[2015] UKFTT 0600 (TC)

TC04743

Appeal numbers: TC/2013/1891, 1893, 1878, 1877, 1886, 1881, 1888, 1875, 1876

VAT –tri-partite arrangement - temps carrying out work for clients of employment business – whether decision in* Reed Employment *should be followed – no –* Redrow, Baxi, Aimia and WHA *applied - whether economic reality inconsistent with contractual position – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ADECCO UK LIMITED
AJILON (UK) LMIITED
BADENOCH AND CLARK LIMITED
HY-PHEN.COM LIMITED
LAWSON BISHOP FINANCIAL LIMITED
MODIS INTERNATIONAL LIMITED
ROEVIN MANAGEMENT SERVICES LIMITED
SPRING PERSONNEL LIMITED
SPRING TECHNOLOGY STAFFING SERVICES LTD **Appellants**

- and -

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

TRIBUNAL: JUDGE Barbara Mosedale

Sitting in public at the Royal Courts of Justice, the Strand, London, on 11-15 May 2015 with further submissions from HMRC on 29 May 2015 and from the appellant on 9 June 2015

Mr S Grodzinski QC and Ms V Sloane, Counsel, instructed by Deloittes LLP for the Appellant

Ms E Mitrophanous, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION ON PRELIMINARY ISSUE

1. The companies listed as appellants are now all members of a single VAT group the representative member of which is Adecco UK Limited. They were not all VAT group members at the time to which the voluntary disclosure the subject of this appeal relates. Therefore, there is doubt whether the appellant should only be Adecco UK Ltd or should include the other group companies. I was not asked to resolve this. For the sake of simplicity, I will refer to Adecco UK Ltd ("Adecco") as the appellant in the singular and refer to it as if it had made all the supplies at issue in this appeal.

2. Adecco was a provider of recruitment services. The appeals concern the VAT liability of Adecco on payments made to it by its clients in respect of work carried out by temporary workers ('temps') introduced to the clients by Adecco.

The issue

3. Adecco has three business models:

(1) **Employed temps:** it employs persons who it assigns to its clients on a temporary basis. There is an employment contract between Adecco and the employee under which the employee agrees to act exclusively for Adecco and Adecco guarantees to find a minimum number of paid assignments for the employee;

(2) **Non-employed temps:** these are the subject of this appeal and I will refer to them as 'temps'. They are persons who are on the books of Adecco but are not considered to be employed by that company. Adecco may introduce them to clients looking for a temporary worker to undertake an assignment. The temps are not obliged to accept any assignment offered and Adecco is not obliged to find them an assignment. Nevertheless, Adecco undertakes with these persons to pay them for the work they do for Adecco's clients and is classed as their 'employer' for various regulatory matters, including the working time regulations and payment of PAYE/NIC. Adecco's payment by its clients will be periodic and normally calculated as an amount representing the payment Adecco must make to and on behalf of the temp plus a commission element.

(3) **Contract workers:** these are self employed workers which Adecco may introduce to a client, and with whom the client will enter into a separate contract direct with the contract worker to provide the work required. They are not Adecco's employees in any sense, and Adecco does not undertake to pay them. Adecco's charge to its clients will typically be a one-off fee (albeit normally calculated by reference to the contract worker's rate of pay and the length of the assignment).

4. The appeal is concerned only with the middle category, non-employed temps. During the period of the claim the subject of the appeal, Adecco accounted for VAT on the full charge paid by its client for the services of the temps. In other words, it accounted for VAT both on the element of the charge paid by the client which was

equivalent to or represented the wages paid to the temp (including amounts paid in tax) and it accounted for VAT on the element of the charge effectively retained by itself (ie the commission or gross profit element).

5. On 24 March 2011, this Tribunal (Judge Roger Berner) released a decision in the case of *Reed Employment Ltd* [2011] UKFTT 200 (TC) (‘*Reed Employment’)*. In that decision the Tribunal found that the employment bureau appellant in that case providing non-employed temps to its clients was making a supply of introductory services to its clients in return for its commission. It was therefore not liable to account for VAT on the element of the charge representing the wages which it received from its clients and paid to the temps.

