R (on the application of BMW AG and another) v Revenue and Customs Commissioners

[2009] EWCA Civ 77

COURT OF APPEAL, CIVIL DIVISION

PILL, LLOYD AND MOSES LJJ

17 DECEMBER 2008, 18 FEBRUARY 2009

Value added tax – Return – Length of accounting period – Power to give permission or make directions in relation to length of accounting periods – Motor vehicle exporter supplied by associated company – Supplier accounting for value added tax on quarterly basis – Exporter accounting for value added tax on monthly basis – Revenue and Customs directing exporter to make quarterly returns so as to align accounting period with that of associated company – Whether policy underlying direction irrational and unfair – Whether decision-making process by which policy was applied flawed – Value Added Tax Regulations 1995, SI 1995/2518, reg 25 – EC Council Directive 77/388, art 22(4).

The claimants, BMW AG and BMW UK, were members of the same corporate group, and were associated companies. BMW UK was part of a United Kingdom value added tax ('VAT') group which accounted for VAT quarterly; BMW AG was not part of that group and originally accounted for VAT quarterly. BMW AG acquired all the vehicles manufactured by BMW UK and exported most of them. As most of the vehicles were exported, BMW AG's input tax exceeded its output tax: it was a repayment trader. It suffered a cash-flow disadvantage because it was obliged to pay its suppliers (thus incurring input tax) before it received repayment from Revenue and Customs. From December 2002, BMG AG was permitted by Revenue and Customs to account for VAT on a monthly basis to alleviate the burden of its cash-flow disadvantage. However, from June 2006, Revenue and Customs, pursuant to powers conferred by art 22(4) of EC Council Directive 77/388 ('the Sixth Directive') and reg 25[a] of the Value Added Tax Regulations 1995, SI 1995/2518, directed BMW AG to make quarterly returns in order to ensure that the accounting periods of BMW UK and BMW AG were aligned. The direction was made pursuant to Revenue and Customs' policy of aligning accounting periods of associated businesses where there was little or no commercial rationale for such businesses to stagger their accounting periods other than to obtain a cash-flow advantage at the expense of the revenue. BMW AG applied for permission to seek judicial review of the direction contending that Revenue and Customs had no power to revoke the permission to make monthly returns and replace that permission with a direction to make quarterly returns, and that the policy pursuant to which the direction was made was irrational and discriminatory. The judge refused BMW AG permission to challenge the direction on the grounds of lack of vires, and although he granted permission on the other grounds, concluded that Revenue and Customs' policy was

a Regulation 25, so far as material, is set out at para 19, below.

neither irrational nor unfair. However, he quashed the decision directing BMW AG to make monthly returns on the basis that the decision-making process by which the policy was applied was flawed for two reasons: first, Revenue and Customs had not considered a comparison between the existing arrangements between BMW UK and BMW AG and the situation as it would have been if BMW UK were the exporter of its own cars; and, secondly, Revenue and Customs had not considered the effect of the decision in relation to BMW AG's purchase from third-party suppliers in the United Kingdom. Revenue and Customs appealed.

Held – (1) Revenue and Customs were conferred the power the give permission or to make directions as to whether a trader should account quarterly or monthly, and it was for Revenue and Customs, not the court, to decide how best they might ameliorate the cash-flow disadvantage the revenue suffered. The opportunity for a corporate group to exercise control over the essential ingredients for ensuring a cash-flow advantage to both purchaser and supplier within the group, and for the group to retain the input tax until the supplier accounted for output tax were benefits not available to non-associated traders. That advantage entitled Revenue and Customs to distinguish between associated and non-associated companies to alleviate the cash-flow disadvantage to the revenue, and there was no legal principle precluding such a view. Revenue and Customs were entitled to identify a distinction between associated and non-associated traders and to treat them differently. The policy adopted by Revenue and Customs was neither unlawful nor irrational (see [44]–[48], below).

(2) The comparison between the cash-flow advantage obtained by both exporter and manufacturer by reason of a mismatch in their accounting periods and the cash-flow advantage available to the manufacturer were it to export directly did not meet Revenue and Customs' concerns and their justification for requiring alignment. No question of mismatch or alignment would arise in the case of a single trader who both manufactured and exported its products. Once it was accepted that the advantages of association, derived from unaligned accounting periods, justified the policy to require alignment, it was inconsistent to condemn the application of that policy by reference to circumstances in which no question of alignment arose. Revenue and Customs were not required to consider the hypothetical situation which had not been advanced prior to the making of the decision. The justification of the policy depended on comparison of circumstances of non-associated traders who could not secure a systematic cash-flow advantage to those of associated traders who had the power to ensure such a disadvantage (see [50]–[52], below).

(3) Revenue and Customs were under no obligation to consider the effect of moving BMW AG to quarterly returns in relation to supplies from non-associated suppliers. It was for the decision-maker, not the court, to decide on the manner and intensity of inquiry to be undertaken into any factor which the decision-maker accepted to be relevant. There was no basis for quashing the decision on that ground unless the judge concluded that no reasonable decision-maker could have decided not to investigate the effect of the direction in relation to supplies from non-associated businesses within the United Kingdom. Input tax arising from third-party supplies was only incurred to a very small extent and formed no part of the only relevant concern. Thus, there

was no basis for concluding that Revenue and Customs had erred as a matter of law in failing to consider the point when the facts demonstrated that there was no point to consider (see [57] and [59], below).

(4) There was nothing in the 1995 Regulations that denied Revenue and Customs the power to alter or revoke any permission or direction previously given. To deny such a power undermined the very purpose for which it was conferred, namely to assist in the management of the tax under the Value Added Tax Act 1994 (see [63], below).

