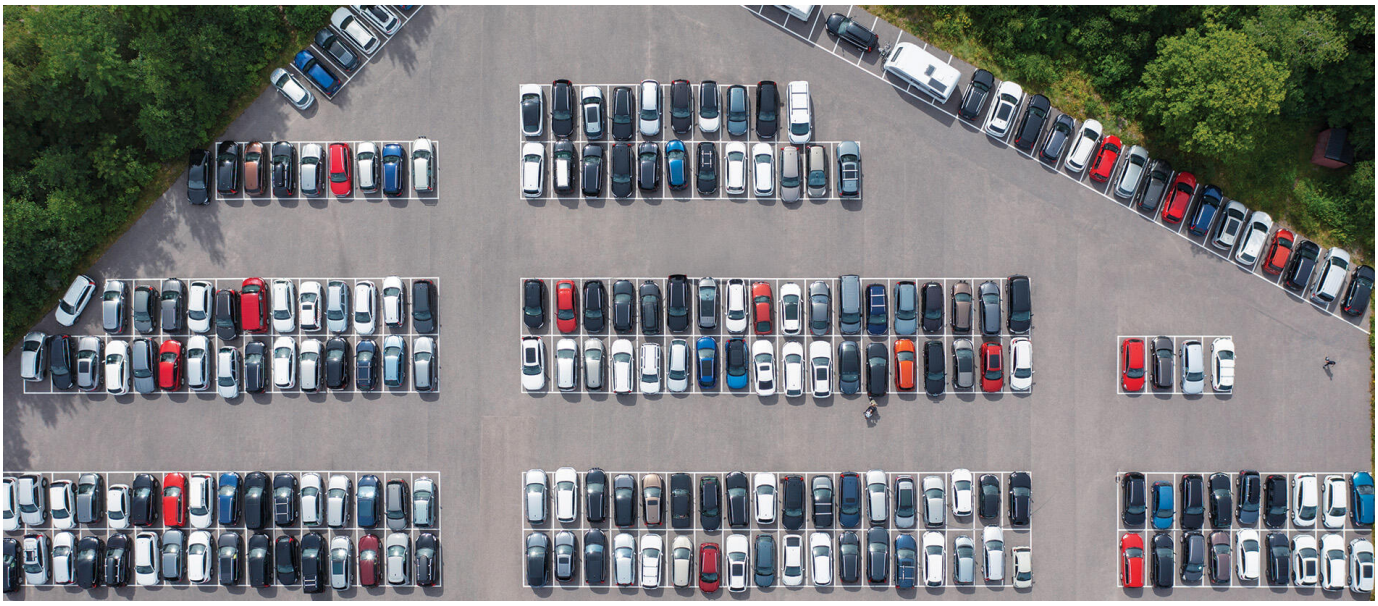
# Distortion of competition: the burden of proof

**Indirect Tax**



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The UK Supreme Court decided that VAT must be applied to car parking charges at Northumbria Healthcare NHS Foundation Trust.

## Key Points

### What is the issue?

The Supreme Court has overturned the Court of Appeal’s decision and held that NHS hospital parking does not fall outside the scope of VAT.

### What does it mean for me?

The court held that binding guidance cannot constitute a ‘special legal regime’ and that, applying a fiscal neutrality approach, treating NHS parking as non-VATable would significantly distort competition with private operators.

**What can I take away?**

Only statute and statutory regulations can amount to a special legal regime. On significant distortion of competition, HMRC may rely on a presumption that differential VAT treatment will distort competition wherever private providers operate – effectively shifting the evidential burden onto public bodies.

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I wrote in the September 2024 edition of 'Tax Adviser' about the Court of Appeal's decision in *Northumbria Healthcare NHS Foundation Trust* [2024] EWCA Civ 177 and its potentially profound implications for the VAT treatment of income-generating activities carried out by public bodies. On reflection, the article's title – 'When HMRC's guidance is binding' – may have been somewhat misleading…

Under Article 13(1) of the Principal VAT Directive, implemented by Value Added Tax Act 1994 s 41A, a public body's income-generating activities fall outside the scope of VAT where:

- the activity is carried out under a special legal regime only applicable to public bodies; and
- treating the activity as non-VATable would not lead to significant distortion of competition.

Northumbria Healthcare argued that its provision of car parking at its hospitals and similar facilities met these criteria and the Court of Appeal agreed. The Supreme Court, however, has taken a fundamentally different view.

