

**THE HIGH COURT  
REVENUE JURISDICTION**

2007 No. 659 R

**BETWEEN****EDWARD CUSSENS, JOHN JENNINGS AND VINCENT KINGSTON****APPLICANTS****AND****T. G. BROSAN (INSPECTOR OF TAXES)****RESPONDENT****Judgment of Mr. Justice Charleton delivered on the 11th day of June, 2008**

1. This judgment constitutes the opinion of the High Court on questions asked by His Honour Judge Harvey Kenny, by a case stated, dated 22nd October, 2007, pursuant to s. 943 of the Taxes Consolidation Act 1997, as applied to Value Added Tax by s. 25(2) of the Value Added Tax Act 1972, as substituted and amended.

2. Value Added Tax assessments were raised against the applicants, whom I will refer to as the partnership, and by similar expressions, for the periods January/February 2002 to November/December 2002 and for the period May/June 2004, by the respondent, whom I will refer to as the Inspector of Taxes. In essence, the partnership claimed they were not liable to VAT on the sale of holiday cottages. The Inspector of Taxes rejected that proposition because this exemption from VAT arose from a series of artificial transactions. The partners were unsuccessful in their appeal before the Appeal Commissioner on 21st July, 2005. The partners then appealed to the Circuit Court, and Judge Kenny dismissed the appeal, stating this case for the opinion of the High Court as to whether he was correct in law on a number of legal issues. The full text of the case stated is appended to this judgment. The Value Added Tax Act 1972, as amended, implements the Sixth Council Directive on VAT, properly called the Sixth Council Directive 77/388/EEC of 17th May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – common system of value added tax: uniform basis of assessment, and is the Directive herein referred to, unless the context otherwise requires.

**Case Stated**

3. The basic facts need to be stated. The partners developed a site at Baltimore in County Cork where they built fifteen holiday homes for speculative sale. In order to reduce their VAT liability, which would arise by virtue of such a sale, the partners purportedly entered into a twenty year and one month lease “with a connected company”, Shamrock Estates Ltd. The property was then purportedly leased back immediately to the partners by Shamrock Estates Ltd for two years. Then the lease and the leaseback were extinguished by a mutual surrender. Because the partners accounted for the VAT on the capitalised value of the twenty year and one month lease and had therefore paid VAT, pursuant to s. 12 of the VAT Act 1972 on those apparent transactions, they claimed to be entitled to dispose of their freehold interests in the holiday homes without paying VAT on a sale amount totalling approximately €3million. The Inspector of Taxes raised a VAT assessment on the basis that the partners were obliged to account for VAT in respect of the freehold sales of the holiday homes, without the exemption claimed by them as a result of the purported leasing arrangements, and this is what is disputed. Shortly put, under the Value Added Tax Act 1972 as amended, the scheme of lease and leaseback, as described, giving rise in itself to a liability in relation to VAT, exempted them, they claimed, for liability for VAT in respect of the ultimate sale by the partners of the individual holiday homes. Crucial to the issue of payment of VAT on the sale of the holiday homes is whether there was any reality to the purported scheme of lease and lease back that the partnership claimed had preceded it.

4. The indenture of lease between the partners and Shamrock Estates Ltd is for a term of twenty years and one month and dates from 8th March, 2002. The memorandum of agreement whereby Shamrock Estates Ltd let to the partners that same interest for a term of two years is dated 8th March, 2002. When a relevant transfer was registered in the Land Registry on 19th March, 2002, the partners signed as alleged vendors, in the name of the applicants herein, and then two of the applicants signed as Directors of Shamrock Estates Ltd in their alleged capacity as purchasers of the leasehold interest. On 20th March, 2002, Shamrock Estates Ltd purportedly surrendered the twenty year and one month lease to the partners. On 20th March, 2002, the partners, purportedly acting as tenants, surrendered the two year lease. All of this was done expressly for the purpose of tax avoidance. It is improbable, at the least, and I so hold, that the partners or Shamrock Estates Ltd ever intended to do what any ordinary party entering a lease intends to do; namely, to exclusively occupy and use the property for a fixed term of years as determined by the lease and perform the covenants therein set out, including the payment of rent. It is also improbable that Shamrock Estates Ltd and the partners by entering into these transactions ever intended to create binding legal relations with each other.

5. The land on which these holiday homes was built, and in respect of which these transactions were effected, was owned as to the legal interest by the ACC Bank plc pursuant to a mortgage dated 12th March, 2001. The equitable interest in the property, that of redemption on payment of the loan for the purchase of the land, was held by the partners, two of whom signed the mortgage deed. Clause 6.1 thereof contains a negative pledge in the following form:-

“The Borrower shall not except with the prior written consent of the Bank (a) create, extend or permit to subsist any Encumbrance over the Secured Assets or any of them ranking in priority to or *pari passu* with or after the security hereby created, or (b) part with, sell, convey, assign, transfer, lend, lease or otherwise dispose of, whether by means of one or of a number of transactions related or not and whether at one time or over a period of time, the whole or any part of the Secured Assets or any interest therein.”

6. Since the mortgage deed barred the partners from entering into the purported lease transactions to which I have referred, the first issue before Judge Kenny was the validity of the twenty year one month lease by the partners in favour of their own company Shamrock Developments Ltd. The second issue before Judge Kenny was whether the two purported leases, with subsequent surrender, should be disregarded for the purposes of VAT assessment because this process constituted an abusive practice in accordance with European law. To these issues have been added a third issue before this Court, which is as to the extent of the powers of review of the High Court on such an appeal.

**Finding of Fact**

7. Judge Harvey Kenny had the advantage of hearing evidence in the appeal before him in the Circuit Court. The only evidence offered by either side was that of Edward Cussens, who is an accountant as well as being one of the partners. Having heard that evidence, Judge Kenny reached a conclusion which is binding on me and which informs all that follows in this judgment. It is as follows:-

“It was for the applicants to satisfy the Court that their transactions were not abusive, and they had failed to do so. The Irish Court had to consider what was the real substance and significance of the transactions concerned, and could take

into account the purely artificial nature of these transactions and links of a legal, economic or personal nature between the operators involved in the scheme for a reduction of the tax burden: the real substance and economic significance of the transactions was solely for the purpose of creating a tax advantage: there was no possible economic sense in the partnership disposing of the property at an annual rent of €66,100 and having to pay a higher rent on the leaseback: there was no cash flow advantage, no change in de facto occupation and no economic benefit; in the interim, the partners had an unmarketable title. As a result the whole arrangements was an artifice; no more than a device, which may have been within the letter of s. 4 of the 1972 [Value Added Tax] Act, but certainly not within the spirit of the section or of the [Sixth European VAT] Directive and constituted an abusive transaction. There was no element of penalty involved [in the tax assessment by the Inspector of Taxes], because the assessments took full account of the input VAT and of the output VAT already accounted for by the partners. (The interest issue had not been raised at this point [in the appeal before Judge Kenny])."

### Scope of the Appeal

8. Judge Kenny held that the leasing transactions between the partners and some of themselves acting as Shamrock Estates Ltd were not void. He reasoned that as there was no privity of contract between the bank, which then owned the legal interest in the property pursuant to the mortgage deed, and the lessees, the lease for twenty years and one month was valid. The partners, as taxpayers, had therefore succeeded on that issue. It was only on the issue of abusive practice in European law that Judge Kenny was found against the partnership. The partners have appealed to this Court and argue that the sole issue which the Court is entitled to determine is that of the applicability of the doctrine of abusive practice in European law to their scheme. If this were so, I would not be entitled to revisit any issue as to the effect of the legal ownership by the bank of the property subject to the leasing scheme.

9. This appeal is based on s. 941 of the Taxes Consolidation Act 1997, as amended by s. 17 of the Finance Act 2003, which provides as follows:-

"941.—(1) Immediately after the determination of an appeal by the Appeal Commissioners, the appellant or the inspector or such other officer as the Revenue Commissioners shall authorise in that behalf (in this section referred to as "other officer"), if dissatisfied with the determination as being erroneous in point of law, may declare his or her dissatisfaction to the Appeal Commissioners who heard the appeal.

(2) The appellant or inspector or other officer, as the case may be, having declared his or her dissatisfaction, may within 21 days after the determination by notice in writing addressed to the Clerk to the Appeal Commissioners require the Appeal Commissioners to state and sign a case for the opinion of the High Court on the determination.

(3) The party requiring the case shall pay to the Clerk to the Appeal Commissioners a fee of £20 for and in respect of the case before that party is entitled to have the case stated.

(4) The case shall set forth the facts and the determination of the Appeal Commissioners, and the party requiring it shall transmit the case when stated and signed to the High Court within 7 days after receiving it.

(5) At or before the time when the party requiring the case transmits it to the High Court, that party shall send notice in writing of the fact that the case has been stated on that party's application, together with a copy of the case, to the other party.

(6) The High Court shall hear and determine any question or questions of law arising on the case, and shall reverse, affirm or amend the determination in respect of which the case has been stated, or shall remit the matter to the Appeal Commissioners with the opinion of the Court on the matter, or may make such other order in relation to the matter, and may make such order as to costs as to the Court may seem fit.

(7) The High Court may cause the case to be sent back for amendment and thereupon the case shall be amended accordingly, and judgment shall be delivered after it has been amended.

(8) An appeal shall lie from the decision of the High Court to the Supreme Court.

(9) Notwithstanding that a case has been required to be stated or is pending, income tax or, as the case may be, corporation tax shall be paid in accordance with the determination of the Appeal Commissioners; but if the amount of the assessment is altered by the order or judgment of the Supreme Court or the High Court, then—

(a) if too much tax has been paid, the amount overpaid shall be refunded with interest, in accordance with the provisions of section 865A, or

(b) if too little tax has been paid, the amount unpaid shall be deemed to be arrears of tax (except in so far as any penalty is incurred on account of arrears) and shall be paid and recovered accordingly."

10. Section 942 of the Act of 1997, as amended by the Finance Acts 2002, 2003 and 2005, provides for an appeal from the Appeal Commissioners to the Circuit Court. Under s. 943, s. 941 applies in a like manner to any case stated by a judge of the Circuit Court for the determination of the High Court.