The Revenue and Customs' appeal would, accordingly, be allowed.

Notes

For the periods for which value added tax returns are made, see De Voil Indirect Tax Service V5.102.

For the Value Added Tax Regulations 1995, SI 1995/2518, reg 25, see the Orange Tax Handbook 2008–09 p 740.

For EC Council Directive 77/388, art 22(4), see the Orange Tax Handbook 2008–09 p 1022.

Cases referred to in judgments

Associated Provincial Picture Houses Ltd v Wednesbury Corpn [1948] 1 KB 223, [1947] 2 All ER 680, CA.

IRC v National Federation of Self-Employed and Small Businesses Ltd [1981] STC 260, [1982] AC 617, [1981] 2 All ER 93, 55 TC 133, HL.

Marks & Spencer plc v Revenue and Customs Comrs (Case C-309/06) [2008] STC 1408, [2008] ECR I-2283, [2008] 2 CMLR 1145, ECJ.

R v IRC, ex p Unilever plc [1996] STC 681, 68 TC 205, CA.

R (*on the application of Khatun*) *v Newham London BC* [2004] EWCA Civ 55, [2005] QB 37.

Appeal and application for permission to appeal

The Revenue and Customs Commissioners appealed with permission of Mummery LJ, granted on 23 June 2008, against a judgment of Tugendhat J dated 9 May 2008 ([2008] EWHC 712 (Admin), [2008] STC 3090) quashing a decision of the Revenue and Customs directing the first claimant, BMW AG, to make monthly returns on the basis that the decision-making process by which the policy, pursuant to which the decision had been made, was applied was flawed. BMW AG appealed against the decision of the judge refusing its application for permission to challenge the Revenue and Customs' decision on the grounds that they had no power to revoke the permission to account monthly and that the policy was irrational and discriminatory. The second claimant was BMW UK Manufacturing Ltd. The facts are set out in the judgment of Moses LJ.

Nigel Pleming QC and *Philip Woolfe* (instructed by the *Solicitor for Revenue and Customs*) for the Revenue and Customs.

Jonathan Peacock QC and *Francis Fitzpatrick* (instructed by *Dorsey & Whitney* (*Europe*) *LLP*) for BMW AG.

Cur adv vult

18 February 2009. The following judgments were delivered.

MOSES LJ (giving the first judgment at the invitation of Pill LJ).

INTRODUCTION

[**1**] The system by which value added tax ('VAT') registered traders account for VAT may give rise to cash-flow benefits to traders at the expense of the Exchequer. This appeal by Her Majesty's Revenue and Customs ('HMRC') relates to a decision by which it sought to ameliorate what it perceived to be a cash-flow disadvantage to the Exchequer.

[**2**] A VAT registered trader accounts for VAT on its taxable supplies (output tax). It is entitled to reclaim VAT incurred for the purposes of making those taxable supplies (input tax). Such traders make VAT returns and account for VAT normally on the basis of an accounting period of three months. Those accounts show the amount of VAT payable by the trader to HMRC or by HMRC to the trader. Input tax is offset against output tax. If the output tax exceeds the input tax then the trader must make a payment of VAT; if he normally makes net payments of VAT he is known as a 'payment trader'. If input tax exceeds output tax the trader is entitled to a net repayment of VAT from HMRC. If that is the normal situation he is known as a 'repayment trader.'

[**3**] It will, generally, be in the interests of a repayment trader to recover input tax as soon as possible. To assist repayment traders to achieve early recovery, HMRC has power either to allow or to direct such a trader to account for VAT on the basis of monthly accounting periods. It is the exercise of that power which is at the heart of this appeal.

[**4**] The source of the dispute is the cash-flow effect of this VAT system. If a payment trader receives payment from a purchaser before it is required to account for output tax then it will obtain a cash-flow advantage. It will have the use of the output tax up to the time when it must pay VAT to HMRC. But if the payment trader does not receive payment for a supply until after it is required to account for output tax to HMRC in respect of that supply it will suffer a cash-flow disadvantage.

[**5**] The cash-flow effects of the VAT accounting system in respect of a repayment trader mirror those of a payment trader. If a repayment trader recovers input tax from HMRC before it is required to pay for that supply the repayment trader receives a benefit. Conversely, it suffers a disadvantage if it is required to pay its supplier before it can recover input tax in respect of that supply from HMRC.

[**6**] In short, the cash-flow effects of the VAT accounting system are determined by the relationship between the date on which payment is made in respect of a particular supply and the date on which a return is submitted in respect of that supply. Every benefit to a payment trader or a repayment trader is matched by a corresponding burden to the fisc. To some extent that disadvantage is reduced by a payments on account ('POA') scheme by which traders with a large annual VAT liability are required to make interim payments on account of VAT liability for each quarter at the end of the second and third months. The POA scheme is irrelevant to this appeal. The balance of VAT for an accounting period, with the return for that period, is due one month after the end of the accounting period.

[**7**] Repayment traders suffer a cash-flow disadvantage because they are obliged to pay their suppliers before they receive repayment from HMRC may reduce that disadvantage if HMRC permits them to account for VAT on a monthly basis. As I have indicated, the power to allow a repayment trader to

account for VAT on a monthly basis is central to this appeal. A trader permitted to account for VAT monthly must file its return within one month of the end of the accounting period including any claim for repayment. The input tax must, to put it generally, be repaid within 30 days, if HMRC is to avoid liability to make an additional interest payment, 'repayment supplement'. The burden upon the Exchequer arises because in cases where HMRC repays VAT it will generally be required to do so before receiving output tax in respect of the supply on which input tax was charged and recovered.

