



Neutral Citation Number: [2021] EWCA Civ 942

Case No: A3/2020/1517

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

His Honour Mr Justice Zacaroli

Judge Thomas Scott

UT/2019/0102

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 23rd June 2021

Before :

LORD JUSTICE LEWISON

LADY JUSTICE ASPLIN

and

SIR TIMOTHY LLOYD

Between :

**MILTON KEYNES HOSPITALS NHS FOUNDATION
TRUST**

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE & CUSTOMS ("HMRC")**

Respondents

David Southern QC & Denis Edwards (instructed by Clyde & Co LLP) for the Appellant
Valentina Sloane QC (instructed by the General Counsel and Solicitor to HM Revenue and
Customs) for the Respondents

Hearing date : 15th June 2021

Approved Judgment

Lord Justice Lewison:

1. The issue on this appeal is whether HMRC are entitled to raise an assessment under section 73 (2) of the Value Added Tax Act 1994 (“VATA”) on Milton Keynes Hospitals NHS Foundation Trust (“the Trust”) claiming repayment of amounts wrongly refunded to the Trust under section 41 of VATA. The amount in issue relates to VAT paid by the Trust in relation to a new computer system, which it reclaimed from HMRC. HMRC take the view that it was wrongly claimed and seek to recover the amount in question. Whether HMRC are right or wrong about that is not the question before us. The question is whether they are entitled to invoke section 73 (2) at all. Both the FTT (Judge Mosedale) and the UT (Zacaroli J and Judge Scott) decided that they were. The decision of the UT is at [2020] UKUT 231 (TCC), [2020] STC 2263. Having heard argument on behalf of the Trust, we announced that we would dismiss the appeal with reasons to follow. These are my reasons for joining in that decision.
2. As is well-known the origins of VAT lie in Europe. The scheme applicable is contained in Council Directive 2006/112/EC (“the Principal VAT Directive”). Article 2 defines the transactions that are subject to VAT. They include:
 - “(a) the supply of goods for consideration within the territory of a Member State by a taxable person acting as such
 - (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such”
3. Another of the key concepts is a “taxable person”. That expression is defined by article 9 (1):

“ “Taxable person” shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.

Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as “economic activity”.”
4. Article 13 (1) of the Principal VAT Directive provides:

“States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.

However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.”
5. The Principal VAT Directive is implemented in the UK by VATA. Section 3 (1) of VATA provides:

“A person is a taxable person for the purposes of this Act while he is, or is required to be, registered under this Act.”

6. On the face of it, therefore, it does not matter whether a person is required to be registered or is in fact registered under the Act without having been required to be registered. The latter category would, for example, include persons whose turnover is below the threshold required for compulsory registrations but who, nevertheless, choose to be registered. Either way, such a person falls within the definition of a taxable person.
7. Section 4 of VATA provides:
 - “(1) VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.
 - (2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply.”
8. Where a taxable person makes taxable supplies, he is liable to charge output tax on those supplies, and will be entitled to deduct any input tax that he pays on supplies to him. But a person’s status as a taxable person does not require that person to account for VAT where he does not make taxable supplies in the course of a business. Thus where, for example, a person makes supplies some of which are taxable and some of which are exempt, he need only account for those which are not exempt.
9. The process of accounting to HMRC for the balance between input tax and output tax is accomplished by means of VAT returns. Each return is made up by reference to a prescribed accounting period. The balance (if positive) will be paid to HMRC; while if negative it entitles the taxable person to a VAT credit: VATA section 25.
10. The Trust is treated, for the purposes of VAT, as a body of persons exercising functions on behalf of a Minister of the Crown: VATA, section 41(7)(c). Its principal activity is the provision of medical services for the NHS. They are free at the point of use. In so far as the provision of free at the point of use medical services are supplies, they are not supplies for a consideration. One consequence of this is that the Trust is not liable to charge output tax on those supplies. A further consequence is that in so far as the Trust is the recipient of supplies used in the performance of its public functions it is not entitled, under the ordinary system of VAT accounting, to deduct input tax on those supplies. But in addition to its core functions, the Trust makes some supplies for consideration, which come within the scope of VAT (for example car parking and catering). It is, therefore, registered for VAT as a taxable person; and in so far as it makes supplies of the latter character it is entitled to deduct the input tax attributable to supplies made to it for the purposes of those supplies.
11. The fact that such a body cannot recover the VAT element of the price charged to it by suppliers of relevant services for the purposes of its public functions might tend to operate as a disincentive to the use of outside contractors for such supplies, rather than having the work done by employees, which would not give rise to any VAT charge. In order to remove this disincentive, Parliament enacted section 41 of VATA (as well as

a somewhat similar provision for local authorities, in section 33). It provides, so far as relevant:

“(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—

(a) of any business carried on by the department, or

(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.

(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.”

12. In exercise of the power under section 41 (3) the Treasury made a direction on 10 January 2003. It is known as the Contracted Out Services Direction (“COSD”). It states (so far as relevant):

“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.