6. Following this decision, various repayment claims relating to charges paid for non-employed temps for the period 1 April 2007 to 31 December 2008 were submitted to HMRC by Adecco totalling some £11,125,661. HMRC rejected the claims, and that decision is the subject of this appeal.

7. The reasons for the rejection include the ground that the appellant (in HMRC’s opinion) is liable to account for VAT on the full charge paid by the clients because, says HMRC, it supplies the services of the non-employed temps and is not merely supplying the service of introducing temps to its clients. There are other grounds for rejection of the claim, such as whether the claim was in time and whether HMRC have a defence of unjust enrichment, but this hearing was to determine only the preliminary issue of the question of liability. I will not consider these other grounds which, depending on the outcome of this preliminary hearing, may become unnecessary to decide.

8. The question for the Tribunal was simple in essence. What did Adecco supply to its clients? However, that question was logcially indistinguishable from the question of to whom did the temps supply their work? If Adecco merely supplied introductory services to its clients, then it follows logically that the temps supplied their services direct to the clients and not via Adecco: if, however, the temps supplied their services to Adecco, then it follows that Adecco must have on-supplied these services to its clients. So the question of *what* services Adecco provided to its clients is really indistinguishable from the question of *to whom* did the temps supply their services.

9. To answer these questions, I have to consider the facts.

The facts

The representative contracts

10. The parties agreed that (save for two exceptions) the Tribunal should makes its decision on the basis of four particular contracts, on the grounds that these were representative of the supplies at issue in the appeal and the Tribunal’s decision on these two contracts will apply to all supplies at issue in this appeal (barring the two exceptions).

11. The four representative contracts selected by the parties were, on the one hand, the 2006 and 2007 contracts (including the standard documents used with them (such as the confirmation letters and payroll guide)) which Badenoch & Clark required all its non-employed temps to sign ("the standard temp contract") and, on the other, the 2006 and 2007 standard contracts on the basis of which Badenoch and Clark contracted with its clients ("the standard client contract"). The two exceptions, which must be considered as individual contracts, are two bespoke contracts between Badenoch & Clark and two clients.

12. The two clients were Bank A and Bank B. I will refer to the two banks as A and B because it was agreed by the parties and ordered by the Tribunal that their identities would not be referred to in the hearing nor in this decision notice. Their identities are irrelevant to the issues in the appeal and Adecco did not wish to threaten its relationship with these clients by putting in the public domain its commercial dealings with them.

13. For convenience, which reflected what was said at the hearing, I will refer to Adecco as if it was the counter party in all these contracts, although the counterparty was of course Badenoch & Clark.

14. Perhaps bizarrely, as it was chosen as a representative contract, some parts of the 2006 standard client contract were difficult to read as the appellant had been unable to find a clear copy of it. Submissions therefore concentrated on the 2007 contract. The parties were agreed that so far as this appeal was concerned there was little if any material difference between the two. I have not discerned a material distinction between the 2006 and 2007 versions of both types of representative contracts in this appeal and so I will below refer to the standard temp contract as if it were the same for both years, and similarly to the standard client contract as if it were the same for both years.

The witnesses

15. The Tribunal heard evidence from Mr Tagg who is a non-practicing barrister and has been head of Adecco's legal department since 2013. He was not employed by either Adecco or Badenoch & Clark at the time of the events in issue although he was employed by 3 of the other appellants, including Spring Personnel and Spring Technology, albeit at the time they were not part of the Adecco group.

16. He did not give evidence as an expert so his evidence was limited to factual evidence of how contracts similar to those at issue in this appeal operated in practice. I accepted this evidence as reliable.

17. His evidence was that the Badenoch & Clark standard temp contract was materially the same as the one at Spring in the relevant period, with one exception. That exception was that the Badenoch & Clark contract required the temp to complete a 'leave request' form and the Spring contract did not.

18. It was also his evidence that the Badenoch & Clark standard client contract (but not the contracts with Bank A and B) at issue in this appeal was materially the same as the one at Spring in relevant period with the exception that he believed that the period in which a client could reject a temp for free was not the two hours that it was in the Badenoch & Clark contract (see §62, §136 and §156 below).