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## Northumbria Healthcare: the facts

Northumbria Healthcare operated car parks at its hospitals, charging members of the public. The Trust contended that NHS charging guidance – including requirements for transparency, fairness and concessionary rates – meant its parking activities were governed by a special legal regime, and that exempting the activity from VAT would not distort competition.

HMRC argued that NHS guidance is not 'law', and that private parking operators in the area were in direct competition and obliged to charge VAT, so exempting the Trust would distort competition.

The First-tier Tribunal agreed with HMRC, finding actual competition between the Trust's car parks and private operators. The Upper Tribunal upheld this. The Court of Appeal reversed both findings. The Supreme Court has now reinstated the First-tier Tribunal and Upper Tribunal decisions.

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## The legal framework

The Court of Appeal held that:

1. Binding guidance with which public bodies must comply unless they have good reason not to – so-called 'tertiary law' – can constitute a special legal regime, provided such guidance is issued pursuant to a statutory or regulatory power.
2. HMRC must prove any significant distortion of competition through economic analysis. Unlike the principle of fiscal neutrality, there can be no presumption of distortion merely because similar activities are carried out by public and private bodies.

This approach reflected what many VAT practitioners felt to be the correct interpretation. However, with around 70 similar appeals by NHS bodies stayed behind *Northumbria Healthcare* and approximately £100 million in VAT at stake, it is hardly surprising that HMRC sought to appeal.

What is disappointing, however, is that some aspects of the Supreme Court's reasoning seem to set back the commonly held view of how the two tests are to be applied.

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## Supreme Court judgment

The Supreme Court judgment [2025] UKSC 37 has unanimously allowed HMRC's appeal.

#### Special legal regime confined to statute

The Supreme Court rejected the Court of Appeal's conclusion that binding guidance ('tertiary law') can constitute a special legal regime.

The court held that a qualifying regime must:

- impose a legal obligation on the public body that governs the activity in question or materially affects the way that it is carried out; and
- for VAT purposes, it must have the degree of legal certainty fundamental to the VAT regime, which guidance – even when binding in practice – does not.

Because public bodies may depart from guidance where they have good reason, such guidance lacks the legal certainty of an imposed statutory obligation. This returns the law to HMRC's long-advocated position that only statute and statutory instruments can constitute a special legal regime.

#### Significant distortion of competition

Although the absence of a special legal regime disposed of the appeal, the Supreme Court nevertheless addressed the question of significant distortion of competition, and in doing so reached several important conclusions.

It observed that the purpose of the significant distortion of competition condition is to guarantee fiscal neutrality by ensuring that two similar supplies are treated consistently for VAT purposes, thereby preventing private providers from being placed at a disadvantage because they are subject to VAT when public bodies are not.

Following the seminal ECJ judgment in *Isle of Wight Council and others* (Case C-288/07), the question to be addressed is whether differential VAT treatment of public and private bodies carrying out the same or similar activity would lead to a distortion of competition in the nationwide market for that activity that is more than negligible.

In *National Roads Authority v Revenue Commissioners* (Case C-344/15), the CJEU confirmed that the burden of proving a significant distortion rests with the tax authorities; and that this must be proved through an economic analysis of the nationwide market in question.

The Court of Appeal in *Northumbria Healthcare* agreed with this, noting that HMRC had not undertaken such an analysis and that – if it were to do so – the market in question must be carefully identified. It felt that the market might well be specifically 'hospital parking', rather than parking generally.

The Supreme Court rejected both these findings. Referring back to the First-Tier Tribunal [2021] UKFTT 71 (TC), the Supreme Court highlighted its finding that actual competition existed between Northumbria Healthcare's car parks and parking provided by private providers. On that basis, the tribunal held that treating Northumbria Healthcare's provision of parking as non-VATable would lead to distortion of competition that was more than negligible. The Upper Tribunal upheld this finding [2022] UKUT 267 (TCC).

The Supreme Court found the Court of Appeal's contrary conclusion difficult to understand. In its view, the First-tier Tribunal's reasoning clearly supported the conclusion that non-VATable treatment of 'hospital parking' would significantly distort competition. The Supreme Court held that the First-Tier Tribunal was correct in this regard.

The important point, held the Supreme Court, is whether a competitive disadvantage arises from differential VAT treatment of identical or similar activities meeting the same needs of the typical consumer – even where a public body chooses to maintain its pricing and therefore retains a higher net receipt by not accounting for VAT. This is, of course, a fiscal neutrality test, which the Court of Appeal had effectively dismissed.

