VAT focus

Totel: pay now, argue later

Speed read

Appeals against assessments to VAT are only entertained on prior payment of the tax (subject to hardship). Although not unique to VAT, which is an EU tax, this requirement is not universal to all UK taxes. In *Totel v HMRC*, the Supreme Court considered whether the different regime that applies in relation to VAT constitutes less favourable treatment in contravention of the EU principle of equivalence. The court concluded that appeals against income tax, capital gains tax or stamp duty land tax assessments are not true domestic comparators to appeals against VAT assessments, which was sufficient to dispose of the appeal.

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A trader is assessed to VAT. It disagrees with the assessment. Discussions with HMRC break down. The trader wants to appeal the assessment to the tribunal. However, as we all know, it would only be able to do so if it were first to pay the tax to HMRC – under the so-called 'pay first' requirement – or, alternatively, to demonstrate successfully that to do so would cause it hardship.

Most traders do one or the other. Hardly any would even think to suggest that the 'pay first' requirement is unlawful (and should, therefore, be struck down). One trader did – Totel – and this is its story.

The story so far

Totel sells mobile phones. In 2006, HMRC denied certain claims Totel had made for input tax recovery, and sought also to claw back certain input tax that had already been paid. This resulted in a number of appeals, including two that were subject to the 'pay first' requirement (provided for under VATA 1994 s 84(3)).

The requirement does not apply where HMRC is satisfied or (where this is not the case) the tribunal decides that it would cause the appellant to suffer hardship (VATA 1994 s 84(3B)). Citing hardship, Totel applied for the appeals to be heard without payment or deposit of the VAT in dispute.

This was denied by the First-tier Tribunal. Totel appealed to the Upper Tribunal, where the appeal was dismissed. Totel then appealed to the Court of Appeal, arguing that the 'pay first' requirement was in breach of applicable EU law; namely, the principle of equivalence. This appeal was also dismissed.

Totel appealed to the Supreme Court. On 26 July, the Supreme Court delivered its judgment (*Totel v HMRC* [2018] UKSC 44).

However, before we get to it, we should ask: what is the principle of equivalence?

The principle of equivalence

Where a right is conferred under EU law, but there is no EU legislation on precisely how it is to be protected, it is for each member state to establish its own (domestic) procedural rules for the purpose. That is not to say the member state has absolute freedom, however; the principle of equivalence requires that the rules regulating the right – the right to recover taxes levied in breach of EU law, for example – must be no less favourable than those governing a similar domestic right. To determine whether a particular rule is consistent with, or in breach of, the principle, one must:

- first identify a domestic comparator – a right similar to the EU right which the taxpayer is seeking to vindicate, for example; and
- then, if the domestic comparator is governed by different procedural rules to those which regulate the EU right, assess whether the difference is justified.

The reason that equivalence is relevant in *Totel* is because VAT is an EU tax. It is regulated by the provisions of the Principal VAT Directive (2006/112). An appeal against an assessment to VAT is, therefore, a claim based on EU law. It can be contrasted with assessments to income tax (IT), capital gains tax (CGT), corporation tax (CT) and stamp duty land tax (SDLT), which are claims based on domestic (UK) law.

The 'pay first' requirement is a feature of the procedural regime for appeals against VAT assessments, but not of that for appeals against IT, CGT, CT or SDLT assessments. There is, therefore, a difference. The question is whether this means that the UK procedural rules regulating a claim based on EU law are less favourable than those governing similar claims based on domestic law, with the result that the former are in breach of the principle of equivalence.

This depends, in the first instance, on whether appeals against IT, CGT, CT or SDLT assessments are true domestic comparators to an appeal against a VAT assessment.

The Supreme Court judgment

In its judgment, the Supreme Court observed that:

> '… the principle of equivalence is essentially comparative. The identification of one or more similar procedures for the enforcement of claims arising in domestic law is an essential pre-requisite for its operation. If there is no true comparator, then the principle of equivalence can have no operation at all … The identification of one or more true comparators is therefore the essential first step in any examination of an assertion that the principle of equivalence has been infringed.' (para 7)

Finding a true domestic comparator is not as straightforward as it may at first appear. The question arises as to the level of generality at which the comparison is to be carried out.

On the one hand, one could argue (as Totel did) that because all appeals against assessments to tax are made to the same tribunal and made for the same general purpose (to establish that tax is not payable, or as in the *Totel* case, that amounts are due from HMRC), the comparison should be carried out at a very high level, so that all appeals against tax assessments are true domestic comparators to an appeal against a VAT assessment.

On the other hand, one could assert (as HMRC did) that the comparison should be carried out on a much narrower basis; and because there could never be a true comparator to an appeal against a VAT assessment – apart from some other assessment to VAT – there is no true domestic

comparator arising from any other type of tax.