[**8**] BMW AG, the respondent to the appeal, is a repayment trader. It purchases cars from the manufacturer BMW UK Manufacturing Ltd ('UKM'). Both BMW UKM and BMW AG are members of the BMW corporate group. They are described as 'associated' companies. BMW AG exports most of the cars it purchases from BMW UKM to places outside the United Kingdom. Such supplies are zero-rated and give rise to a right to recover input tax from HMRC with no obligation to account for output tax. BMW UKM is part of a UK VAT group which accounts for VAT quarterly. But BMW AG is separately registered for VAT. It could not be a member of the UK VAT group since it had no place of business in the United Kingdom. From 1 December 2002 BMW AG was permitted by HMRC to adopt monthly accounting periods. But on 22 June 2006 HMRC directed BMW AG to make returns in respect of the same three-month period as the VAT group of which BMW UKM was a member. HMRC would no longer permit BMW AG to make monthly VAT returns although it was open to a request to permit the BMW UK VAT group to make monthly returns. HMRC's central concern was to ensure that the returns of the VAT group of which BMW UKM was a member and of BMW AG were aligned.

[**9**] HMRC's decision to require BMW AG to align its accounting period with that of BMW UKM was made pursuant to a policy of HMRC, which originated in explanatory note to cl 30 of the Finance Bill 1972, the Bill which introduced VAT, and which was developed and refined in a *Business Brief 12/05* dated 15 June 2005.

[**10**] BMW AG challenged the decision of HMRC dated 22 June 2006, contending that HMRC had no power to withdraw the permission to account monthly, and that the policy was irrational and discriminatory.

[**11**] Tugendhat J in his decision dated 9 May 2008 (see [2008] EWHC 712 (Admin), [2008] STC 3090) refused BMW AG permission to challenge the decision on the grounds of lack of vires. BMW AG seeks to appeal against that refusal.

[**12**] Tugendhat J also concluded that HMRC's policy pursuant to which it made its direction dated 22 June 2006 was rational and lawful. But he quashed the decision to direct BMW AG to make a monthly return on the basis that the decision-making process by which the policy was applied was flawed in two respects:

(i) HMRC had failed to consider the effect the decision would have on BMW AG's ability promptly to recover input tax incurred on transactions with non-associated parties; and

(ii) it had failed to consider whether the export through BMW AG resulted in a significant cash-flow advantage for the BMW group which it would not have obtained if BMW UKM was itself both manufacturer and exporter.

[**13**] Although it will be necessary to consider BMW AG's challenge to the vires of HMRC to make the impugned decision and the particular grounds upon which the decision was quashed by the judge, the central issue in this appeal is whether the policy pursuant to which the decision was made was rational and lawful. The essential feature of that policy was the distinction HMRC sought to make between associated and non-associated repayment and payment traders.

[**14**] I shall deal first with the issues relating to policy, which include the second ground upon which the judge quashed the decision. I shall then consider the discrete issues of third-party supplies and the power to revoke permission to account monthly.

THE FACTS

[**15**] BMW AG is a German incorporated company. With effect from 1 March 2000 it was registered for VAT in the UK and, originally, accounted for VAT quarterly. It acquired all of the vehicles manufactured by BMW UKM, a member of the same corporate group. It sold those vehicles either on the UK market or for export. As I have said, BMW AG was separately registered. The UK VAT group was a payment trader accounting for VAT quarterly. On 25 October 2002 BMW AG requested that it be placed on monthly VAT returns since, because of its export business, its input tax exceeded its output tax: it was a repayment trader. On 14 November 2002 HMRC approved that application.

[**16**] It is important to record that there were valid commercial reasons, which had nothing to do with VAT, for the existence of BMW AG as an exporting company separate from the manufacturer BMW UKM. HMRC has accepted throughout the validity of the commercial reasons for the separate existence of BMW AG. BMW AG paid BMW UKM on the 15th day of the month following that in which an invoice was raised for the cars. There has never been any suggestion that there was anything other than a good commercial reason for the supplies to be timed as they were. The supplies were not overvalued.

[**17**] The judge recorded detailed findings as to the process leading to the decision impugned dated 22 June 2006. For the purposes of this appeal it is the policy pursuant to which the decision was made rather than the process which is of most importance. It is sufficient to record that BMW AG argued, during the course of the dispute leading to the decision, that it was inequitable to refuse permission to account monthly to an exporter which sourced its products from an associated company but afford such permission to an exporter which sourced its products from unconnected third parties. At a meeting on 13 January 2006 BMW suggested that HMRC's proposal to direct BMW AG to make the same quarterly returns as the VAT group was discrimination against associated companies.

[**18**] HMRC remained unpersuaded and relied upon its policy, set out in *Business Brief 12/05*, which it said restated existing policy. It recalled that it had been giving more attention to what it described as 'cash-flow cases' 'because we have become increasingly aware of the considerable amounts involved'. It concluded:

> '*Direction of BMW AG onto a Quarterly Stagger*
>
> The Commissioners remain of the view that BMW AG having a monthly VAT stagger does give a significant cash flow advantage and that there is no commercial rationale for having the monthly VAT stagger other than to obtain this cash flow advantage.

> I therefore wish to formally advise you that the Commissioners will now take action to remove this cash flow advantage by aligning the VAT accounting periods for BMW AG and BMW UK (the UK VAT group) and I hereby DIRECT under Regulation 25(i)(a) VAT Regulations 1995, that BMW AG will no longer be allowed to make returns in respect of periods of one month and instead will be placed on standard quarterly tax returns with accounting periods ending on 31 January, 30 April, 31 July and 31 October.'

