. Authorisation was given at group level for purchases. When equipment was to be purchased by Weald for onward leasing, instructions were given for the equipment to be invoiced to Weald with a reference number.
25. The group was structured so that staff of all group companies including Weald were employed by CML with responsibility over all group business. The

originator of an order would put forward a business case. Management decisions were taken by the group executive committee which met weekly. No separate decisions on the purchase and leasing of assets was taken by the board of Weald. The group executive committee included Mr O'Roarke and Martin Long, chief executive and director, both of whom were directors of Weald.

26. Delivery of equipment purchased for use by group companies was to the premises where it would be used. At that stage Suas was unaware of the specific equipment and its purchase. Following delivery of the equipment the originator of the purchase would requisition a cheque. Payment was made from the group finance department by a cheque drawn on Weald's bank account. All group bank accounts were reviewed daily and any necessary transfers were made to cover any liabilities. If Weald would otherwise be overdrawn, a transfer would be made to avoid this.
27. At this stage a list of assets purchased by Weald for leasing to Suas was sent to Suas accompanied by the purchase invoices to Weald and a listing of cheques to evidence that payment had been made. Mr Buffery considered these, rejecting some as unsuitable for leasing, for example an invoice for software. He then prepared an agreement using the normal form employed by the parties together with a schedule with details of the equipment or, alternatively, a schedule for additions to an existing agreement.
28. The schedule would contain descriptions of the items covered, the quantity, the date of delivery, the location of the asset, serial number (if any) and the rental. This information was derived from the invoices with the rent being based on an agreed formula. An example of the quarterly rent for four Isuzu recovery vehicles purchased for £26,224 each excluding VAT was £2,622.40 for all four : the rent would cover the cost after 10 years, ignoring capital allowances and interest. The initial rent was calculated not from the date of the schedule but from the date of delivery to CML or CARC which was of course earlier.
29. Mr Buffery advised Weald as to the invoices for submission to Suas. He also prepared agreements and schedules for the assets to be subleased by Suas to CML or CARC as appropriate. The schedule would be as for the lease by Weald to Suas but the rent was 7.5 or 5 per cent higher. Following discussions between Mr Buffery and Mr Hardy the margin was reduced from 1 November 2000. The payment dates were not necessarily the same. When Weald invoiced Suas, Suas would invoice CML or CARC, and when Suas received the rent, it would pay Weald. Sometimes the invoices were two or three months behind. All rents were however paid.
30. If it was decided that an asset was no longer needed, the sublease and lease were terminated and the asset was sold. The four Isuzus were sold on 6 June 2003 for a total of £36,000 plus VAT after 5½ years in use. At the time of the

hearings in 2005 8,000 computers were in use, of which 3,000 were more than five years old. Older computers were moved to call centres with less sophisticated needs.

31. The assets were almost invariably in use by CML or CARC before Suas was aware of their acquisition and thus before any sublease to CML or CARC by Suas. In the small number of cases where goods were not accepted by Suas for leasing, the asset was invoiced by Weald to CML or CARC as appropriate and was included as an output in Weald's VAT return.
32. On 11 June 1998 a Customs officer visited Weald's registered office at Wadhurst and saw Mr Boddy. The visit followed repayment returns which had triggered a credibility query. Mr Boddy explained that purchases of assets required for the Churchill group would be authorised by Mr O'Roarke and invoiced to Weald which paid for them with money loaned within the group; no interest had been charged from January 1998. Weald leased them to Suas which leased them on to Churchill with a charge. The officer noted that the purpose appeared to be to "drip-feed the non-recoverable input tax into Churchill over ten years".
33. Mr Dean-Webb visited Suas on 24 June 1998 and saw Mr Buffery. During discussions Mr Buffery had stated that the sole purpose for the activity of Suas was the facilitation of two avoidance schemes for the Churchill group. The other scheme involved a property, Churchill Court, with which this appeal is not concerned. He noted that the uplift on the leases by Suas was 9-10 per cent. On 7 July 1998 he visited CML at Bromley and saw Mr O'Roarke and Mr Boddy. Mr O'Roarke told him that the function of Weald was as a purchasing vehicle for assets to be used by CARC and CML and to acquire non-exclusive repair businesses.
34. The next visit was by Mr Knight in January 2001 and was to Weald at Wadhurst. He concluded that the scheme for purchases by Weald, leases to Suas and onward leases by Suas to Churchill Insurance was a "technically acceptable tax avoidance scheme."
35. On 29 October 2002 Mr Gaskell and another officer visited Mr Buffery at the premises of Suas to re-evaluate the scheme in the light of the Tribunal decision in *Halifax*. Mr Buffery told them that no new assets had been leased for 18 months but that this was not due to *Halifax*. Mr Buffery told them that the mark-up was 5 to 7.5 per cent depending on the volume of assets leased and was reduced after four years.
36. Mr Gaskell concluded that on the principles established in *Halifax* the transactions were not undertaken in the course of any economic activity and that assessments should be raised going back to period 10/00 on the basis of the two year time limit under section 73(6)(a) of the VAT Act 1994 since the further information did not add significantly to that held since 1998. Between

30 October 2002 and 4 July 2003 successive assessments were made disallowing input tax totalling £2,140,195 for periods 10/00 to 04/02 but crediting back output tax totalling £842,187 for periods 10/00 to 10/02, the net tax assessed being £1,298,008. These assessments are the subject of consolidated appeal LON/03/43.

37. Weald's VAT return for period 10/00 showed output tax of £75,479 and input tax of £386,012 and a reclaim of £310,533 which was paid by Customs. The assessment was for £310,533 disallowing the entire input tax but giving credit for the entire output tax. The assessments for 01/02 to 01/03 followed the same pattern.
38. The return for 04/02 showed output tax of £112,009 and input tax of only £40,250 and net VAT payable of £71,759. The returns for 07/02 and 10/02 showed no input tax. The assessment notified on 4 July 2003 for periods 07/01 onwards gave credit for all the output tax from 07/01 to 10/02.
39. Following the first assessment in October 2002 Weald, while disputing the assessment, made nil returns in accordance with the ruling.
40. On 2 December 2004 Mr Gaskell notified assessments and further assessments for the periods 01/02 to 07/04 on the basis that the transactions by Weald constituted an abuse, and that Weald should be denied the benefit of the abusive transactions. The assessments were for periods 01/02-10/02 and totalled £181,777, in effect amending the earlier assessments for those periods by reducing the credit for output tax, and assessments totalling £266,243 were made for output tax for periods 01/03 to 07/04, for which periods, although the Appellant had made nil returns in respect of output tax on leasing, Suas had claimed input tax on leasing supplies by the Appellant. Mr Gaskell considered that credit for output tax was only appropriate to the extent that it derived from input tax claimed from 10/00 onwards. Another assessment on the same basis was made on 9 December 2004 for period 10/04. These assessments which were all based on output tax totalled £488,422 and are the subject of consolidated appeal LON/04/2399.

Evidence of the Appellant's witnesses

Mr O'Roarke's evidence

41. Mr O'Roarke, who was a director of Weald at all relevant times, finance director of CIC from 1990 and subsequently deputy manager director and managing director, as well as being a director of CML and CARC, confirmed his written statement and gave oral evidence. Since the acquisition in 2003 by the Royal Bank of Scotland group ("RBS") he has been Chief Operating Officer of RBS Insurance, a managing division of the group. He is a chartered accountant.

42. He said that Mr Martin Long, the founder, was focussed on Churchill becoming the biggest personal lines insurance company and that by the time of the acquisition by RBS it was the second biggest such company. It was an exciting period with Churchill regularly beating its targets. It was the first insurance company to operate from India using computers. It was the first company to sell policies on the internet and the first to own its own repair centres. Mr Long had set up the company in the late 1980s with capital provided by Winterthur on the understanding that he would have total autonomy to run the business.
43. Mr O’Roarke said that effectively all employees of the group were employed by CML. Finance and authority for purchases was handled on a group basis. An executive committee for the group met every Tuesday morning, with Mr Long and Mr O’Roarke and around ten others including Mr Hardy (group finance director), the marketing director, claims directors and the IT director. Fairly comprehensive reports were prepared for those meetings. The minutes were taken by Mr Long’s personal assistant, who had left the group, but these were no longer available. The leasing arrangements involving Weald would have been discussed by the executive committee and minuted and reported for information to the boards of CML and CIC. He said that the implementation of the leasing scheme would not have been approved by the boards of Weald, CML or CARC; it would have been the responsibility of Mr Long and himself, both of whom were directors of Weald, and the decision would have been minuted by the executive committee.
44. Mr O’Roarke stated that the possibility of leasing assets to optimise cash flows was first considered around 1993. The financing charges by third party lessors would however have meant that most of the cash flow benefit was lost. The solvency requirements for regulated insurance companies were another problem since the future liabilities under finance leases had to be included in the liabilities for solvency purposes, whereas only 1 per cent of the value of the leased assets counted towards the capital requirement. The outright purchase of assets depleted the capital available to meet the capital requirement, however only 1 per cent of the value of the asset purchased could be included in the solvency calculation. The purchase of assets through a company within the group which was separate from the regulated company had the effect that all or most of an intercompany loan to finance the purchase could be used in the solvency calculation.
45. He stated that in 1995 Mr Buffery raised the idea of using Suas, a captive leasing company owned by himself and his wife, which would be completely independent from Churchill and would avoid the drawbacks of leasing from a third party while gaining some of the benefits. A benefit of leasing would be that on upgrading assets by part exchange the effective charge to VAT on the value of the asset given in part exchange would be avoided.

