THREE-YEAR CAP –Appellant claiming input tax unclaimed through administrative error more than three years after the period incurred – whether cap valid in European law – yes

LONDON TRIBUNAL CENTRE

LOCAL AUTHORITIES MUTUAL INVESTMENT TRUST - Appellant
- and -
THE COMMISSIONERS OF CUSTOMS AND EXCISE Respondents

Tribunal: DR JOHN F AVERY JONES CBE (Chairman)

MRS J M NEILL ACA

Sitting in public in London on 27 January 2003

David Southern instructed by Reynolds Porter Chamberlain for the Appellant

Owain Thomas instructed by the Solicitor for the Customs and Excise for the Respondents

DECISION

1. This is an appeal by Local Authorities Mutual Investment Trust against a decision in a letter dated 28 November 2001 that input tax relating to periods more than 3 years earlier cannot be reclaimed. The Appellant was represented by Mr David Southern and the Commissioners by Mr Owain Thomas.
2. The issue in this appeal is whether the three-year cap is valid in preventing such repayment. Both counsel provided extensive skeleton arguments which we summarise only so far as necessary to our decision.
3. We heard evidence from Mr David Butler, the finance and administration director of CCLA Investment Management Limited (CCLA), to which the management of the Appellant's properties have been delegated. Previously CCLA had kept its accounting records manually and prepared the VAT returns from the records without reconciling them back to the accounting records. From 1 June 2001 the Appellant changed to making an application for rent without issuing a tax invoice and issuing the VAT invoice on payment. Accordingly, previously submitted VAT returns had to be reconciled to the accounting records in order to ensure the correctness of future VAT returns due to the change in method of accounting for VAT. As a result, twelve errors were discovered for periods 02/98 to 05/01 relating to both output and input omissions resulting in a repayment of £118,758 being claimed by way of voluntary disclosure on 20 November 2001. The Commissioners agreed the items within the three year limit, but

disallowed the items for periods 02/98 to 08/98, amounting to one output tax underpayment of £8,750 and six input tax overpayments totalling £153,058.33, with a net amount claimed from the Commissioners of £144,308.33 being the subject of this appeal. The only issue is the validity of the three-year cap; the repayment is otherwise agreed to be due.

European law

4. Mr Southern for the Appellant contended that in European law the Appellant had a right to repayment of the input tax which could not validly be taken away by imposing an arbitrary three-year cap. The right to repayment of input tax is a fundamental feature of VAT, see for example paragraph 19 of the judgment in *Rompelman v Minister van Financiën* (Case 268/83) [1985] ECR 655, 664:

   "…the deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of his economic activities. The common system of value-added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way."

5. Mr Southern makes a distinction between the obligation to pay output tax and the right to recover input tax, only the latter being the subject of the direct effect of the Directive. He points out that in *University of Sussex v Customs and Excise Comrs* [2001] STC 1495 a failure to claim input tax was characterised not as an overpayment of VAT but merely that the taxpayer had not yet exercised its right to claim input tax which it could do at any time, subject to limitation periods which were not in issue in that case because the three year cap was inserted after the claim in that case was made.
6. He contends that the right to reclaim VAT as a matter of Community law must be protected in national law and can be taken away only by means of a proportional restriction, in a way strictly necessary to attain its objective, based on reasons, and subject to effective judicial control. For example, in *Garage Molenheide v Belgium* [1998] STC 126, 155 the European Court said in paragraph 47 of the judgment:

   "Accordingly, whilst it is legitimate for the measures adopted by the member states to seek to preserve the rights of the treasury as effectively as possible, they must not go further than is necessary for that purpose. They may not therefore be used in such a way that they would have the effect of systematically undermining the right to deduct VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation."

   Here an arbitrary three-year cap offends this fundamental principle of European law. The national provision is therefore to be disregarded to the extent necessary to give effect to community law. As the Advocate-General said in that case in paragraph 42 (STC at page 144e):

   "Although member states may remain competent to determine their own systems of VAT collection, they are nevertheless required to operate those systems in conformity with the Sixth Directive, and especially its fundamental provisions such as the right of deduction."