The direction was stated to be prospective with effect from 1 August 2006.

STATUTORY PROVISIONS

[**19**] Pursuant to art 22(4) of EC Council Directive 77/388 of 17 May 1977 on the harmonisation of the laws of the member states relating to turnover taxes—common system of value added tax: uniform basis of assessment ('the Sixth Council Directive') (now 252 of the EC Council Directive of 28 November 2006 on the common system of value added tax 2006/112 ('the Principal VAT Directive')), a broad power is conferred on member states to fix tax periods of a month, two months or a quarter. By s 25(1) of the Value Added Tax Act 1994 ('the 1994 Act') a taxable person is required in respect of supplies made by him to account for and pay VAT by reference to prescribed accounting periods at such time and in such manner as determined under regulations. The relevant regulations are the Value Added Tax Regulations 1995, SI 1995/2518 ('the 1995 Regulations'). By reg 25:

> '(1) Every person who is registered … shall, in respect of … every period of 3 months ending on the dates notified either in the certificate of registration issued to him or otherwise, not later than the last day of the month next following the end of the period to which it relates, make to the Controller a return … showing the amount of VAT payable by or to him … provided that—
>
> > (a) the Commissioners may allow or direct a person to make returns in respect of periods of one month and to make those returns within one month of the periods to which they relate …
> >
> > (c) where the Commissioners consider it necessary in any particular case to vary the length of any period or the date on which any period begins or ends or by which any return shall be made, they may allow or direct any person to make returns accordingly, whether or not the period so varied has ended …'

THE POLICY

[**20**] The policy pursuant to which the direction was made originated with the explanatory note to cl 30 of the Finance Bill 1972. That explanatory note explained that the purpose of permitting monthly as opposed to quarterly accounting periods was to alleviate the potential burden of a cash-flow disadvantage for repayment traders. The explanatory note stated:

> '4. Traders whose outputs consist wholly or mainly of zero-rated supplies of goods or services (e g exporters and food producers) will normally claim a net repayment of tax at the end of each accounting period. If they were able to claim a repayment only once every three months, they could experience some difficulty in financing the temporary tax burden. To overcome this problem as far as possible, regular repayment traders … will be permitted to lodge their claims once a month …'

[**21**] The first mention of a distinction to be drawn in relation to associated businesses was contained in the policy set out in a 2004 *VAT Manual* which at section VI-24A was headed 'Stagger Manipulation and the Alignment of Accounting Periods between Associated Businesses'. Paragraph 4.2 stated:

> 'Our policy is that staggers be aligned if there is a consistent pattern of supplies between associated businesses, timed so that there is a VAT cash flow advantage to the business with little or no apparent commercial reason for the supplies to be timed as they are. We are particularly concerned about high value cases, especially where there is a suspicion that supplies are overvalued.'

[**22**] HMRC's *Business Brief* dated 15 June 2005 set out the policy which HMRC purported to apply in making its decision dated 22 June 2006. It stated that HMRC (see para 3):

> '3. … continue to be concerned about situations in which businesses "stagger" their VAT accounting periods in order to gain an unjustified and unintended cash flow benefit at the expense of the revenue …
>
> HM Revenue & Customs intend to continue to exercise [their power to allow VAT periods between associated businesses] where there is little or no commercial rationale for the VAT period "stagger" between the associated businesses besides obtaining the cashflow advantage. They may do so, notwithstanding that the usual policy for businesses expecting to make regular claims for repayment of VAT in other factual situations is to allow monthly returns.'

[**23**] The policy was explained further during the course of the correspondence leading to the adverse decision of 22 June 2006. HMRC complained that:

> '… when transactions are routed through associated businesses on different staggers, and input tax is claimed by the associated business before the main business pays the output tax on the transaction, the accumulative effect of these schemes is that the government consistently receives a substantial amount of tax later than it would do otherwise. In effect, it provides to the business an interest-free loan of the VAT involved at the expense of the Exchequer.
>
> Of course, businesses are entitled to structure themselves as they choose and we are not objecting to them routing transactions via associated businesses if that is what they wish to do. We do, however, reserve the right to put both businesses on the same VAT return period ends, if they do not have a reason for the differing period ends other than to generate a VAT cash flow advantage.' (Letter dated 2 November 2005.)

Later HMRC asserted:

> 'We are tackling what we believe are essentially artificial arrangements which have little or no commercial rationale. The "normal" cash flow benefit that is inherent in monthly repayment returns is a long-established feature of the tax, which we have no wish to disturb.' (Letter dated 8 March 2006.)

[**24**] Thus, the justification for the distinction drawn between associated and non-associated traders appears to be that to permit monthly accounting to a repayment trader associated with its supplier brings an 'unjustified and unintended benefit' at the expense of the Exchequer.

[**25**] Before considering the rationale for the distinction drawn by HMRC, I should express my concern that, from time-to-time, HMRC has been guilty of some opacity in explaining its reasons, particularly in referring to 'manipulation' in circumstances in which innocent commercial arrangements have been made. As I have already emphasised, none of the arrangements in relation to supply, invoicing or payment were made for other than good commercial reasons. 'Manipulation', as used by HMRC, appears to refer to the unaligned accounting periods chosen by the UK VAT group and BMW AG for the obvious reason that it was in BMW AG's interests as a repayment trader to recover input tax as soon as possible whereas it was in BMW UKM's interests as a payment trader to postpone payment of output tax for as long as possible. To describe that in pejorative terms as 'manipulation' diverts attention from the justification now advanced.

The rationality of the policy

[**26**] The judge concluded that the policy pursuant to which the decision was made was neither irrational nor unfair. Nor, he concluded, was it inconsistent with EU law.