19. Mr Tagg's experience with Spring at the time and Adecco now was that Adecco and any other recruitment agency would prefer all clients to contract with it on its standard terms but had to accept that larger clients might well insist on an agency adopting the client's own standard terms instead. In reality, while Adecco would in some cases agree to this, such as in the case of Bank A and Bank B, Adecco operated as if all its clients contracted on its standard terms. He accepted that the client's concern was likely to be the risk of the temp claiming employee status and therefore the client's standard terms was likely to put more responsibility on Adecco for the temp than Adecco's own standard terms.

20. Ms Bronwyn Bands also gave factual evidence. She was now a principle recruitment consultant at Badenoch & Clark. At time of events at issue in appeal she was a junior recruitment consultant. I accepted her evidence as reliable.

21. From the evidence of these witnesses and from the documents in front of the Tribunal I make the findings of fact as follows:

22. When Adecco is notified that a client requires a temp, it reviews the CVs of temps it has on its books to identify temps suitable for the role and prepared to accept the level of pay offered by the client. It sends these CVs of suitable candidates to the client from which the client (sometimes after interview) can select a temp. If a non-employed temp is offered the assignment, the temp can accept or decline it.

The standard temp contract

23. All temps who wanted Adecco to place them in such temporary positions, but who were not employed temps, had to agree to and sign the standard temp contract. These were the non-employed temps, to whom I refer as 'temps' in this decision. The identity of the recipient of their services was the fundamental question in this appeal.

24. The contract, which I will refer to as the 'standard temp contract', was stated not to be a contract of employment, and no one suggested that it was. Nevertheless, regulatory law gave Adecco some of the obligations of an employer such as to pay NIC and PAYE on behalf of the temps.

Recitals and definitions:

25. I find that the recitals and definitions in the standard temp contract were somewhat ambiguous on whether the temp would be providing a service to Adecco or to Adecco's client. It contained statements such as the following:

> 'assignment' 'means the services to be provided by you to the Client…'

> 'Client' 'means the person…requiring your Services through [Adecco]….'
>
> "You are engaged by us to undertake an Assignment for a Client"
>
> "It is agreed that…We may from time to time offer you an Assignment."

26. This is scarcely surprising when the nature of what was agreed between the temp and Adecco necessarily meant that the temp would be doing whatever role or job Adecco's client wished the temp to perform. It was a contract under which A agreed with B to do something for C. So the recitals and definitions are scarcely likely to answer the question of to whom the temps supplied their services.

27. Mr Grodzinski put a lot of weight on these definitions and other references in the documents in so far as they referred to the temp providing services to the client. But I consider this meaningless in this context. The contract was not seeking to define the VAT position and could not do so in any event: all it was doing was stating the obvious which is that the temp's contract with Adecco was for the temp to do the work it was required by Adecco's client to do. But that does not answer the question whether the temp was supplying its services of carrying out the work to the client, or whether its service was supplied to Adecco and was the service of agreeing to do the work it was instructed to do by the client. The definitions do not provide the answer to this VAT question.

Control, monitoring and termination of the temp

28. A large part of the appellant's case relied on the fact that it was clear under the contracts, and indeed clear as a matter of practical and economic reality, that it was the client who told the temp what to do on a day to day basis. The contract provided that the temp would be subject to the 'legitimate instructions, monitoring, direction, supervision, management, and control' of the client and indeed, were this not the case, the client would presumably not have been prepared to pay a fee for the temp.

29. Nevertheless, under the contract the temp did owe duties to Adecco with respect to the work it performed for Adecco's client. The temp agreed:

> to perform Assignment professionally promptly and efficiently and in good faith using own skill and expertise with due care and to the best standards
>
> to indemnify [Adecco] against loss claim or damages from breach of the Agreement or from negligent acts of the temp
>
> to keep confidential business matters between [Adecco] and its client
>
> not to take leave without [Adecco]'s agreement

30. I find that in reality Adecco did not monitor the performance of its temps. If the client was unhappy with the temp's performance, the client could simply terminate the assignment (see §§67-70 below) and the evidence was that this is what happened in practice. There was no call for Adecco to monitor performance and in reality it

was not capable of doing so. Ms Bands, like other recruitment consultants, would keep in touch with the temps when they were on assignment, but the purpose of this was business promotion and not to monitor the temp's performance. The consultant's aim was to find out whether the temp was unhappy and planning to move on (so that Adecco could fill the spot with another temp) and whether there were other assignments vacant with that client (for which Adecco could recommend another temp.) It was not to monitor performance.