46. Mr O’Roarke stated that the capital budget was not large enough in 1995 to justify a wholesale change. However in 1997 the planned capital expenditure on fixed assets was more significant and the proposals were revisited.
47. He stated that the prime benefit was the deferral of VAT charged on the purchase of the assets and the subsequent matching of the charge to the use in following years. The use of operating leases meant that there was more margin in the solvency calculations compared with an outright purchase. Although assets were commonly depreciated over a period from two to ten years, many of the assets would last longer, including computer and telecommunications equipment.
48. He stated that short periods of notice were agreed with Suas in order to reduce the risk if Suas became insolvent. These operated on either side. Rentals were agreed with Suas which would cover the costs of the assets to Weald over 10 years, making profits achievable for Weald taking account of the residual values after 10 years. For the Churchill group the effect, after taking account of the margin for Suas, was to reduce the initial cash outflow by the input tax recovered by Weald but to pay slightly more than 10 per cent per year thereafter.
49. He stated that leasing through Suas had the benefit that Suas would prepare all the leases and provide details for invoices, that there would be more flexibility, that since Suas was not a connected party Customs could not intervene to set market rentals, and that risks would be reduced by the short notice needed to terminate; there was however a risk if the rate of VAT was increased.
50. Mr O’Roarke said that the initial negotiations were at meetings or by telephone but that he had no records. The margin proposed initially by Mr Buffery was significantly reduced. Later negotiations were the responsibility of Mr Boddy and Mr Hardy.
51. Having looked at CML’s board minutes from 21 August 1995 to 24 February 1998, typically three or four a year, he said that there were no references to Weald. Nor were there any such references in CIC’s board minutes on the same days. Again there were no references to Weald in the executive committee meetings from late 1999. He said that Weald did not have independently minuted board meetings. He believed the scheme would have been considered by the executive committee before the first lease. He said that the cash benefit of some £300,000 was relatively modest for a company with assets at the time of £400 million. (We note that in fact gross assets of the group at 31 December 1997 were £346 million). He agreed that a CIC minute referred to the annual VAT benefit of having CARC as £100,000.
52. He said that no independent advice was taken by Weald before entering into the leases and no advice was taken at any stage on the terms. He recalled

negotiating the terms in a broad sense with Mr Buffery who had outlined its workings. He himself was not an expert on leasing but the agreements looked sensible. He was not concerned with the minutiae because they had worked with Mr Buffery for many years starting from his time with KPMG and he was a trusted adviser.

53. Mr O’Roarke said that he was unaware of how assets, which were invoiced to Weald but rejected by Suas, were dealt with. He thought that they were not accepted by Weald in the first place. If they had been acquired by Weald he would expect them to have been sold on at cost to CML or CARC. They would not show in the turnover of Weald in its profit and loss account because its turnover was leasing income. He said that Suas has not terminated any leases and he could not recall any discussions as to termination after say 18 months; if that had happened he would have expected the asset to be sold to the user. It would have been acceptable accounting treatment for rejected assets to be transferred to CML or CARC, debiting the intercompany account with the transferee company and not showing this in Weald’s report and accounts.
54. Mr O’Roarke said that he normally authorised group expenditure over £10,000. There was a single capital expenditure budget for the group. The decision as to which entity would buy came after the decision to purchase.
55. He stated that by the end of 2000 interest rates had fallen, thus reducing the cash flow benefits of the arrangements involving Weald. Furthermore by the end of 2000 the allowable limit for intercompany loans for solvency purposes had been breached, so that there were no significant solvency benefits in procuring assets through Weald. There were also concerns as to Customs’ attitude to avoidance schemes. In the middle of 2001 a decision was made to cease procuring assets through Weald for the time being and since 2001 no purchases had been made through Weald. Existing leases had however been continued.

Mr Boddy’s evidence

56. Mr Boddy stated that he joined the Churchill group in September 1996 as a manager in the finance department. He said that by the time he joined Mr O’Roarke and Mr Buffery had taken the decision to put the scheme in place. The actual scheme was not quite the same as that in the draft letter of April 1997 (see paragraph 13 above).
57. He said that the intention to terminate leases after a period changed at some point after the letter of April 1997. Termination was only one of the options. He did not know who made the decision not to terminate; it was probably partly corporate inertia, there being other more important matters.
58. He accepted that Suas was interposed to avoid a direction under Schedule 6.

59. He said that the rents under the leases were kept low because the higher the rent paid by Suas the higher the rent that it charged and the higher the irrecoverable VAT. He said that the rents were set to give a return of 10 per cent which all parties agreed was reasonable. He told Mrs Hall that he could not say whether the rentals were below or above open market value. He did not look to see what the market rates were.
60. Mr Boddy said that he had no record of his meetings with Mr Buffery but that he did meet him regularly for general discussions. He could not recall meeting with Mr Buffery on 30 May 1997.
61. He said that Mr Timmis reviewed and signed the early agreements until Mr Hardy took this over after joining in 2000. Mr Boddy accepted that he was responsible for agreeing the initial leasing agreement which he discussed with Mr O’Roarke. Mr Buffery provided the draft; he did not know if Mr Buffery had legal advice and had not asked. He read the document carefully but did not try to negotiate better terms.
62. He said that he was not surprised that under the lease to Suas Weald was responsible for maintenance: it was just a commercial contract. There was no system to monitor or enforce the obligations under the leases. He accepted that, given the relationship between Weald and Suas, there was never any intention to enforce the maintenance obligation or to assign the warranties to Suas. If a computer broke down, the IT staff would contact the repairer and CML or CARC would be involved. Insurance was covered by a Churchill group policy.
63. Mr Boddy agreed that the identity of the company within the group to which the invoice was sent was driven by the VAT scheme. Weald bought what CML or CARC needed. Weald itself did not have a budget. The group had a series of cost centres which were reviewed when the leasing arrangements were set up. He said that purchase requisitions were effectively by Weald, suppliers being told to invoice Weald. He was not aware of any agency document and would not have used the word “agency”. He had produced a decision chart explaining to those people in the group who were likely to originate purchases which company should be invoiced. It was difficult to ensure that everything was correct and there were some mistakes every month. Some invoices initially paid by CML had to be recharged to Weald.
64. He said that Mr Buffery generated schedules of assets leased by Suas to CML or CARC with rents which were checked by himself or his assistant. He also produced schedules of assets rejected by Suas; usually the reason was apparent from the invoice; in such cases the asset had to be recharged by Weald to CML or CARC and paid for by inter company account. Rejection produced a lot of administrative work. If the scheme had worked to perfection recharging

would not have been needed. Mr Buffery prepared letters adding assets to the leases from Weald to Suas and sent them for signature.

65. Mr Boddy accepted that Suas was Weald's only leasing customer and that Weald never sought to advertise or procure further custom for leasing assets.
66. He could not say whether a significant number of leased assets had reached the end of their useful life although some such as four Isuzu trucks had been sold. If assets became useless they would have been scrapped but the rent would have continued. There was no need for a system recording such assets.
67. Mr Boddy said that when Weald invoiced Suas, Suas would invoice CML or CARC and would pay when it was paid. Payment should have been in advance but sometimes the administration was slow. He was not aware that on some leases Mr Buffery had changed the payment dates.
68. He said that Mr Nash, the managing director of CARC, had decided that he wanted to sell four Isuzu recovery vehicles and they were removed from the leases at the end of April 2003 although the sale invoice to Europa Corporation was not until 6 June. He suspected that they were delivered to Europa but that the invoicing was delayed for some reason. Very often the date of delivery and the invoice date would be the same.
69. Mr Boddy said that all assets purchased by the group were put onto a separate fixed assets system interfacing with the general ledger system. Normally the value of the invoice was registered rather than the individual asset. The building in which it was located was recorded. Assets with a value below £500 were not normally capitalised.

