[2015] UKFTT 0463 (TC)

TC04631

Appeal number:TC/2014/01188

VALUE ADDED TAX – transfer of machinery forming part of the assets of a business – transfer taking place as part of a settlement agreement – whether a supply – Para 5 Schedule 4 VAT Act 1994 – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PHOENIX OPTICAL TECHNOLOGIES LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE JONATHAN CANNAN
MR DEREK ROBERTSON

Sitting in public in Manchester on 7 September 2015

The Appellant did not appear and was not represented

Mrs Ann Sinclair of HM Revenue & Customs for the Respondents

DECISION

Background and Findings of Fact

1. The Appellant disputes that it is liable to account for output tax on the transfer of an asset where the transfer was made as part of an agreement which compromised a claim for damages. There is no issue as to the amount of output tax if the transfer is a supply for VAT purposes.

2. In an email to the tribunal dated 22 April 2015 the appellant stated that it would not attend the hearing of the appeal as the tribunal already had all the evidence the appellant wished to put before the tribunal. We were satisfied pursuant to Tribunal Rule 33 that it was in the interests of justice to proceed with the hearing.

3. The Appellant carries on business as a manufacturer and supplier of optical components. One customer was CVI Laser Limited ("CVIL") with whom it had a diamond turning contract. We do not know the details, but a difficulty arose with the appellant's performance of the Contract.

4. CVIL commenced proceedings against the appellant in the Chancery Division, Birmingham District Registry seeking damages for breach of contract.

5. In 2011 the appellant negotiated a settlement with CVIL which was recorded in a settlement deed. The terms of the settlement were that the appellant was to make a payment to CVIL of £20,000 together with a contribution towards its costs of £15,000. In addition the appellant was to transfer to CVIL an item of machinery known as a Precitech 250 Ultra ("the Machine"). In or about November 2011 the payments were made and the Machinery was transferred.

6. The Machine was a diamond turning machine which had been purchased in 2007 from an American supplier. Import VAT paid at that time was recovered by the appellant as input tax. By 2011 the Machine was being under-utilised in the appellant's business. The reason the appellant agreed to settle with CVIL partly in cash with the balance funded by transferring the Machine was because at that time the appellant did not have funds to pay the claim in full.

7. Following a VAT visit on 30 October 2013, the visiting officer considered that the appellant ought to have accounted for VAT on the transfer of the Machine. She relied on Paragraph 5(1) Schedule 4 Value Added Tax Act 1994 ("VAT Act 1994") which provides as follows:

> "*… where goods forming part of the assets of a business are transferred or disposed of by or under the direction of the person carrying on the business so as to no longer form part of those assets, whether or not for a consideration, that is a supply by him of the goods.*"

8. HMRC told the appellant that the cash payments made by the appellant to CVIL under the settlement deed amounted to compensation and as such were outside the scope of VAT. Reference was made to HMRC's guidance at VATSC35600 (see below).

9. In due course the value of the Machine was agreed at £56,502 including VAT and the output tax due on the supply was assessed at £9,417.

10. The appellant contended that the transfer of the Machinery and the payments of cash were all compensation to settle the dispute with CVIL arising from the alleged breach of contract. In the same way that HMRC accepted the payments of cash were outside the scope of VAT, the transfer of the Machinery was also outside the scope of VAT. The appellant relied on HMRC's guidance at VATSC35600 which states:

> "*On the face of it, payments of compensation or damages are not consideration for supplies for VAT purposes. This is because they invariably amount to financial settlement of losses caused by breach of agreement or infringement of rights rather than the provision of goods or services. However, there are circumstances when such payments are consideration for taxable services by the recipient of the payments.*"

11. Essentially the appellant's argument to HMRC and on this appeal is that if the payments are not consideration for a supply then by the same token the transfer of an asset as part of a compromise agreement does not amount to a supply. It contends that a transfer of assets pursuant to a compromise agreement is an exception to what must be treated as a general rule in Paragraph 5(1) Schedule 4. The VAT Act 1994 makes no specific provision which deems an asset transferred as part of a compensation agreement to be a supply of goods.

Reasons

12. Section 1 VAT Act 1994 provides that VAT shall be charged "*on the supply of goods or services in the United Kingdom (including anything treated as such a supply*". Section 5 provides that Schedule 4 shall apply for determining what is or what is to be treated as a supply of goods or a supply of services. Section 5(2) provides that subject to schedule 4, "supply" includes all forms of supply, but not anything done otherwise than for a consideration.

13. We have quoted the terms of Paragraph 5(1) Schedule 4 which was relied on by HMRC in making the assessment. Paragraph 1(1) Schedule 4 also provides that "*any transfer of the whole of property in goods is a supply of goods*".

14. Assistance can also be derived from the Principal VAT Directive (2006/112/EC) upon which UK VAT law is based and which provides in Article 14(1):

> "'*Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner*"

15. There was a transfer of the Machine to CVIL. On any view, whether under Paragraph 1(1) or Paragraph 5(1) of Schedule 4, that transfer amounted to a supply of goods. The consideration was CVIL's agreement not to pursue its claim for damages.

16. There is no basis upon which to say that the transfer of an asset pursuant to a compromise agreement falls outside Paragraph 5(1) or indeed Paragraph 1(1). Any exception to the definition of a supply would have to appear on the face of the statute. For example, Paragraph 5(2) makes an exception in relation to certain business gifts and samples of goods. There is no exception in relation to assets transferred as part of a compromise agreement.

17. There is a fallacy in the appellant's approach. It is highlighted in the notice of appeal where the appellant states "*if we had sold the machine and paid cash over to CVI why would it have been different*". The answer is that it would not have been different. The appellant would have been required to account for output tax on the sale of the Machine.

18. The reference by HMRC to compensation payments being outside the scope of VAT appears to have caused some confusion. As the HMRC manual indicates, whether compensation payments are consideration for a supply will depend on the circumstances in which they arise. However, any supply would be by the recipient of the compensation and not the person receiving it. In the present case it is the appellant which is paying the compensation and which transferred the Machine. CVIL does not make any supply in relation to the compensation it received. But that does not mean that the appellant does not make any supply of the Machine.

19. For the reasons given above we are satisfied that the appellant made a supply of the Machine for VAT purposes. In those circumstances we must dismiss the appeal.

20. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 14 SEPTEMBER 2015