[2020] UKUT 231 (TCC)

Appeal number: UT/2019/0102

VALUE ADDED TAX – whether HMRC are entitled to make an assessment under section 73(2) VATA to recover an amount of VAT which has been incorrectly refunded under the Contracted Out Services Directions made under section 41 VATA - yes - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

MILTON KEYNES HOSPITALS NHS FOUNDATION TRUST	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

TRIBUNAL: MR JUSTICE ZACAROLI
JUDGE THOMAS SCOTT

Sitting in public by way of video hearing treated as taking place in London on 24 June 2020

David Southern QC, instructed by X-vat Ltd, for the Appellant

Valentina Sloane QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. With the permission of the First-tier Tribunal (the "FTT"), Milton Keynes Hospitals NHS Foundation Trust ("MKH") appeals against the decision of the FTT reported at [2019] UKFTT 330 (TC).

2. MKH is an NHS trust which is entitled, pursuant to regulations made under section 41 Value Added Tax Act 1994 ("VATA"), to make claims to recover from HMRC certain VAT charged on supplies to the trust which were not for business purposes. It claimed and recovered VAT under the regulations in respect of expenditure on IT equipment. HMRC subsequently took the view that MKH was not fully entitled to that refund, and assessed it under section 73(2) VATA for the amount which (according to HMRC) had been overclaimed.

3. In addition to appealing to the FTT against that assessment, MKH argued that, in any event, HMRC were not entitled to recover any over-payment which may have been made by way of an assessment under section 73. That issue was set down for determination by the FTT as a preliminary issue. The FTT concluded that HMRC did have power to make such an assessment under section 73(2), and MKH appeals against that decision.

VAT Refunds to Government Departments

4. Under the EU's Principal VAT Directive, only taxable persons have a right to recover VAT which they incur. A public body such as a Government department, acting in its capacity as a public body, does not have that right (subject to certain exceptions in the Directive which are not relevant here) because it is not acting as a taxable person.

5. This might cause public bodies to undertake activities in-house which in business terms could most sensibly have been outsourced, simply to avoid the VAT charged by external contractors. In order to avoid such a bias, the UK, in common with some EU Member States, has enacted a regime which permits the reclaim of some such VAT on certain terms. The Directive does not provide for this, but nor does it prohibit it.

6. The statutory basis for the regime, referred to colloquially as the Contracted Out Services or COS system, is section 41(3) and (4) VATA, which provides as follows:

> (3) Where VAT is chargeable on the supply of goods or services to a Government department, on the acquisition of any goods by a Government department from another member State or on the importation of any goods by a Government department from a place outside the member States and the supply, acquisition or importation is not for the purpose—
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> (*a*) of any business carried on by the department, or
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> (*b*) of a supply by the department which, by virtue of section 41A, is treated as a supply in the course or furtherance of a business,

> then, if and to the extent that the Treasury so direct and subject to subsection (4) below, the Commissioners shall, on a claim made by the department at such time and in such form and manner as the Commissioners may determine, refund to it the amount of the VAT so chargeable.
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> (4) The Commissioners may make the refunding of any amount due under subsection (3) above conditional upon compliance by the claimant with requirements with respect to the keeping, preservation and production of records relating to the supply, acquisition or importation in question.

7. An NHS foundation trust such as MKH is treated as a Government department for this purpose by section 41(7).

8. The current Treasury direction made pursuant to section 41(3) was published in the Belfast, Edinburgh and London Gazettes on 10 January 2003. The direction lists eligible departments and eligible services, and states as follows:

> The Treasury, in exercise of the powers conferred on them by section 41(3) of the Value Added Tax Act 1994, hereby direct as follows.
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> (1) This direction shall come into operation on 2 December 2002.
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> (2) Subject as provided in paragraph 3, a Government department listed as belonging to a category of departments listed in List 1 of this direction may claim and be paid a refund of the tax charged on:
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> (a) the supply to it of any services of a description in List 2;
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> (b) the supply to it of leased accommodation for more than 21 years as part of the supply to it of any services of a description in List 2; or
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> (c) the supply to it or acquisition from another member state of importation from outside the member states by it of goods closely related to the supply to it of any services of a description in List 2.
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> (3) A tax refund as described in paragraph 2 will only be paid if:
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> (a) either the supply of those services or goods is not for the purpose of: (i) any business carried on by the department; or
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> (ii) any supply by the department which, by virtue of directions made under section 41(2) and (5) of the Value Added Tax Act 1994, is treated as a supply in the course or furtherance of a business; and
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> (b) the department complies with the requirements of the Commissioners of Customs and Excise both as to the time, form and manner of making the claim and also on the keeping, preservation and production of records relating to the supply, acquisition or importation in question.

9. HMRC have exercised their powers under Section 41(3) and (4) to determine the time, form and manner of claims, and to set out record-keeping requirements. The relevant requirements are set out in HMRC's Guidance Notes for Government Departments, the Section 41 Guide for NHS Bodies and HMRC's internal manual on VAT and Government and Public Bodies, at VATGPB9720. Broadly, claims under

section 41(3) are to be made by NHS trusts on their monthly VAT100 returns, within certain time limits, by completing a special form attached to the VAT100. The guidance states that total VAT charged is to be shown in Box 1 on the return, input tax and amounts claimed under section 41 are to be shown in Box 4, and the netting off of those sums is to be shown in Box 5.

The FTT's decision

10. The FTT initially recorded two points on which the parties were agreed. First, the VAT which had been claimed by MKH was incurred by it other than in the course of any business or deemed business. Second, the VAT in dispute had been recovered by MKH for financial years 2013/14, 2014/15 and 2015/16, HMRC had assessed MKH to recover it in July 2017, and MKH had appealed that assessment to the FTT.

11. In relation to the preliminary issue before the FTT, Mr Southern (who also acted for MKH below) raised a number of arguments which were not pursued before us, although the thrust of MKH's case remained the same. The FTT (and HMRC) agreed with Mr Southern's summary of the EU law position, and in particular that the Principal Directive gave no right to recover the VAT claimable under section 41 VATA. However, noting that EU law did not prohibit a system such as that laid down in section 41(3), it concluded that that had no relevance to the question of whether section 73 permitted the assessment of wrongly recovered VAT. In relation to the submission that "COS VAT was outside the UK VAT system", the FTT again saw that as irrelevant to the proper interpretation of section 73. The FTT agreed that VAT claimed under section 41(3) was not input tax, but again concluded that that was irrelevant. It derived no assistance from authorities cited by Mr Southern relating to VAT recovery by councils and other authorities under section 33 VATA.

12. The FTT then turned (at [26] onwards) to the interpretation of section 73. Its conclusions were as follows:

> 29. Based on a consideration of s 73 by itself, I therefore find it difficult to understand the appellant's case that HMRC cannot use s 73 to assess COS VAT which they consider the appellant to have over-claimed. There has been paid or credited to the appellant, which is a 'person' for the purposes of the VATA, a refund of VAT. The appellant can therefore be assessed under s 73 if HMRC are right that they claimed too much VAT, being VAT charged on the supply of goods or services to them. It does not matter why they claimed the VAT if they were not entitled to do so. It does not matter that they overclaimed the VAT because they thought it was COS VAT, or because they thought it was input VAT. As long as it was VAT charged to them which they were not entitled to recover from HMRC under *any* provision, HMRC could assess them under s 73(2) to recover it.
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> 30. Indeed, the status of COS VAT versus input tax is not relevant to s 73. The purpose of s 73 is to enable HMRC to recover sums of money which the claimant was not entitled to: so whether the claimant was not entitled to the sum claimed because the sum claimed was not VAT at all, or not input VAT, or not COS VAT, does not matter: if the claimant

was not entitled to claim it, the money was wrongly claimed and can be recovered under s 73. This case is not about the meaning of s 41 but that of s 73(2).