[**27**] In admirably lucid and attractive arguments Mr Peacock QC concentrated his attack on the policy. HMRC's concern is to avoid the cash-flow disadvantage it suffers in circumstances in which it is compelled to repay input tax to a repayment trader which accounts monthly before it receives output tax in respect of the same supply from a payment trader who accounts quarterly.

[**28**] BMW AG's challenge to the policy rests on two propositions. Firstly, the cash-flow disadvantage suffered by the Exchequer is exactly the same whether the repayment trader, permitted to account monthly, pays input tax in respect of a supply from an associated payment trader or from a non-associated payment trader. The delay suffered by the Exchequer between repayment of input tax and receipt of output tax is no greater whether the purchaser is associated with the supplier or not.

[**29**] This point can be made good by considering the unaligned accounting periods of two non-associated traders. When accounting for VAT on different dates, both non-associated payment and repayment traders may obtain a cash-flow advantage in respect of a particular supply. If the sequence is, firstly, HMRC repays input tax to the purchaser, secondly, the purchaser pays the price under the contract to the supplier and then the supplier accounts for output tax, both purchaser and supplier obtain a cash-flow advantage and the Exchequer suffers a corresponding disadvantage. The cash-flow advantage to both traders and the disadvantage to the Exchequer, arising from the circumstances of that particular supply, are no greater whether the repayment trader is associated with its supplier or not.

[**30**] Based on that proposition, Mr Peacock contends that BMW AG's monthly accounts give rise to a normal cash-flow benefit, which HMRC had said it had no wish to disturb (letter of 8 March 2006 cited at [23]). The interest-free loan at the expense of the Exchequer, of which HMRC complains, is exactly the same whether the repayment trader is associated with its supplier or not.

[**31**] The second proposition on which the challenge is founded is that the same temporary tax burden is suffered by an associated repayment trader, if required to account quarterly, as by one who is not. As Mr Peacock QC pointed out, the repayment trader in the same corporate group as its supplier may well

need finance to bridge the delay between payment for the supply and repayment of input tax in the same way as a repayment trader which is not a member of a corporate group. If any member of the group had to make loans to the repayment trader to finance the delay between payment for supply and repayment of input tax, it must do so on arm's length terms. Transfer pricing rules contained in Sch 28AA to the Income and Corporation Taxes Act 1988 as amended in 2004, may impose direct tax charges where arrangements between associated companies, including those relating to payment of interest, are not on arm's length terms. When an associated repayment trader suffers a cash-flow disadvantage the burden which permission to account monthly is designed to relieve is no different from that suffered by a non-associated trader.

[**32**] HMRC's objection rests upon the fact that the mismatch of accounting periods between BMW AG and BMW UKM is used to ensure that the corporate group as a whole obtains a systematic cash-flow advantage. The group ensures that where a supply is made from one group member to another, the purchaser recovers input tax before it pays the associated supplier and before that supplier is required to account for output tax in respect of the same supply. That ability to secure and maintain a systematic cash-flow advantage to both purchaser and supplier, in HMRC's view, is a benefit which is not available to non-associated companies. It is a benefit which HMRC is not willing to permit at the expense of a systematic cash-flow disadvantage to the Exchequer.

[**33**] As I have endeavoured to explain, the cash-flow effect of the VAT system depends on the relationship between the date on which payment of the contract price is made and the date on which a return is submitted in respect of that supply. HMRC takes the view that the controlling mind, often located within the finance or tax department, of a corporate group, will have a direct interest in the relative dates on which the supplier and recipient members of that group account for VAT; it may also have the means of exercising control over the relationship between those dates when applying for or adjusting their respective accounting periods or 'staggers.'

[**34**] Moreover, the dates for payment may be adjusted so as to suit the overall interests of the group. By setting the terms of payment, the controlling mind may allocate where the benefit of a cash-flow advantage or the burden of disadvantage should fall.

[**35**] Rosemary Turner, an officer of HMRC's Anti-Avoidance Group, explains HMRC's concern:

> '… the operation of the VAT accounting system will mean that HMRC will suffer a cash flow disadvantage in respect of some supplies, but gain a cash flow advantage in respect of other supplies. Where parties deal at arm's length, it is to be expected, globally, the cash flow advantages and disadvantages for HMRC will broadly balance out. Any imbalance arising from parties dealing at arm's length will usually be part of the normal operation of the VAT system.
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> However, where the parties are not dealing at arm's length, they may time their supplies or their VAT period ends such that they consistently obtain a cash flow advantage, that advantage always coming at the expense of the Exchequer.' (See paras 20 and 21, statement dated 23 February 2007.)

[**36**] Contrast the position of non-associated traders. Non-associated traders have no control over the dates on which the third party with whom they trade

accounts for VAT. The repayment trader will seek to make payment in respect of a supply as late as possible in the hope that it will receive credit for input tax before it is required to make payment to its supplier and thus obtain a cash-flow advantage. The commercial interests of the supplier are different. It will seek to receive payment from the recipient as soon as possible before it is required to account for output tax on that supply and thus obtain a cash-flow advantage. The interests of the two conflict and are beyond the control of either.

[**37**] Nor does a non-associated trader have any interest in the relationship between the date on which it must account for VAT and the date on which its third party supplier or purchaser accounts for VAT. It has no interest in whether any cash-flow advantage accrues to the person with whom it is trading. Its own cash-flow advantage or disadvantage will depend on the date on which payment of the contract price is agreed as due. Further, if, as is likely, business is conducted with a number of non-associated traders it will rarely be possible for it to set its VAT accounting periods so as to obtain a consistent cash-flow advantage overall.