11. Article 34 of the Constitution provides for courts of first instance and the Supreme Court as the final court of appeal. This Court is acting as a court of appeal in relation to this matter, but not a court of final appeal. It is invested, under the Constitution, pursuant to this Article, "with full original jurisdiction in and power to determine all matters and questions whether of law or fact, civil or criminal". This, of course, does not mean that the High Court has the power to determine everything that might be regarded as a legal controversy. The High Court does not have power to give planning permission, to issue a mining license or to raise a tax assessment. Its power of control over lower courts and tribunals is generally limited, unless there is an express appeal provision giving wider powers, to judicial review under O. 84 of the Rules of the Superior Courts. Even there, the grounds on which such an action may be initiated may be circumscribed by legislation to require something more than merely an arguable case; see for instance s. 5 of the Illegal Immigrants (Trafficking) Act 2000, as amended. The circumstances, under which the decisions of a tribunal that considers legal controversies must be subject to an appeal to a court, if such decisions are to be constitutionally valid, are ill-defined. Nonetheless, it seems reasonable to propose that as the normal appeal from a tribunal to a court, or from a court to a court, is by way of a complete re-hearing, that this should be the starting point in the construction of the powers of any court exercising an appellate jurisdiction.

The nature of the appeal may, of course, be limited by statute but the construction of that limiting legislation should be set against that background.

12. Certainly, under this legislation it is for one of the parties, whether the taxpayer or the Revenue Commissioners, to declare their dissent to a decision before the Appeal Commissioners. That dissatisfaction with the determination as being erroneous in point of law may be capable of precise formulation at that point or may require to be considered in a more refined way, as seems often to be likely, at a later time. There is nothing in the legislation which limits the hearing of an appeal from the Circuit Court to this Court solely to the precise point that generates the appeal through the expression of dissatisfaction by a party appealing. Moreover, it is clear in s. 941(6) that even if the initial words that might be read as limiting the issues before the High Court to the "question or questions of law arising on the case", and thus might be somehow construed as referring solely to the point decided against the party appealing, the general words which follow make it clear that the purpose of the appeal is to cause the determination that is made to be rendered correct in law. The courts exist under the Constitution to assist the parties before them through making a determination that is correct in law and in fact on the issues in controversy. Confining a case to a single issue can result in a failure to properly address and settle the issues. Express words would be needed for that. Where a case is stated under s. 29 of the Courts of Justice Act 1924, as amended, from the Court of Criminal Appeal to the Supreme Court, a point of law of exceptional public importance must be identified. The Supreme Court, however, reviews all the issues in the original appeal; which is limited only by the notice of appeal. The only exception is to differentiate sentencing from conviction issues; *The People (Director of Public Prosecutions) v. Gilligan (No. 3)* [2006] 3 I.R. 273. The courts have always set their face against any construction of a statute which leads to any manifest absurdity or repugnance. In which case, the language of the statute may be construed, if that is possible, so as to avoid an interpretation arising from an apparent ambiguity of language that would cause injustice. It is not necessary, in this case, to have regard to that cannon of construction because the language used in s. 941 of the Act of 1997 is sufficiently clear in stating that the duty of the High Court is to "reverse, affirm or amend the determination in respect of which the case has been stated". The duty of the High Court, in this regard, is not to merely determine one point in respect of which dissatisfaction has been expressed. Were that to be the case then manifestly absurd results could follow. For instance, an amount might be affirmed, even though wrong as a taxation calculation, because dissatisfaction had been expressed as to another point not affecting the calculation. This would result in injustice, which is not the function of the courts. Rather, the power of the High Court is to look at the entire of the determination and to address and settle all the questions of law that arise on foot of it.

13. I am fortified in this conclusion by the decision of Pennycuik J. in *Muir v. Inland Revenue Commissioners* [1966] 1 All E.R. 295. Before the Special Commissioners, the equivalent in England and Wales of the Appeal Commissioners, two points were ventilated. The taxpayer argued in favour of one of them, and the Crown the other. It was contended before the High Court that the point on which the Crown won could not be reconsidered. At p. 299, Pennycuik J., is recorded in the following terms:-

"It seems to me that the Crown were under no obligation to express dissatisfaction in order to keep alive the uncertainty issue. It often happens that a party before the commissioners advances two contentions, succeeds on the one and fails on the other. So far as I know, it has never been suggested that in such a case the successful party must express dissatisfaction as regards the contention on which he has failed in order to keep that contention alive on an appeal. The requirement that dissatisfaction must be declared goes to the decision on the appeal, and not, it seems to me, to the decision on any particular contention."

14. This reasoning was upheld in the Court of Appeal by Harman L.J., who commented in relation to this point that "there is no substance in it whatever"; [1966] 3 All E.R. 38 at p.44. In consequence, in my consideration of this appeal, all of the issues that are necessary to a proper determination of the correct law to apply to the proper payment of tax should be considered. The correct approach by the High Court to the determination of matters of fact and law on this kind of appeal was set out by the Supreme Court in *Ó Cúlachain v. McMullan Brothers Ltd* [1995] 2 I.R. 217 at 222 through Blayney J., as follows:-

"In the light of these statements of the law it seems to me that when a court has before it a case stated seeking its opinion as to whether a particular decision was correct in law, the following principles apply (I refer in them to a case stated by a judge, as is the position here, but they apply equally where the case is stated by the Appeal Commissioners or by any other party):-

1. Findings of primary fact by the judge should not be disturbed unless there is no evidence to support them.
2. Inferences from primary facts are mixed questions of fact and law.
3. If the judge's conclusions show that he has adopted a wrong view of the law, they should be set aside.
4. If his conclusions are not based on a mistaken view of the law, they should not be set aside unless the inferences which he drew were ones which no reasonable judge could draw.
5. Some evidence will point to one conclusion, other evidence the opposite: these are essentially matters of degree and the judge's conclusions should not be disturbed (even if the court does not agree with them, for we are not retrying the case) unless they are such that a reasonable judge could not have arrived at them or they are based on a mistaken view of the law."

## **Mortgage**

15. A mortgage is an instrument whereby an estate in real property, or in the case of a chattel mortgage a thing, is vested as to its legal interest in a lending institution, the mortgagee, in consideration of a loan, usually for purchase, but subject to the equity which the purchaser of the property, the mortgagor, has to redeem that legal interest from the lending institution through repayment. In informal mortgages, often called equitable mortgages, once common outside Dublin, this arrangement is arrived at symbolically when the borrower deposits the title deeds of the property with the bank manager. As with any other legal instrument, the terms of the mortgage deed define the mutual obligations of the parties. These will invariably include the duty of the borrower to repay the loan, the duty of the lending institution to then extinguish the mortgage, the right of the lending institution to sell in the event of default and the duty of the borrower to preserve the property so that its value will be available to the lending institution in the event of default. As regards leases of mortgaged property, the position at common law, and then under the Conveyancing Act 1881, in relation to mortgages is set out in Andrew Lyall – *Land Law in Ireland, 2nd Ed. (Dublin, 2000)* at pages 822/3:-

"At common law the mortgagor may grant leases which will be binding between the mortgagor and the tenant by estoppel. They will not, however, bind the mortgagee in the absence of provisions in the mortgage granting a power to lease to the mortgagor. Many mortgages prohibit the mortgagor from letting the premises without the consent of the mortgagee, since the mortgagee wishes to protect the right to enforce the security by sale with vacant possession.

Where, in such a case, the mortgagor creates a letting of the premises with the mortgagee's consent, the lease binds the mortgagee and successors in title. A legal mortgagee, as holder of a legal estate, has, under the principles discussed above, the right to possession of the premises and, consistent with this, was treated at common law as having the right to create leases. Such leases, however, are subject to the mortgagor's equity of redemption and so liable to be destroyed by the mortgagor's paramount right to redeem in equity. The Conveyancing Act, 1881 section 18 resolved the insecurities of leases created at common law by mortgagor or mortgagee by giving power to either of them to create binding leases, depending upon which of them is in possession. Provided they comply with the provisions of the statute a lease made by the mortgagor will bind every mortgagee and a lease made by the mortgagee will bind the mortgagor and prior mortgagees. Leases granted under the statutory power must not exceed 21 years for agricultural or occupational leases and 99 years for building leases. The lease must be at the best rent reasonably obtainable. It must contain a covenant by the lessee for payment of rent and a condition for re-entry if the rent is not paid within a time specified which must not exceed 30 days. The statutory power to lease may be excluded or extended by agreement between the mortgagor or mortgagee. Many mortgage deeds contain a covenant binding the mortgagor not to let the premises without the consent of the mortgagee. "

16. Section 18 of the Conveyancing Act 1881, governs the making of leases by a mortgagor or mortgagee. This arrangement does not comply with that section in several respects, as to some of which I now wish to make reference.

17. The learned author does not comment as to whether a mortgage made in breach of covenant by a mortgagor is void. His treatment of the issue, whereby he indicates that the mortgagor would be estopped from denying the tenancy, as against the tenant, necessarily implies that such a lease would be void. Among the documents submitted on this appeal was a letter, dated 16 February 2005, written by the lending bank, as mortgagee, to the partners three years after these legal instruments purportedly were effected, stating:-

"We note that the property was subsequently let. We confirm that this transaction is allowed by the bank. At no stage was it the intention of the bank to void such a transaction despite any powers granted to the bank under the above loan agreement."