31. The appellant suggested that because s 73(2) used the phrase 'amount of VAT due' from the NHS trust, it could not apply to NHS trusts acting as NHS trusts because as such they did not make supplies of any kind. However, that is a mis-reading of s 73 which simply said HMRC 'may assess that amount as being VAT due from him'. In other words, there was no suggestion that the amount of the assessment *was* an amount of VAT due on supplies: it was simply *deemed* to be VAT due from the taxable person. The point about the use of the word 'VAT' in s 73 where it refers to VAT 'paid or credited' was that it was referring to true VAT, but it was true VAT charged on supplies *to* (and not by) the taxable person, which the taxable person had wrongly reclaimed, for whatever reason or no reason. It did not matter that the recipient of the VATable supply could not itself make taxable supplies.

32. Nor does it matter that there is no right to recover any COS VAT under the PVD. Quite simply, if a VAT registered person reclaimed VAT which it had paid on supplies to it when it was not entitled to reclaim it, s 73 permitted HMRC to assess that VAT. And s 83 gave the taxable person the right to appeal that assessment to this Tribunal. That would seem to be the simple and correct answer to the preliminary issue, but I go on to consider all the points raised by the appellant.

13. The FTT then considered and rejected points based on the form in which departments were obliged to claim on their VAT return, and various arguments based on alleged Parliamentary intention.

Submissions of the parties

14. For MKH, Mr Southern's main arguments can be summarised as follows:

(1) VAT claimed under section 41 is not VAT within section 73 and cannot therefore be the subject of a section 73 assessment. It is not input tax, and is paid under a public sector refund scheme operating outside the VAT system.

(2) Section 73 applies only to taxable persons.

(3) The FTT wrongly approached the interpretation of section 73 as a question of semantics, and disregarded or failed properly to take into account the essential features of the VAT system in reaching its conclusion. The VAT system for this purpose means the EU system; there is no such thing as a separate UK VAT system.

15. For HMRC, Ms Sloane submitted that there was no reason to depart from the plain literal reading of section 73, and certainly no reason to place the gloss on it proposed by MKH. It was irrelevant whether section 41 operated outside the EU VAT system or whether VAT claimed under section 41 was input tax. The only "system" which was relevant in relation to the interpretation of section 73 was the system provided under the VATA.

Discussion

16. HMRC assessed MKH under section 73(2) VATA to the amounts which they considered had been incorrectly claimed. The only issue before the FTT, and in this appeal, was whether section 73(2) permits an assessment of an amount over-claimed under section 41(3). Whether the assessment was made in time, and whether it was made for the correct amount, are issues to be determined in the substantive appeal, if we find that the FTT's decision on the preliminary issue was correct.

17. Many of the points covered by Mr Southern before us were in fact not in dispute between the parties. In particular, the following points were common ground:

(1) For VAT purposes, the vast majority of MKH's activity (being the provision of medical treatment free at the point of delivery) was not carried out for business purposes. In relation to that activity, MKH was entitled, and only entitled, to claim VAT charged on supplies to it under section 41(3) in the way set down in the guidance we describe above. However, NHS trusts such as MKH do typically carry out a small amount of business activity (such as catering and car parking) which necessitates them registering and making returns for VAT purposes in the normal way.

(2) Section 41(3) and the regulations implementing it are not made pursuant to the Principal Directive or any other provision of EU VAT law. There is, however, nothing in the Directive or other EU law which would operate to make the arrangements under section 41(3) illegal or invalid.

(3) VAT claimed under section 43(1) is not input tax.