Mr Hardy's evidence

70. Mr Hardy stated that he joined the Churchill group as Finance Director in May 2000 reporting to Mr O'Roarke. Soon after joining he met Mr Buffery and Mr Boddy to gain an understanding of the leasing arrangements. At the time an increasing amount of assets was being purchased by Weald. He was concerned at the commercial risk of Suas having title even for a short time to group assets and the risk of Suas becoming insolvent with rent owed to Weald; he was also concerned that Suas could decide whether to accept leases of assets. He was unhappy that Suas was in the loop at all.
71. He examined the benefits. Weald recovered input tax on purchases, whereas the group only incurred irrecoverable VAT when the rentals were paid : this had worked as planned. The reduced VAT on upgrading was academic because assets had not been upgraded. The margin charged by Suas on leases was less than other leasing companies would have charged, however if Weald had leased direct to group companies no money would have gone out of the group. Purchasing through Weald gave a better chance of monitoring capital

expenditure and obtaining economies of scale, but Suas was irrelevant to this. The involvement of Suas could potentially inhibit any restructuring of the group. Mr Hardy did not accept that interposing Suas generated more administration than if Weald had leased directly to a group company saying that the work undertaken by Suas outweighed the extra burden on Churchill. He took the view however that the group could pay less for the services provided. He concluded that it was in the group's interests to continue the arrangements but to reduce Suas' margins basing them on £5 per asset.

72. Mr Hardy said that the decision to cease procuring assets through Weald was taken in the middle of 2001 although it was not immediately implemented.
73. He said that when preparing the 2000 solvency returns for submission to the Financial Services Authority it became clear that the use of Weald was beginning to cause a solvency strain for CIC. At 31 December 2000 there was an excess of £35 million in available assets for general insurance business over the required minimum margin, however £6.5 million of loans by CIC to Weald and to CML for lending to Weald had to be excluded because the unsecured loans exceeded the admissible limits. The limit for loans had not previously caused a problem. In early 2001 Churchill was negotiating to acquire Pearl's insurance portfolio and had acquired that of Nationwide Building Society which together would probably result in turnover being doubled. The Pearl acquisition was for cash thus reducing the assets available to meet the solvency requirements. Further purchases by Weald would require more loans from CIC creating a further solvency strain. The solvency calculations at 31 December 2001 showed an increase in the required minimum margin from £71.9 million to £170.5 million and a shortfall in available assets of £60.5 million necessitating a cash injection from Switzerland.
74. He said that, if CIC had bought the assets directly, only a very small proportion of the assets would have been admissible for solvency, there being a limit of 1 per cent of the general business amount ("GBA") which was 20 per cent of premium income plus balance sheet liabilities. Company loans were allowable up to a limit for each individual debt of 5 per cent of the GBA. Provided the limits were not exceeded there was therefore a benefit in lending to Weald, which was a non-insurance entity, to enable it to purchase assets needed by the group.
75. Mr Hardy said that it was the loan to the non-insurance entity to finance the purchase which produced the solvency benefit rather than the leasing by that entity. No solvency calculation was required for Weald or CML. In 2002 assets were acquired by CML funded by a bank loan. The solvency benefit arose from CIC lending the money to finance the purchase rather than buying the assets itself. The interposition of Suas into the leasing arrangements was unrelated to the solvency requirements.

76. Mr Hardy said that there were two group finance teams, one for CARC and another for everything else including Weald. There was no need for a separate budget for Weald. He said that, apart from a brief period when it was operating accident repair centres, Weald's only customer was Suas, although he could not comment on the position before he joined. He said that Weald has yet to make a profit either overall or on a year to year basis but that it would come into profit in the future. He said that no charge was made by CML for the services provided to Weald; it was not policy to recharge costs within the group.

Mr Buffery's evidence

77. Mr Buffery confirmed two witness statements and was cross-examined for two days. He was in fact the first witness to be called, although we have found it convenient to cover the Churchill group witnesses first.
78. He qualified as a chartered accountant in 1984 and became an FCA in 1995. From early 1991 until August 1995 he worked as a manager in the indirect tax department of KPMG. While with KPMG he advised the Churchill group on VAT. In August 1995 he left KPMG and started in private practice. Churchill started using him personally. At one point 45 per cent of his earnings was from Churchill.
79. In March 1995 Suas Ltd was incorporated with Mr Buffery as director; he and his wife were equal shareholders. The company had wide powers but was dormant initially. The plan was to use it for one of Mr Buffery's business ideas.
80. In April 1995 Churchill House Ltd bought a property in Bromley to redevelop and let to CML as a headquarters having opted to tax. Mr Buffery said that it made perfect sense for Churchill House Ltd to let to Suas on a 25 year sublease and for Suas to grant a further sublease to CML so as to avoid the connected persons provisions in Schedule 10. A commercial rent was charged. The leases were signed in 1996.
81. Mr Buffery had discussed proposals for leasing involving Suas with other potential clients and with Churchill. The initial discussions with Churchill were with Mr O'Roarke and Mr Boddy. Insofar as notes were made of such discussions they had not been retained. Mr Buffery had a business plan which he had not retained. Before these proceedings he did not see Mr Boddy's draft letter of 25 April 1997. Initially termination was envisaged in 4-5 years but that had changed by June 1997. It was agreed that the rent paid by Suas would be 10 per cent of the cost to Weald. Some assets would have an expected life of more than 10 years, some less; there was however no differentiation. Weald would get the rents, any sales proceeds and group tax relief from capital allowances. Mr Buffery agreed with Mr O'Roarke and Mr Boddy that Suas

would receive a margin of 7.5 per cent for the first £2 million of assets leased and 5 per cent thereafter. He initially sought 10 per cent.

82. He said that short termination periods were agreed so that the leases were operating leases rather than finance leases. If there was a dispute the leases could be terminated by either side; he did not consider any other dispute procedure. The short period minimised any risk. There was no discussion as to how to identify individual assets leased or their cost: many were bought and leased as a package. No procedure was agreed for removing assets. He said that they did not employ lawyers to negotiate the terms. The parties were more concerned with the commercial effect than the legal minutiae.
83. Mr Buffery said that the company secretary of Suas, who was his solicitor, drafted the original lease. Mr Buffery had made amendments and was sure that there were several drafts. The terms were discussed with Mr O'Roarke and possibly Mr Boddy. The object was to keep matters as simple as possible.
84. He said that after the initial leases there were no further negotiations as to terms. There were fourteen master leases from Weald to Suas, and fourteen from Suas to each of CML and CARC.
85. Mr Buffery said that the equipment was initially selected by Churchill employees; Weald had no employees of its own. Suas was not consulted at that stage but became aware of a purchase when the invoice from the supplier to Weald was provided together with evidence of payment and sometimes other documents such as delivery notes; Suas would receive a summary schedule from Churchill's computer system.
86. Mr Buffery said that he and sometimes his wife would decide whether to reject goods. It was their decision. They were never pressured to take assets. He accepted that the predominant purpose was the VAT advantage to Churchill and that without such advantage the leases would not have been entered into : the costs would have outweighed the benefits. The policy on rejections evolved over the years. There was no agreed system or procedure. Software was rejected because of the problem of title. Fixtures were not accepted, nor were motor vehicles. Items under £500 were not accepted. Sometimes the decisions were inconsistent. He provided letters specifying the rejections.
87. He said that, having received the invoices and documents, he prepared leases with schedules or letters adding equipment to existing leases. The schedules would contain a description of the equipment taken from the supplier's invoice, the quantity, date of delivery, location, serial number (if any) and the initial and quarterly rental excluding VAT. The leases were backdated to the date of delivery. He provided as much back-up to Weald as possible.

88. He sent Weald's leases to Wadhurst, Kent, which was its registered office and the business address of Mr Timmis. He imagined that Mr Timmis would open them and pass anything necessary to Mr Boddy at Bromley. Mr Buffery calculated the rent to be included on the invoices by Weald and provided that information so that the invoices could be issued by Weald on its own paper. There were no disputes although there were sometimes queries on the telephone. Some mistakes were inevitable. Until 2001 or 2002 Suas drafted the invoices for Weald.
89. Mr Buffery said that normally Suas invoiced CML and CARC before Weald invoiced it and Suas was typically paid first. It had no capacity for an overdraft. He accepted that the timing specified in the leases was not followed and that there were numerous late payments. He said that in general payment was well within 30 days of the invoice. He said that any interest due from Suas to Weald would have offset interest from CML or CARC to Suas. There was no point in trying to enforce the interest clause because any benefit would be outweighed by the damage to relationships. He said that the change in the payment date under later leases was probably his decision but he could not remember the reason. It was however agreed. He did not accept that the parties were indifferent as to when they were paid : payment was always made quite promptly. He agreed that on one occasion in 1999 payment was two months late and on another in 2002 it was three months late.
90. He said that he prepared letters removing items from the leases for Weald to sign as well as addition letters.
91. Mr Buffery said that in 2000 following negotiations with Mr Hardy he agreed to the rent charged by Suas being reduced to cut Suas' margin. He agreed to this because further business was coming. There was no document recording that the margin was to be £5 per asset. The new rentals were staggered because the leases ran from different dates. He said that margin of £5 per asset still left a profit margin.
92. Mr Buffery refused to agree that once an asset had been delivered to CML or CARC there was no realistic prospect of it being leased to a third party.
93. He said that although on occasion the written lease by Suas came before the lease to Suas, it had already been agreed verbally.
94. He said that it was intended throughout that the user would be responsible for maintenance: there was a "typo" in clause 5 of the leases by Weald (paragraph 16). In practice CML and CARC maintained the equipment. He said that the warranties were never assigned by or to Suas : the purpose of clause 3 was to ensure that the lessee could claim under the warranties if necessary. He said that insurance was covered by a Churchill group policy.