31. Mr Tagg accepted that Adecco did have a reputational interest in the performance of its temps, but his evidence was that Adecco would still not monitor their performance. Adecco protected its reputation and its desire to obtain repeat business from its clients by vetting the CVs of temps for suitability before presenting them to its clients rather than by monitoring their performance during an assignment. While the contract did give the temp an obligation to perform to a certain standard, it was extremely unlikely Adecco would ever attempt to sue a temp for breach of this clause. The reality was, as I have said, that the client terminated the assignment if it found the temp's work unsatisfactory.

32. The standard temp contract included a clause that the contract ended automatically if the contract between the client and Adecco came to an end. More pertinently, Adecco could bring it to an end without notice if either the client or Adecco reasonably considered the temp's performance unsatisfactory, and could bring it to an end without a reason on 7 days' notice. This effectively mirrored the standard client contract: Adecco could terminate an assignment in the same circumstances that the client could end the assignment under the standard client contract (see §64 and §§67-70), so Adecco could bring to an end its liability to pay the temp as soon as the client's liability to pay Adecco came to an end.

33. In practice, termination was more direct. The client would normally directly inform the temp that they were no longer required. Adecco might not be told immediately.

34. Adecco placed great significance on the fact that virtually all assignments ended because either the temp or the client chose, for whatever reason, to end them and that Adecco might not even discover this until some time after the termination. It would often not discover the termination until it investigated the reason why the temp had not submitted a timesheet. This belated discovery of a termination was an inconvenience to Adecco because it was legally obliged to send out certain paperwork on a termination plus it wanted to know if its income from that source had ended.

35. The evidence was that Adecco would not terminate a temp's contract other than at the request of a client or – very rarely – where it was at financial risk. It would be at financial risk if the client was insolvent because Adecco would be liable to pay the temps for the work performed irrespective of whether the client could or would pay it under the standard client contract. Apart from situations where the client no longer required the temp and the rare cases of client insolvency, Adecco would have no interest in terminating the assignment. Its interest was in allowing the assignment to continue in order to earn its commission.

36. In conclusion, Adecco did not conduct, and was really incapable of conducting, appraisals of its non-employed temps. Nor did it have any disciplinary procedure for its non-employed temps. The appellant relied on this as probative that the temp's services were supplied to the client and not Adecco but I do not consider it as probative either way. There was no evidence that the client had disciplinary procedures for non-employed temps either. The remedy for the client if it had taken on an unsatisfactory or now unwanted temp was to exercise its right in the contract it had with Adecco to terminate the assignment (discussed below at§§67-70). Disciplinary procedures are only necessary for contracts of employment where dismissals must be "fair" and there is no automatic right to terminate without cause. But a non-employed temp was, I find, not perceived to be an employee by either Adecco or the client and could (on 7 days notice) have their assignment terminated without cause. Neither Adecco nor its clients needed disciplinary procedures in order to manage an unsatisfactory or unwanted temp. They could be dismissed without repercussions on (at most) 7 days notice.

Zero hours contracts

37. Adecco was not obliged to offer any assignment to a temp on its books, and if it did offer an assignment with a client, the temp was not obliged to accept it. Nor was there any exclusivity on either party's side: Adecco had many temps on its books at any one time and would send the CV of as many of these temps as it considered suitable to a client to consider for any particular assignment. It left it to the client to choose the temp to whom the assignment would be offered (if any). And the temp could be signed on with any number of agencies.

38. Whether or not the contract between Adecco and the temp was one of employment or not, it is clear that the obligations under that contract only subsisted during the time that the temp actually worked on an assignment. Neither party owed the other any obligation under the contract outside any period the temp was actually working an assignment. In current jargon, the agreement between the temp and Adecco would be referred to as a 'zero hours contract'.

39. The appellant attached a great deal of significance to this matter, as did the Tribunal in *Reed Employment* where the contract was similarly one where the agent was not obliged to offer the temp any assignments and the temp, if offered an assignment, was not obliged to accept it. I consider the *Reed Employment* decision below at §§179-203.