18. It is clear that the foregoing letter was written because someone feared that by reason of the covenant in the mortgage deed against letting, that the leasing artifice of the partners was void. I think that this apprehension was correct. The most comprehensive treatment of the issue of the validity of a lease in contravention of a mortgage deed is that by Farwell J., in *Irontrades Employers Insurance Association v. Union Land and House Investors* [1937] 1 Ch. 313. In order to determine the issue before the court Farwell J. had to consider the position as to making leases as between mortgagor and mortgagee before the passing of the Conveyancing Act 1881. I find his reasoning persuasive and it is, at pp. 317-319, as follows:-

"Under the law as it was before the Act of 1881 the position was this, that in the case of a legal mortgage the mortgagor, although in possession, had no power at all to grant a lease which was binding on the mortgagee. Any lease granted by him to some third party would be in no way binding on the mortgagee and as between the lessee and the mortgagee would create no estate or interest other than that which I will mention in a moment. So far as the mortgagor, who had granted the lease, was concerned, it was binding upon him as against the lessee, and he was estopped from disputing it and as against the mortgagor or against any one other than a person having a title paramount to the mortgagor, e.g., the mortgagee, such a lease was good and the lessee was entitled to the benefit conferred thereby, but so far as the mortgagee was concerned the lessee had no estate or interest as against him, except that he had a right to redeem in the event of the mortgagee taking steps to evict him from possession of the property which had been leased to him by the mortgagor, but beyond that right to redeem he had no rights as against the mortgagee nor had he any estate or interest as against the mortgagee in the land at all; he had by virtue of equity a right to redeem if he was in danger of being evicted by the mortgagee who had, as I have said, a paramount title, but except to that extent a lease granted by the mortgagor prior to the Act of 1881 was ineffective as against the mortgagee. That position was altered by the Conveyancing Act, 1881, because by that Act express power was given to the mortgagor in possession to grant leases on certain terms and subject to certain conditions which were good as against the mortgagee. The effect of that statutory power was to enable the mortgagor for the first time to do something which hitherto it had not been possible for him to do - namely, to grant a lease during the continuance of the charge which would be binding on the mortgagee. The fact that that power was given to the mortgagor did not, and as the law now stands does not, in my judgment, deprive the mortgagor of the power of doing that which he could have done apart from the Act - namely, grant a lease to a third party, which without the consent of the mortgagee is not binding on him, but is binding as between the lessor and the lessee. I cannot find that the power which the mortgagor had in that regard was taken away by the Act, which merely gave the mortgagor a wider power of granting leases on certain conditions which were binding on the mortgagee. The position, apart from the Act, in my judgment, remained the same. The mortgagee as soon as he ascertained that the mortgagor had granted a lease to a third party was entitled to take steps immediately to evict the tenant, to treat him as a trespasser, and, subject to the tenant's right to redeem, the mortgagee could evict him and recover possession of the property. On the other hand, he might, if he desired, confirm what had been done, but if, knowing the facts, he stayed his hand and did nothing, he might find himself in danger of being held to have acquiesced in and thereby confirmed the lease and, therefore, not entitled to oust the tenant. These respective rights of the mortgagor and mortgagee with regard to a lease by the mortgagor were not, in my judgment, altered by the Conveyancing Act, but what the Conveyancing Act did was to make the position one which was more satisfactory as between the mortgagor and mortgagee by enabling the mortgagor, subject to the conditions and provisions of the Act itself, to grant a lease which was binding on the mortgagee, which theretofore he could not do."

19. I note that Farwell J. refers to any lease created between a mortgagor and a tenant as arising by estoppel. The issue as to privity of contract, which was the basis for Judge Kenny holding in favour of the partner taxpayers on this issue, therefore does not arise. It is clear as between a mortgagor, as landlord, and a tenant to whom he lets the mortgaged property, supposing for the moment that this is not a wholly artificial series of transactions, that there is ordinarily an agreement where both intend to create legal relations in respect of obligations which are certain and that there is consideration passing between both parties. There is thus ordinarily privity of contract. Yet, in those circumstances, if the tenancy arises only by virtue of the representation of the parties and the unfairness of allowing a mortgagor as landlord to deny the tenancy, the conditions for estoppel in these circumstances, it is clear that another legal factor stands between them which has upset the normal consequence of legal validity in a lease. This, in my judgment, is that having conveyed the legal interest in the property to the lending institution, the mortgagor has no legal title to alienate by way of lease. He or she holds the property in equity subject only to the right of redemption of the legal interest. Such a lease is void. When Farwell J., refers to an estoppel arising in circumstances where the mortgagee, namely the bank or lending institution, becomes aware of the tenancy apparently effected in breach of a covenant against any form of alienation, but does nothing about it, then the same conclusion, but this time absent any possible argument as to privity of contract between the lessee

and the mortgagee, arises.

20. The issue as to whether a lease made in breach of a covenant under a mortgage was void arose on an interlocutory basis in *ICC Bank plc v. Verling & Ors* [1995] 1 I.L.R.M. 123. In that case, Lynch J. regarded a lease made in breach of covenant under a mortgage deed as being void. The same view was taken by Laffoy J. in *The Wise Finance Company Limited v. Jeremiah O'Regan* (Unreported, High Court, 26th June, 1998). In that case an individual called Dr. Grimes sought to be joined in proceedings to have a mortgage well charged as against the defendant on the basis that a lease had been granted in respect of those premises to a company of which he was the receiver. That application was refused on the basis that the lease in question was void. In her judgment, Laffoy J. makes this clear at pp. 8-9:-

"On behalf of the Plaintiff, Ms. Butler argued that Dr. Grimes is not entitled to be joined as a party to these proceedings on two grounds. First, she submitted that the purported lease dated 1st November, 1996 having been purportedly made after the creation and registration of the two indentures of charge in favour of the Plaintiff was void. In each indenture of charge in Clause 14(k) the Defendant covenanted with the Plaintiff not to demise or let or part with the possession of the mortgaged property or any part thereof without the prior consent in writing of the Plaintiff and not to exercise the statutory powers of leasing or agreeing to lease contained in Section 18 of the Conveyancing Act, 1881 (the Act of 1881). Ms. Butler cited the decision of this Court in *I.C.C. Bank Plc. -v- Verling*, (1995) 1 I.L.R.M.123, and she relied, in particular, to the following passage from the judgment of Lynch J. at page 129:-

'Before the passing of the Conveyancing Act, 1881 a mortgagor could not make any lease binding upon the mortgagee without the mortgagee joining in the grant of such a lease. Section 18 of the Conveyancing Act, 1881 gave power to a mortgagor in possession to make such a lease as has been made in this case but that power is subject to various provisos set out in the section. Sub-section (13) provides as follows:

'This section applies only if and as far as a contrary intention is not expressed by the mortgagor and the mortgagee in the mortgage deed, or otherwise in writing and shall have effect subject to the terms of the mortgage deed or of any such writing and to the provisions therein contained.'

Clause 15 of the mortgage deed of 31 May, 1991 which I have quoted above, is of course such a contrary intention as is referred to in Section 18(13) of the Conveyancing Act, 1881 and it is clear therefore and indeed counsel for the second and third defendants conceded that the lease of 23rd May, 1993 was null and void when it was first granted by the first defendant to the second and third defendants.'

In my view, Ms Butler's submission is well founded. Clause 14 (k) of each of the indentures of charge in this case is a contrary intention which excludes the operation of Section 18 of the Act of 1881. Apart from that, in any event, the purported lease of 1st November, 1996 is not such a lease as a mortgagor in possession would be entitled to make so as to bind a prior encumbrance if Section 18 was not excluded because it did not 'reserve the best rent that can reasonably be obtained, regard being had to the circumstances of the case' as required by Section 18(6) and, in fact, did not reserve any rent at all."

21. I regard these decisions as being authoritative and I have no doubt that I should follow them. Nor could I possibly infer, in this case, any intention by the lessors to obtain "the best rent that can reasonably be obtained", under the Conveyancing Act 1881 since this entire transaction was essentially effected within the partnership merely using Shamrock Estates Ltd as a convenient vehicle for their tax device. Obviously, there are other breaches of the 1881 Act as well.

22. It therefore follows that the purported leases to which I have referred are void and that I must respectfully differ from the legal conclusion arrived at by Judge Kenny in this regard.

23. In consequence, the partnership, as taxpayers, were liable to VAT in precisely the same way as if these purported legal instruments of lease, leaseback, and surrender had never been signed.

24. I consider that it is my duty to answer all of the questions raised on the case stated, as this jurisdiction exists for the purpose of giving the assistance of the High Court to those courts entitled to seek it. It is also important to dispose of these questions from the point of view of costs as most of the hearing was taken up with the European law point. I will now go on to consider, but in concise form, the issue as to abusive process that would have arisen had these purported leases been valid.

### **Abusive Process**

25. Judge Kenny held that the series of legal devices in this case constituted an abusive process. As such, he held that he was obliged to define the series of purported transactions so as to reflect the true nature of what had occurred. Fundamentally, he regarded the leases and related legal documents as being of no effect, thereby giving rise to a liability in VAT against the partnership for the sale of the holiday homes as if the purported legal instruments had not been entered into. His reasoning was as follows:-

"...I was satisfied that neither the lease nor the leaseback had any commercial reality: there was no evidence of intention to sell the property by way of lease to any third party; in effect the partners were simply leasing to themselves, and surrendering back to themselves, for the purpose of reducing VAT. In the circumstances, I was of the view that the lease and leaseback arrangement constitutes an abusive practice, contrary to the purpose of the Directive, and accordingly the respondent is correct in saying that the applicants should be subjected to VAT upon the freehold sales of the houses to the third parties."

26. The concept whereby an abusive process identifies and then nullifies a purported compliance of law has been part of the jurisprudence of the European Court of Justice since 1974; *van Binsbergen v. Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid*, (Case 33/74) [1974] E.C.R. 1229. It is now a principle of general application applying to all branches of European law, including taxation. Although the principle first appeared in the context of the free movement of services and freedom of establishment, the nature of the definition of abusive practice, requiring an objective and subjective element of analysis, has clearly now been defined as being of general application. In particular, it clearly applies to the interpretation of taxation provisions.

27. The essential argument on behalf of the partnership is this: that I am obliged to regard the legal instruments to which I have referred as being valid, notwithstanding the stark findings of fact made by Judge Kenny after hearing both evidence and legal argument. This is because of the absence, it is said, of a legal instrument transferring the principle of abusive practice from European into Irish law. The principle of the reinterpretation of an artificial transaction in accordance with its real nature due to an abusive process, is thus equated with the failure to transpose into Irish law any one of the specific rules set out in any particular Directive, be

it this one or any other.