The Supreme Court accepted that the assessment of significant distortion must be supported by an economic analysis of the nationwide market. However, it did not agree that this requires a detailed economic study of how non-VATable treatment impacts the pricing or retained net receipts decisions of public bodies. Instead, it held that the First-Tier Tribunal's analysis – which simply identified the existence of private sector competitors required to charge VAT – was sufficient.

The Supreme Court thus applied a strict fiscal neutrality approach to demonstrating significant distortion of competition. Where two activities meet the same needs of the typical customer, a rebuttable presumption by HMRC that differential VAT treatment will significantly distort competition is acceptable.

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## Implications of this decision

While the Supreme Court's judgment comes as no great surprise – given HMRC's concern that the Court of Appeal's approach could open the floodgates to non-VATable treatment for an increasing number of public bodies' income-generating

activities – it is nonetheless disappointing in several respects.

First, the court's treatment of the concept of a 'special legal regime' is troubling – in particular, its rejection of the idea that binding guidance with which public bodies must comply, without a good reason not to, can qualify as such a regime.

Many public sector VAT practitioners have long regarded this form of 'tertiary law' as capable of amounting to a special legal regime. Indeed, the Court of Appeal's own limitation – that this would apply where the guidance was issued under express statutory powers – appeared to strengthen that view.

The Supreme Court, however, in effect held that a special legal regime must be grounded in statute, or in regulations made under statutory authority, reflecting the long-held position of HMRC. In practice, few arguments for the existence of a special legal regime have relied solely on binding guidance as 'tertiary law', but such guidance has often been regarded as a supporting factor in determining how public bodies are required to undertake their activities.

Second, the Supreme Court has determined that significant distortion of competition and fiscal neutrality are not distinct tests but the same condition. To be fair, the ECJ in the seminal *Isle of Wight Council* case was clear that significant distortion of competition is a subset of fiscal neutrality.

However, this had never appeared so explicit as to mandate a strict fiscal neutrality approach, whereby the mere existence of private providers required to account for VAT gives rise to a rebuttable presumption of distortion, with only the question of whether such distortion is more than negligible – and therefore 'significant' – remaining to be determined. Yet this is now the position endorsed by the Supreme Court.

This outcome sits uneasily with the CJEU's reasoning in *National Roads Authority*, where the court emphasised that the burden lies with the tax authorities to demonstrate, on the basis of an economic analysis, that significant distortion of competition would arise. The Supreme Court's approach may therefore be seen as shifting the balance markedly in HMRC's favour.

This was the basis of the Court of Appeal's decision in *Northumbria Healthcare*; namely, that significant distortion of competition and fiscal neutrality are distinct concepts. The distortion of competition requires an economic analysis of the market

with no presumption in either direction – unlike fiscal neutrality, where a breach can be presumed if differential VAT treatment applies to the same or similar activities.

The Supreme Court has, however, overturned the Court of Appeal's decision. It has rejected the conclusion that HMRC must demonstrate significant distortion of competition through an economic analysis of the relevant market, and has reinstated the First-tier Tribunal's finding that empirical evidence of private sector competitors who are obliged to account for VAT is sufficient to give rise to a presumption that competition would be significantly distorted.

The Supreme Court's reasoning – applying a strict fiscal neutrality approach – is that it is not necessary in every case to produce the kind of detailed economic evidence laid before the Court of Appeal in *Isle of Wight Council* in order to determine whether a significant distortion exists. That level of evidence was presented simply because of the way the appellant public bodies had put their case. The Supreme Court further considered that *National Roads Authority* must be understood in the context of a situation where only a purely theoretical possibility existed that private operators might enter the market.

Neither decision, therefore, established a general requirement for detailed economic analysis in all cases concerning significant distortion of competition.

This is particularly disappointing. Although the Supreme Court noted that public bodies may always adduce evidence to show that no significant distortion exists in a given case, this requires them to prove a negative – something jurisprudence generally frowns upon. It also gives HMRC latitude to take a more cursory view of the competitive landscape, assert that a significant distortion would arise, and place the burden on public bodies to rebut that assertion. In practical terms, this reverses the established position that the onus of proof lies with HMRC.

Moreover, it is difficult to see how HMRC can credibly demonstrate that a distortion of competition exists, let alone that it is significant, without undertaking more than a cursory economic analysis of the relevant market.

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## Conclusion

The Supreme Court has restored HMRC's preferred interpretation of Article 13(1) and s 41A, narrowing the scope for public bodies to treat income-generating activities as

non-VATable. The combined effect of a restrictive special-legal-regime test and a presumption-based approach to competition means public bodies face an uphill battle. Early, robust evidence-gathering will be essential for any future claims.