40. However, I do not agree with the appellant that this point is significant in determining the nature (rather than the duration) of the parties' obligations. I consider the lack of obligation on Adecco and the temp outside an assignment irrelevant to the question of what the contractual obligations were during an assignment. While everyone accepted the temp had no obligation to accept work nor Adecco to offer work, the question is whether the temp agreed with Adecco during an assignment to undertake work in consideration of payment. And I find that the temp did make that agreement: and the work it agreed with Adecco to undertake was to do what Adecco's client asked it to do.

Holidays

41. The standard temp contract required the temp to agree holidays in advance with Adecco. The reality was that this contractual clause was not enforced. The temp would agree holidays with the client and the first that Adecco would usually know of it was when the temp failed to submit a timesheet covering the holiday period.

42. Mr Tagg's evidence was that contracts with other employment agencies might in fact only require the temp to agree the holiday with the client (see §17). This evidence makes commercial sense. While an employment agency wished to earn, no doubt, as much commission as possible from an assignment and none would be earned while the temp was on holiday, nevertheless it could not force a reluctant worker to work and would no doubt lose the goodwill of its temp and perhaps its client if it tried to do so. Its only real concern with the temp's holiday must therefore be that the client had agreed to it. So Adecco's failure to enforce a contractual term that required a temp to agree its holiday with Adecco made commercial sense. In reality, whatever the contract said, Adecco, like other agencies, only really required its temps on assignment to agree the dates of their holiday with the client.

43. The appellant considered this was also a significant factor. I deal with this below at §109-110.

Payment

44. Under its own contract with Adecco, the client was liable to pay the agreed fee for the time worked by the temp on assignment. The obligation was triggered by the temp's submission of timesheets signed by the client giving the time worked each week by the temp. It was therefore an obligation of the temp under the standard temp contract that he would keep accurate timesheets.

45. The standard temp contract specifically provided that Adecco would pay the temp for work satisfactorily performed whether or not the client paid Adecco for that work.

46. The appellant considers that this obligation was not significant because it was 'only' there for commercial and regulatory reasons. So far as the regularly reasons I concerned, I deal with these below at §§83-86. I accept that Adecco had good commercial reasons to take on the obligation to pay its temps: one would expect genuine contractual terms to be in the contract for good commercial reasons. But that is the point. When considering what a person has actually agreed to do under a contract, the court considers the genuine contractual terms, which will be terms that have been agreed to for commercial reasons, whether or not they represent a negotiated compromise and whether or not the appellant might have preferred a less onerous term. The fact is that, in its contract with the temp, the appellant agreed to pay the temp for his work. And that is, in my view, very significant in defining what it was Adecco provided to its client under the client contract discussed below.

Employment status of temps – a red herring

47. Neither party suggested that the temps were employees of Adecco even during an assignment. While it is possible to have an employment relationship during an assignment where there is no obligation to offer or accept an assignment (eg *McMeecham* – see below*)*, no one suggested that the temps here had such a relationship with Adecco.

48. So far as the VAT question in this appeal is concerned it does not seem to matter. If the temp provided the service to Adecco of agreeing to work under Adecco's client's direction, I see no reason in logic why, whether the temp was an employee of Adecco or self-employed, would affect Adecco's liability to VAT under the standard client contract. It might well affect the temp's own VAT liability of course. In other words, whether Adecco was supplying staff to its clients or merely introductory services does not depend on whether the temp was employed by Adecco or not. Adecco could theoretically supply the services of the temp even if the temp was self-employed.

49. That this is correct is suggested by the decision of the CJEU in *ADV Allround Vermittlungs AG* C-218/10 [2012] STC 708. There was a similar position with temps and an employment agency. The agency provided the services of self-employed temps to its clients. The question for the CJEU was the place of supply of the agency's services. Under the VAT Directive, a particular place of supply rule applied to the 'supply of staff'. The CJEU held that the 'supply of staff' included the supply of the services of self-employed persons:

> "…the answer to the first question is that the sixth indent of art 9(2)(e) of the Sixth Directive must be interpreted as meaning that the 'supply of staff' referred to in that provision also includes the supply of self-employed person not in the employ of the trader providing the service.'