7. Mr Thomas for the Commissioners contends that the Community right is to repayment of input tax in the period in which it is incurred. The cases in which the right was preserved were all cases in which the taxpayer was prevented by national law from making the claim in that initial period. For example, in *Rompelman* the taxpayer was not at the time treated as a taxable person; in *Commission v France* (Case 50/87) [1988] ECR 4797 national law prevented the right to input tax because of an arbitrary limit that the rent was less than one-fifteenth of the value of the property; in *Lennartz v Finanzamt München* (Case C-97-90) [1991] ECR I-3795 the taxpayer's business use of the car was less than an arbitrary limit of 10 per cent; and in *Molenheide* the tax authority had made a preventative attachment of the debt due to the taxpayer pending resolution of a dispute.
8. After the initial period any repayment may be made subject to conditions. Article 18(3) of the Sixth Directive provides:

   "Member States shall determine the conditions and procedures whereby a taxable person may be authorised to made a deduction which he has not made in accordance with the provisions of paragraphs 1 and 2 [dealing with the right to deduct in the initial period]"

   The Commissioners' discretion to refuse late input tax claims during the following three year period therefore implemented European law.

9. After considering the European cases Neuberger J did not consider that the existence of a limitation period (although the facts of that case were before the introduction of the three-year cap) was contrary to this article in *University of Sussex* (which is under appeal):

   "If a member state can impose a 'condition' on late claim procedures, that must, in my view, include time limits." (paragraph 52)

10. *While the issue in Marks and Spencer (Case C-62/00) [2002] STC 1036 was the retrospective effect of the introduction of the cap without any transitional provisions, the European Court accepted the validity of the principle of a three year period for recovery of overpaid output tax:*

    "As regards the latter principle [the principle of effectiveness], the court has held that in the interests of legal certainty, which protects both the taxpayer and the administration, it is compatible with Community law to lay down reasonable time limits for bringing proceedings (see Aprile Srl (in liquidation) v Amministrazione delle Finanze dello Stato (No.2) [2000] 1 WLR 126, para.19, and the case law cited therein). Such time limits are not liable to render virtually impossible or excessively difficult the exercise of the rights conferred by Community law. In that context, a national limitation period of three years which runs from the date of the contested payment appears to be reasonable (see, in particular, Aprile, para.19, and Dilexport Srl v Amministrazione delle Finanze dello Stato [1999] ECR I-579, para.26)." (paragraph 35 of the judgment)

    There was no reason in principle why a three-year cap for claiming input tax should not be equally valid in European law.

    Domestic law

11. *The domestic law is contained in Regulation 29 of the VAT Regulations 1995:*

"(1) Subject to paragraphs (1A) and (2) below, and save as the Commissioners may otherwise allow or direct either generally or specially, a person claiming deduction of input tax under section 25(2) of the Act shall do so on a return made by him for the prescribed accounting period in which the VAT became chargeable.

(1A) The Commissioners shall not allow or direct a person to make any claim for deduction of input tax in terms such that the deduction would fall to be claimed more than 3 years after the date by which the return for the prescribed accounting period in which the VAT became chargeable is required to be made.

(2) At the time of claiming deduction of input tax in accordance with paragraph (1) above, a person shall, if the claim is in respect of—

(a) a supply from another taxable person, hold the document which is required to be provided under regulation 13;

(b) a supply under section 8(1) of the Act, hold the relative invoice from the supplier;

(c) an importation of goods, hold a document authenticated or issued by the proper officer, showing the claimant as importer, consignee or owner and showing the amount of VAT charged on the goods;

(d) goods which have been removed from warehouse, hold a document authenticated or issued by the proper officer showing the claimant's particulars and the amount of VAT charged on the goods;

(e) an acquisition by him from another member State of any goods other than a new means of transport, hold a document required by the authority in that other member State to be issued showing his registration number including the prefix "GB", the registration number of the supplier including the alphabetical code of the member State in which the supplier is registered, the consideration for the supply exclusive of VAT, the date of issue of the document and description sufficient to identify the goods supplied; or

(f) an acquisition by him from another member State of a new means of transport, hold a document required by the authority in that other member State to be issued showing his registration number including the prefix "GB", the registration number of the supplier including the alphabetical code of the member State in which the supplier is registered, the consideration for the supply exclusive of VAT, the date of issue of the document and description sufficient to identify the acquisition as a new means of transport as specified in section 95 of the Act;

provided that where the Commissioners so direct, either generally or in relation to particular cases or classes of cases, a claimant shall hold, instead of the document or invoice (as the case may require) specified in sub-paragraph (a), (b), (c), (d), (e) or (f) above, such other documentary evidence of the charge to VAT as the Commissioners may direct.

