

Bond House ~ To know or to have the means of knowing, that is the question

By Melanie Hall QC
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The European Court of Justice delivered its judgment in Bond House on 12 January. The case was concerned with "carousel fraud" concerning chains of supplies of goods involving a missing trader who defaults on the obligation to account for VAT.

The essential question of principle was whether the entitlement of an innocent trader to credit for a payment in respect of VAT is to be judged by reference to the totality of transactions in the chain or whether individual transactions which are not themselves vitiated by fraud must be considered in isolation. The entitlement to a credit ultimately depended upon whether the transactions which were not vitiated by fraud could be classified as supplies of goods or services effected by a taxable person acting as such within the meaning of Articles 2(1), 4 and 5(1) of the Sixth Directive. In finding that if they fulfilled the objective criteria on which the definition of those terms is based they could be so classified, the Court relied upon and reaffirmed three well-established points of principle:

1. The common system of VAT is based upon a uniform definition of taxable transactions
2. The Sixth Directive assigns a very wide scope to VAT, the terms economic activities covering *all* activities of producers, traders and persons supplying services and covering *all* stages of production, distribution and the provision of services. The expression "taxable person acting as such" is equally broad in that output tax encompasses all transactions carried out in the course of a taxable activity.
3. The terms "economic activities", "supply of goods" and "taxable person acting as such" are objective in character in the sense that the transactions are to be considered per se without regard to their purpose, results or the intention of the taxable person.

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Having regard to these three principles, the Court concluded that any attempt to classify individual transactions by reference to the intention of a trader other than the taxable person concerned and/or by reference to the possible fraudulent nature of other prior or subsequent transactions in the chain *of which the taxable person had no knowledge or no means of knowledge* would be contrary to the objectives of the VAT system as reflected in the three principles summarised above. (See paragraph 46 of the judgment). In so finding, the Court rejected the two arguments which lay at the heart of HMRC's case. It dismissed as irrelevant the case law such as C-400/98 *Breitsohl* where the Court had regard to the question whether the declared intention to *begin* an envisaged economic activity was in good faith. This was quite distinct from the intended purpose of the economic activities themselves. The Court also rejected HMRC's argument that unlawful transactions fall outside the scope of VAT on the basis that the mere fact that conduct amounts to an offence is not sufficient to justify exemption from VAT.

In dealing with the entitlement to deduct input tax the Court held that the right to deduct cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by VAT fraud *without the taxable person knowing or having any means of knowing*. (See paragraph 52).

The Court further reiterated the well-established principle that the right to deduct may not in principle be limited and must be exercised immediately adding that the question whether VAT on earlier or subsequent sales has or has not been paid to the public purse is irrelevant to the scope of the right to deduct.

It can therefore be seen that, apart from paragraphs 46 and 52, *Bond House* does not establish any new point of principle. The battle ground for future cases is therefore likely to be whether the innocent trader was truly innocent. The question whether such a trader knew of prior or subsequent VAT fraud will be relatively easy to establish. The more interesting and difficult aspect of the judgment will be how the UK courts and tribunals determine whether the innocent trader had the *means of knowing* of a prior or subsequent fraud and if he did, what the VAT consequences will be. Does a taxpayer have the means of knowledge if he has the resources to investigate but chooses not to use them? If that is the case, then the potential for invidious distinctions being made between large and small taxpayers would itself be contrary to the principle of equality and the common system of VAT. Is negligent oversight of a fraud sufficient or does it have to be reckless in the sense of turning a blind eye to the obvious or not caring whether or not there has been fraud? If we are in the realms of negligence, what is the standard of care? If a transaction which has all the objective characteristics of a taxable transaction is merely tainted by a VAT fraud because of negligence, recklessness or even knowledge of the misdeeds of others, how will it be possible to re-classify a transaction which would otherwise fall within the Sixth Directive having regard to cases such as *Coffeeshop Siberie* which clearly establish that mere illegality, dishonesty or other unlawful conduct is insufficient to remove a transaction from the scope of VAT? What if a trader had the subjective intention to assist others in the carousel by engaging in transactions which objectively fall within the scope of the Sixth Directive and properly accounting for VAT? Since subjective intention is irrelevant, what is the basis upon which such transactions could be brought outside the scope of the Sixth Directive? These are but a few of the many questions to which the caveats in paragraphs 46 and 52 of the Court's judgment will give rise.

Paul Lasok QC and Michael Patchett-Joyce represented Bond House and Rupert Anderson QC and Ian Hutton represented HMRC.

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