95. Mr Buffery said that at the start he had spent a week each month on administration. Since new assets had ceased to be added the time spent was less.
96. He agreed that on other leasing transactions by Suas involving leases to Bloke Ltd of which his wife was a director and leases to himself the initial rents were higher for three and two years until Suas had made a profit being lower thereafter.
97. He said that the decision to cease new leases was taken before Customs inquiries in October 2002. All of the leases were continuing, involving over two thousand assets although some 3 or 4 assets per lease had been removed.

Expert evidence of Mr Edmunds

98. Mr Edmunds, who is a partner of Beaumont and Son, solicitors, specialising in asset finance, leasing and commercial aviation matters and author among other publications of the volume of the Encyclopaedia of Forms and Precedents entitled "Leasing of Equipment", confirmed a 20 page statement.
99. In his statement he said that under SSAP No.21 a finance lease would be reflected on a lessee's balance sheet whereas an operating lease would not. He considered that because of the break clauses the leases between Weald and Suas and between Suas and CML/CARC are operating leases, despite the fact that the lessees are responsible for maintenance and insurance.
100. He stated that in his view Weald and Suas are each carrying on leasing businesses and that objectively speaking their activities are the same as those of other leasing companies. He stated that there is nothing unusual about the end-user selecting the assets. Objectively speaking, the leases are typical leasing transactions notwithstanding that there is an intermediate lessor : leasing and subleasing are not unusual. Lessors do not normally maintain warehouses and stock controls and do not need to do so. There is nothing unusual in the use of master leasing agreements. He stated,

"The structure of the transaction entered into by Weald/Suas/Churchill is typical of a lease and leaseback and the fact that Weald and Churchill are in common ownership is also quite usual."
101. He said the practice of labelling in the industry varies : sometimes office machinery is labelled, sometimes it is not.
102. He said that the lease by Weald is a typical document used for general equipment, often in a situation where there is a head lease and sublease. Very often there is no pre-contract correspondence.
103. He said that intermediate lessors not uncommonly provide administrative services which can be of many sorts.

104. There was no substantial challenge by Mrs Hall to his evidence. He agreed with Mrs Hall that many of the advantages of leasing could be achieved by a direct lease without an intermediate lease, such as the financing of the purchase, the deduction of the rents for tax purposes and the benefit of capital allowances.

Submissions

Submissions for Customs

105. Although the legal burden of proof is on Weald, because of the nature of the issues we find it convenient to set out the submissions for Customs first.
106. Mrs Hall said that the decision of the Court of Justice in *Halifax* [2006] 2 WLR 905 established that in the context of determining whether transactions constitute an economic activity the subjective intention is not material. The Court decided however that the Sixth Directive precludes the deduction of input tax where the transactions from which the right to deduct is derived constitute an abusive practice. She said that the doctrine of abuse of rights operates to disallow a tax advantage obtained under the deduction rules where the conditions for obtaining it had been created artificially. The principles in *Elmsland Stärke GmbH v Hauptzollamt Hamburg-Jonas* (Case C-110/99) [2000] ECR I – 11569 and other cases were adapted to VAT at [74] and [75] of *Halifax*. The formulation in *Halifax* was so close to the facts of this case that no further evidence was needed. She did not contend that the leases were shams but submitted that the principle of abuse of rights applied.
107. Mrs Hall said that the deduction mechanism is designed to ensure that the burden of VAT falls on the final consumer, see *Elida Gibbs Ltd v Customs and Excise Commissioners* (Case C-317/94) [1996] STC 1387; where a supplier is exempt he is treated as a final consumer, see *Debouche v Inspecteur der Invoerrechten en Accijnzen* (Case C-303/93) [1996] ECR I-4495 at [16] and the Advocate General at [9].
108. Mrs Hall said that the issue for the Tribunal is the legitimacy of the assessments which disallow Weald's input tax on assets acquired for leasing to Suas but which set off the output tax charged to Suas, that being the tax advantage obtained by Weald in the transactions. That advantage to Weald was integral to the cashflow benefit to the Churchill VAT group from deferring its non-deductible input tax.
109. She said that the judgment in *Halifax* was fairly vague about the advantage and invited the Tribunal to step back and consider whether the transactions as a whole were abusive and whether the consequence was the accrual of a tax advantage. She said that in essence CML and CARC received the supplies contractually made to Weald. The insertion of Weald and Suas into the transactions was the abusive practice. The deferral by the Churchill VAT

group, an exempt trader, of the immediate burden of VAT was contrary to the purpose of the Sixth Directive and the UK legislation. The insertion of Suas avoided a direction under Schedule 6, paragraph 1. The essential aim was to obtain a tax advantage. The “transactions” at [74] of *Halifax* were the whole transactions. Here Weald deducted the input tax, however under [81] it is necessary to look at all the transactions. The abusive practice started with the decision to interpose Suas and Weald and included the ordering of the goods and the purchases by Weald. *Halifax* involved different legal entities and the redefining envisaged at [94] inevitably involved those entities. The Advocate General regarded avoiding or deferring payment of VAT as a tax advantage, see paragraph 98 of his opinion.

110. Mrs Hall relied on a series of factors under [81] of *Halifax*. Weald was wholly-owned, its directors being directors of CML; it had no employees and the group made no charge for services provided to Weald. Weald had no other customers. Mr Buffery was Churchill’s tax adviser. The assets were sourced by CML and CARC. No interest was paid from 1998. The cost of the assets was included in the capital expenditure budgets of CML and CARC. The rent took no account of the economic life of the assets. Weald had made accumulated losses of £6.9 million to 2002. Suas was exposed to no risk. The warranties were never assigned. There was a lack of concern as to the time of payments.
111. She said that none of the Appellant’s explanations for the transactions was credible. Abuse could be inferred from the almost total disregard of the provisions in the leases, from the connection between the parties, from the lack of negotiations or legal advice and from the artificiality of the arrangements which could be collapsed at any time without any penalty.
112. She submitted that the Tribunal could not ascertain whether the transactions were “purely artificial” within [81] of *Halifax* without considering the motives of the participants. Their motivation was one of the “objective factors” under [75]. At [81] the Court said the Tribunal must “determine the real substance and significance of the transactions concerned.”
113. She said that the reference to “objective factors” meant that the Tribunal must consider the evidence objectively “in accordance with the rules of evidence of national law.” To disregard the intention of the participants would not be consistent with preventing abuse. In *Cadbury Schweppes plc v Inland Revenue Commissioners* (Case C-196/04) [2006] STC 1908 the Court referred to a subjective element consisting of an intention to obtain a tax advantage, citing [74] and [75] of *Halifax*. In *Agip Petroli SpA v Capitaneria di porto di Siracusa* (Case C-456/05) the Court referred to the need for objective evidence citing *Halifax*.

114. She said that although the Court referred at [72] of *Halifax* to the need for legal certainty, the conditions for a finding of abuse in [74] and [75] took account of this.
115. Mrs Hall said that the Court in *Halifax* considered the remedies for abusively deducted input tax at [87]-[98]. The assessments in the present case were for repayment of input tax deducted in abuse of rights but gave credit for output tax; they precisely achieved the situation obtaining if there had been no abuse. If there had been no leases to Suas, no input tax would have been deductible. Customs retroactively seek repayment as envisaged in *I/S Fini H v Skatteministeriet* (Case C-32/03) [2005] STC 903 at [33].
116. Mrs Hall said that the original assessments totalling £1,294,202 for periods 10/00 to 10/01 had given credit for the whole of the output tax deducted by Weald for those periods. However £201,709 of that output tax related to lease payments by Suas on assets on which input tax credit had been given before 10/00 which was therefore out of time for assessment. The entire scheme was abusive. In assessing to counteract the abuse it was not appropriate to give credit for that £201,709 output tax. A further £5,272 of output tax did not arise from Suas leases and had been correctly declared; this should not be deducted from the assessments. She asked the Tribunal to increase the original assessments by those amounts under section 84(5) to give effect to the redefining at [94] of *Halifax*. In *Rahman (No.2) v Customs and Excise Commissioners* [2003] STC 150 the Court of Appeal after referring to section 84(5) said that the purpose of the assessment provisions is to ensure the correct tax. In *Elias Gale Racing v Customs and Excise Commissioners* [1999] STC 66 Carnwath J said that the power to increase an assessment under section 84(5) is not constrained by the time limit. She said that if the Tribunal is satisfied that the assessments were less than they ought to have been, it has a duty to increase the assessments in the absence of any contrary reason. The fact that Customs were out of time to make further assessment is not such a reason. She said that *Ridgeons Bulk Ltd v Customs and Excise Commissioners* [1994] STC 427 was not concerned with section 84(5) and should be re-evaluated in the light of *Halifax*.
117. She said that CML and CARC could apply for a refund of output tax under section 80 subject to the time limit.