18. We note that the second and third points of common ground were reiterated in a recent decision of the Court of Appeal published after the hearing in this case: *HMRC v Northumbria Healthcare NHS Foundation Trust* [2020] EWCA Civ 874, at [7] and [8], describing the claim under section 41(3) as "a claim for a refund of VAT which is outside the usual method of offsetting input and output tax".

19. The only question before the FTT was one of statutory construction. Issues such as the essential features of the VAT system, the nature and characteristics of VAT clamed under section 41, and whether there was a meaningful distinction between the EU and UK VAT systems were of potential relevance only as elements of the context in which the question of statutory construction fell to be resolved.

20. We begin with the wording of the legislation. The starting point is section 41(3), set out at paragraph 6 above. It applies in the circumstances stated "where VAT is chargeable" on a supply to, or acquisition or importation by, a Government department other than for the actual or deemed purpose of any business carried on by the department. Where VAT is so chargeable, then, if and to the extent set out in Treasury directions, HMRC shall, on a claim by the department, "refund to it the amount of the VAT so chargeable".

21. It is plain that a claim under section 41(3) does relate to VAT for the purposes of VATA. As the FTT correctly observed, it encompasses VAT charged *to* a department. The VAT may not otherwise be recoverable (whether as input tax or by some other

means), that indeed being the whole point of section 41(3), but that does not mean it is not VAT. So, under section 41(3) VAT has been charged, the department has made a claim, and, subject to the requirements imposed pursuant to section 41(4), HMRC shall "refund…the amount of VAT so chargeable".

22. The relevant parts of section 73 are as follows:

> (2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—
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> (a) as being a repayment or refund of VAT, or
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> (b) as being due to him as a VAT credit,
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> an amount which ought not to have been so paid or credited, or which would not have been so paid or credited had the facts been known or been as they later turn out to be, the Commissioners may assess that amount as being VAT due from him for that period and notify it to him accordingly.
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> …
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> (9) Where an amount has been assessed and notified to any person under subsection (1), (2), (3), (7), (7A) or (7B) above it shall, subject to the provisions of this Act as to appeals, be deemed to be an amount of VAT due from him and may be recovered accordingly, unless, or except to the extent that, the assessment has subsequently been withdrawn or reduced.

23. Mr Southern described as his core submission the proposition that section 73(2) only permits HMRC to assess a person who is a taxable person for VAT purposes. He maintained that the fundamentals of the VAT system laid down in EU law are concerned only with taxable persons and supplies made to or by persons in such capacity. Because the amount claimed by MKH under section 43(1) was not VAT incurred for the purpose of a business, and was not input tax, MKH's claim had not been made as a taxable person, so it it could never be the subject of an assessment under section 73(2).

24. The submission fails for the simple reason that that is not what section 73(2) says. It permits an assessment where "there has been paid or credited to any person as being…a refund of VAT…an amount which ought not to have been so credited". Mr Southern sought to persuade us that, construed in context, by "any person" the draftsman must have meant "any taxable person (acting as such)". We have no hesitation in rejecting that argument. The distinction between a person and a taxable person is fundamental to the VAT legislation. Section 3(1) VATA sets the scene by stating that "a person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act". The VATA distinguishes between a person and a taxable person, and section 73(2) is expressed to apply to any person. Where a particular provision is applicable only to a narrower category of persons, it says so. Within section 73 itself, to take an example close to home, subsection (7) is expressed to apply only to taxable persons.

25. In any event, we do not accept the proposition that the VAT legislation, whether it be EU or domestic, is exclusively concerned with taxable persons. The legislation deals, for instance, with local authorities and other bodies (section 33), charities and any person carrying out certain building or construction work otherwise than in the course or furtherance of a business (section 35).