50. In other words, supplying the services of self-employed persons can be a supply under the Directive. If such a supply is made, it is subject to VAT. The issue here is whether Adecco made such a supply, or whether it merely supplied introductory services. Another way of putting it is this: it was accepted that the temps were self-employed, but the question was whether they supplied their self-employed services to Adecco or to the client.

Employed temps contract

51. The Tribunal was also shown the contract under which Adecco actually employed the 'employed temps' (see §3(1)). This standard contract was undated and was actually Adecco's standard contract and not a Badenoch & Clark standard, as Badenoch & Clark had no employed temps.

52. The terms were distinctly different. Under the employed temps' contract, Addecco did have control of the temps' work; if there was a conflict between Adecco's and its client's instructions, Adecco's were to prevail. The temp was

obliged to accept any assignment offered and was not allowed to sign up with any other agency. Adecco also had a disciplinary procedure.

53. Adecco's obligations were different too. It was obliged to offer so many days work at a particular pay rate in a 12 month period. It expected to fulfil this obligation by finding assignments for its temps but if it failed to do so would have to make up the difference out of its own pocket.

54. I accept HMRC's point, however, that in some respects the operation of this contract was not much different. And Mr Tagg accepted that the client would not necessarily know whether a temp they took on was employed by Adecco or not, as from an operational point of view there was little or no difference so far as the client was concerned.

The standard client contract

55. The standard contract between Adecco and its clients at issue in this appeal covered both temps and contract workers, and some of the clauses therefore applied to both types of worker, while some only applied to one or the other. A contract worker (see (3)) was a worker whom both sides agreed was providing his services direct to the client and for which Adecco merely provided and was paid for introductory services. The client paid the contract worker for his work direct.

56. It was not entirely clear if the same or a similarly worded contract would be used when Adecco provided employed temps. Indeed, as Badenoch & Clark had no employed temps it is not surprising that there was no reference to them in the standard client contract. As I have said, Mr Tagg's evidence was that a client, taking on a temp worker rather than a contract worker, would probably not know whether the temp was employed by Adecco or not. This indicated that the same standard contract between Adecco and its clients would be used for all three types of worker, albeit some terms only applied to contract workers, and some terms only applied to non-contract workers.

What Adecco provided to the client

57. The contract defined Adecco's services as 'the selection, recruitment and payrolling of a Candidate on Assignment with the Client' and this definitions clause applied to both kinds of worker even though it was not suggested that Adecco had any responsibility to pay (or payroll) a Contract Worker. Adecco's "provision of services" clause applied to both kinds of worker too:

> 3.1 [Adecco] will use its reasonable endeavours to ensure that Candidates are efficient, honest and reliable but [Adecco] gives no warranty in this regard and it remains the Client's responsibility to ensure that the Candidate is suitable for the Client's requirements
>
> 3.2 During the period of an Assignment each Worker will be under the Client's direction, supervision, management, and control as to the manner in which they perform the Assignment. The Client is

> responsible for the health and safety of each Worker. The Client will comply in all respects with all statutes including for the avoidance of doubt, the Working Time Regulations, codes of practice and other legal requirements and the Client will provide adequate insurance for each Worker during the period of an Assignment."

58. One way of looking at this is that Adecco agreed to do provide exactly the same thing whether or not the worker was a PAYE temp paid by Adecco or a contract worker paid by the client. That indeed was Adecco's case: it provided introductory services only, whether the worker was a contract worker or a PAYE temp.

59. However, the contract did, I find, recognise differences between what Adecco supplied when a temp went to work at a client's and what it supplied when a contract worker went to work at a client's. The definition of a temp worker was a candidate:

> "whereby the worker contracts with, and is paid by, [Adecco]"

A contract worker was defined as:

> "engaged by the client on a fixed term assignment and whereby the contract worker contracts directly with, and is paid by, the Client"

Other differences arose out of this distinction. For example, for temps, but not contract workers, the client was obliged to sign timesheets to verify the hours worked by the temps.

Liability for unsatisfactory work?

60. The appellant's position was that whatever duties the temp owed Adecco under the contract with Adecco, under Adecco's contract with its client, it had no responsibility for the work performed by the temp and therefore its services were no more than introductory services with certain admin services, such as operating the payroll, tacked on.