[**38**] As I have already recalled, even when the supplier and purchaser are not associated, both may obtain a cash-flow advantage (see at [29]). But HMRC's essential justification lies in the fact that that cannot be assured. Non-associated traders do not have the power to control the accounting period of the trader with whom they are dealing. A corporate group does.

[**39**] Associated traders secure a further benefit. When a non-associated purchaser pays input tax to its third party supplier it loses the use of that money. In the case of supplier and recipient within the same corporate group, no money leaves that group until the output tax is paid by the supplier. (See para 10, statement of Turner.)

[**40**] The benefits of ensuring a cash-flow advantage to both purchaser and supplier within a corporate group were demonstrated by the cash-flow advantage to the BMW group in the instant case. The BMW group derived a substantial cash-flow advantage in every single quarter in which BMW AG and BMW UKM's accounting periods were not aligned. Mr Hulin, who made the decision, asserts that the BMW group received a payment of approximately £30m, which it held for about two months before repaying it. It also received another payment of approximately £30m from the Exchequer which it held for around one month before repayment.

[**41**] HMRC took the view that the two-fold benefits of securing and maintaining a cash-flow advantage to both BMW AG and BMW UKM, and of retaining input tax paid by BMW AG within the group, should not be permitted when they cause a systematic disadvantage to the Exchequer. HMRC seeks to alleviate that disadvantage by requiring the accounting periods of the companies to be aligned.

[**42**] Mr Peacock challenges HMRC's reliance on the apparent benefits of association by reference to its failure to explain what is meant by association. No definition has ever been promulgated. Nor has any investigation been undertaken as to the shareholding in the respective companies. He points out that HMRC does not believe it necessary to evaluate the cash-flow advantage to the group by reference to shareholders, or indeed the extent to which the associated companies are under common ownership. It has never investigated or produced evidence of the relationship between BMW AG and BMW UKM, although the court was told, at the Bar, that BMW UKM was the 100% subsidiary, indirectly, of BMW AG. If, contends Mr Peacock QC, HMRC are

indifferent as to the precise nature of the benefit they are in no position to conclude that the detriment to BMW AG by requiring it to account quarterly is offset by the benefits to the group.

[**43**] In my judgment, BMW AG's challenge fails to acknowledge the extent of the power conferred upon the commissioners, by art 252 of the Principal VAT Directive and by reg 25 of the 1995 Regulations, in relation to decisions as to accounting periods. Since 1982 taxpayers have sought, usually without success, to clothe themselves with the wool of a sacrificial lamb. The obligation, identified by Lord Scarman (in *IRC v National Federation of Self-Employed and Small Businesses Ltd* [1981] STC 260 at 279, [1982] AC 617 at 651), not to discriminate between one group of taxpayers and another, without justification in the interests of good fiscal management, has been recognised in the Court of Justice of the European Communities. The general principle that equal treatment requires that similar situations are not treated differently unless differentiation is objectively justified applies in the exercise of the powers of tax management (see recently *Marks & Spencer plc v Revenue and Customs Comrs* (Case C-309/06) [2008] STC 1408, [2008] ECR I-2283, paras 49–51 of the judgment). But whilst the taxpayer has been successful in establishing what Simon Brown LJ described as outrageous unfairness (in *R v IRC, ex p Unilever plc* [1996] STC 681, 68 TC 205) in particular cases, the task is more Herculean when the challenge is to a policy pursuant to which it is proposed to exercise powers of tax management.

[**44**] Since the directive and Regulations which confer the power on HMRC to give permission or to make directions as to whether the trader should account quarterly or monthly provide no 'lexicon for the matters to be treated as relevant by the decision-maker' (see *R (on the application of Khatun) v Newham London BC* [2004] EWCA Civ 55 at [35], [2005] QB 37 at [35]), it is for HMRC and not for the court to decide how best it may ameliorate the cash-flow disadvantage it suffers. It alone is entitled to conclude which factors are relevant in order to achieve that objective, subject only to *Wednesbury* review (see *Associated Provincial Picture Houses Ltd v Wednesbury Corpn* [1947] 2 All ER 680, [1948] 1 KB 223).

[**45**] The opportunity for a group to exercise control over the essential ingredients for ensuring a cash-flow advantage both for the purchaser and supplier within the group, and for the group to retain the input tax until the supplier accounts for output tax were benefits not available to non-associated traders. That advantage entitled HMRC to distinguish between associated and non-associated companies to alleviate the cash-flow disadvantage to the Exchequer.

[**46**] I accept that in any case where both repayment and payment trader achieve a cash-flow benefit (as described at [28]–[29]) the disadvantage to the Exchequer will be the same as if both were associated. I also accept that when HMRC requires the accounting periods of associated traders to be aligned, it will not be possible for both to achieve a cash-flow advantage. But no statutory restriction or legal principle requires HMRC to maintain a systematic and unceasing cash-flow advantage for the benefit of associated payment traders and of repayment traders. Rather, the distinction HMRC drew between the two categories of traders provided an opportunity for it to reduce the disadvantage to the Exchequer. I can detect no legal principle precluding such a view.

[**47**] Mr Peacock QC supported his challenge by reference to the general principle of equal treatment which applies, in Community law, with equal

force to VAT-registered traders. But if I am right that HMRC was entitled to identify a distinction between associated and non-associated traders then their circumstances were not alike and HMRC was entitled to treat them differently. Mr Peacock QC accepted that in invoking Community law he was advancing an argument which depended on acceptance of those which he had previously advanced.

[**48**] I agree with Tugendhat J that the policy adopted by HMRC was neither unlawful nor irrational.