(1) This direction shall come into operation on 2 December 2002.

(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:

(a) the supply to it of any services of a description in List 2;

(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

(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.

(3) A tax refund as described in paragraph 2 will only be paid if:

(a) either the supply of those services or goods is not for the purpose of:

(i) any business carried on by the department; or

(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

(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.”

13. HMRC have, in turn, exercised the power to make requirements, as contemplated both by sections 41 (3) and (4); and by paragraph (3) (b) of the Treasury Direction. 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. Paragraph 1.22 of the Guidance Notes state that government departments are “required to register for VAT regardless of the annual value of their taxable supplies”. Paragraph 1.23 goes on to say that if a government department is not registered “it will not be able to reclaim ... refunds” under section 41 (3). Broadly, claims under section 41(3) are to be made by public bodies 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. A refund of VAT made under this procedure has been referred to as “COS VAT”. Thus the manner in which a claim to a refund of COS VAT is to be made is by means of a VAT return. Accordingly, it is necessarily made by reference to a prescribed accounting period.

14. Section 73 of VATA gives HMRC the power to make assessments in certain cases. So far as relevant to this appeal it provides:

“(2) In any case where, for any prescribed accounting period, there has been paid or credited to any person—

(a) as being a repayment or refund of VAT, or

(b) as being due to him as a VAT credit,

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.

...

(6) An assessment under subsection (1), (2) or (2) above of an amount of VAT due for any prescribed accounting period must be made within the time limits provided for in section 77 and shall not be made after the later of the following –

(a) 2 years after the end of the prescribed accounting period; or

(b) one year after evidence of facts, sufficient in the opinion of the Commissions to justify the making of the assessment, comes to their knowledge,

but (subject to that section) where further such evidence comes to the Commissioners' knowledge after the making of an assessment under subsection (1), (2) or (3) above, another assessment may be made under that subsection, in addition to any earlier assessment.

...

(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.”

15. There have been some changes to the wording of section 73 in consequence of the United Kingdom's departure from the European Union; but we were told that those changes have no bearing on what we have to decide.
16. The Trust argues that HMRC's power to make an assessment under section 73 (2) does not apply where the person to whom the refund was made under section 41 (3) is not a taxable person as regards the supplies which were the subject of the refund.
17. Mr Southern QC and Mr Edwards argue on behalf of the Trust that the effect of the Principal VAT Directive and the domestic legislation implementing it is to put a public body performing statutory (non-business) functions outside the scheme of VAT.
18. The important point, however, is that the public sector refund schemes are not part of the European framework. They are purely domestic provisions. In *R (Cardiff County Council) v Customs & Excise Commissioners* [2003] EWCA Civ 1456, [2004] STC 356 at [12] Schiemann LJ described a similar scheme involving local authorities as follows:

“In effect what the section provides is a subsidy by the state to councils of VAT which is not recoverable under the VAT regime set up by the Act pursuant to our obligations as a member of the European Community. The provision for the subsidy could have been contained in separate legislation.”

19. He went on to say at [38] that the refund scheme under consideration in that case “has nothing to do with rights given under Community law.” Provisions of this kind are not, therefore, required by European legislation; but there is nothing to preclude such provisions as part of domestic legislation.

20. This court described the policy underlying section 41 in *HMRC v Northumbria Healthcare NHS Foundation Trust* [2020] EWCA Civ 874, [2020] STC 1720 at [7] as follows:

“The purpose underlying the enactment of section 41 was to encourage public authorities to “outsource” the provision of services. When they perform services in-house, using their own employees, they incur no VAT. If they were to outsource those services, they would be exposed to having to pay VAT charged by the outside contractor. That was seen as a disincentive to outsourcing the provision of services. Hence the need to provide for a refund of VAT.”

21. In addition, if a public body financed out of general taxation were itself required to pay tax, the money would simply go round in a circle from one public budget to another.

22. Although it would serve that policy to permit a public authority to reclaim a refund of VAT properly incurred on a supply to it, it would not serve that policy to permit a public authority to retain the amount of a refund (or a subsidy) to which it was not properly entitled. Nor would it accord with that policy for a public authority to retain more than its fair share of public money. As I said in *Pollen Estate Trustee Co Ltd v HMRC* [2013] EWCA Civ 753, [2013] 1 WLR 3785 at [24] (omitting citation of authority):

“The modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. This approach applies as much to a taxing statute as any other.... In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole.”

23. This court approved those observations in *TFS Stores Ltd v Designer Retail Outlet Centres (Mansfield) General Partner Ltd* [2021] EWCA Civ 688 at [36]. The Supreme Court adopted a similar approach in *Rosendale Borough Council v Hurstwood Properties (A) Ltd* [2021] UKSC 16, [2021] 2 WLR 1125 at [10]. Mr Southern frankly accepted that the consequence of his argument would be that a public sector body is entitled to retain public funds to which it was never entitled. That, to my mind, is at least one pointer to the conclusion that his argument is not correct. But in my judgment the policy argument is amply borne out by the language and structure of VATA.