28. It is beyond argument that in Irish law a Directive cannot have effect absent a national legal instrument effecting its transposition, usually under the European Communities Act 1972. This principle is one of both European and national law and applies notwithstanding the importance of the subject matter of the Directive or the consequences that may result in a failure to fully or properly transpose it; *Kofoed v Skatteministeriet* (Case C-321/05) [2007] E.C.R. I-05795 paras. 42-48. In *Albatros Feeds Ltd v. The Minister for Agriculture* [2007] 1 I.R. 221, a cargo of grain and animal feed was imported which, on inspection, contained fragments of animal bone. If eaten by an animal, these constituted a clear infection risk and one that the European institutions were intent on avoiding. The Minister caused the consignment to be seized pursuant to the European Community (Processed Animal Products) Regulations 2000. This was the national legislation passed to give effect to a European Regulation and two European Directives which contained the power to retain and dispose of a product containing organic animal matter. These were anti BSE measures. This specific power of seizure, however, was not transposed into the national legislation. It was argued that, in some way, because it was the duty of the national court to give supremacy to European law, and to interpret national legislation in the light of the relevant European law provisions that these principles supplied the necessary power notwithstanding the failure to correctly transpose the power of seizing animal feed from European to national level. This argument was unanimously rejected by the Supreme Court. This is apparent from the relevant passages from the judgment of Fennelly J. at pp. 243-245:-

"59. It is, at the same time, perfectly clear that the court is under an obligation to interpret national law, so far as possible, in the light of the Community law provisions it is designed to implement. The important qualification is: so far as possible. The European Court of Justice does not interpret national law. It is a fundamental principle that the Community law respects national procedural autonomy. The national court is subject to the obligation of 'conforming interpretation,' as the court described it in its judgment in *Criminal proceedings against Pupino* (Case C-105/03) [2005] E.C.R. I-5285. There are, however, limits to that obligation. Most recently, the European Court of Justice in its judgment in *Adeneler v. Ellinkos Organismos Galaktos* (Case C-212/04) [2006] I.R.L.R. 716 repeated at para. 110 that 'the obligation on a national court to refer to the content of a directive when interpreting and applying the relevant rules of domestic law is limited by general principles of law, particularly those of legal certainty and non-retroactivity, and that obligation cannot serve as the basis for an interpretation of national law *contra legem*.'

60. The national court is not obliged so to interpret its national law in a way which would be incompatible with the relevant national legislation.

61. In the application of that principle to the facts of the present case, it is of the first importance to note that the powers claimed by the first respondent entail a drastic incursion into the fundamental property rights of the affected trader. Such action must be justified, if at all, by clear words. There are no words in the Regulations of 2000, which are capable, on even the most extended and generous interpretation, of justifying the first respondent's actions.

62. The first respondent claims, nonetheless, that a number of provisions of Community law expressly authorise, or even oblige, the authorities of the member states to take direct action to prevent trade in contaminated products. It said that the provisions of the Regulations of 2003 (replacing the European Communities (Animal Nutritional Inspections) Regulations 2000) apply to any inspections carried out under the Regulations of 2000 and that reg. 7 of the Regulations of 2003 authorised the first respondent to issue the various instructions and notices. I am prepared to accept these propositions for the purposes of the argument. However, the entire attempt to import these powers into the Regulations of 2000 depends on reg. 9 of the latter instrument, which provides only that, making the necessary substitution of the Regulations of 2003 for the European Communities (Animal Nutritional Inspections) Regulations 2000, 'shall apply to inspections undertaken by an authorised officer for the purposes of these Regulations'. I simply cannot accept that this reference to inspections can encompass the far reaching powers expressed in the two letters of instructions or the several seizure and detention notices. It does too much violence to language to claim that they do.

63. I am fully conscious of the obligation of 'conforming interpretation' (a poor rendering of the French *interprétation conforme*). I am equally conscious of the need for severe action to prevent the spread of B.S.E. Severe action may be indispensable and it may be necessary to infringe fundamental rights including property rights. However, clear words are necessary where fundamental rights are at issue. I do not accept that our courts are obliged to interpret our laws so as to confer drastic powers by vague or indirect words or, indeed, by none. In the present case, such a result cannot be achieved by any normal process of legal reasoning."

29. It was submitted that to apply the principle of abusive process whereby apparently valid leases are redefined as being invalid is to infringe the first principle of revenue law whereby taxation is entirely based upon the application of statute law without the modification of any general principle of fairness or equity. Income tax is entirely based on Irish legislation and is not obligated by our membership of the European Union. The courts in interpreting domestic legislation do not apply any general principle whereby, what might be called, unworthy transactions, which have no apparent benefit apart from being a tax avoidance mechanism, are analysed in terms of the substance of the transaction. Carroll J. disagreed with the English approach to this matter, as exemplified in *Furniss v Dawson* [1984] A.C. 474, in her judgment in *McGrath v McDermott (Inspector of Taxes)* [1988] I.R. 258. She stated that the correct approach to interpreting taxation legislation in this jurisdiction was literal; tax avoidance was a matter to be dealt with by the legislature through detailed statutory provisions, enacted year after year, through identifying the gaps through which revenue was seeping away by tax avoidance and by filling the want in literal interpretation by specific legislation. She said that if the legislature "has failed to 'plug a hole' in advance or has failed to pass a law which strikes generally at tax avoidance schemes... it is not the function of the court to intervene."; at p. 272. The Supreme Court upheld this approach. Finlay C.J., however, specifically noted that in relation to the facts of that case that the complex scheme was not a sham and that the shares transactions that constituted the tax avoidance measures were genuinely sold and purchased. He held that the courts do not possess the power to add to or delete from express statutory provisions in order to achieve a fair or desirable result. This would be an invasion by the courts into the powers expressly reserved to the legislature; [1988] I.R. 258 at p. 277. Since that case, the principle of literal interpretation of taxation legislation has been an undoubted feature of our law; see in particular the analysis by Carney J. in *McCabe v South City & Country Investment Co. Ltd* [1997] (Vol.5) I.T.R. 107. The general anti-avoidance measure, passed in consequence of these decisions, is now s.811 of the Taxes Consolidation Act 1997. These decisions, however, are all in relation to domestic legislation, where none of the obligations to pay tax arose by virtue of measures imposed by the European Union. In applying a measure in European law, the approach of the courts to the construction of the transactions engaged in by taxpayers should reflect the obligations that Ireland has undertaken by virtue of its membership of the Union. On my analysis of the relevant case law, this does not amount to a redefinition of the applicable legislation, where the transactions in question are objectively lacking in commercial reality and were engaged in subjectively as a sham.

30. I am of the view that there is a general principle of European law whereby a transaction maybe redefined if it was subjectively

entered into for the purpose of avoiding the application of a European legal measure and, objectively, the transaction is not such as might be seen as constituting a legitimate choice or the exercise of any form of ordinary commerce. My view is that this is matter of definition, interpretation and judicial control. It is therefore a principle which is within the sphere that has always been exercised by the judiciary of the Member States; namely properly characterising transactions according to their true nature. It is urged that no general principle of law allows for the application of abusive process to taxation measures. However, at common law the principles that "fraud undoes everything" and, in the sphere of company law, whereby the veil of incorporation may be lifted if a separate corporate identity was set up merely "to avoid the eye of equity", are both examples of that general principle of interpretation whereby a legal manoeuvre may be identified as to its underlying reality. On consideration of the case law in the European Court of Justice on the issue of abusive process, my judgment is that the principle has derived from civil law systems, where it has very wide application, and has become an overriding principle whereby the effect of European Union measures are not to be set at nought through legal transactions that may be apparently valid on their face but which are entered into with the essential aim of undermining the supremacy of European legislation.

31. The earliest appearance of this principle in the *van Binsbergen* case illustrates that the approach of the European Court of Justice was never towards the creation of a new rule requiring a legal instrument, but the application of a general principle whereby transactions may be properly interpreted in accordance with the express provision and purpose of European law measures. In that case a Dutch lawyer, chosen to represent the litigant *van Binsbergen* before a Dutch court, had moved his seat of practice to Belgium. The Court ruled that a Dutch law restricting legal representation to lawyers resident in The Netherlands constituted a restriction on the free movement of services. That principle did not sit alone, however, as the Court made it clear that facts purportedly established through legal instrument could be reinterpreted if their purpose was abusive. At para. 13 the Court ruled:-

"Likewise, a Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by Article 59 EC [now Article 49] for the purpose of avoiding the professional rules of conduct which would be applicable to him if he were established within that State; such a situation may be subject to judicial control under the provisions of the chapter relating to the right of establishment and not that on the provision of services."

32. In *Commission v. Belgium* (Case C-211/91) [1992] E.C.R. I-6757 and *Vereniging Veronica Omroep Organisatie v. Commissariaat voor de Media* (Case C-149/91) [1993] E.C.R. I-487, the principle of abusive process was affirmed as a rule of interpretation that is of general application. In the *Veronica* case the Court of Justice approved the principle that national legislation could be valid in prohibiting radio and television companies from setting up abroad, in other words outside the territory of the Member State, for the purpose of providing services directed towards The Netherlands. This was because, as the Court stated at para. 13:- "...The Netherlands legislation at issue has the specific effect, with a view to safeguarding the exercise of the freedoms guaranteed by the Treaty, of ensuring that those organizations cannot improperly evade the obligations deriving from the national legislation concerning the pluralistic and non-commercial content of programmes." This meant that the Treaty provisions on freedom to provide services were to be interpreted as not precluding a Member State from treating as a domestic broadcaster a broadcasting body constituted under the law of another Member State and established in that State, whose activities are wholly or principally directed towards the territory of the first Member State, if that broadcasting body was established there in order to enable it to avoid the rules which would be applicable to it if it were established within the first State.

34. Similarly, in, *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex-parte Daily Mail and General Trust Plc* (Case 81/87) [1998] E.C.R. 5483, the Court of Justice again referred to the applicability of Articles 52 and 58 EC as being one of interpretation. In that case a newspaper claimed that it was against the rules of freedom of establishment for the United Kingdom to be allowed to legally oblige the newspaper to be authorised before transferring its seat of business from the United Kingdom to The Netherlands. The Court of Justice held, at para. 24, that the Articles of the Treaty could not:-

"...be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State."

35. *Emsland-Stärke GmbH v. Hauptzollamt Hamburg - Jonas* (Case C-110/99) [2000] E.C.R. I-11569 concerned monetary compensation payments whereby Emsland- Stärke, on exporting potato starch to Switzerland was entitled to be paid an export refund under Commission Regulation (EEC) No. 2730/79 of 29 November 1979 laying down common detailed rules for the application of the system of export refunds on agricultural products, as amended. The applicability of this judgment to the current problem derives from the fact that monetary compensation amounts, although not characterised as taxation, are akin to taxation measures. Under the relevant Regulation, on exporting certain products outside the EEC, monetary compensation might be paid from central funds. This could also arise on transfers across national borders within the Community. The entitlement in that case arose when the potato starch left Germany for Switzerland. That was a strict compliance with a Council Regulation, giving rise to an apparent and strict legal entitlement to payments. However, the lorries carrying the product then went through Switzerland and, without any economic activity taking place there apart from the driving of a truck, went straight back to Germany. What was to be looked at, the strict compliance in law or the reality underlying an apparently clear compliance by the potato starch company with Regulation 2730/79 EEC. The Court of Justice, held that apparently strict compliance is not, of itself, sufficient to gain a benefit in European law where the intention behind that purported compliance is to undermine the purpose of the legislation giving rise to the benefit. This was, again, a matter of the correct interpretation of the movement of the lorries not as being an export of goods but as not being any such thing in reality. I therefore rely upon the following passage from the judgment:-

"50. However, in the light of the specific circumstances of the operation at issue in the main proceedings, which might suggest an abuse, that is to say a purely formal dispatch from Community territory with the sole purpose of benefiting from export refunds, it must be examined where the Regulation No. 2730/79 precludes an obligation to repay a refund once granted.