Submissions by Appellant

118. Miss Shaw said *Halifax* shows that the concept of abuse of rights is very limited; at [69] the Court said that the transactions must not be “in the context of normal commercial operations” and must be “solely for the purpose of wrongfully obtaining advantages.” This was reinforced at [72] by the requirement for legal certainty and at [73] by the right to structure the business to limit tax. The expert evidence of Mr Edmunds was that objectively speaking the transactions were normal commercial leasing. She said that the

transactions were not solely for tax advantages; the primary purpose was to enable CML and CARC to acquire assets for their business. They chose to lease. The advantage arose from the application of the legislation. For any exempt trader leasing gives the benefit of spreading the cost including VAT. She said that Customs had the burden of proving abuse by Weald. The rents were based on 10 per cent per year of the cost of assets and assumed a 10 year life. Customs had produced no evidence that this was below open market value for equivalent operating leases. The assessments were not made on the basis that the level of rents was an abuse. Customs were essentially saying that CML and CARC did not have the choice of leasing.

119. She submitted that the purpose of the Directive had not been circumvented. The arrangements applied the legislation as intended. CML and CARC recovered no input tax and although Weald did recover input tax it made taxable supplies of leasing. The facts in *Halifax* were very different: Leeds Development recovered £6.6 million input tax but made very limited taxable supplies and those were contrived. Weald, however, had made genuine taxable supplies of leasing for over eight years and in 2005 made a profit. Customs had argued that the Tribunal should take account of the opportunity to terminate the leases, however Mr Edmunds' evidence was that there was nothing unusual in the termination arrangements. She said that Suas was a wholly independent third party.
120. Miss Shaw said that Customs must show by objective factors that the essential aim of the transactions was to obtain a tax advantage, see *Halifax* at [75] and [81]. The objective factors must be ascertainable by a third party, see *Cadbury Schweppes* [2006] STC 1908 at [67]. The means by which the acquisition of the leased assets were facilitated may have been motivated by tax considerations but that did not make the transactions artificial: motive is not relevant to artificiality. Intention is subjective. *Halifax* at [75] was solely concerned with objective factors.
121. She said that the assessments treated CML and CARC as having purchased the assets outright. If the commercial reality was that Weald should be excluded, then all the lease rentals should be disregarded including those paid by CML and CARC. There is no power for the Tribunal to do this : that indicates that any re-establishment under [94] of *Halifax* should be of the rents; however that is not what Customs seek. Customs has no power to change an input tax assessment to an output tax assessment, see *Ridgeons Bulk Ltd v Customs and Excise Commissioners* [1994] STC 427 at 439h.
122. Miss Shaw said that the jurisdiction of the Tribunal is limited to the assessments under appeal disallowing Weald's input tax. Unless Customs succeed as to abuse, the appeal must be allowed. The principle in *Ridgeons Bulk* logically applies to section 84(5). If Customs cannot re-characterise input tax as output tax nor can the Tribunal. The remedy for Customs is to make a further assessment under section 73. She submitted that the time limit

under section 77 is relevant to the power under section 84(5). Section 73(6) contains a mechanism for supplementary assessments, subject however to time limits. The question of an increase under section 84(5) arises because Customs have changed the whole basis on which the assessments are supported. The time limit exists to provide certainty.

123. She said that it was not implicit in *Halifax* that it was irrelevant whether there were different entities. The reference at [80] was to Leeds Development which was a taxable person and was claiming £6.9 million input tax. Paragraph [81] does not entitle the Tribunal to pierce the corporate veil.

Conclusions

124. We start by considering the decision of the Court of Justice in *Halifax plc and Others v Customs and Excise Commissioners* (Case C-255/02) [2006] 2 WLR 905. The other two Appellants were Leeds Permanent Development Services Ltd (“Leeds Development”) and County Wide Property Investments Ltd (“County”) both of which were wholly owned subsidiaries of Halifax. It was heard with *University of Huddersfield Higher Education Corporation v Customs and Excise Commissioners* (Case C-223/03).
125. The following outline facts appear from the original Tribunal Report in *Halifax* at [2001] V&DR 73. Leeds Development agreed with Halifax, a 95 per cent exempt trader, to carry out certain construction on sites owned by Halifax. Leeds Development was paid £120,000 plus VAT for initial construction work. Halifax granted Leeds Development 20 year leases of the sites with options to extend. Leeds Development entered into a contract with County to arrange for construction work to be carried out on each site. Halifax loaned £44.8 million to Leeds Development which paid £38.1 million plus over £6.6 million VAT to County as an advance payment for the construction work. All of the above transactions were on the last day of Leeds Development’s VAT period 02/00. Leeds Development claimed recovery of almost £6.7 million input tax for that period. County made stage payments to arms’ length builders. County accounted for VAT on the sum received from Leeds Development and claimed input tax on the stage payments to the builders and on professional fees. Customs refused the input tax claims by Leeds Development and also those by County on the basis that the transactions were solely to avoid tax and were not economic activities and that on a proper analysis Halifax itself received the supplies from the arm’s length builders and could claim its normal partial exemption percentage. The appeal by Halifax was against the decision that it had received the supplies of construction services by the builders. The appeals of Leeds Development and County were against the refusal of input tax credit.
126. The London Tribunal referred the following questions to the Court of Justice (see [2002] V&DR 117):

“1(a) In the relevant circumstances, do transactions:

- (i) effected by each participator with the intention solely of obtaining a tax advantage; and
- (ii) which have no independent business purpose;

qualify for VAT purposes as supplies made by or to the participators in the course of their economic activities?

(b) In the relevant circumstances, what factors should be considered in determining the identity of the recipients of the supplies made by the arms' length builders?

2. Does the doctrine of abuse of rights as developed by the Court operate to disallow the claimants their claims for recovery of or relief for input tax arising from the implementation of the relevant transactions?"

The "participators" were defined as the three Appellants.

127. The Grand Chamber of 13 judges ruled as follows in *Halifax*:

"1. Transactions of the kind at issue ... constitute supplies of goods or services and an economic activity ... provided that they satisfy the objective criteria on which those concepts are based, even if they are carried out with the sole aim of obtaining a tax advantage, without any other economic objective.

2. The Sixth Directive must be interpreted as precluding any right of a taxable person to deduct input tax where the transactions from which that right derives constitute an abusive practice. For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of 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. Secondly, 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.

3. Where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice."

128. The outline facts in *University of Huddersfield* were as follows. The University wished to refurbish a mill but its supplies were mainly exempt. It created a discretionary trust over the trustees of which it had control and having elected to waive exemption leased the mill to the trust for 20 years at a nominal rent; the trust also elected to waive exemption and leased the mill back to the University. The University contracted with a wholly owned subsidiary to procure the carrying out of the works by independent contractors and paid the subsidiary £3.5 million plus VAT. The University claimed input tax credit on the invoice from the subsidiary. After the works were completed

the rents under the lease and underlease were increased to £400,000 per annum and £415,000 per annum respectively. The Manchester Tribunal which made the reference found that the sole purpose of the lease and underlease were to facilitate a scheme to reduce VAT; it also found that it was the University's intention to obtain an absolute tax saving by terminating the arrangements after two or three years, thereby terminating payment of VAT on the rents. The Tribunal found that there was nothing in the documents to show that the University intended mere deferral, but abundant evidence to show that absolute saving was intended, see [2003] V&DR 96 at [134].

129. The questions referred were solely directed to whether the lease and underlease qualified as economic activities in circumstances where,

“... (4) the lease and lease-back amounted to, and was intended by the University and the trust to be, a deferral scheme (that is, a scheme for the deferral of payment of VAT) with a built-in feature that allowed an absolute tax saving at a later date”.

