Binding effect of VATA 1994 section 85 agreement on partial exemption issue
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Summary

Under s85 VATA 1994 a taxpayer who has lodged an appeal against an adverse decision by HMRC may effectively settle the matter outside of the VAT Tribunal. The effect of settlement is that the agreement reached is deemed to reflect the decision of the VAT Tribunal as if the case had been heard.

In this case, the VAT Tribunal has held that HMRC is prohibited from arguing before it an issue concerning partial exemption that has been settled with the taxpayer in a 's 85 agreement', even though that agreement only covers certain specified accounting periods. The Tribunal invoked the legal principle of "issue estoppel" and also held that HMRC's conduct amounted to an "abuse of process". This decision is relevant to all businesses that have entered into s85 agreements (or otherwise settled the dispute) and then encountered a volte-face from HMRC.

Background

The case arose out of a dispute over the attribution of residual input tax to certain exports of goods that were deemed to be zero-rated supplies under s 30(5) VAT Act 1994. The Taxpayer submitted voluntary disclosures to HMRC on the basis that the value of these goods should be included in its partial exemption calculations, resulting in an increase in its residual recovery rate. HMRC rejected these claims on the grounds that the supplies had no value; the Taxpayer appealed that decision to the VAT Tribunal; and the appeal was settled prior to hearing by the parties entering into an agreement under s 85 VAT Act 1994 (the s 85 agreement) that:

- the value of the goods should be included in the Taxpayer's partial exemption calculations; and
- value should be determined under para 6(2)(c) Schedule 6 VAT Act 1994 (i.e., a cost basis).

The Taxpayer then submitted further voluntary disclosures on this basis, but HMRC also rejected these claims - on the basis that the s 85 agreement only bound HMRC as regards the periods covered by the appeal and not subsequent periods. The Taxpayer appealed this decision to the VAT Tribunal. It considered that HMRC's actions amounted to an attempt to re-litigate an issue which had been pursued under the original appeal, which had ultimately been settled between the parties by way of the s 85 agreement. The Taxpayer therefore sought preliminary Directions under Rule 19(3) of the VAT Tribunal Rules 1986 that HMRC should be prohibited from advancing an argument that the value of the zero-rated supplies should be excluded from the special method on the basis that:

- HMRC were estopped from raising this argument by reason of the s 85 agreement ("issue estoppel");
  and/or
- HMRC's conducted amounted to an abuse of process.

Counsel for the Taxpayer reviewed the case law on issue estoppel and submitted that it established that, once an issue had been raised and determined between parties to proceedings before a court of competent jurisdiction, no party to those proceedings could challenge the outcome on that issue in subsequent proceedings. Whilst accepting that it is not a rule of universal application (and in particular that there is an important exception for tax cases), Counsel argued that the scope of that exception is limited to appeals against assessments where the only issue is one of quantum or amount. The Taxpayer's appeal, on the other hand, was not against an assessment and concerned matters of principle rather than mere disputes over the facts and figures. Counsel for the Taxpayer argued that the s 85 agreement dealt with the principles rather than the details, and the effect of s 85 was to elevate that agreement on the questions of principle to the status of a Tribunal decision.

In the alternative, the Taxpayer argued that permitting HMRC to advance this argument represented an abuse of process, and cited authority to the effect that this is a route "untrammelled by the technicalities of

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estoppel". The purpose of the concept is to ensure that justice is done between the parties, and allowing HMRC to re-argue the issue of principle would be manifestly unfair and would open up the possibility of inconsistent treatment between periods. This problem was particularly acute for the Taxpayer, as the supplies in question arose from a number of ongoing projects which spanned several accounting periods. Allowing the proceedings to continue would bring the whole administration of justice into disrepute.