51. In that regard, it is clear from the case law of the Court that the scope of the Community regulations must in no case be extended to cover abuses on the part of a trader... The Court has also held that the fact that importation and re-exportation operations were not realised as bona fide commercial transactions but only in order wrongfully to benefit from the grant of monetary compensation amounts may preclude the application of positive monetary compensatory amounts, (*General Milk Products*, cited above, paragraph 21).

52. A finding of an abuse requires first, a combination of objective circumstances in which despite formal observance of the conditions laid down by the Community rules, the purpose of these rules has not been achieved.

53. It requires, second, a subjective element consisting of the intention to obtain an advantage from the Community rules

by creating artificially the conditions laid for obtaining it. The existence of that subjective element can be established, inter alia, by the evidence of collusion between the Community exporter receiving the refunds and the importer of the goods in the non-member country.

54. It is for the national court to establish the existence of these two elements, evidence of which must be adduced in accordance with the rules of national law, provided that the effectiveness of Community law is not thereby undermined (see, to that effect, in particular, Joined Cases 205/82 to 215/82 *Deutsche Milchkontor and Others v. Germany*, [1983] ECR 2633, paragraphs 17 to 25 and 35 to 39; Case 222/82 *Johnston v. Chief Constable of the Royal Ulster Constabulary* [1986] ECR 1651, paragraphs 17 to 21; and Case C-212/94 *FMC and Others v. Intervention Board for Agricultural Produce and Ministry of Agriculture, Fisheries and Food* [1996] ECR I-389, paragraphs 49 to 51, and Joined Cases C-418/97 and C-419/97 *ARCO Chemie Nederland and Others v. Minister van Volkshuisvesting* [2000] ECR I-4475, paragraph 41)."

36. *Halifax plc, Leads Permanent Development Services Limited, County Wide Property Investments Limited v. Commissioners of Customs and Excise (Case C-255/02)* [2006] E.C.R. I-1609 concerned a complex series of transactions making up a VAT planning scheme. *Halifax*, as a banking company, provided supplies which were exempt from VAT. So, input VAT was absent from its main business. For the purpose of its business, it established a number of call centres whereby it could have recovered 5% of the VAT paid on construction works. However, the bank and its related companies then set up a scheme to enable it to recover the full amount of input of VAT incurred on the building works through a series of apparently legitimate transactions involving different companies. The Court of Justice held that this was an abusive process and that, in consequence, the assessment of tax should take place as if this mechanism had not been effected. Following this ruling, *Halifax* withdrew its appeal before the relevant taxation appeals body in the United Kingdom. Nothing which I have found indicates that the United Kingdom authorities were operating on the basis of legislation that in some way made the principle of abusive process a part of a United Kingdom statute law. The case arose due to the VAT and Duties Tribunal in London stating a case to the Court of Justice for a preliminary ruling, at para. 43, on two questions:-

"1(a) In the relevant circumstances, do transactions

(i) effected by each participator with the intention solely of obtaining a tax advantage and

(ii) which have no independent business purpose

qualify for VAT purposes as supplies made by or to the participators in the course of their economic activities?

(b) In the relevant circumstances, what factors should be considered in determining the identity of the recipients of the supplies made by the arm's - length builders?

2. Does the doctrine of abuse of rights as developed by the Court operate to disallow the appellants their claims for recovery of or relief for input tax arising from the implementation of the relevant transactions?"

37. In answering the second question, the Court of Justice held that the Sixth Directive on VAT must be interpreted as precluding any apparent right deriving from an abusive process. This was defined as follows at para. 86:-

"For it to be found that an abusive practice exists, it is necessary, first, that the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and of national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage."

38. The earliest principles that had been laid down by the Court of Justice in the *van Binsbergen* case of subjective intention and objective failure to comply with the spirit of legislation is thus preserved; see para. 74. An abuse does not occur where the economic activity carried out may be interpreted other than as the attainment of a tax advantage; see para 75. The Court of Justice held, however, that European legislative measures cannot be relied on for abusive or fraudulent ends and cannot be extended to cover abusive practices. These are defined as being outside the context of normal commercial operations but which are instead effected solely for the purpose of wrongly obtaining advantages that are otherwise provided for in genuine instances by European legislation; see paras. 68 and 69. The Court of Justice referred to the requirement of certainty in community legal rules. No tax payer is obliged to choose, where there is a choice of two transactions, that economic activity which yields to the Revenue Commissioners, or other national taxation body of a Member State, the highest amount of taxation. However, legal certainty is advanced where an abusive process is struck down in favour of the obvious and inescapable underlying reality to what is objectively a non-economic activity. This is, in addition, a foreseeable consequence of an abusive process since, subjectively, it is entered into only for the purpose of misapplying the proper application of advantages derived from European legislation.

39. In the *Halifax* case the Court of Justice also emphasised the principle whereby purported legal transactions are subject to interpretation before the courts of the Member States. That interpretation by the national courts must take into account the purpose of the national legislation as transposing the relevant European legal measure. In that regard, the *Halifax* case confirms what is, in any event, stated in Article 13 of the Sixth Directive, that preventing possible tax evasion, avoidance or abuse is an objective recognised and encouraged by the Sixth Directive; see para. 76 where the Court of Justice indicates that it is for the national court to verify whether the practice is abusive in accordance with the rules of evidence of national law. This is particularly relevant here as the claimed benefit in favour of the partnership is sought under that Article. This was emphasised at paras. 80 and 81 of the judgment:-

"80 To allow taxable persons to deduct all input VAT even though, in the context of their normal commercial operations, no transactions conforming with the deduction rules of the Sixth Directive or of the national legislation transposing it would have enabled them to deduct such VAT, or would have allowed them to deduct only a part, would be contrary to the principle of fiscal neutrality and, therefore, contrary to the purpose of those rules.

81 As regards the second element, whereby the transactions concerned must essentially seek to obtain a tax advantage, it must be borne in mind that it is the responsibility of the national court to determine the real substance and significance of the transactions concerned. In so doing, it may take account of the purely artificial nature of those transactions and the links of a legal, economic and/or personal nature between the operators involved in the scheme for reduction of the tax burden (see, to that effect, *Emsland Stärke*, paragraph 58)."

40. I am bound by the finding of Judge Harvey Kenny as to the purpose of these transactions by the partnership. I have no doubt that they are entirely contrary to the correct interpretation of the Sixth Directive and operate so as to undermine the foundational



certainty of the exemptions provided for in national law and under the Directive.

41. In *Ministero dell'Economia e delle Finanze v. Part Service Srl* (Case C-425/06) (Unreported, European Court of Justice, 21 February 2008) the Court of Justice revisited the *Halifax* judgment. Where the objective factors point to the essential aim of a transaction as being to obtain a tax advantage, there can be a finding of an abusive practice when the accrual of the tax advantage constitutes the principle aim of the transaction or transactions at issue; see para. 45. In that case, and in order to obtain a taxation advantage, a series of apparent contracts were entered into between interested parties. The Italian tax bureau interpreted these transactions. It held that these together constituted a single contract which had been artificially divided in order to reduce the taxable amount. On the interpretation of schemes of that kind, and again following the line of authority from the earliest cases before the Court of Justice, the court held as follows:-

"51. However, in certain circumstances, several formally distinct services, which could be supplied separately and thus give rise, in turn, to taxation or exemption, must be considered to be a single transaction when they are not independent.

52. Such is the case for example, where, in the course of a purely objective analysis, it is found that there is a single supply in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service (see, to that effect, CPP, paragraph 30 and *Levob Verzekeringen* and *OV Bank*, paragraph 21). In particular, a service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied (CPP, paragraph 30 and the facts of the dispute in the main proceedings giving rise to that judgment).

53. It can also be held that there is a single supply where two or more elements or acts supplied by the taxable person to the customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split (*Levob Verzekeringen* and *OV Bank*, paragraph 22).

54. It is for the national court to assess if, the contractual structure of the transaction notwithstanding, the evidence put before the court discloses the characteristics of a single transaction."

42. Overall, the principle of abusive process requires me to agree with the findings of Judge Kenny on this issue. This is a matter of applying the principle as stated by the Court of Justice in the *Halifax* case whereby the transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice; *Halifax* quoted below at para. 46 of this judgment. All the transactions between the partners and their related company were clearly entered into for no economic purpose and were constructed solely for the purpose of obtaining a tax advantage. There was nothing in the transactions which could possibly constitute an independent objective justification. The transactions were effected solely for the purpose of undermining the application of the national transposition of the Sixth Directive. None of the transactions constituted the exercise of any economic activity such as would qualify for the payment of tax, and so excuse the payment of VAT on these holiday cottages. As so characterised, it seems to me that the principle of abusive process operates so as to properly define the economic activity which is subject to VAT and to the circumstances in which it applies and the rate at which it applies.

43. Two provisions of the Treaties of the European Union refer to general principles. Article 6 (2) of the Treaty on the European Union, refers in the context of human rights protection to "general principles of Community law". Article 288 of the Treaty Establishing the European Community makes reference to "the general principles common to the laws of the Member States" in the context of legal liability. Here the liability in law is to pay tax at the prescribed rate. The principle of abusive process is one of interpretation and is of general application. Rita de la Feria in her article, '*Prohibition of Abuse of (Community) Law: The Creation of a New General Principle of EC Law though Tax*' CML Rev 2008 395 at p.435, comments that general principles from the laws common to most of the Member States can be re-transplanted into European law and adopt a key role within the EU legal system. She characterises the principle of abusive process as being a general principle applicable to all fields of European law. Although she identifies apparent exceptions in the field of nationality law, which she explains as nonetheless being in conformity with the doctrine, there is no doubt as to the general applicability of the principle of abusive process in redefining purported transactions in order to discover their real effect.

