

## EDITORIAL

### Debenhams—the UK fails to discharge its obligations

On 30 June, Customs and Excise issued Press Release 29/04 entitled *Customs will appeal or legislate to end high-street VAT avoidance scheme*. The Press Release relates to the *Debenhams* [2004] STC 1132 litigation regarding the scheme operated by many retailers for reducing their VAT liabilities.

The question which this article asks is why do Customs regard the options of appealing and legislating as alternatives, in other words, why is it an appeal *or* legislate rather than appeal *and* legislate?

By way of background, the Press Release notes that the High Court has overturned the ruling by the VAT & Duties Tribunal in relation to the Debenhams planning scheme. The objective of the scheme, as is well known, is to reduce the taxable element of a sale by (on current practice) 2.5%. The mechanism used requires retailers to set up a wholly owned subsidiary company which purports to provide VAT-exempt card-handling services to customers for 2.5% of the price of the goods. So, while the customer pays exactly the same amount, whether paying by cash or card, VAT would only be paid on 97.5% of the price of the goods for those paying by card.

The Press Release stresses the importance of the ruling, mentioning that over 70 major UK high-street retailers now operate the scheme. It notes that Customs intend to appeal the High Court ruling to the Court of Appeal. In parallel, the Government will work with other Member States to amend EC VAT law to make it clear that VAT cannot be avoided via this route.

The Press Release then quotes the Economic Secretary to the Treasury and Customs Minister, John Healey, as follows:

“People will find this decision difficult to understand. Customers will not understand why retailers should pocket a proportion of the VAT they pay on their purchases, or why they pay the same price whether they pay by cash or by card, regardless of the supposed ‘card-handling fee’. Small shopkeepers will not understand why major retailers should gain a competitive advantage just because they accept card payments and can afford to set up subsidiary companies to exploit complex avoidance schemes. And ordinary taxpayers will not understand why they should pay their fair share towards our public services if some of our biggest household name retailers do not”.

There is one additional fact which people, customers, small shopkeepers and VAT advisors alike, will find difficult to understand: why has the UK not fulfilled its duty under Article 13B of the Sixth VAT Directive? This provision states that Member States shall exempt, inter alia, financial services “under conditions which they shall lay down for the purpose of ... preventing any possible evasion, avoidance or abuse”. The word “shall” makes it clear that this is a duty imposed, rather than discretion conferred, on Member States. Note in particular the wide phrase “any possible ... avoidance or abuse”. If Customs are convinced that the scheme does involve such avoidance or abuse, why, one may ask, have they not convinced the Treasury (who have the power to vary the descriptions of exempt supplies in VATA 1994 Sch 9) to exercise this

power? Surely, given the entirely credible allegation by Customs that hundreds of £millions of VAT are at stake, the Treasury could be persuaded of the need to close the scheme down? After all, many retailers have now been operating the scheme for over three years, and one would have thought that this is long enough for the various Government departments to have understood the Revenue implications of the scheme.

There is no obvious strategic reason for Customs to keep the law in its present state, in terms of the progress of the *Debenhams* litigation.

As mentioned above, the Press Release states that the Government intends to work with other Member States to amend the Sixth VAT Directive to make it clear that VAT cannot be avoided via this route. Is this because the Government believes that the obligation imposed by Article 13 does not require or allow a change to the UK law? The Press Release does not say, and in the absence of any further clarification the issue is shrouded in obscurity.

Anyone buying goods from a retailer who operates the scheme and who pays by credit or debit card is party to (what is in Customs' eyes) an avoidance scheme and has a legitimate right to ask why Government has not discharged its obligation to bring the scheme to an end.

**Alan Sinyor**  
**Freshfields Bruckhaus Deringer**