(3) Where the Commissioners are satisfied that a person is not able to claim the exact amount of input tax to be deducted by him in any period, he may estimate a part of his input tax for that period, provided that any such estimated amount shall be adjusted and exactly accounted for as VAT deductible in the next prescribed accounting period or, if the exact amount is still not known and the Commissioners are satisfied that it could not with due diligence be ascertained, in the next but one prescribed accounting period."

12. *Mr Southern contends that the words in paragraph (1) "save as the Commissioners may otherwise allow or direct either generally or specially" qualified the whole of the regulation, including paragraph (1A). The effect of his interpretation is that the Commissioners may still allow a late claim and if they refuse it must be a reasoned refusal. Since they did not call any evidence they cannot show that they have properly exercised their discretion.*
13. *Mr Thomas contends first that Regulation 29(1) is subject to paragraph (1A), whereas Mr Southern's interpretation has the opposite effect; that the words "the Commissioners shall not allow" are mandatory; and that the existence of the proviso to paragraph (2) enabling the Commissioners to accept other documentary evidence in place of the mandatory requirements listed in paragraph (2) would be unnecessary if Mr Southern's interpretation were correct.*

Reasons for our decision

14. *We prefer Mr Thomas's approach to the interpretation of Regulation 29 which accords better with the wording. The words in paragraph (1A) "The Commissioners shall not allow or direct a person to make any claim…" clearly exhaust the scope of "save as the Commissioners may otherwise allow or direct" in paragraph (1). Since they have no discretion to accept late claims, the issue of the exercise of the Commissioners' discretion does not arise. Accordingly we need not consider whether the Tribunal has jurisdiction to review the exercise of any such discretion. Accordingly, as a mater of domestic law the three-year cap is applicable.*
15. *So far as European law is concerned Mr Southern put forward a persuasive case against the validity of an arbitrary three-year cap, but in the end we are not persuaded. While we accept that recovery of excessive output tax collected in breach of European law is different in principle from the claiming of input tax for the first time, where the taxpayer is claiming back his own money which has in effect been the subject of an interest-free loan to the tax authority, in Marks and Spencer the European court has approved a three year time limit for the recovery of excessive output tax collected in breach of European law in the interests of legal certainty, protecting both the taxpayer and the administration. In this case, in the periods under appeal there is one overpayment of output tax, to which the court's reasoning applies, and six failures to reclaim input tax, to which it does not directly apply. It seems to us that the principle of legal certainty applies just as much to protect the tax authority from late claims for input tax. The right to reclaim input tax applies without qualification to the initial period in which it is incurred. The taxpayer has a continuing right during the next three years subject to conditions which article 18 of the Sixth Directive requires a state to determine, and so during that period there is nothing to render virtually impossible or excessively difficult the exercise of the rights conferred by Community law. After three years with a tax based on three monthly periods, it is reasonable for there to be a time*

limit even though the effect of it is to prevent recovery of the taxpayer's own money. While the court said nothing about the position on the late recovery of input tax we do not think that the position in this respect is any different. If the court has approved a three year cap on the repayment of tax collected from customers contrary to European law, there is no reason in principle why the cap should not apply to the taxpayer's failure to made a claim which it was entitled to make three years earlier; if anything, the former case is the greater restriction on the taxpayer's rights in European law. The interests of legal certainty require that finality should be achieved. Following Marks and Spencer we do not consider that there in any doubt about this to warrant a reference to the European Court.

16. *On the facts of this case, the failure to recover the input tax could have been discovered at any earlier time if the same investigation had been made earlier. The retrospectivity issue in Marks and Spencer is not applicable here since all the periods in issue are after imposition of the three-year cap; the claim was made 4½ years after the introduction of the cap.*
17. *Accordingly we dismiss the appeal.*

J F AVERY JONES

CHAIRMAN

LON/02/313