44. At p. 425 of her survey of the law she makes the following comment:-

"Although what is exactly a general principle of Community law is difficult to define and there is no apparent full doctrinal agreement, three main characteristics have been proposed as essential:

- *Generality* - a principle should have, not only a level of abstraction which distinguishes it from a specific rule, but equally, a degree of recognition by a relevant constituency, such as the courts.
- *Weight* - a principle must express a core value of an area of law or the legal system as a whole; although the degree of importance of that value might diverge from principle to principle.
- *Non-conclusiveness* - a principle does not necessitate a decision, but rather point towards a decision, i.e. it is "orientative" rather than conclusive.

In formulating these general principles, the Court [of Justice] draws inspiration from different sources, the most important of which are the laws of the Member States. This process, which has been designated as 're-transplantation', means in practice that principles which are common to most of the Member States' legal systems, but not necessarily all, will become principles of Community law."

45. This is not a case where a Directive is being relied on per se by a member State against an individual; *Hans Markus Kofoed v. Skatteministeriet* (Case C-321/05) [2007] E.C.R. I-5795, of which see paras. 42-44. Nor is it a case where a law is being invented, or attempted to be improperly transposed, without national legislation, providing for taxation when none otherwise would apply, as in *Kofoed*. Rather, the principle of abusive process requires this Court to properly construe a purported transaction, or more often, a series of apparent transactions, as to its subjective intention and objective reality so as to properly apply the text of the Sixth Directive.

## Interest

46. As a result of a question asked during the course of this hearing, it emerged that interest may be required to be paid by the partnership in consequence of late payment of tax. I am told that the relevant interest rate is fixed by statute at 12%. It is argued that this is a penalty provision which is contrary to the ruling of the Court of Justice in the *Halifax* case. In that regard, I quote paras. 90 to 97 of the judgment:-

"90 It must be noted at the outset that no provision of the Sixth Directive deals with the recovery of VAT. That directive merely defines, in Article 20, the conditions which must be complied with in order that deduction of input taxes may be adjusted at the level of the person to whom goods or services have been provided (see the order of 3 March 2004 in Case C-395/02 *Transport Service* [2004] ECR I-1991, paragraph 27).

91 It is therefore, as a rule, for the Member States to lay down the conditions under which the tax authorities may recover VAT after the event, while remaining within the limits imposed by Community law (*Transport Service*, paragraph 28).

92 It is important, however, to note in that respect that the measures which the Member States may adopt under Article 22(8) of the Sixth Directive in order to ensure the correct levying and collection of the tax and for the prevention of fraud must not go further than is necessary to attain such objectives (see *Gabalfria and Others*, paragraph 52, and the order in *Transport Service*, paragraph 29). They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation (see Case C-454/98 *Schmeink & Cofreth and Strobel* [2000] ECR I-6973, paragraph 59).

93 It must also be borne in mind that a finding of abusive practice must not lead to a penalty, for which a clear and unambiguous legal basis would be necessary, but rather to an obligation to repay, simply as a consequence of that finding, which rendered undue all or part of the deductions of input VAT (see, to that effect, *Emsland Stärke*, paragraph 56).

94 It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

95 In that regard, the tax authorities are entitled to demand, with retroactive effect, repayment of the amounts deducted in relation to each transaction whenever they find that the right to deduct has been exercised abusively (*Fini H*, paragraph 33).

96 However, they must also subtract therefrom any tax charged on an output transaction for which the taxable person was artificially liable under a scheme for reduction of the tax burden and, if appropriate, they must reimburse any excess.

97 Similarly, it must allow a taxable person who, in the absence of transactions constituting an abusive practice, would have benefited from the first transaction not constituting such a practice, to deduct, under the deduction rules of the Sixth Directive, the VAT on that input transaction."

47. It is said that a 12% interest level goes beyond any economic cost of money and that I ought to take judicial notice of the relevant financial pages in newspapers in order to declare that interest at this rate should not be payable because of its penal nature. Firstly, the recovery of the money is pursuant to a clear statutory provision. Secondly, no evidence was put before His Honour the learned Circuit Court judge on this issue. I am unable to state what the cost of money would be to the State in the event that there is a late payment of tax. It is potentially a matter that goes beyond what a private borrower might expect to pay on the open market in respect of a loan, or to be paid on a deposit of spare money in a bank or financial institution, but I simply do not know. This kind of failure to pay the proper tax on time may involve the non-payment, or late payment, of operators of services provided to the Government. It may also involve the Government borrowing money at rates which are outside any means of general knowledge that I have. It may cause administrative inconvenience and expense of which I could not possibly be aware, and for which some other taxpayer has to foot the bill. I would regard it as unsatisfactory for a judge to rely on the principle of judicial notice where matters are outside areas of his or her personal knowledge or expertise and which are not notorious. I note that interest repayments on an interest-only mortgage can run at around 5% or 6%. That rate, however, seems to be so in respect of debtors who are regarded as a good credit risk. I have no idea of the situation of a person who is regarded as sub-prime, to use the unattractive phrase current in public discourse, in lending terms. Nor am I aware of what interest rate might apply to defaulters. As to compound interest charged by banks, I believe that it can be charged on not just one day in a year but on two, making the expense of default greater than a notional default rate. As to how default provisions as to interest is measured, in banking terms or in terms of the administration of government, I can have no expertise. Nor do I know anything about the rate of default from the Revenue Commissioners or the cost of that late payment, or risk of non-payment, to the taxpayer in real terms. On reading the relevant financial pages, I discovered that a particular leading bank in this jurisdiction is said to charge a rate of 27.5% on unauthorised overdrafts. If this is correct, and I do not know whether it is or not, then the approach of the Revenue Commissioners seems to be restrained; source, article by Sarah Carey, *The Sunday Times*, Irish Ed., Sunday 11th May, 2008. In looking to such sources, I am obliged to bear in mind that there may be errors that emerge in good faith, and which might be corrected by open debate and evidence in court; and that is way I cannot rely on them. Fundamentally, I am unhappy to attempt to deal with this matter of interest as a legitimate rate of return as a cost of money, or as a penalty, in the absence of evidence.

#### **Lease**

48. Finally, it is argued that whether or not these transactions are leases, should be defined by European, and not by national, law. In *Sinclair Collis Limited v. Commissioners of Customs and Excise* (Case C-275/01) [2003] E.C.R. I-5965, the Court of Justice, at para. 25, held that the fundamental characteristic of a letting of a immovable property for the purposes of Article 13(b) of the Sixth Directive constituted:-

"...conferring on the person concerned, for an agreed period and for payment, the right to occupy property as if that person were the owner and to exclude any other person from enjoyment of such a right..."

49. In *Belgium State v. Temco Europe SA* (Case C-284/03) [2004] E.C.R. I-11237, the court held that a right of exclusive occupation can be restricted in the context of allowing the landlord to regularly visit the property or to cause certain parts of a property to be used in common with other occupiers; see paras. 24 and 25.

50. In the light of the findings of Judge Harvey Kenny, there is no basis upon which these purported legal measures of lease and leaseback by the partnerships could be defined in European law as a letting. They qualify, in reality, for none of these characteristics.

## Answers

51. Therefore, the answers to the questions of law posed by His Honour Judge Harvey Kenny are, in my opinion: -

(i) The lease dated 8th March, 2002, between the partnership and Shamrock Estates Ltd. was ineffective for the purpose of VAT because of the absence of prior written consent of the mortgagee, namely, ACC Bank, which was required by clause 6.1 of the Deed of Charge. The said lease and leaseback are void.

(ii) The lease and leaseback had no commercial reality and constituted an abusive practice within the doctrines identified by the European Court of Justice. As such, even if such lease and leaseback were apparently valid, which they are not because of the prior mortgage, they should be redefined for the purpose of VAT in order to reflect the true reality of the actions of the partnership.

(iii) The European Court decisions as to abusive process are of general application and they require national courts to redefine abusive measures in accordance with reality. As this is a matter of interpretation, and given the supremacy of European law, implementing national legislation is not required in a Member State in respect of this principle of European law and nor has any such implementing national legislation come to my attention where the doctrine of abusive practice has been applied at national level, as in the *Halifax* case.

(iv) As to whether interest is due on any late payment of VAT by the applicants is a matter to be decided by the Inspector of Taxes and is not something which was before His Honour Judge Harvey Kenny and neither was it before this Court.

## Result

52. In the result, this appeal by the partnership against the Inspector of Taxes is dismissed.

## Text of the Case Stated

There now follows, in the form in which it was received, the text of the case stated by His Honour Judge Harvey Kenny for the opinion of the High Court:

### THE HIGH COURT

### REVENUE

### BETWEEN

EDWARD CUSSENS, JOHN JENNINGS AND

VINCENT KINGSTON

APPLICANTS

AND

T. G Brosnan (INSPECTOR OF TAXES)

RESPONDENT

### CASE STATED

### PURSUANT TO SECTION 943 OF THE TAXES CONSOLIDATION ACT, 1997 AS APPLIED TO VALUE ADDED TAX BY SECTION 25(2) OF THE VALUE ADDED TAX ACT, 1972 AS AMENDED

1. This case is stated by me, Judge Harvey Kenny, Judge of the Circuit Court at the request of the Applicants following the decision made by me on 10th October 2006 in the Circuit Court in Cork, when I refused the Appeal of the Applicants against VAT assessments raised against them by the Respondent pursuant to Section 23 of the VAT Act 1972 for the periods January/February 2002 to November/December 2002 and for the period May/June 2004, on a re-hearing of the Appeal of the Applicants from the determination of Appeal Commissioner John O'Callaghan made on the 21st July 2005.

2. Briefly stated, the background to the assessments raised is as follows:

The Applicants are partners who owned and developed a site at Baltimore, County Cork, on which they built 15 new houses for sale on the open market. Shortly prior to the sale of the houses, and with a view to reducing their VAT liability in relation thereto, the partners entered into a 20-year 1- month lease with a connected company, Shamrock Estates Limited who leased the property back to the partners. Both the lease and leaseback were then surrendered. The partners accounted for VAT on the capitalised value of the 20-year 1-month lease and claimed input VAT (the entitlement to which is not disputed). The Applicant partners then disposed of their unburdened freehold interests in the developed houses to third parties for various sums totalling approximately €3 million. The Respondent raised assessments to VAT on the basis that the Applicant partners are obliged to account for VAT in respect of the freehold sales of the holiday homes. The said assessments (which are attached to this Case Stated as Appendix 1) make allowance for the undisputed input VAT and for the sum of €40,000 VAT accounted for by the Applicants in respect of the creation of the 20- year 1-month lease.