The Supreme Court held that to determine the correct level at which the comparison is to be carried out, one must look to the context in which the principle of equivalence is invoked. Or, as the Court of Justice put it in *Levez* (Case C-326/96):

> '… the national court – which alone has direct knowledge of the procedural rules governing actions in the [*relevant*] field … must consider both the purpose and essential characteristics of allegedly similar domestic actions.' (para 43)

The Supreme Court did not consider it appropriate to hold 'that, for all purposes connected with the principle of equivalence, VAT claims must be treated as *sui generis*, with no possibility of there being a true comparator in a claim arising out of some other tax'. However, it did conclude that, on application of the context-specific approach, IT, CGT and SDLT did not constitute true domestic comparators to VAT for the purpose of assessing whether the 'pay first' requirement on appeals against VAT assessments constituted less favourable treatment in contravention of the principle of equivalence.

And it based its decision on an analysis of (for want of a better phrase) the relevant economic structures. In its opinion:

> '… a trader seeking to appeal a VAT assessment is typically in a significantly different position from a taxpayer seeking to appeal an assessment to any … other taxes, and in a manner which is properly to be regarded as sufficiently connected with the imposition of a pay-first requirement … VAT is a tax of which the economic burden falls upon the ultimate consumer, but which is collected by the trader from the consumer, and accounted for by the trader to HMRC. By contrast, taxpayers seeking to appeal an assessment to income tax, CGT and SDLT are being required to pay, from their own resources, something of which the economic burden falls on them, and which they have not collected, for the benefit of the Revenue, from anyone else. It is therefore no less than appropriate that traders assessed to VAT should be required (in the absence of proof of hardship) to pay or deposit the tax in dispute, which they have, or should have, collected, while no similar requirement is imposed upon the taxpayers in those other, and different, contexts.' (paras 22 and 23)

The fact that the economic burden of a trader's liability to VAT is typically borne by its clients or customers is not, of course, the reason why an appeal against a VAT assessment is subject to the 'pay first' requirement. (Reportedly, this exists primarily to protect HMRC against taxpayers who seek to delay the payment of tax by lodging unmeritorious appeals.) This did not concern the court, however, which stated that:

> 'I do not by reference to this connection between the pay-first requirement and the trader's paradigm status as a tax collector rather than a taxpayer mean to suggest that it is a condition of the recognition of this important difference separating VAT from other taxes that the pay-first requirement was devised for that specific reason. The evidence before the court did not show what, in fact, the reason was. The existence of a logical rather than causal connection is sufficient to justify the conclusion that VAT is different from those other taxes in this context, rather than a true comparator, regardless of the reason for the imposition of the pay-first requirement.' (para 24)

The Supreme Court's conclusion on whether appeals against IT, CGT or SDLT assessments are true domestic comparators to appeals against VAT assessments was sufficient to dispose of the appeal (they are not, and the appeal was dismissed).

However, the parties had also made full arguments on a particular facet of the principle of equivalence; what is more, this same facet was 'the first plank upon which the Court of Appeal dealt with the case'. Because of this, the Supreme Court made some limited observations on the point.

This is the so-called 'no most favourable treatment proviso' point.

The proviso

As stated in *Edis* (Case C-231/96), the principle of equivalence requires that:

> '… the procedural rule at issue applies without distinction to actions alleging infringements of Community law and to those alleging infringements of national law, with respect to the same kind of charges or dues … [However,] that principle cannot … be interpreted as obliging a member state to extend its most favourable rules governing recovery under national law to all actions for repayment of charges or dues levied in breach of Community law.' (para 36)

In other words, the principle of equivalence does not require a claim based on EU law to be treated as favourably as the most favourably treated comparable claim based on domestic law.

Consider the scenario where in *Totel* (instead of the actual judgment) the Supreme Court had found that all appeals against tax assessments were true domestic comparators to an appeal against a VAT assessment. In that event, comparisons would have arisen not only with appeals that were not subject to the 'pay first' requirement (such as appeals against IT, CGT, CT and SDLT assessments), but also with appeals that, like appeals against VAT assessments, *were* subject to the 'pay first' requirement (such as appeals against assessments to insurance premium tax, landfill tax, the climate change levy and the aggregates levy). VAT appeals would have been found to be treated less favourably than some true domestic comparators, but no less favourably than others.

The question then would be whether this infringed the principle of equivalence. The Supreme Court considered that: 'What is required is that the procedure should be broadly as favourable as that available for truly comparable domestic claims, rather than the very best available' (para 45).

The purpose of the principle of equivalence is to prevent member states from discriminating against claims based on EU law by according them inferior procedural treatment. In light of this, provided that a claim based on EU law is not accorded the worst treatment, a member state is free to apply any available procedural rules that already exist in relation to similar claims based on domestic law.

Totel is the last word on whether the 'pay first' requirement is consistent with the principle of equivalence. It is, however, less definitive on the question of the proviso, if only because the Supreme Court expressly stated that it would have considered referral to the Court of Justice had a decision on the point been necessary to resolve the appeal. Of course, should the point arise again, and a decision is necessary, that option (referral to the Court of Justice) will no longer be available after March of next year. ■

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- Cases: *Totel v HMRC* (31.7.18)