The Grand Chamber's ruling was identical to that of paragraph 1 of the ruling in *Halifax* (see paragraph 127 above) and did not address abuse of rights although at [53] the Court stated that the Directive precludes the deduction of input tax “where the transactions from which that right arises constitute an abusive practice.”

130. In applying the principles laid down in *Halifax*, the Tribunal must therefore address three basic issues:

- (a) Did the transactions from which Weald's input tax claims were derived result in tax advantages contrary to the purpose of the relevant provisions of the Sixth Directive and the UK legislation implementing it?
- (b) Has it been shown from objective factors that the essential aim of the transactions was to obtain tax advantages?
- (c) If there has been abuse, how should the transactions be redefined?

Were there tax advantages contrary to the purpose of the relevant provisions?

131. The essential submissions as to this are summarised at paragraphs 106 to 109 and paragraphs 118 and 119 above.

132. The first condition under paragraph 2 of the ruling in *Halifax* replicates the wording of [74] which however is subject to the considerations set out in the preceding paragraphs which include the requirement for legal certainty in [72] and the right to structure the business to limit tax liability in [73].

133. It is clear from *Debouche* [1996] ECR I-4495 at [16] that under Article 17 a trader is not entitled to deduct input tax on supplies used for exempt transactions. There is however nothing in the Directive which precludes an exempt trader from leasing an asset and thus spreading the irrecoverable VAT, provided that ownership does not pass on payment of the last instalment in

which case Article 5.4(b) applies. It was not suggested by Mrs Hall that if CML or CARC had leased the equipment at arm's length from a finance company, the deferral or spreading of the VAT would have been contrary to the purpose of the Directive.

134. It is clear from the context of *Halifax* that the transactions giving rise to the right to deduct are not confined to the immediate transactions, in that case the payments by Leeds Development to County and the stage payments by County. The “transactions concerned” referred to at [74] and [75] must logically be the same as those referred to at [81] which also refers to “the transactions concerned” and goes on to refer to the links “between the operators involved in the scheme for reduction of the tax burden.” The transactions here thus include the leases as well as the acquisitions of the assets and arguably the loans to Weald.
135. Mrs Hall emphasised the reference by the Advocate General at paragraph 96 to the “purpose of avoiding or deferring the payment of VAT.” We note that two paragraphs earlier he stated that the schemes involved the recovery in full of VAT. Apart from that opinion Mrs Hall did not point to any provision of the Sixth Directive or European case law to support the proposition that an exempt trader should bear the immediate burden of input tax and that spreading the burden over a period of time by leasing is contrary to the purpose of the Directive. Many, perhaps most, traders who make exempt supplies also make taxable supplies as Article 17(5) recognises. Fully taxable traders can lease assets instead of buying them. If a partially exempt trader could not lease assets to be used both for taxable and exempt supplies because this would involve deferral, that would conflict with the principle of fiscal neutrality to which the Court referred at [80] in *Halifax*, in that it would distort competition in relation to taxable supplies between fully taxable suppliers and those partially exempt. Furthermore there is an essential difference between buying and leasing as is reflected in Article 5(4)(b) which makes special provision for hire purchase and credit sale agreements. When the Advocate General referred to “avoiding or deferring the payment of VAT” he was clearly referring to the *University of Huddersfield* where the Tribunal had found that absolute saving was intended. It seems to us that the Advocate General must have been referring to deferment of VAT by transactions of a purely artificial nature as in that case where deferral was to be followed after a short time by termination so avoiding the burden of input tax.
136. While it is clear that a trader is not entitled to credit for input tax attributable to exempt supplies and may not artificially avoid the burden of input tax attributable to such supplies, we can find nothing in the Directive either expressly or by implication to show that an exempt trader may not defer or spread the burden of input tax by leasing. Leasing by exempt traders has been widespread without any suggestion that it is not legitimate; indeed that was the conclusion of the visiting officer in January 2001 (see paragraph 34 above).

137. No question of recovering input tax would arise in the first place unless the immediate transactions complied with the formal conditions for relief. Since the remedy for abuse lies in redefining the transactions to re-establish the situation prevailing in the absence of abuse, it seems that the first condition must be directed to the result of the transactions as a whole which potentially constitute an abuse. If the submission of Miss Shaw that the Tribunal is not entitled to pierce the corporate veil is correct, it is difficult to see what is the effect of the last sentence of [81] where it refers to the artificial nature of the transactions and the links between the operators; the operators in *Halifax* were the parent and two subsidiaries. When we refer to the transactions as a whole we mean the transactions relevant to each supply. This does not include what happens subsequently unless it is shown to be pre-planned, but it does include what has happened previously under the relevant leases.
138. We return therefore to compare the result of the transactions as a whole with the purpose of the Directive. The Churchill VAT group, which made supplies which were 99 per cent exempt, obtained the use of assets for its business by arranging for their purchase by Weald, a wholly-owned subsidiary outside the VAT group, with cash loaned interest free by the Churchill group on the footing that Weald would lease the assets to Suas at a quarterly rental of one-fortieth of their cost and that Suas would lease them on to Churchill group companies at a small agreed mark-up, the leases being operating leases which could be terminated without a penalty in less than a month.
139. The result of the transactions was that Weald, the Appellant, recovered the excess of the input tax incurred by it on purchasing the assets over the output tax payable by it on the rentals charged to Suas, which rentals were based on an assumed life for the assets of 10 years compared with a maximum of four years assumed for accounting purposes (see paragraph 8); the companies in the Churchill VAT group provided the finance for the purchases free of interest, although enjoying the benefit of the corporation tax losses arising to Weald through capital allowances, and incurred VAT, which was largely exempt, on the rentals paid to Suas; the interposition of Suas in the transactions prevented Customs from giving a direction under Schedule 6, paragraph 1 requiring the VAT on the rentals to be based on open market values.
140. The criticisms by Mrs Hall of the transactions (see paragraph 110 above) are a brief summary of those set out in the extensive written submissions prepared by her and Mr Hill in February 2005. Mr McKay also put in detailed written submissions on the evidence.
141. The evidence of Mr Edmunds, an acknowledged expert in leasing of equipment, was that objectively the leases were typical leasing transactions. We accept his evidence, which was not subject to any substantial challenge, in so far as it was expert evidence. He did not however address the level of the rentals, no doubt because this was not within his expertise as a solicitor.

142. In the light of his evidence recorded at paragraph 100 we do not consider that the facts that Weald was wholly-owned and that the arrangements for purchase of the assets were made by group employees made the deferment artificial. Any artificial deferment arose from the level of the rentals rather than from the fact of leasing. Mr O'Rourke referred to the financing charges by third party lessors (paragraph 44) and avoiding intervention to set market rentals (paragraph 49) and Mr Hardy referred to the margin charged by Suas being less than other leasing companies would have charged (paragraph 71). This shows that they regarded the rentals as low.
143. There was however no evidence as to what would have been open market rentals. The reason for this was that Customs based the assessments and the submissions as to abuse of rights not on the level of rentals but on the entire leasing arrangements. The eventual case following the decision of the ECJ in *Halifax* was that the entire input tax incurred by Weald should be disregarded as arising out of abusive practices. As Miss Shaw stressed (see paragraph 118) Customs did not contend that the level of rents was itself an abuse.
144. It might have been argued by Customs that the introduction of Suas into the transactions thus preventing Customs from making directions under Schedule 6, paragraph 1 resulted in the accrual of tax advantages contrary to the Sixth Directive and to the domestic legislation including Schedule 6, paragraph 1. This would have involved widening the ambit of the second answer in *Halifax* somewhat so as to encompass the purposes of national legislation enacted pursuant to a derogation under Article 27 of the Sixth Directive. There is no doubt that Schedule 6, paragraph 1 was enacted under such a derogation, see *RBS Leasing & Services (No.1) Ltd and others v Commissioners of Customs and Excise* [2000] V&DR 33. Since it was not argued by Mrs Hall that the abuse consisted of low rentals coupled with the introduction of Suas to counter Schedule 6, paragraph 1, not only were there no submissions as to this but no evidence was adduced as to what open market rentals would have been.
145. We considered re-listing the appeal for further submissions and evidence, however we decided that this would not be appropriate because Customs had not raised the argument and had clearly taken a conscious decision not to produce further evidence (see paragraph 106 above).
146. We conclude that the fact that the Churchill VAT group obtained the use of assets for its predominantly exempt business by leasing the said assets so spreading the burden of irrecoverable input tax did not result in a tax advantage contrary to the purpose of the Directive and the implementing legislation. Nor did the mere fact that the assets were acquired by a connected company outside the VAT group which leased them to an unconnected company on the basis that the unconnected company would lease them to companies in the Churchill VAT group.

