Northumbria Healthcare: when HMRC’s guidance is binding

Indirect Tax

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The Court of Appeal’s decision in *Northumbria Healthcare* sheds light on when HMRC’s guidance can be considered binding.

Key Points

What is the issue?

The case taken by Northumbria Healthcare was effectively a test case for the NHS on the VAT liability of hospital parking (though in fact it covered all fee-paying parking provision for patients, visitors and staff at any NHS facility).

What does it mean for me?

HMRC had been alarmed at the breadth of the Upper Tribunal's finding in *Chelmsford City Council*, fearing that it would open the floodgates to public bodies arguing that all their activities are subject to a special legal regime.

What can I take away?

Whilst the Court of Appeal's decision on the 'significant distortion of competition test' raises nothing radically new – other than clearly differentiating that test from fiscal neutrality – its judgment on the existence of a special legal regime is profound.

In Tax Adviser (April 2024), I considered the *Chelmsford City Council* [2022] UKUT 149 (TCC) decision on whether local authorities' provision of sports services should fall outside the scope of VAT under Article 13(1) of the EU Principal VAT Directive (as transposed into VAT Act 1994 s 41A) and HMRC's eventual acceptance that that is the case. I referred in the postscript to the Court of Appeal's judgment in *Northumbria Healthcare NHS Foundation Trust* [2024] EWCA Civ 177 and its possibly profound implications.

Setting the scene

By way of reminder, in order to fall outside the scope of VAT under Article 13(1)/s 41A, the activity in question must be*:*

- delivered by a body governed by public law (taken as read for a local authority and the NHS);
- subject to a special legal regime only applicable to bodies governed by public law; and
- such that non-VATable treatment would not cause significant distortion of competition.

The Upper Tribunal in *Chelmsford* concluded that the Local Government (Miscellaneous Provisions) Act 1976 s 19 does amount to a special legal regime governing local authorities' provision of sports facilities but only when taken together with the multitude of other statutory and regulatory prescriptions, proscriptions and constraints with which local authorities must comply when doing so.

HMRC had been alarmed at the breadth of this, fearing it would open the floodgates to public bodies arguing that all their activities are subject to a special legal regime. And indeed, in *Northumbria Healthcare* at the Upper Tribunal [2022] UKUT 267 it was faced with almost this exact argument.

Northumbria Healthcare: a test case

The case taken by Northumbria Healthcare was effectively a test case for the NHS on the VAT liability of hospital parking (though in fact it covered all fee-paying parking provision for patients, visitors and staff at any NHS facility).

Although there is no specific statutory or regulatory regime governing hospital parking, Northumbria Healthcare argued that the requirement to comply with binding government guidance – the 'Parking Principles' issued by the Secretary of State – nevertheless constitutes a special legal regime.

HMRC's fears were assuaged when the Upper Tribunal held that it did not. In any event, the tribunal held that non-VATable treatment would clearly cause a significant distortion of competition vis-à-vis commercial car parking providers that were required to charge VAT.

However, the Court of Appeal has held in favour of Northumbria Healthcare on both counts.

Binding guidance as a special legal regime

The Court of Appeal held that Northumbria Healthcare's provision of hospital parking is subject to a special legal regime as binding guidance, with which a public body must comply – the 'Parking Principles' which govern the management of NHS car parks in the case of hospital (and similar) parking – meets this criterion.

The court's only caveats were that:

1. The binding guidance must be issued by government pursuant to a statutory or regulatory power enabling the relevant secretary or state, minister or other duly authorised person to do so.
2. The public bodies to which the binding guidance is addressed must have a legal duty to comply with it (unless there is a demonstrably good reason not to).

Key to the court's reasoning was that a special legal regime can exist if government issues statutorily or regulatorily empowered guidance that constrains the activity in question and is combined with a legally enforceable duty to adhere to that guidance (unless there is a good reason to depart from it).

The Court of Appeal held this to be the case with the 'Parking Principles', issued by the Secretary of State under the NHS Act 2005 ss 1 and 2, and with which NHS bodies providing hospital and similar parking must comply.

The court justified this by reference to the ECJ's judgment in *Fazenda Pública v Câmara Municipal do Porto* (Case C-446/98) that 'all the conditions laid down by national law for the pursuit of the activity' must be taken into account; i.e. the source of the conditions is immaterial.

The public law duty to comply with policies laid down by way of binding guidance (unless there is a good reason not to) was laid down in four recent Supreme Court judgments: *Lumba* [2012] UKSC 12; *Mandalia* [2015] UKSC 59; *Lee-Hirons* [2016] UKSC 46; and *Hemmati and others* [2019] UKSC 56.