61. It is true that the contract (under the heading 'Liability and Insurance' and in a clause applying to both temps and contract workers) specifically excluded liability for loss or damage to the client arising out of any defective work by the worker. However, to me this reads as a limitation of liability clause and not one which defines what services are actually supplied.

62. And to a limited extent the appellant did accept liability for unsatisfactory temps because the contract also provided that as long as the client terminated the assignment in the first two hours the client would have no liability to pay the temp for the time worked. Nevertheless, under its contract with the temps, Adecco would be liable to pay the temp for the time worked (unless the quality of the work was a breach of the temp's contract with Adecco, although Mr Tagg's evidence suggested that in practice Adecco might just pay up rather than argue the point). This meant that if the temp was terminated by the client within the first two hours, Adecco had to pay the worker without receiving payment from its client and therefore would make a loss on that assignment.

63. The appellant's view was that this clause was of little significance to resolution of the VAT issue: it was nothing more than a commercial decision to maintain goodwill with its clients. It did not, however, apply to contract workers. While the appellant saw it as some sort of warranty that the introduction it made was a good one, nevertheless it was not a warranty given for contract workers. For the first two hours, Adecco was at risk if the temp's work was unsatisfactory to the client. This was not true for contract workers.

64. But after the first two hours, the provisions of the contract meant that the risk of unsatisfactory work was with the client. If, as in most cases, the first two hours of an assignment passed without a termination, the contract provided that the client was not allowed to decline the timesheet of a temp due to dissatisfaction with the quality of the temp's work. Acceptance of timesheets was key to the client's liability to pay Adecco, and Adecco's liability to pay the temps. So what this clause meant was that the client had to pay Adecco even if dissatisfied with the work of the temp. The only way the client could bring this obligation to pay for an unsatisfactory worker to an end was to terminate the assignment. As explained below, the client could terminate an assignment without cause on 7 days notice and with cause without notice.

65. In other words, for the bulk of the assignments worked, Adecco had no liability for or control over the quality of the work performed by the temps. Nevertheless, in this very limited circumstance, it did provide some sort of guarantee or assurance to its client against unsatisfactory work by agreeing to pay for the work if the temp was terminated in the first two hours. In this it went beyond merely introducing a worker, as it took on some responsibility for the worker being suitable, but, bearing in mind its limited nature, I do not see that that factor is decisive in deciding whether or not the temp supplied its services to the client or to Adecco.

Termination rights

66. The client had no termination rights set out in this contract in respect of contract workers. This is not surprising as it was clear that Adecco merely introduced the contract worker, and the contract under which the contract worker provided his work was negotiated between the client and the contract worker. One would not expect to find in Adecco's contract with the client any termination rights affecting the contract worker's assignments, and there aren't any.

67. The same is not the case for temp workers, where there are detailed provisions in Adecco's standard client contract on both parties' rights to termination.

68. Ordinarily, the client had to give 7 days notice of termination to Adecco in order to bring an assignment to an end and could do so for any reason.

69. Adecco or the client could terminate an assignment if the other party was in material breach of the contract. In addition, and more relevant to this appeal, either party could terminate without notice if

(a) the temp was in material breach of its contract with Adecco; or

(b) there was any breach of any duty of care owed by the temp to the client.

70. As the temp's contract with Adecco obliged it 'to perform Assignment professionally promptly and efficiently and in good faith using own skill and expertise with due care and to the best standards' (see §29) the effect of this right to terminate meant that the client could terminate without notice the assignment of a poorly performing temp. I find termination of an assignment was the client's remedy for unsatisfactory work, either immediately in the more serious cases or on 7 days notice.

71. Adecco also had the right to terminate an assignment on 7 days notice and again did not have to give reasons for doing so. It could also suspend any assignment for any reason without notice. I accept the evidence that these rights was only rarely exercised and then only where there were real concerns over the client's solvency, as already discussed. Adecco was at real risk in such a case as it would be liable to pay the temps for work performed irrespective of whether the client paid Adecco. Mr Tagg's evidence was that Adecco therefore necessarily carried out careful credit checks on its clients and in practice almost never had to terminate an assignment because of concerns over the client's solvency.

72. The contract also provided, as one would expect, that either party could bring the contract to an end without notice on the insolvency of the other party or for material breach of its terms.