147. Any abuse arose not from the leases themselves but from the level of the rentals under the leases and from the arrangements to avoid directions under Schedule 6, paragraph 1. This was not how Customs chose to argue the case. No doubt this was for good reasons. It would have involved widening the ambit of *Halifax*; it would have involved a substantial reduction in the assessments and it would also involve a substantial problem in redefining the transactions.

The essential aim of the transactions

148. In case we are incorrect in concluding that it has not been shown that the transactions on which Weald's input tax claims were based resulted in tax advantages accruing either to Weald or to the Churchill VAT group contrary to the provisions of the Directive and the UK legislation implementing it, a question which is primarily a matter of law, we turn to consider whether it has been shown from objective factors that the essential aim of the transactions was to obtain tax advantages, which is a question of fact.
149. The second condition for an abusive practice to exist is set out at [75] of *Halifax* as follows:

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

150. It was not suggested that the aim of the transactions was not to defer the liability to the VAT borne by the Churchill VAT group, whether this is to be ascertained solely by purely objective factors or not. Nor was it argued that the tax advantage was by the Churchill VAT group rather than the Appellant. The issue under the second condition is whether viewed objectively the transactions may have some explanation other than the mere attainment of tax advantages. It seems to us that such other explanations are only relevant if they have the effect that it is not apparent that the essential aim was to obtain tax advantages. A purely secondary aim would not have this effect.
151. We do not find any of the explanations for the transactions other than the attainment of tax advantages by the Churchill VAT group to be remotely convincing. Although there was an initial solvency benefit, Mr Hardy's evidence (paragraph 75) was that this was through the loans to the non-insurance entity rather than through the leasing arrangements. Another justification for the arrangements was that they facilitated control over the group's expenditure on capital assets. We find this even less convincing since the arrangements added considerably to administration and accounting complications, particularly when assets were considered unsuitable for leasing. The fact that Suas undertook responsibility for administering the leases cannot be a reason for the leases themselves, it merely addressed the additional work

created by the leases. There was no immediate financing benefit to the group from the leasing apart from the VAT aspect since the purchases were financed by loans from within the group. There was no evidence of any serious consideration being given to arm's length leasing, no doubt because of the margin that lessors would require. None of the explanations displaces the fact that viewed objectively the essential aim was to obtain a tax advantage by reducing the irrecoverable input tax. We find that, if contrary to our conclusion, the first condition in *Halifax* was satisfied, the second condition was also satisfied.

Redefinition of the transactions

152. In view of our conclusion above this does not arise. Again, however, in case we are incorrect in this we consider redefinition. Since it is clear that mere leasing by an exempt trader is not contrary to the purpose of the Directive, any abuse arose from leasing at less than market value and from the insertion of Suas as a party to the leases in order to prevent a direction under Schedule 6, paragraph 1. The redefinition required on that basis would be to re-establish the position which would have prevailed if the assets had been leased directly by Weald to CML and CARC at open market value. This of course is substantially different from the basis on which the original, further or protective assessments were based. It would involve allowing the input tax credited to Weald but would make Weald liable to output tax on the basis of open market rents. This in fact would seem to be the same basis as if the assessments had been based on a direction under Schedule 6, paragraph 1, although such a direction could not be given now for most of the periods under appeal because of the 3 year time limit.
153. When considering the consequences of transactions constituting abusive practices, the Court said at [92] that the measures which member states may adopt under Article 22(8) to ensure the correct levying and collection of tax and for the prevention of fraud "must not go further than is necessary to obtain such objectives." In the context of that paragraph that principle clearly applies when counteracting abusive practices. At [93] the Court said

"It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary".

The Court then said at [94],

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

154. Although the third reply of the Court in *Halifax* is expressed in mandatory terms, the consequences of redefining the transactions must depend on domestic law. The judgment of the Court of Justice and of course the answers

concerned the interpretation of the Sixth Directive. Member States cannot rely on direct effect but must transpose the provisions by domestic legislation. The powers of the Tribunal remain those which arose in respect of the assessments under appeal. The assessments which are the subject of this decision are the preferred assessments totalling £1,786,430 for periods 10/00 to 10/04. Customs have applied for the assessments for periods 10/00 to 10/01 to be increased under section 84(5). The appeals against the protective assessments have been stood over. This Tribunal has no powers in respect of any period of assessment not under appeal and a fortiori no jurisdiction in respect of any person who is not a party to the appeal.

155. As already stated the preferred assessments were ultimately supported by Customs on the basis that the input tax incurred by Weald on acquiring the assets should be disallowed since the redefining of the transactions under *Halifax* involved treating the input tax as incurred by CML and CARC rather than by Weald. The assessments gave credit for output tax declared by Weald which was not chargeable on the basis that Weald should be treated as not having leased any assets to Suas. For periods 04/02 to 10/02 the assessments by Mr Gaskell even with the further assessments showed no VAT as due from Weald and were not therefore assessments within section 73. The decisions in respect of those three periods were not assessments at all but decisions with respect to the VAT chargeable on the supply of services within section 83(b), see *Touchwood Services Ltd v Revenue and Customs Commissioners* [2007] EWHC 105 (Ch) at [45]. The fact that they were notified in a document entitled a notice of assessment did not make them assessments.
156. If the transactions were redefined to substitute an increased output tax liability on the rentals based on higher open market values while allowing the input tax, the result would be that the assessments for the first six periods, 10/00 to 01/02, would be based not on input tax disallowed with an output tax credit but on underdeclared output tax by Weald. Once open market values were substituted the interposition of Suas would have no relevance
157. This would bring us to Miss Shaw's submission based on *Ridgeons Bulk Ltd v Customs and Excise Commissioners* [1994] STC 427 at 439h that Customs cannot change input tax assessments to output tax assessments and that the Tribunal cannot do so either.
158. In *Ridgeons Bulk* the Appellant company took a 25 year lease of a sawmill from an associated company at an annual rent of £140,000 with a 3 year rent holiday on undertaking to carry out specified work at a cost of £375,518. The Appellant claimed £51,598 input tax on the work and was credited with that sum. In the following year Customs made an assessment disallowing the input tax. The Appellant appealed. A year later on 25 July 1990 Customs accepted that the input tax was allowable but sought to maintain the assessment on the footing that the Appellant had made a supply of the building work to the associated company equal to the rental value over the rent-free period and was

liable to output tax of £54,728 which is 3/23rds of £420,000. The Appellant appealed against the Tribunal decision reported at [1991] VATTR 372 that the change of basis did not involve a new assessment. The issue before the High Court was whether Customs could maintain an assessment based on overclaimed input tax on the grounds that a different amount of output tax had been underdeclared, no new assessment being possible because it would be out of time.

159. In a reserved judgment, Popplewell J held that Customs could not on fresh evidence treat the assessment for overclaimed input tax as an assessment for underdeclared output tax for a different amount and maintain it. The appeal was allowed. A separate issue was decided in Customs' favour. Leave to appeal was granted to both parties but neither appealed. The decision of Popplewell J. has stood for over 12 years without challenge and is clearly binding on the Tribunal. Mrs Hall did not submit that *Ridgeons Bulk* was wrongly decided but said that it was not concerned with section 84(5) and should be re-evaluated in the light of *Halifax*.
160. In order to decide whether *Ridgeons Bulk* would apply to this case it is necessary to consider the ratio decidendi or reason for the decision. We did not have the benefit of submissions from counsel on this aspect because Mrs Hall sought to uphold the assessments disallowing input tax and did not address the possibility of an independent output tax liability. Instead she asked the Tribunal to increase the existing assessments disallowing input tax by reducing the credit for output tax (see paragraph 116 above). On this footing the relevance of *Ridgeons Bulk* was more limited and somewhat different. Since Mrs Hall did not seek to uphold the assessments (or part thereof) on the basis of output tax, Miss Shaw did not address the Tribunal on that aspect apart from submitting that *Ridgeons Bulk* prevented such a course of action.
161. The actual paragraph in *Ridgeons Bulk* where Popplewell J set out the reason for his decision was at page 439h,

“I turn back to the 1983 Act itself. I find no basis for the Commissioners' contention that where an assessment for overclaimed input tax cannot be supported it is open to them on fresh evidence to seek to treat that assessment as an assessment for underdeclared output tax for a different amount and maintain it. Their proper course is to issue a new assessment relying on the proviso.”

The reference to the proviso was to the closing words of Schedule 7, paragraph 4(5) of the VAT Act 1983, which are substantially reproduced in section 73(6) of the 1994, enabling Customs to make an assessment in addition to the initial assessment when further evidence comes to their knowledge after the making of the initial assessment.

162. Popplewell J cited the following passage from *Jeudwine v The Commissioners* [1977] VATTR 115 at 119,

“Therefore it seems to us that section 31(1) and (2) initially authorise the Commissioners, if they come to the conclusion that they have got an incomplete or incorrect return, to raise only a single assessment. They can raise that assessment at any time within two years of the accounting period or within one year after the facts have come to light, but having done that, in our judgment, they are bound by that assessment unless and until further evidence comes to their knowledge, when of course they have the power to raise an additional assessment.”