## 3. The Issues

It was agreed that the outcome of the Appeal before me involved two issues, which may be briefly stated as follows:

(A) The validity for the purposes of VAT of the 20-year 1-month lease dated 8th March 2002, having regard to the provisions of a deed of mortgage/charge dated 12th March 2001 in favour of ACC Bank Plc, which contained a prohibition against disposing of the whole or any part of the secured assets by way of lease or otherwise, without the prior consent of the said ACC Bank Plc, which consent was not sought or obtained; and

(B) The question whether the creation of the 20-year 1-month lease and the associated leaseback and subsequent surrender should be disregarded for the purposes of VAT as constituting an abusive practice, in accordance with the decision of the European Court of Justice in the *Halifax* case *Halifax Plc, Leeds Permanent Development Services Limited, County Wide Property Investments v Commissioner of Customs and Excise*; Case 225/02 – Judgment of ECJ of 21st February 2006..

#### 4. Evidence

Edward Cussens, Accountant, the first named Applicant, gave evidence before me.

#### 5. The Facts

I found the following facts relevant to my determination, having been either admitted or proved:

(A) The Applicant partners were registered as freehold owners of a plot of land comprised in Folio 111670 County Cork. The Applicant partners acquired that land with the intention of developing it by building 15 houses on it and selling those houses on with freehold title and for profit.

(B) The Applicant partners entered into a contract with the third named Plaintiff for the construction of the houses. The houses were substantially completed by December 2001.

(C) For the purposes of the development of the houses, it was necessary for the Applicants to borrow substantial sums from ACC Bank Plc ("ACC"). The initial loan agreement (IR£930,000) was made with ACC on 17th October 2000.

(D) By deed of mortgage/charge dated 12th March 2001 the Applicant partners granted ACC a charge over the land in Folio 111670 County Cork. Clause 6.1 of the deed of mortgage/charge contained a prohibition against disposing of the whole or any part of the secured assets by lease or otherwise, without the prior consent in writing of ACC.

(E) It was necessary from time to time to extend the borrowings from ACC. ACC issued further letters of loan sanction in October 2001 (IR£160,000 - €203,000), on 22nd November 2001 (IR£155,000), in January 2002 (€130,000): Each loan facility letter contained a special condition stating that no lettings or renewal of lettings in or of the secured property were to be made without the ACC's prior consent in writing; it was important (as Mr Cussens accepted) for ACC to protect its security by such provisions. The last letter of sanction dated 11th January 2002 indicated ACC wanted their money back within 2 months of that date.

(F) The Applicants commenced to market the houses in or about May or June of 2001 through selling agents, Sherry Fitzgerald O'Neill in Clonakilty. However, the market was not favourable, due partly to the impact of the Bacon report and partly to the fact that at the time there was no interest relief available against rental properties, which meant investors weren't buying houses at the time (around December 2001).

(G) At all times it was the intention of the Applicants to sell the developed houses with freehold title at the best price available on the market.

(H) In order to reduce the VAT liability of the Applicants and on the advice of their tax advisors, Deloitte & Touche, the following transactions were put in place:

(i) By lease dated 8th March 2002, the Applicants (without obtaining the prior consent of ACC) leased the houses to Shamrock Estates Limited (a company the share capital of which had been purchased by the second and third named Applicants, John Jennings and Vincent Kingston on 1st March 2002) for a period of 20 years and 1 month from 8th March 2002 at an annual rent, payable in arrears (a feature Mr Cussens agreed was unusual) of €66,100 per annum, subject to annual review. A copy of the lease is annexed hereto as Appendix 2.

(ii) By agreement made 8th March 2002, the said Shamrock Estates Limited let the said houses back to the Applicants for a term of 2 years. The rent was stated to be €67,000 per annum, based upon a rate of €5,833.33 per month, the amount of which payment was to be based upon the number of months during which the tenant was in occupation of the premises. No rent was payable until the termination of the tenancy. It was a term of the leaseback (by clause 4 (c)) that the tenancy would terminate immediately prior to the disposal by the landlord of a freehold or long leasehold in the property and it was further provided (by clause 4 (d)) that, in the event the landlord were to dispose of part of the property, a new tenancy would be deemed to be created over the retained part, on the same terms, including as to rent (which also seemed unusual).

(iii) On 3rd April 2002, Shamrock Estates Limited surrendered the 20-year 1-month lease to the partnership and on the same date the partnership surrendered its leaseback to Shamrock Estates Limited.

(I) It was at all times the intention of the Applicants that the transactions above would take place within a short period of time in order to allow the developed houses to be sold by the Applicants with freehold title. The houses would not have been marketable on the basis of the title held by the Applicants between 8th March 2002 and 3rd April 2002.

(J) The Applicants had the 20 year 1 month lease dated 8th March 2002 valued for VAT purposes at €320,000 and, in their VAT return for the period March/April 2002 accounted for VAT in respect thereof at 12.5% thereof, i.e., €40,000.

(K) Although some prices had been agreed with intending purchasers and booking deposits had been taken prior to 8th March 2002, no binding contract for the sale of any of the houses was entered into with any purchaser until about 15th May 2002. In no case was the price of any house reduced as a result of the transactions referred to at paragraph H: The

houses were all sold at the best price the Applicants could obtain. What those transactions permitted, according to Mr Cussens, was for the Applicants to make a profit on the sale of the developed houses, with the benefit of a reduction in VAT liability.

(L) By approximately January 2003 all the developed houses had been sold and paid for, and ACC had been repaid in full.

(M) By letter dated January 2005, ACC wrote a letter to the Applicants, on the basis of a draft provided by Mr Cussens, indicating: "we note the property was subsequently let. We confirm this transaction was allowed by the Bank. At no stage was it the intention of the Bank to avoid such a transaction despite any powers granted to the Bank under the above loan agreement". ACC was not aware of the lease at the relevant time.

## **6. Arguments of the Applicants in relation to Issue (A) - Validity of Lease**

Mr Gerard Hogan SC on behalf of the Applicants made the following arguments in relation to issue (A):-

6.1 The letter from ACC stating they at no time intended to void the lease between the partnership and Shamrock Estates Limited operated to estoppel ACC from ever voiding the lease under the mortgage deed.

6.2 Even if the ACC letter was not relevant, on the ground that it was retrospective consent, the Revenue Commissioners could not invoke the point, because there was no privity of contract as between the Revenue Commissioners and the parties concerned. The Revenue are not a party to the lease and only the bank and not the Revenue Commissioners could invoke the provision requiring their consent in writing in advance of the making of a lease.

6.3 The authorities relied upon by the Revenue Commissioners, *ICC Bank v Verling* High Court, unreported, 5th August 1994 and the *Wyse Finance Company v O'Regan* High Court, unreported, 26th June 1998 were both cases in which the bank holding the mortgage over the property invoked their rights to void the leases granted by the mortgagor without permission. There was no authority to show that any party other than the mortgagee could invoke the clauses. Mr Hogan referred to the Law of Contract by Paul Anthony McDermott at paragraph 18.01, which referred to *Tweedle v Atkinson* and *Dunlop v Selfridge* relating to privity of contract.

6.4 Referring to *Iron Trades Employer Association* 1937 1 All ER 481, he argued that judgment made it clear that the mortgagor had a common law right to grant a lease which would be binding on everybody but the mortgagee.

6.5 Mr Hogan also referred to the European decision in *Sinclair Collis* Case C-275/01 grounds for a fall-back argument in the event that the Court held that the leases were void under Irish law. Mr Hogan cited a definition of letting for VAT purposes given by the European Court in paragraph 27 of the judgment, which entailed the conferring of a right to occupy property as if that person were the owner and would exclude any other person from enjoyment of such a right.

6.6 Mr Hogan went on to argue that even if the leases were void under Irish law, there was a letting for VAT purposes by virtue of the arrangements between the partnership and Shamrock Estates Limited, which led to a self-supply under Section 3(1)(f) in accordance with Section 4(3) of the VAT Act in circumstances where there was not a supply under Section 4(2) of the VAT Act and this led to a claw back of input deduction claimed in respect of the development, and not a VAT liability on the disposal of the units.

## **7. Arguments of the Respondent on Issue (A) – Validity of the Lease**

Mr. Anthony Aston SC on behalf of the Respondent made the following arguments in relation to issue (A):-

7.1 As in respect of all issues, the onus was on the Applicants to show that the assessment was correct, and to establish the validity of the lease.

7.2 The letter from ACC purporting to consent to the lease had no relevance to the proceedings, because it was given 2 years after the loan had been paid off in full and the mortgage had been discharged. It was of no evidential value whatsoever, because it was not possible to speculate as to what the Bank might have said, had it been asked to give its consent prior to the creation of the lease.

7.3 Prior to the Conveyancing Act, 1881, it was not possible for a mortgagor to create a lease binding on the mortgagee at all. Clearly, if a mortgagee gave his consent, then a tenancy would arise by agreement, or by estoppel. What the Conveyancing Act did was to allow a lease to be created by a mortgagor, provided there wasn't a contrary term in the mortgage agreement. There was such a contrary term in the ACC mortgage.

7.4 The question that now arose for the Court to decide was whether, if a mortgagor made a lease contrary to the terms of a provision such as that contained in clause 6(1), that simply gave rise to personal rights between the mortgagor and the lessor or whether it gave rise to rights in rem. The *Iron Trades Employers Association and Union Land Investors* case is authority for the proposition that if a lease is granted in such circumstances, it gives rise to a tenancy by estoppel only and does not create rights in rem. That situation applies where the tenant is ignorant of the terms of the mortgage. Here, the directors of Shamrock Estates Limited were also partners and they must have been aware of the restriction. In circumstances where both parties know of the restriction, it is doubtful whether an estoppel can be raised. In any event, no estoppel can be raised that is binding against third parties.

7.5 It is clear from the *Verling* and *Wyse Finance* cases that any lease granted is void.

7.6 Article 5(3)(b) of the Sixth Directive makes it clear that, for a lease to exist for VAT purposes at European Law, it must confer rights in rem. The best argument that could be made by a tenant as an innocent third party would be that they are entitled to a tenancy by estoppel, but not a tenancy giving rise to rights in rem.