24. What is refunded to the public sector body under section 41 (3) is described by that section as an “amount of ... VAT.” Thus even though the person to whom the refund is made may not be a taxable person as regards the supply which gave rise to the VAT, what is claimed back is, nevertheless, VAT. I do not accept Mr Southern’s argument that the “VAT” referred to in section 41 is limited to input tax and output tax in relation to the activities of the public sector body claiming the refund. The payment made by way of refund does not, in my judgment, lose its character as an amount of VAT. Section 73 (2) is concerned with a “refund of VAT” which ought not to have been refunded. Thus the descriptions in section 41 (3) and 73 (2) match precisely. As both tribunals correctly pointed out, section 73 (2) applies where a refund has been made to “any person”. It is not limited to a taxable person. The obvious purpose of section 73 is to recover for the Exchequer money which has been wrongly paid away.
25. Mr Southern fastens on the phrase “for any prescribed accounting period”. Section 25 (1) of VATA provides that “a taxable person” must account for and pay VAT by reference to prescribed accounting periods. They are defined as:

“... such periods (in this Act referred to as “prescribed accounting periods”) at such time and in such manner as may be determined by or under regulations and regulations.”
26. He argues that someone who is not a taxable person does not have any prescribed accounting periods. If, therefore, that phrase is given its ordinary and natural meaning, section 73 can only apply to VAT incurred by a person when acting as a taxable person. A public body, acting as such, is by definition not a taxable person. Section 73(2) cannot therefore apply to refunds of COS VAT.
27. I do not accept this argument. First, the Trust (like most, if not all all, public sector bodies) does in fact make supplies which fall within the scope of VAT. But in any event it is also required to be registered in order to take advantage of the refund scheme. It is therefore a taxable person. In my judgment the distinction that Mr Southern seeks to draw between the same body being a taxable person for some activities but not for others, is an artificial reading of section 73 when seen in the context of section 41. Nor does it accord with the statutory definition of a taxable person in section 3 (1).
28. Second, in accordance with requirements that were within HMRC’s power to make, a claim for a refund of COS VAT must be made on the same form as the ordinary VAT return, which must, itself, be made by reference to prescribed accounting periods. So the power to claim a refund is inextricably linked to the obligation to make returns by reference to prescribed accounting periods, which the Trust in fact does. Moreover, if they were not registered for VAT they could not in practice claim the refunds. Indeed it was common ground that all those bodies who make claims for refunds of VAT under section 41 are registered for VAT. So it makes administrative sense for the requirements to be linked to their existing obligations to make VAT returns by reference to prescribed accounting periods.
29. Third, the obvious purpose of the reference to prescribed accounting periods is lay down the administrative machinery for claiming refunds; and also to trigger the running of time under section 73 (6) which limits HMRC’s power to make retrospective assessments. As Mr Southern himself pointed out in his skeleton argument, both the Treasury Direction and HMRC’s requirements are administrative directions. Fourth, it

is not correct that public sector bodies are “scoped out” of VAT as Mr Southern argues. They are outside the European framework for VAT; but they are firmly within the domestic framework. At least for the purpose of properly participating in the refund scheme, they are taxable persons. The domestic framework for VAT is simply the legislative vehicle that Parliament has chosen in order to relieve public sector bodies of the burden of paying VAT which they could recover under the ordinary VAT regime. As Schiemann LJ said in *Cardiff*, the legislature could have chosen a different legislative vehicle for that purpose. Fifth, the interpretation for which Mr Southern contends would, in my judgment, undermine the policy underlying both the scheme for refunding COS VAT and the policy of ensuring that a public sector body does not retain more than its fair share of public funds. Sixth, Mr Southern’s argument would mean that the procedural mechanics of reclaiming a refund of VAT wrongly paid triumph over the substance of the right to recover public money which should not have left the consolidated fund.

30. Nearly a century ago Viscount Haldane said in *Auckland Harbour Board v R* [1924] AC 318, 326:

“... it has been a principle of the British Constitution now for more than two centuries ... that no money can be taken out of the consolidated Fund into which the revenues of the State have been paid, excepting under a distinct authorization from Parliament itself. The days are long gone by in which the Crown, or its servants, apart from Parliament, could give such an authorization or ratify an improper payment. Any payment out of the consolidated fund made without Parliamentary authority is simply illegal and ultra vires, and may be recovered by the Government if it can, as here, be traced.”

31. Section 73 of VATA is, in part, designed to avoid HMRC (or perhaps the Attorney General) from having to resort to the more cumbersome procedure that Viscount Haldane described.
32. For these reasons, which are in substance the reasons given by the Upper Tribunal, I would dismiss the appeal.

Lady Justice Asplin:

33. I agree.

Sir Timothy Lloyd:

34. I also agree.