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ANALYSIS - CONFLICTS IN THE TAX CODE: TWO CASE STUDIES

In *The Prudential Assurance Company*, the First-tier Tribunal was faced with a case of two provisions in the VAT rules producing contrary outcomes, with no clear way of determining which should prevail. In a similar vein, a familiar and long-standing conflict within the chargeable gains regime — namely, the three-way battle between TCGA 1992 s135, s171 and Sch 7AC — presents an arguably thornier question, and one that is yet to be tested in the courts. Resolving such conflicts within the tax code is no easy task, particularly where there is no obvious 'right' answer in policy terms.

One can usually make sense of a deeming provision when considered in its own right. Things can get trickier where two sets of deeming provisions come into play so as to produce results that are contradictory. The recent First-tier Tribunal case of *The Prudential Assurance Company Ltd v HMRC* (TC/2018/07480) provides a fine example of this: a supply was made within a VAT group but invoiced after de-grouping, with one rule requiring the supply to be disregarded and the other deeming the supply to have occurred.

Two conflicting provisions in Prudential

The facts in the *Prudential* case were not particularly complicated. The taxpayer had received investment management services from SCL, a company that was a member of the same VAT group at the time those services were performed. SCL subsequently left the VAT group and ceased performing those services. However, it had not yet been fully paid for them: in addition to the management fee that had been paid during the term of the arrangement on a regular basis, there was a one-off performance fee payable only when the performance of the relevant funds over the stipulated period could be determined. The calculation, invoicing and payment of the performance fee did not therefore occur until several years later. The question before the tribunal was whether that fee was consideration for a taxable supply, notwithstanding that the related services had been performed during SCL's membership of the taxpayer's VAT group.

The taxpayer and HMRC each pointed to different deeming provisions in support of their case. The taxpayer made the perhaps obvious point that, as the services had actually been performed whilst SCL was a member of the VAT group (and had no longer been rendered after it left), VATA 1994 s43(1) required the supply to be disregarded; the performance fee was therefore consideration for something that is deemed not to be a supply for VAT purposes. HMRC, seizing upon the fact that the services had been supplied on a continuous basis, drew on SI 1995/2518, reg 90: the supplies were deemed to take place upon the earlier of invoicing or payment, and not when they were actually made. Accordingly, reg 90 deemed the supplies to have been made (in part) at a time when SCL was not VAT-grouped with the taxpayer and could not therefore be disregarded. Not so, countered the taxpayer: the purpose of reg 90 is to fix the time of supplies that exist in the VAT world; it cannot be used to breathe life back into supplies that the VAT rules say are to be disregarded and therefore has no supply to bite on due to the operation of s43(1).

Thus, the tribunal was seemingly faced with a difficult choice as to which of the two deeming provisions should prevail. After surveying the relevant case law, the judge essentially concluded that both would apply in this case. Regulation 90 would indeed deem a supply to have been made at the later time when the performance fee was invoiced. However, that was not the end of the matter. The making of a supply is not itself sufficient to attract a VAT charge; the supply must also, amongst other things, be made by a taxable person in the course or furtherance of their business. Whilst the disregard of the actual supply by s43(1) was effectively overridden by reg 90's revival of the supply in deemed form, another feature of s43(1) — namely, that business carried on by any member of a VAT group is deemed to be carried on instead by its representative member — remained unaffected. Accordingly, during its

time in the VAT group, SCL (which was not the representative member) was deemed to be not itself carrying on a business. The supply deemed into existence by reg 90 was therefore not a supply made in the course or furtherance of any business of SCL and so did not attract VAT. In essence, HMRC won the battle and lost the war.

In order to have found in HMRC's favour, the judge considered that he would have been required to 'take SCL's real world supplies … and in the VAT world treat them as being supplied when they were invoiced' and that such an exercise would be 'to lift supplies out of the VAT group world only to place them in an alternative VAT time of supply world' – something he described as a 'mixed approach' that was not supported by the case law. And so there things were left, with the result falling the taxpayer's way.

In the circumstances of this case, however, it seems somewhat counterintuitive to have arrived at the conclusion that a supply does exist for VAT purposes, but that it is not one made in the course or furtherance of a business. One might ask whether that is really the end of the analysis. A supply cannot exist purely in the abstract: it must have certain essential characteristics. Just because one cannot use the real world supplies made by SCL to provide any of that colour, it doesn't necessarily follow that our task of analysing that supply comes to an end. One can (and arguably should) go on to determine positively what kind of supply it is. We know that the deemed supply is made between SCL and the taxpayer and we must be able to deduce something about their relationship, even if we must draw a veil over real world events during their time as fellow members of a VAT group. Were one to compile a list of the kinds of supply that it might therefore be, at the top must be a supply in the course or furtherance of a business (rather than, for instance, a supply made in some domestic or personal capacity, or rendered by employee to employer). It can't be the case that s43(1) tells us positively that the deemed supply is *not* a supply made in the course or furtherance of a business, because that section bites only on the real world supply – and we know that we must avoid a 'mixed approach'. In the absence of any other indications, one must surely pick the description that fits best.