Indeed, that guidance combined with a duty to adhere to it in the absence of a good reason not to amounts to 'tertiary law' can be found in *R v Ashworth Hospital Authority* [2005] UKHL 58, in which the House of Lords considered a code of practice issued by the Secretary of State that encompassed binding guidance.

Ashworth Hospital's policy departed from that guidance but the House of Lords held that the guidance was law with which it must comply. It observed that Parliament could have chosen to embody the code of practice in legislation but that its choice to rather empower the Secretary of State to issue the code did not lessen its

legislative character.

HMRC objected that reliance on broad public law constraints, such as following policies or guidance, even if binding, would permit a public body to determine its own VAT treatment through self-authored policies.

However, the Court of Appeal stressed that it is not self-authorised policies that constitute a special legal regime but rather binding guidance issued on behalf of government pursuant to a statutory or regulatory power to do so and with which the public body must comply (unless there is a demonstrably good reason not to).

Such binding guidance issued by government is, felt the court, encapsulated within what the ECJ meant when referring to a 'special legal regime', being an externally imposed and legally enforceable body of law which constrains a public body's behaviour and which cannot be easily changed without Parliamentary check.

This is very different to self-authorised policies which the public body has the freedom to alter at any time it wishes. Local authorities have long felt that such 'tertiary law' – binding guidance with which they must comply – constitutes a special legal regime but this is the first time a court or tribunal has said so.

The 'significant distortion of competition test'

On the 'significant distortion of competition test', in *National Roads Authority v Revenue Commissioners* (Case C344/15) the ECJ found that such a significant distortion must be proven by the tax authorities by reference to economic analysis and that there can be no presumption of such, even where both public and private bodies provide similar services.

Following this finding, the Court of Appeal allowed Northumbria Healthcare's appeal on the grounds that HMRC had not met this burden of proof.

Indeed, it appears that HMRC had carried out no economic analysis at all but merely relied on the empirical existence of private sector car parking provision.

In fact, the court doubted whether such an economic analysis would have seen hospital parking as in competition with other parking anyway, suggesting a need to carefully determine the relevant market for the purposes of such an economic analysis (e.g. in this case, whether that is the market for parking generally or, more likely, specifically for hospital parking).

The Court of Appeal also contrasted the 'significant distortion of competition test' with fiscal neutrality. It observed that the former requires an analysis of the market without any presumption, whereas the latter presumes a breach where two supplies are identical from the perspective of the typical consumer.

This has some relevance given that HMRC deployed a fiscal neutrality argument before the Upper Tribunal in *Mid-Ulster* [2022] UKUT 267 in support of its assertion that non-VATable treatment of local authorities' provision of sports and leisure services in Northern Ireland would cause significant distortion of competition.

Conclusion

Whilst the Court of Appeal's decision on the 'significant distortion of competition test' raises nothing radically new – other than clearly differentiating that test from fiscal neutrality – its judgment on the existence of a special

legal regime is profound.

It has always been accepted by HMRC that a statutory obligation placed upon a local authority to do something does amount to a special legal regime. Indeed, HMRC then accepts that there can be no significant distortion of competition, as the local authority is simply carrying out its mandated functions and is not competing on a market.

HMRC also generally accepts that a discretionary or enabling statutory power can amount to a special legal regime, providing it differs materially from the private law powers under which a private sector body might undertake the same or similar activity.

The *Chelmsford* decision added some context to this by holding that to constitute a special legal regime, a discretionary or enabling power must generally be supported by other prescriptions, proscriptions and constraints as to how the local authority carries out the activity which would not apply to a private sector body undertaking the same or similar activity.

Chelmsford held that those prescriptions, proscriptions and constraints must themselves be contained in statute or regulation.

In *Northumbria Healthcare*, however, the Court of Appeal has held that is not the case but rather that binding guidance with which the local authority must comply when undertaking the activity can be sufficient providing that:

- the binding guidance is issued by government pursuant to a statutory or regulatory enabling power; and
- public bodies to which the binding guidance is addressed have a legal duty to comply with it (unless there is a demonstrably good reason not to).

Footnote: HMRC is understood to have sought leave to appeal the *Northumbria Healthcare* decision on the definition of special legal regime. (It is doubtful that any appeal is possible against the Court of Appeal's decision that HMRC failed to carry out the necessary economic analysis to determine whether there would be significant distortion of competition.) Whether the Supreme Court perceives that to be a matter of sufficiently important public interest to grant leave is moot.