

Isle of Wight Council and ors v Commissioners for Revenue and Customs (2006) Decision 19427

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Off-street car parking – taxable person – whether treatment as non-taxable person in relation to off-street parking activities would result in significant distortions of competition – Sixth VAT Directive (77/388/EEC) Art 4.5

This decision of the Tribunal (see News in Brief in De Voil Issue 118, March 2006) is the latest development in a long-running case concerning the VAT treatment of the provision of off-street parking by local authorities. Although the decision only concerns appeals brought by the Isle of Wight and three other local authorities, it is clear that the decision will be of great importance throughout the UK, as the majority of local authorities are involved to some degree in the provision of off-street parking.

Article 4.5 of the Sixth Directive establishes a special regime for the tax treatment of activities engaged in by public authorities.

Firstly, the article takes into account that public bodies may sometimes act as private undertakings; where they do so they are subject to the same rules as any other economic operator.

Secondly, however, when they act in their official capacity as a body governed by public law, the basic principle laid down in Article 4.5(1) is that they should be non-taxable as regards activities carried out in that capacity. Activities pursued as public authorities within the meaning of Article 4.5 are those in which they engage under a special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private economic operators.

Thirdly, by way of exception to the general rule in Article 4.5(1), where local authorities carry on activities which may also be carried on in competition with private operators they will be regarded as taxable in relation to activities that “would lead to significant distortions of competition” under Article 4.5(2). Thus,

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Article 4.5(2) ensures that private operators are not placed at any undue competitive disadvantage by reason of the disapplication of VAT to certain activities of local authorities which are (or can be) carried on by private operators.

Finally, Article 4.5(3) provides that in any event public bodies are to be regarded as taxable persons in relation to the activities set out in Annex D, unless those activities are negligible in scale. It appears that this is to resolve any doubt over certain activities which might be performed by the public or the private sectors depending on national legislation. Like Article 4.5(2), the purpose of Article 4.5(3) is to prevent distortions of competition.

In a previous decision (see (2004) Decision 18557) the Tribunal found that the local authorities provided off-street parking under a special legal regime and were therefore in principle non-taxable in relation to such activities. No appeal was made by HMRC against that decision. The local authorities also argued that HMRC could not rely on the exception in Article 4.5(2) to bring them back within the scope of VAT as Article 4.5 had not been implemented in UK law. The Tribunal agreed with them, but on appeal the High Court confirmed that, although not implemented in the UK, Article 4.5 in its entirety was nevertheless directly applicable as between HMRC and the appellant local authorities, who could not assume the benefit of Article 4.5(1) without also assuming "the burden" of Article 4.5(2) (see [2005] STC 257, Pumfrey J). The case was therefore remitted to the Tribunal to determine whether the disapplication of VAT to the provision of off-street car parking by the local authorities "would lead to significant distortions of competition" so as to bring them within Article 4.5(2) and consequently back within the scope of VAT.

In its decision the Tribunal first addressed where the burden of proving that the criteria in Article 4.5(2) lay. It concluded that the general principle is that public bodies acting under a special legal regime are outside the scope and it is up to the member state to bring into charge those activities whose exclusion would lead to significant distortions of competition, either by legislation, as has happened in some member states (eg Portugal), or by leaving the matter to the domestic courts (eg the UK).

As to the general approach to the question of assessing a significant distortion of competition, HMRC argued that if the activities in question were carried out on a national basis by private operators, the matter should be looked at on a nationwide "broad brush" basis to see whether the amount of income generated from the activity is significant. The local authorities argued that the right approach was to look at the evidence which applied to each of them individually. The Tribunal agreed with this approach, considering it was necessary to focus on the public body and then examine the competitive effects of that body's treatment in the context of the relevant market (or markets) on which it was active.

As to "significant", HMRC argued that this meant something which was meaningful, ie more than de minimis. However, the Tribunal, relying heavily on some remarks of Advocate-General Jacobs in *Waterschap Zeeuws Vlaanderen v Staatssecretaris van Financien* (Case C-378/02), disagreed. In that case the A-G said it was inherent in excluding public bodies from the scope of VAT that this would to some extent interfere with the application of the principle of neutrality and of equality of treatment. From this the Tribunal concluded:

"there must be something by way of distortions of competition which are 'exceptional', i.e. have effects above and beyond those which are the normal consequences of the fact that the public body is active in the same market as a private body and is treated as outside the scope of VAT. A self-evidently obvious 'normal' consequence of this is that the public body in question would not be required to account for VAT on any charges made for its services, whereas a private company active in the same market would be so required. The corollary of this is that the public body would have the capacity to lower its charges without affecting its net revenue, or to leave its charges unchanged and retain additional revenue. So much is the wholly unexceptional 'normal' result of the public body being outside the scope of VAT".

The concern of the Tribunal was that HMRC's interpretation meant that the exception in Article 4.5(2) would be "automatically engaged" and the objective of excluding public bodies from the scope of VAT would be defeated. However, it may be noted that in *Waterschap* the public authority complained that its inability to deduct input tax would lead to significant distortions of competition with the private sector. While the premise on which its complaint was rejected may be correct, namely that without something "exceptional" the inability of a public authority to deduct input tax is unlikely by itself to give rise to any significant distortion of competition, it is less clear that this is so in relation to whether or not a local authority must charge VAT on supplies which are also widely made by private operators.

HMRC pointed to a number of potential distortions of competition that could occur from the VAT "saving" arising from the disapplication of VAT to the local authorities. One was the additional flexibility in pricing which a local authority would be able to achieve. Another (supported by evidence from private sector operators) was that it might make private-public joint ventures and partnering arrangements less likely, as in some cases the VAT "saving" would lead a local authority to keep the parking operation "in-house" rather than use the services of a private operator. Although the Tribunal decided on the facts in the instant case that these potential distortions of competition would be insignificant, it is unclear how they could ever be anything else; on the Tribunal's approach, they would appear to be distortions that arise as normal consequences of the disapplication of VAT.

Two immediate practical consequences arise from the Tribunal's judgment. Firstly, the need to assess distortions of competition on a local and potentially detailed market analysis may make administration of VAT in this area extremely complicated (it should be remembered that even within one town or city there may be a number of car parks forming discrete car parking markets). Secondly, the Tribunal's interpretation of the word "significant" based on *Waterschap* means that what to a private operator in commercial terms might appear to be a significant competitive advantage is unlikely to suffice to bring a local authority back within the scope of VAT under Article 4.5(2).

These interesting issues will now be considered further by the High Court as it is understood that HMRC intend to appeal the Tribunal's judgment.

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