26. Mr Southern submitted that section 73(2) cannot be used to assess a wrongly claimed refund under section 43(1) because "COS VAT is not VAT but is extraneous to the VAT system". If by that is meant that an amount claimed under section 43(1) is not input tax, we agree. However, in relation to the construction of section 73(2) that is nothing to the point. The question is solely whether as a result of the claim made by MKH under section 43(1) there has been paid or credited to MKH an amount "as being…a refund of VAT" which HMRC consider ought not to have been so paid or credited. Looking at the wording of section 43(1), which requires HMRC to "refund to [MKH] the amount of the VAT so chargeable", it is in our view plain that there has. At the risk of stating the obvious, a colloquial label such as "COS VAT" or "non-input VAT" does not mean that an amount claimed under section 43(1) is not VAT; it is simply VAT actually charged to MKH but not otherwise recoverable.

27. We found that the discussion of whether there was a UK VAT system which was different from the EU VAT system shed no light on the issue in the appeal. Mr Southern suggested at one point that because the system under section 41(3) was not part of the EU VAT system, it followed that it could not be part of any UK VAT system. In so far as there is any merit in this argument, it does not inform the construction of section 73(2). In any event, we were taken to various EC materials which discussed the type of refund system under section 41(3) and similar systems in some EU Member States, which materials were consistent with the agreement between the parties that section 41(3) was neither authorised nor prohibited by EU VAT law. We agree with Ms Sloane that the only "system" which is relevant to the question of construction in this appeal is the system set out in the VATA, of which both section 41(3) and 73(2) self-evidently form part.

28. Our conclusions in relation to supporting submissions made by Mr Southern are as follows:

(1) It was pointed out that the scheme established pursuant to section 41(3) was very detailed, but there was nothing in section 41 and virtually nothing in the regulations and published guidance which dealt with amounts over-claimed under section 41(3). Given the scope and terms of the section 73(2) process, which has the effect of treating amounts assessed as VAT due, we do not consider that the absence of recovery provisions from section 41 itself or the guidance is surprising.

(2) We were taken to a number of decisions relating to section 33 VATA, which sets out a similar but separate system of VAT recovery for bodies such as local authorities and police authorities. None of those decisions was relevant to the issue in this appeal, particularly since section 33 differs from section 41(3) in that it confers a right to make a claim in section 33 itself rather than through and to the extent of any Treasury regulations.

(3) Mr Southern suggested that the words "as being" in section 73(2) showed that the amount refunded under section 41(3) was not VAT, but needed to be deemed to be VAT. We disagree. As we have explained, a claim under section 41(3) does relate to VAT. The words "as being" connote a payment which was considered to be a refund of VAT when paid by HMRC but which (according to the assessment) was not an amount properly so claimed.

(4) Although it was not contained in his skeleton argument, Mr Southern suggested in his oral argument that the reference to a "prescribed accounting period" in section 73(2) showed that the subsection applied only to taxable persons, because only taxable persons had prescribed accounting periods: see the definition in section 25(1) VATA. We do not accept that this phrase bears anything like the weight which this submission suggests. In any event, as we have explained, MKH is registered for VAT and so in fact has prescribed accounting periods. The assessment under appeal in this case, dated 11 July 2017, begins "[T]he Trust has over-recovered VAT in relation to various supplies under the COS Direction. Your records show that you have under-declared your VAT liability in the amounts, and in relation to the prescribed accounting periods as listed below".

29. Our conclusion that section 73(2) does permit HMRC to make an assessment in relation to an amount incorrectly refunded under section 41(3) produces a coherent system under the VATA, with checks and balances such as time limits, to cater for possible incorrect or unjustified claims. There was discussion before the FTT of what rights at common law HMRC might have to recover such over-payments, either in addition to section 73(2) or (on MKH's case) as its sole remedy. We do not need to consider that issue in this appeal, because the right to assess arises under section 73(2). We agree with the FTT that the words of the statute are clear and unambiguous, and no amount of contextualisation would warrant the rewriting of those plain words.

Disposition

30. The appeal is dismissed.

MR JUSTICE ZACAROLI
JUDGE THOMAS SCOTT

RELEASE DATE: 23 July 2020