## **8. Submissions on Behalf of the Applicants in relation to Issue (B) – Doctrine of Abusive Practice**

8.1 *Inspector of Taxes -v- Kiernan* 1981 IR 117 and *Keogh -v- Criminal Assets Bureau, Revenue Commissioners and Collector General* 2004 IESC 32; 2004 2 IR 159; 2004 2 ILRM 481 illustrate that taxing statutes are to be construed strictly, and the tax payer is not to be penalised by slack or oblique language; a position that had not been altered by the Interpretation Act 2005.

8.2 Mr. Hogan then cited the judgment of the European Court in *Kolpinghuis Nijmegen BV* 1987 ECR 03969, C-80/86 and *Marshall* C-152/84; 1986 ECR 723. respectively as the basis for stating that the State could not rely as against an individual on the provisions of a European directive that had not been implemented into national law and that the doctrine of direct effect only applies to the State or emanations of the State and does not apply to third parties or private citizens.

8.3 Mr. Hogan then cited the *Marleasing* C-106/89; 1990 ECR I-4135; 1992 CMLR 305 case (C-106/89) and argued that, while this was authority for the proposition that the Courts of member states were obliged to interpret national laws in conformity with the purposes of European directives, that duty had a limit; that it was not possible for the Court to do so *contra legem*; if the statute said black it could not be read to be white. He said this was similar to the double construction test.

8.4 Mr. Hogan then referred to the Judgment of the European Court in the *Halifax* C-255/02 21/2/2006 case. He highlighted the fact that the Court had held that transactions carried out by a person solely for the purpose of tax avoidance were an economic activity within the meaning of the Sixth Directive. He pointed out that the Court had held that a person could structure their business to reduce their tax burden. He pointed out that while the Court had held the concept of abusive transactions applied to VAT, there were two criteria for determining whether there was abuse or not.

8.5 Mr. Hogan identified these two criteria as follows: First that the purpose of the transactions must be to gain a tax advantage, the grant of which would be contrary to the purposes of the directive and the second being that gaining the tax advantage was the sole aim of the transactions concerned. He submitted that it was for Revenue to satisfy the Court that there had been a tax advantage "the grant of which would be contrary to the purpose of the provisions" of the Sixth Directive and the national legislation.

8.6 The purpose of section 4(2) and section 10(9) of the VAT Act was to give taxpayers an opportunity to get out of the VAT net by permitting the disposal of property on the basis of the capitalised value of the lease.

8.7 As regards the second point, there is no doubt but that transactions were entered into for the purpose of mitigating VAT liability, but they did this to allow them to dispose of the properties profitably, which would not otherwise have been the case. Whatever about the second issue, Revenue fail on the first issue, because the taxpayers have simply availed of the 20-year lease, which was wholly in harmony with the objectives of the legislation.

8.8 Mr. Hogan then made various submissions on European law in support of his contention that taxpayers were entitled to structure their affairs to reduce their VAT burden. He referred to the *Cadbury Schweppes* (C-196/04) Judgment of the Court 12th September 2006 freedom of establishment case, in which the Court accepted that the incorporation of a company in a member state, even where done solely to avoid tax in another state, did not constitute an abuse within the meaning of *Halifax* unless the establishment of that company was fictitious.

8.9 He referred also to *Hausgemeinschaft Jörg und Stefanie Wollny* C-72/05 and the *Heerma* case (C-23/98) as examples of situations where the European Court had accepted arrangements set up by taxable persons to recover VAT, which the Court had not found abusive because the relevant output tax had been paid on the transactions (in contrast with the situation in *Halifax*): Here, the partners elected to dispose of the property by a long lease and to pay VAT on the capitalised value, and that did not constitute an abuse within the meaning of *Halifax*.

8.10 (In reply) The first disposal of the land was by 20-year lease, in accordance with an option Ireland was entitled to avail of. Further, the abuse of rights doctrine cannot be applied in Ireland unless there is a domestic provision to that effect; there is no provision for the recovery of VAT in these circumstances. Finally, while the recovery of VAT would not of itself lead to a penalty, interest at 12.5% would effectively be penal.

## **9. Submissions on behalf of the Respondent in relation to Issue (B)-Doctrine of Abusive Practice**

9.1 It appeared that the Applicants were not really disputing the second part of the test in *Halifax*: both Mr. Hogan and Mr. Cussens had accepted that the leases were put in place for the predominant purpose of gaining a tax advantage: while Mr. Cussens had asserted that the actual price of the property was affected as a result of the transactions, he ultimately agreed that either way the houses had to be sold at their market value, and there was no evidence (and it was nonsense to suggest) that the purchasers of the houses had benefited from the fact that the partnership had saved money on VAT.

9.2 In relation to the first test in *Halifax*, it was a question of judging whether the tax advantage, if granted, would be "contrary to the purpose of the provisions" Paragraph 74 of the Judgment in *Halifax*, meaning the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it. The purpose of the Sixth Directive in this regard, clearly, was to tax the disposal of developed land when it is first sold after having being developed.

9.3 While the Court indicated that taxpayers may choose to structure their business so as to limit their tax liability, the business of the Applicants' partnership was to develop, market and sell holiday homes – the creation of the 20 year lease had nothing to do with that business, because it was not done for the purpose of disposing of the land by way of sale. It would have been open to the partners to attempt to dispose of the properties by creating 20-year leases, but they would have been very unwise to do so, as there would be no market for such leases. Their intention at all times was to sell the properties freehold; they didn't structure their business so as to limit their tax liability; what they did was to interpose, prior to the sale of the property, an artificial set of arrangements, which had no commercial purpose and which were designed solely to reduce the tax burden.

9.4 The creation of the lease and sub-lease and their surrender were all artificial, because the activity involved had no explanation other than the attainment of a tax reduction, as was frankly admitted by the Applicants.

9.5 It was clear from the Sixth Directive Reference was made to article 2, article 4(3)(a), article 5(3), article 6, and article 13 B(g), which exempts all lands except that which is referred to in article 4(3). that member states had no permission to exempt the supply of building land before first occupation. He referred to the opinion of Advocate General Ruiz-Jarabo Colomer in the *Breitsohl* case Opinion of Mr. Advocate General Ruiz-Jarabo Colomer delivered 16th December 1989 in case C-400/98; ECR 2000 pg. I-04321, and in particular paragraph 108 of the opinion as grounds for submitting that the purpose of the VAT Directive is to tax the supply of land on which a building has been constructed. This was the liability the partnership had sought to avoid by putting in an entirely artificial and temporary lease agreement.

9.6 Section 4 of the VAT Act 1972 was passed to implement the relevant provisions of the Directive, including Article 13(b)(g), which is read subject to Article 3(a). While the partners had brought themselves within the wording of section 4(1)(b) of the 1972 Act, they were not within the spirit of the section, certainly when read in the light of the Directive, because it was never intended that the leases would run their course, but it was at all times intended that the properties be sold freehold, and the partners at the time were under financial pressure to sell and there was no question of it being envisaged that the lease arrangement would last for any length of time.

9.7 As to the arguments in relation to horizontal direct effect, the Halifax case should not be read subject to the principles set out in *Marshall* and *Marleasing*. It is clear from the Halifax case that the doctrine required the Sixth Directive to be interpreted as precluding a right of a taxable person to deduct VAT where the transaction constitutes an abusive practice, having regard to the provisions of the Sixth Directive and the national legislation.

9.8 That rule of interpretation requires giving direct effect to the abusive practices doctrine, but this did not breach the principles set out in the previous case law of the Court.

9.9 The doctrine of supremacy of European Law applies, as set out in various cases including *Murphy -v- An Bord Telecom* [1989] ILRM 53 and reference was made to the comment on that case in Kelly on the Constitution.

9.10 It was for the Applicants to satisfy the Court that their transactions were not abusive, and they had failed to do so. The Irish Court had to consider what was the real substance and significance of the transactions concerned, and could take into account the purely artificial nature of those transactions and links of a legal, economic or personal nature between the operators involved in the scheme for a reduction of the tax burden See paragraph 81 of the Halifax judgment: The real substance and economic significance of the transactions was solely for the purpose of creating a tax advantage: There was no possible economic sense in the partnership disposing of the property at an annual rent of €66,100 and having to pay a higher rent on the leaseback: There was no cash flow advantage, no change in de facto occupation and no economic benefit; in the interim, the partners had an unmarketable title. As a result, the whole arrangement was an artifice; no more than a device, which may have been within the letter of section 4 of the 1972 Act, but certainly not within the spirit of the section or of the Directive and constituted an abusive transaction.

9.11 There was no element of penalty involved, because the assessments took full account of the input VAT and of the output VAT already accounted for by the partners. (The interest issue had not been raised at this point.)

## 10. Determination

10.1 On the first issue, I agreed with Mr. Hogan's submissions in relation to privity of contract and I held as a result that the Revenue Commissioners were not in a position to rely upon the provision in the lease. However, the letter dated 12th February 2005 did not impress me, as it was after the event, when all of the money had been paid back. Notwithstanding this, I found for the Applicants on the first issue.

10.2 In relation to the *Halifax* issue, I was satisfied that neither the lease nor the leaseback had any commercial reality: There was no evidence of intention to sell the property by way of lease to any third party; in effect the partners were simply leasing to themselves, and surrendering back to themselves, for the purpose of reducing VAT. In the circumstances, I was of the view that the lease and leaseback arrangement constitute an abusive practice, contrary to the purpose of the Directive, and accordingly the Respondent is correct in saying that the Applicants should be subjected to VAT upon the freehold sales of the houses to third parties.

10.3 There should be no interest on the VAT chargeable on the fee simple sale of the property as that would amount to a penalty and is not permitted by the *Halifax* decision.

10.4 For the reasons stated at paragraph 10.2 above I decided that the appeal of the Applicants be dismissed.

11. Mr. Hogan on behalf of the Applicants expressed dissatisfaction with my determination.

12. The Applicants, within 21 days of my determination, have requested me to state a case for the opinion of the High Court, which I duly state and sign accordingly.

13. The questions of law for the opinion of the High Court are whether, on the foregoing facts I was correct in holding that:

(1) The lease dated 8th March 2002 between the Applicants and Shamrock Estates Limited was effective for the purposes of VAT, despite the absence of the prior written consent of ACC Bank Plc thereto required by clause 6.1 of the deed of charge.

(2) The lease and leaseback arrangements had no commercial reality and constitute an abusive practice within the doctrine set out in the Halifax case; and should be disregarded for the purposes of VAT.

(3) The European Court decision in Halifax and the doctrine of abusive practice have direct effect in the absence of implementing national legislation.

(4) There should be no interest on any VAT due by the Applicants.