163. In the present case that Customs did not rely on further evidence in relation to their arguments as to abuse. If Customs could not rely on fresh evidence to support an assessment for overclaimed input tax as an assessment for undeclared output tax, logically they could not support an assessment for overclaimed input tax as one for undeclared output tax without fresh evidence. Although Popplewell J referred to “output tax of a different amount” it does not appear that the difference in amount was crucial. In *Ridgeons Bulk* what Customs did was to state in their letter of 25 July 1990 (see paragraph 154 above) that the original assessment of £51,598 was maintained and that a further assessment of £3,184 was enclosed.
164. In *Customs and Excise Commissioners v Sooner Foods Ltd* [1983] STC 376 the Tribunal held on a preliminary issue that the assessment which was based on output tax was wrong and on this basis directed that the assessment be re-examined but that Customs could not introduce further assessments in respect of input tax. Forbes J said at page 379g that the direction was within the power of the Tribunal but went on to rule that in the face of two findings by the Tribunal the direction was unreasonable. The findings in the previous paragraph were that the Appellant had practised some form of deception and that the Appellant was not entitled to claim input tax in respect of certain supplies. In *Ridgeons Bulk* Popplewell J at page 440a rejected the argument that the Tribunal had some discretion to allow the assessment to stand if there was no prejudice, saying at page 440a that this had no support from decided cases or the Act.
165. In *Football Association v Customs and Excise Commissioners* [1985] VATTR 106 Lord Grantchester expressed the view at page 119 that Forbes J reached his conclusion in *Sooner Foods Ltd* on the grounds that Customs could justify an assessment under what is now section 73(1) either on the grounds that output tax had not been declared or that input tax had been wrongly deducted because the provision dealt with a net amount of tax due. Popplewell J did not cite that passage, however in *Ridgeons Bulk* the assessment under appeal was made clearly under what is now section 73(2) whereas an assessment based on output tax would have been under section 73(1).
166. In *International Language Centres Ltd v Customs and Excise Commissioners* [1983] STC 394 Woolf J held that the assessment under appeal was a global assessment which was not made within the time limit and rejected the Tribunal

reasoning which was based on the assessment as having three separate parts. Woolf J said at page 398e,

“... bearing in mind that the taxpayer is entitled to be informed in reasonably clear terms of the effect of the assessment, it seems to be that it would be right to regard this particular assessment as one single assessment ...”

This passage was cited by Popplewell J.

167. Popplewell J also referred to *Silvermere Golf and Equestrian Centre Ltd v Customs and Excise Commissioners* [1981] VATTR 106 where the Tribunal (chairman Mr Neil Elles) allowed the appeal on the grounds that it would be wrong to treat the assessment as relating to input tax wrongly deducted when it was not issued on that basis, stating that a taxpayer was entitled to know the basis on which the assessment was made. In *Sneller v Customs and Excise Commissioners* [1987] 3 BVC 662 the Tribunal decided that there was no power in the legislation to enable Customs to amend a mistake in an assessment so as to cover the correct accounting period, citing *S J Grange Ltd v Customs and Excise Commissioners* [1979]. In *International Institute for Strategic Studies v Customs and Excise Commissioners* [1992] VATTR 245, Mr Elles held, citing *Sneller*, that an assessment which was invalid because it was for the wrong period could not be reduced.
168. All of the above decisions were referred to by Popplewell J in the judgment in *Ridgeons Bulk*. We derive the following principles. A taxpayer is entitled to be informed in clear terms of the basis and effect of the assessment. This includes whether it is made under section 73(1) which covers the net amount due from him or under section 73(2) which is limited to VAT which has been paid or credited to him which should not have been so paid or credited. The assessment must identify the correct accounting period or periods. Where an assessment is made under section 73(1) it may be justified on the grounds of underdeclared output tax or overdeclared input tax; however this does not include introducing matters properly assessable not under section 73(1) but under section 73(2). We find some tension between the decisions in *Sooner Foods Ltd* and *Ridgeons Bulk*, however we consider that they can be reconciled if the decision in *Sooner Foods Ltd* is treated as based on the finding that there was deception by the Appellant.
169. Returning to the present case, it is clear beyond argument that all of the assessments under appeal were made under section 73(2) to recover input tax credit which Customs contended should not have been paid or credited. The original footing which was that Weald was not engaged in an economic activity was clearly wrong in the light of *Halifax*. In our judgment the alternative basis was also wrong because the mere fact of leasing through Weald was not contrary to the purpose of the Directive. Redefinition of the transactions to remove an abusive practice of the rentals being at undervalue would involve increased output tax. This raises the question whether such

redefinition would result in excessive input tax having been paid within section 73(2) or the returns being incorrect within section 73(1) so that VAT is due from Weald. It seems to us that both subsections potentially apply. In those circumstances we consider that, if we had concluded that Weald had engaged in abusive practices, Customs would have been entitled to rely on section 73(2). Although Weald did not practise a deception as in *Sooner Foods*, it would on that hypothesis have engaged in an abusive practices. We hold that the principle in *Ridgeons Bulk* would not have applied in such circumstances.

170. On the view we have taken that any possible abuse consisted in the rental level, no question arises of increasing the assessments under section 84(5). However we accept the submission of Mrs Hall that on the basis of *Elias Gale Racing* it is not relevant to any such increase that the time for new assessments has expired.
171. If we had concluded that the leases via Suas did constitute an abuse if they were at less than open market value, this would have necessitated evidence as to open market rentals. This might well have given rise to considerable difficulties in particular because it seems unlikely that a third party leasing the assets at arm's length would have agreed to leases which could be terminated at short notice without a penalty unless there was such an element of front loading as to be unattractive to a lessee. It is quite possible that one or the other party would have contended that it would be impossible to lease on such a basis. This would be a matter of evidence. Any lease from an independent third party would clearly have to be at a rental which gave a commercial rate of return taking account of the capital tied up or the financing costs and the risks involved. It may well be that the potential difficulty of such an exercise was a factor in the decision of Customs not to rely in the alternative on the level of rents.
172. To avoid any doubt we consider that the open market rentals could not be affected by the margin on the rents in fact paid to Suas. On the basis that the transactions under the leases did involve economic activities, Suas was liable to VAT. The question whether redefinition would involve repayment of that VAT is outside the ambit of this appeal to which Suas is not a party.

Summary of conclusions

169. We summarise our conclusions as follows:
- (1) It is a purpose of the Directive that a trader may not artificially avoid the burden of input tax attributable to exempt supplies (paragraph 136);
 - (2) Nothing in the Directive expressly or by implication precludes a trader from leasing an asset to be used for exempt activities so spreading the burden of irrecoverable input tax (paragraph 136);

- (3) The question whether tax advantages accrued, the grant of which was contrary to the purpose of the Directive, must be considered at the time when the tax advantages accrued considering the result of the transactions as a whole including whether the deferral was artificial (paragraphs 137-139);
- (4) It has not been shown that the transactions on which Weald's input tax claimed were based resulted in tax advantages accruing either to Weald or to the Churchill VAT group which were contrary to the provisions of the Directive and the UK legislation implementing it (paragraph 146);
- (5) The aim of the transactions was to defer the VAT borne by the group; none of the explanations advanced have the effect that it was shown that the obtaining of tax advantages was not the essential aim (paragraphs 150-151);
- (6) Any redefinition would depend on the ambit of the abuse identified. If we had concluded that the level of rentals and the introduction of Suas was abusive, redefinition would have been required to re-establish (or rather establish) the position which would have prevailed if Weald had leased the assets directly to CML and CARC at open market value so making Weald liable to higher output tax than that declared (paragraph 152);
- (7) Redefinition must go no further than is necessary and must not lead to a penalty (paragraph 153);
- (8) Redefinition can only take effect under UK legislation and the powers of the Tribunal are confined to the periods of assessment under appeal and to Weald (paragraph 154);
- (9) In law there were no assessments for periods 04/02 to 10/02 because no tax was shown as due (paragraph 155);
- (10) Redefinition in this case would involve output tax underdeclared rather than input tax overdeclared (paragraph 156);
- (11) Here the assessments were raised under section 73(2) to recover amounts of tax paid or credited to Weald; any underdeclaration of output tax had the effect that too much tax was paid or credited, so that *Ridgeons Bulk* which prevents Customs supporting an assessment under section 73(1) by reference to section 73(2) would not apply (paragraph 169).
- (12) The result is that the appeal is allowed.

**THEODORE WALLACE
CHAIRMAN**

RELEASED: 7 February 2007