THE JUDGMENT OF TUGENDHAT J

[**49**] As I have already recorded, the judge quashed HMRC's direction on two grounds (see at [12]). The second ground related to the application of the policy which he had accepted was not irrational (see [2008] STC 3090 at [76]). I shall deal with that ground first. The judge correctly described this basis for challenge as a new point. It was advanced by Mr Wharton in a second witness statement on 8 June 2007, nearly one year after the decision. The new point was described by the judge as follows (see at [91]):

> '[91] … Neither the applicant companies nor HMRC had previously considered whether a benefit from mismatched staggers might be justified by comparing that benefit with the benefit the manufacturing companies might have enjoyed making the exports directly themselves (and so becoming repayment traders), instead of routing the cars through export companies.'

The judge's conclusion was that the decision-making process was flawed because HMRC had failed to consider a comparison between the existing arrangements between BMW UKM and BMW AG and the situation as it would be if BMW UKM was the exporter of its own cars. He said (at [99]):

> '[99] If the calculation made by Mr Wharton in his second witness statement is correct (and it is not contradicted) it appears that there may be little cash-flow benefit accruing to the BMW group at the expense of the Revenue by the existing arrangements between UKM and AG, compared with the situation as it would be if UKM was the exporter of its own cars. On Mr Wharton's calculation it appears that, if the accounting periods were aligned, then the Revenue would be better off than it would be if UKM were a direct exporter. In other words, the commercial considerations which make it appropriate for exports to be routed through AG, would (if HMRC's arguments prevail) carry a cost to the BMW group in terms of VAT, and a corresponding benefit to the Revenue. So the policy, seen from that point of view, would produce a benefit for the Revenue from UKM's commercial need to export the cars through AG. Seen from this point of view, the policy as applied by HMRC may not protect the revenue from a disadvantage. The disadvantage arising from the mismatched accounting periods may be no more than the disadvantage that HMRC accept they ought to suffer if the exports were made by UKM directly. In other words, the interposition of an associated export company may do no more than shift to the export company a cash-flow benefit substantially equivalent in value to the benefit which the manufacturer would enjoy if it were the direct exporter, with the result that the group as a whole enjoys no new benefit from the arrangement. If the disadvantage which concerns HMRC arises in this way, then in my judgment it is not logical or fair to characterise it as unjustified or unintended.'

He continued (see at [103]–[104]):

> '[103] I have held that the policy is not itself irrational. But in my judgment logic and fairness requires that, in applying the policy in a particular case, there should be some enquiry as to what financial difference, if any, results to the traders (and thus also to HMRC) by the use of the associated export company. It is not logical or fair to apply a policy directed to preventing unjustified and unintended cash flow benefits at the expense of the Revenue under the assumption that the benefit will be unjustified and unintended if there is a mismatch of accounting periods which is not explained by administrative difficulties, and ignoring what the position would be if the trader exported his cars direct.
>
> [104] It may, of course, be that, if the comparison made by Mr Wharton in his second witness statement is investigated, then it could still appear that the benefit to AG is significant, unjustified and unintended. In that case there would be a sound basis for a direction to AG to account monthly. But as matters stand, there has been no such investigation, and the decision-making process was flawed.'

[**50**] The judge's comparison between the cash-flow advantage obtained by both exporter and manufacturer by reason of a mismatch in their VAT accounting periods and the cash-flow advantage available to the manufacturer were it to export directly simply does not meet HMRC's concerns and its justification for requiring alignment. No question of mismatch or alignment arises in the case of a single trader which both manufactures and exports its products. Any cash-flow advantage will depend upon the relationship between the time when it is required to pay for supplies and the time when it submits its accounts. It cannot secure a systematic advantage; it does not retain the benefit of any input tax it pays on supplies, prior to recovery. Accordingly, it makes no sense to seek to compare the mismatch of accounting periods which existed in the present case with a situation where no mismatch can occur. It may be that the judge's attention was diverted to the question of whether a separate exporting company was justified since he said (at [96]):

> '[96] Given that in this case the sole issue raised by HMRC is that exports have been routed through an associated company (and not that there has been any manipulation of dates of supply or payment, or anything else), it seems to me that the comparison made by Mr Wharton in his second statement cannot be dismissed as irrelevant.'

In that paragraph the judge mis-states the issue raised by HMRC. It was not concerned as to routing through an associated company; it was concerned with the mismatch of the accounting periods of the two associated companies.

[**51**] It seems to me that the thrust of the last three sentences of [99] does no more than to return to the proposition that the cash-flow disadvantage imposed on the Treasury by virtue of the association of BMW UKM and BMW AG was no greater than if those two companies were not associated. But once it is accepted, as the judge accepted, that the advantages of association, derived from unaligned accounting periods, justify the policy to require alignment, it was inconsistent to condemn the application of that policy by reference to circumstances in which no question of alignment arises. The judge's decision that the policy was lawful contradicts his conclusion that the existing benefit is simply shifted from one company to another within the corporate group, which does not enjoy any 'new benefit'. The group as a whole does enjoy a

different and distinct benefit. It is that benefit which justifies the policy. There could be no purpose in requiring the suggested comparison to be investigated further (as suggested at [104]), when the only conclusion must be that if the policy was lawful then so was its application.

[**52**] There is a further respect in which, in my view, the judge erred as a matter of principle. HMRC was not required, as a matter of law, to consider the hypothetical situation which had never been advanced, as the judge recorded, prior to the making of the decision. Mr Hulin, as an officer of HMRC, was required to consider the nature of the transactions entered into between BMW UKM, BMW AG and HMRC. He did so when considering whether to exercise the power to direct alignment (para 26 of his statement). He was not required to bring to mind some possible circumstance in which BMW UKM had itself exported the vehicles. The justification for the policy depends upon comparison of the circumstances of non-associated traders who cannot secure a systematic cash-flow advantage with those of associated traders who have the power to ensure such an advantage. But that was the only comparison required. If BMW AG had a legitimate objection either to the policy or to its application by reference to some other comparison then it was incumbent upon it to raise it before the decision was made.