It may therefore be possible to get to the result contended for by HMRC not by extracting or transposing the real world supplies actually made by SCL into the VAT world, but rather by focusing only on the reg 90 deemed supply and undertaking a process of logical deduction in order to determine its most likely nature. This analysis also avoids the quirk of the outcome turning on whether the real world supplier happened to be the representative member of the VAT group.

It's true that the Court of Appeal decision in *B J Rice & Associates v C&E Commrs* [1996] STC 581, on which the *Prudential* decision rests, would seem to go against such a conclusion; but in that case, the issue was the status of the taxpayer (who was not registered for VAT when the supply was made but was registered at time of payment). The supply in question was a real world one that was not disregarded by s43(1) or indeed any other rule, and so the court in that case was not left with any unanswered questions about the nature of the supply itself.

This alternative analysis is not without its own difficulties, however; and it seems unsatisfactory to conclude that a service genuinely performed during the period of the VAT group should attract VAT purely by the operation of the time of supply rules (in contrast to the contrived arrangements in *C&E Commrs v Thorn Materials Supply Ltd and another* [1998] 1 WLR 1106, another case cited to the tribunal).

Three conflicting provisions in TCGA 1992

Another nice example of legislative conflict – this time between three rules – arises in the corporate capital gains context. Take the scenario where a trading subsidiary is transferred intra-group in exchange for an issue of shares by the transferee to the transferor. Again, this is not a complicated fact pattern, but it brings into play three competing provisions:

- TCGA 1992 s171 (which deems transfers of assets intra-group to be a disposal on a no gain/no loss basis, disregarding the actual consideration);
- TCGA 1992 Sch 7AC (which exempts from tax the disposal of a substantial shareholding in a trading company); and
- TCGA 1992 s135 (which deems the disposal of shares as not being a disposal at all where the shares are exchanged for an issue of shares in the acquiring company).

In legislative terms, the result is a three-way game of rock/paper/scissors: s171 is (by virtue of s171(3)) disapplied where s135 applies; s135 is (by virtue of Sch 7AC para 4) disapplied where Sch 7AC applies; and Sch 7AC is (by virtue of Sch 7AC para 6) disapplied where s171 applies.

HMRC's proposed resolution is set out in its *Capital Gains Manual* (at CG53170a). One starts at Sch 7AC and notes that para 4 requires s135 to be ignored. One then turns to para 6 and sees that s171 will operate (s135 having been disapplied), so as to override Sch 7AC in favour of no gain/no loss treatment. However, one then sees that, having disapplied Sch 7AC, para 4 no longer has effect so as to disapply s135; and having been so revived, s135 now knocks out s171 and wins the day.

We are left with a logical paradox in that s171 is at once 'active' in that it is preventing Sch 7AC from applying, but at the same time 'inactive' in that it has been overridden by s135. This also glosses over the fact that para 4 is expressed to apply for the purposes of determining whether Sch 7AC applies and has no direct bearing on the application of s171. But we need a winner, and s135 takes the prize when all three provisions are in play, according to HMRC.

It will be seen that HMRC's conclusion is driven by where its analysis begins, i.e. at Sch 7AC. Is that the right place, or even the best place, from which to start? One might credibly say that this transaction is first and foremost an intra-group transfer, with the fact that the subject-matter of that transfer is a trading company, and that the consideration is an issue of shares, being incidental features of that transfer. On that basis, s171 is the better starting point. Following from there a similar approach to that of HMRC, s171 is disapplied in favour of s135, which is in turn disapplied in favour of Sch 7AC — and Sch 7AC is now unconstrained by the operation of para 6, with s171 having been switched off at the first step. (A supporter of HMRC's approach might argue that Sch 7AC is a more logical starting-point, as it confers exemption from tax whereas ss135 and 171 effectively provide forms of deferral of tax, and, all things being equal, a taxpayer would look for exemption in preference to deferral. The credibility of that is however undermined by the fact that deferral under s135 is the end result.)

Finding the 'right' answer

One might expect that the intention of Parliament — an examination of the policy rationale underlying the conflicting legislative provisions — will provide the answer. So it should in many cases, but not in all. The tribunal in *Prudential* found itself unable to derive any assistance from the principle of fiscal neutrality underlying the VAT legislation, and instead reached the conclusion it did by reference to the (not entirely consistent or on-point) case law. And whilst each of the overrides within s135, s171 and Sch 7AC has a logic in policy terms when considered individually, looking at all three together leaves one with the impression of Parliamentary oversight rather than intention. Absent further legislation to provide the answer by fiat, the outcome in cases such as these would seem to depend on where one starts, or indeed stops, one's analysis.

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