HMRC argued that the application should be dismissed as the VAT Tribunal did not have the jurisdiction to make the Directions sought. In terms of the substantive points, HMRC considered that the effect of the Taxpayer's arguments on "issue estoppel" and "abuse of process" were essentially the same. HMRC focussed on the wording of the s 85 agreement which (in its view) clearly dealt only with the supplies that were subject to the original appeal and which was not intended to have any continuing effect. As the appeals related to particular accounting periods, HMRC argued that they were not concerned with any "matter of overarching principle" but rather simply the question of how much input tax should be credited for those periods. As regards the Taxpayer's alternative contention, HMRC argued that there is no statutory basis for (and no authority for) the Tribunal to strike out an argument for abuse of process and that, in any event, there could be no abuse as the current appeal does not relate to the same circumstances as the original appeal.

Decision

The VAT Tribunal found for the Taxpayer and granted the Directions requested by it (i.e., that HMRC should be prohibited from advancing an argument that the value of the zero-rated supplies should be excluded from the partial exemption calculations). On the jurisdiction issue, the Tribunal decided that the powers granted to it under Rule 19(3) were sufficiently broad to enable them to make the Directions sought although, in relation to abuse of process, it concluded that this power must be exercised sparingly.

As regards issue estoppel, the Tribunal dealt with four questions:

1) Was the exception to the rule for tax cases universally applicable, or limited to issues of quantum or amount?
2) If the exception was limited to matters of quantum, did the issue in the original appeal fall within that category or did it involve an issue of principle?
3) If it involved an issue of principle, did the s 85 agreement resolve that issue? If so did the s 85 agreement constitute the determination of the point of principle before a court of competent jurisdiction?

On the first question, it concluded that issue estoppel is capable of applying to a tax case, and it adopted the distinction drawn by the Taxpayer between issues of principle (where estoppel may apply) and issues of an "annual" or "passing" nature such as the quantum of a particular assessment (which falls within the exception established in the direct tax cases). On the second question, it held that the Taxpayer's appeal fell under s 83(e) VAT Act 1994 and that this concerned matters of principle (i.e., what is, and is not, allowable input tax) and not simply the amount of input tax allowable for particular period(s) - in respect of which the appeal lies under s 83(c). As regards the construction of the s 85 agreement, the Tribunal found that it referred to a question of principle - the types of supply to be brought into the partial exemption calculations, and the basis for determining the value of those supplies. Finally, the Tribunal held that the stringent conditions for allowing as 85 agreement to be taken into account in a subsequent appeal had been met.

The Tribunal also expressed its view that it would accept the taxpayer's alternative argument based on abuse of process and grant the Direction sought.

Implications

The Tribunal's decision is clearly welcome news for businesses that have been (or may become) involved in a dispute with HMRC on a matter of principle. Although this decision was on a preliminary issue and the Taxpayer's appeal was not formally allowed by the Tribunal, the practical effect of the Tribunal's directions

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is likely to be that HMRC will now have to concede the case (subject to any appeal on this preliminary issue).

The logical consequence of accepting HMRC's argument is that, if HMRC loses on any substantive issue before the VAT Tribunal, it is open to HMRC to re-litigate the same point with the same taxpayer before a different VAT Tribunal in relation to any periods not covered by the original decision. This would constitute a charter for continuous litigation and would be inconsistent with the principle of legal certainty.

Whilst it is true that decisions of the VAT Tribunal do not constitute binding precedent, it is generally accepted that the proper course of action where the dispute concerns the same taxpayer is for HMRC to appeal any adverse decision to the higher courts (which are, of course, able to decide the point in a manner that binds future VAT Tribunals). Where HMRC has not done so but has instead settled the dispute and entered into an agreement under s 85, it would seem right that the Tribunal should refuse to entertain a subsequent attempt by HMRC to re-litigate the substantive issue.

In practical terms, businesses should seek to ensure that (where possible) all disputes with HMRC are settled by way of a s 85 agreement, and that the terms of those agreements clearly cover any substantive legal issues that are in dispute - in order that they are on all fours with the taxpayer in this case. More generally, in any other case where a dispute with HMRC is being settled (i.e., outside the s 85 mechanic), care should be taken to ensure that agreement is reached in writing, that all relevant matters are dealt with in it, and that the wording is clear and unambiguous.

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