[**53**] It was for HMRC to decide what was relevant and fairly to consider any objections advanced before the decision was made. It was not for HMRC or any of its officers to exercise their imagination as to hypothetical situations which had no application to the case under consideration.

BMW AG's trade with unassociated third parties

[**54**] I turn to the first ground on which the judge quashed the direction. Under his heading '*The decision-making process*' the judge concluded that the decision-maker, Mr Hulin, failed to give any consideration to the effect of moving BMW AG to quarterly returns, 'in so far as its third party business was concerned' (see [2008] STC 3090 at [101] of the judgment). He concluded that that failure meant that the decision-making process was flawed.

[**55**] It is true that Mr Hulin did not give any consideration to the effect of the decision in relation to BMW AG's purchase from third-party suppliers in the UK. BMW AG contended before the judge successfully and persists in contending that, as a matter of law, Mr Hulin was under an obligation to consider the effect of the decision on supplies to BMW AG from non-associated suppliers.

[**56**] The origin of that contention appears to be the policy to consider whether it is proportionate to withdraw permission to make monthly returns when the repayment trader receives significant supplies from third parties. Mr Hulin accepts that that is a feature of the policy which he sought to apply. In such a case, even if some of the supplies of the repayment traders come from an associated business, the effect of a direction to make quarterly returns may be to impose the very difficulty the policy of granting permission to make monthly returns was designed to ameliorate.

[**57**] There are legal and factual objections to this contention. It is for the decision-maker and not for the court, subject to the same limited review, to decide upon the manner and intensity of enquiry to be undertaken into any factor which the decision-maker accepts to be relevant (see again *Khatun* [2005] QB 37 at [35] per Laws LJ). There was no basis for quashing the decision on this

ground unless the judge concluded that no reasonable decision-maker could have decided not to investigate the effect of the direction in relation to supplies from non-associated businesses within the UK.

[**58**] The judge did not identify the error in law of which HMRC was guilty in failing to consider the point. Still less did he conclude that no reasonable decision-maker could have decided not to investigate this point.

[**59**] This is not surprising. There was no factual basis for such a conclusion. On the contrary, neither side gave it any thought either before the decision was made on 22 June 2006 or after until the argument before the judge. On 10 August 2005 Mr Wharton, on behalf of BMW AG, set out the commercial rationale for the arrangements and advanced the argument, to which I have already referred, that it was inequitable to treat an exporter that sources its products from fellow group companies differently from an exporter that sources its products from unconnected third parties. The third paragraph of the letter dated 10 August 2005 read:

> 'As regards the BMW AG … registration, input VAT is derived from supplies made to it from the BMW (UK) Holdings VAT Group and, *to a very small extent,* from third party suppliers in the UK. Accordingly, as far as I am aware, *the only relevant concern* could be as regards the mismatch between the VAT accounting periods of the BMW AG registration and that of the BMW (UK) Holdings VAT Group.' (My emphasis.)

Thus, far from asserting that the issue of input tax arising from third party supplies was a relevant consideration, it was dismissed by BMW itself. Such input tax was only incurred to a very small extent and formed no part of the 'only relevant concern'. Thus, it cannot be said that in making a decision Mr Hulin was required to consider the point when there was no basis for believing it to be a live issue. Indeed it never became a live issue even when BMW filed its statements of facts and grounds in either of Mr Wharton's two affidavits, or in response to Hulin's statement which referred to the policy of considering the effect of third party supplies. Nor was the point even mentioned in BMW AG's skeleton argument. There was no basis for concluding that HMRC erred as a matter of law in failing to consider the point. Moreover, the facts demonstrate that there was no point to consider.

Power to withdraw permission

[**60**] I must deal finally with a separate ground which BMW AG was not permitted to pursue. It appeals against that refusal. BMW AG sought permission to contend that HMRC had no power to revoke the permission to make monthly returns and replace that permission with a direction to make quarterly returns.

[**61**] The application for permission rested on the absence of any express power to revoke the permission in contrast to other provisions to be found both in the 1994 Act (see e g s 43C) and in the 1995 Regulations themselves (see e g regs 25(4G), 54 and 55P and 102(3)).

[**62**] The argument carried with it the acknowledgement that there would be no power to permit a change even when the taxpayer wants it. BMW AG sought to meet any argument as to the impracticality of denying HMRC a power to revoke by asserting a power to make a conditional grant.

[**63**] The short answer to the appeal is that given by the judge. There is nothing in the Regulations which denies to HMRC the power to alter or revoke any permission or direction previously given. To deny such a power

undermines the very purpose for which it was conferred, namely to assist in the management of the tax under the 1994 Act. There can be no sense in conferring a power to alter the default position of quarterly returns in perpetuity. The judge described the limited power for which BMW AG contended as advancing no discernible legislative purpose, but on the contrary, giving rise to serious practical disadvantages (see [2008] STC 3090 at [63]). I agree.

[**64**] For these reasons I would allow HMRC's appeal, dismiss the respondents' application for permission and restore the direction that BMW AG should account quarterly.

LLOYD LJ.

[**65**] I agree.

PILL LJ.

[**66**] I also agree.

Revenue and Customs' appeal allowed. BMW AG's application for permission to appeal refused.

Aaron Turpin Barrister.