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The Rank Group v The Commissioners for Her Majesty's Revenue and Customs

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January 2010

The First-Tier Tax Tribunal gave judgment recently on the second stage of the appeal by Rank Group plc ("Rank") against the refusal by HMRC to repay VAT paid on income from slot machines ("the slots appeal"). The Tribunal ruled in favour of Rank on the basis that the charging of VAT on that income was in breach of the Community law principle of fiscal neutrality.

While Rank's repayment claim is itself far from derisory, at just under £30 million, the case seems likely to be ultimately more important as a test case, given that behind it sit over 1,000 similar claims. In this context, the Tribunal's approach to determining whether a supply is similar for the purposes of the principle of fiscal neutrality, and its rejection (in law and fact) of a "due diligence" defence raised by HMRC are likely to have significance well beyond this case.

Background

Rank operated during the period October 2002 to December 2005 slot machines covered by sections 31 and sections 34 of the Gaming Act 1968 ("the Gaming Act"). Income from these machines was taxable in domestic law as income from a "gaming machine" by reason of a Note in Schedule 9 to the Value Added Tax Act 1994.

Rank claimed that similar machines operated by competitors were exempt from VAT, and that this was a breach of the principle of fiscal neutrality, which (as usually expressed) precludes treating supplies which are similar and in competition with each other, differently for VAT purposes. In particular, machines operated under section 16 Lotteries and Amusements Act 1976 and section 21 Gaming Act 1968 (section 16/21 machines') and fixed odds betting terminals ('FOBTs') were both said to be similar and in competition with taxable machines,

The Tribunal's judgment on the first stage of Rank's appeal (Decision No. 20777, V&DR 304), in which it was held that there was a prima facie breach of the principle of fiscal neutrality from November 2003 at the latest, was upheld by Norris J in June of this year ([2009] STC 2304), and is currently pending before the Court of Appeal.

The case came before the Tribunal in October for it to determine (i) whether the difference in treatment covered the whole period of the claim, (ii) whether there was available in principle a defence to the claim if it could be shown that the United Kingdom had acted with due

diligence in responding to the development of exempt machines by amending the law to end the disparity in treatment, and (iii) whether the UK had so acted on the facts.

The Tribunal's Judgment

The first question for the Tribunal was whether there were in the earlier period covered by the claim exempted machines that were, in the necessary sense, similar those in respect of which Rank accounted for VAT.

Similar machines- determining the test

HMRC accepted at the outset that the Tribunal should not address whether there was on the facts a distortion of competition, because it was bound by the judgment of Norris J on that point. This being so, a distortion would be assumed from the fact of similar supplies being treated differently. The Tribunal would, nonetheless, have to decide what test to apply in identifying whether a supply is similar to another for the purposes of the principle of fiscal neutrality.

In this respect, HMRC relied first upon the recent judgment of the European Court of Justice ("ECJ") in *R (TNT Post UK Ltd) (Case C-357/07 [2009] STC 1438)* in which the Court ruled that services provided by Royal Mail and TNT were not similar because of the context in which they were supplied, particularly the respective "legal regime[s]" under which they were made. In HMRC's submission, the differences between the regulatory regimes covering the allegedly similar machines prevented them being similar for the purposes of the principle of fiscal neutrality. In particular, FOBTs were betting activities, regulated under the Betting, Gaming and Lotteries Act 1963, whereas taxable machines were gaming activities and regulated as such under the Gaming Act 1968.

The Tribunal held that the ECJ had not in the *TNT* case ruled that supplies under different regulatory regimes are *as a matter of principle* not similar for fiscal neutrality purposes, although the greater the difference in regime, the greater would be the relevance of that difference. The obligations on Royal Mail (principally, its universal service obligation) put it in a such a different position from that of a competitor that the difference between the two regulatory regimes "overrode everything else"; by contrast, the equivalent differences in respect of taxable and exempt machines "fell far short" of doing so.

Dealing with other factors alleged to show the supplies not to be similar, the Tribunal held that differences in respect of the maximum stake, maximum winnings and game rules applying to, on the one hand, Rank's machines and, on the other hand, the exempt machines, were not relevant. The Tribunal reasoned that it can be taken from the ECJ's electing not to answer the second question in *Linneweber (Case C-453/02 [2008] STC 1069)*, in which the referring court had sought guidance on such factors, that the Court must not have considered these to be relevant, but rather considered that the supplies were, despite any differences in these respects, "the operation of the same activity".

The Tribunal held that the test for similarity requires a comparison from the point of view of consumers at a high level of abstraction, where the consumer is an "objective synthesis of the generality of players".

Similar machines- finding the facts

The Tribunal heard evidence from appellant and respondent witnesses on the introduction to the market of exempt machines. It held that exempt machines that were similar to taxable gaming machines in that they "had similar characteristics and met the same needs" were on the market for the entire period covered by the claim. The Tribunal upheld Rank's claim that both FOBTs and section 16/21 machines were similar to taxable machines.

A due diligence defence?

There was, therefore, a breach of the principle of fiscal neutrality entitling Rank to the repayment of overpaid VAT, unless HMRC could rely on a defence.

The Tribunal confirmed the view it had expressed in its decision on the first stage of the appeal that there is in law no defence of due diligence to an infringement of the principle of fiscal neutrality. It reasoned that such a defence would introduce uncertainty and would "sit very uneasily with the right of traders to rely on the direct effect of the Sixth Directive".

Having held that the argued due diligence defence was unavailable in law, the Tribunal proceeded at the request of the parties to make the findings relevant to the availability of such a defence on the facts. It considered, therefore, when the UK knew or ought to have known of the entry of the exempt machines onto the market and of the consequent unequal treatment. It held that, contrary to the HMRC's submission, the knowledge of persons other than those within the tax authority could qualify as the knowledge of the Member State; accordingly, the UK could be fixed with the knowledge of the Gaming Board (now the Gambling Commission). As it had licensed the exempt machines, the Gaming Board was unsurprisingly held to be aware of them upon their respective times of entry to the market.

The Tribunal further held that, even if it was wrong as regards the necessity for knowledge to rest with a particular body or department, the lapse of time between the entry of certain of the exempt machines onto the market and this knowledge reaching (in 2004) persons within HMRC with the power or responsibility to address the resulting inequality of treatment involved a failure by HMRC to exercise due diligence. And even after this point, HMRC did not act with sufficient expedition to constitute due diligence in acting to reinstate equality of treatment.

Comment

While the result was perhaps unsurprising given the findings of facts made by the Tribunal, there are several interesting legal questions raised by this judgment. It might be asked, for instance, how domestic courts and tribunals are to reconcile similarity being determined on the basis of the perspective of the consumer and at a "high level of abstraction" with the apparent requirement in *TNT* to take account of the regulatory context in which the supplies are made. It seems likely that there will be cases in which it will be more difficult to determine whether a difference in regulatory context "overrides" the apparent similarity between supplies such that they may be treated differently for VAT purposes.

Dr Paul Lasok QC and Valentina Sloane represented Rank

Christopher Vajda QC, George Peretz and Laura Elizabeth John appeared for HMRC

For more information on **Paul Lasok QC, Christopher Vajda QC, George Peretz, Valentina Sloane, Laura Elizabeth John** and **Owain Draper** please contact the Clerks on 020 7405 7211 or consult the 'Find a Barrister' section at www.monckton.com.