Did Adecco provide a payrolling service to the client?

73. Whether Adecco provided a payrolling service, as claimed by the appellant, depends on what is meant by 'payrolling'. Does it mean paying the workers <u>on behalf of the person</u> who has the liability to the workers to pay them for the work that they have performed? Or does it mean taking on the liability <u>to the workers</u> to pay the workers for the work that they have performed?

74. A clause of the standard client contract which applied only to temps, and not to the contract workers, concerned payment. It did not apply to contract workers as the client was liable to pay them direct. The clause for temps provided:

> "4.1.1 The Client shall pay [Adecco]'s fee …for each hour actually worked by a Temporary Worker. [Adecco] will pay each Temporary Worker. [Adecco] will invoice the Client weekly for all fees due.

75. This clause could be read two ways. It could be read as a promise by Adecco to pay the temps on behalf of the client; alternatively it could be read as making clear that the client had no liability to pay the temps. The appellant proposed the former reading and HMRC the latter.

76. In my view, the proper interpretation of the contract is that Adecco was agreeing with its client that Adecco would owe the workers the liability to pay them for the work that they performed. It was quite clear from the definitions clause mentioned above (§59 – first quotation), the clauses on timesheets, and the clauses on payment that the intention was that the client was obliged to pay Adecco for the work

that the temps (but not the contract workers) performed, and that that was because Adecco would owe to the workers the liability to pay them for their work.

77. If the intention had been that Adecco merely discharged the client's liability to pay the workers, the contract with the client would not have required Adecco to contract directly with the temps nor would it have required the client to sign timesheets. It would not have needed to. Nor would the contract have needed termination rights for Adecco. The contract was clearly drafted to protect Adecco's position on the mutual understanding that Adecco was liable to pay the worker for the work irrespective of whether its client paid it.

78. I would not describe this as a payrolling service. To me payrolling indicates an administrative function of helping another person fulfil their obligations to pay workers. Adecco did not do this. It effectively agreed that it would owe to the temps the legal obligation of paying them. That is the clear inference from the contract and is reflected in the evidence of what happened in practice.

Disclosure of the temp's rate of pay

79. Adecco charged its client a single fee. It did not break its charges down between the gross wages paid to and on behalf of the temp and its own commission. Nevertheless in practice, clients would frequently negotiate a rate of commission with Adecco. And where such a rate was agreed, the client would be able to calculate from what Adecco charged it, what the gross pay of the temp actually was.

80. The appellant's position was that the client's lack of knowledge of the temp's actual wages in the cases where the client did not negotiate a particular rate of commission was immaterial to the outcome of this case. The rate of commission was not disclosed in *Secret Hotels2 Limited* [2014] UKSC 16 (discussed below) and the Supreme Court did not consider that that prevented a finding of agency ([39-41]). While I agree it is not decisive, the fact that the client would not necessarily know how much the temp was earning is yet one more factor which reinforces the view that the standard client contract envisaged that Adecco would be the party which owed to the temps the obligation to pay them.

One off and periodic payments

81. Neither party, as I recall, specifically referred me to the method of calculation of the contractual remuneration as an indication of the nature of the services supplied. But the point seems worth mentioning. The standard client contract made a clear distinction: there was a lump sum payment for the introduction of a contract worker, but periodic payments during the assignment of a temp. A lump sum payment is consistent (if far from conclusive) of a one-off service; periodic payments are consistent with (but far from conclusive) of a continuous supply.

82. An introductory service is a one-off supply; the supply of staff is continuous until the contract comes to an end. Therefore, the payment structure in the standard client contract is consistent with an introductory service being provided for contract

workers, but with the supply of their work being provided in respect of the temps. It is yet one more pointer that the standard client contract, so far as temps were concerned, was for the supply of staff.

The relevance of the regulatory framework

83. In *Reed Employment* at [78] the Tribunal held that the statutory law which made Reed an employment business did not determine the nature of the supply for VAT purposes. I agree: to the extent UK law deems the temps to be an employee, that is only for a particular purpose of employment or direct tax law. It cannot affect the taxpayer's VAT liability which is in any event determined by the Principle VAT Directive and not national laws. However, as was said in *Reed Employment*, where a supplier chooses to carry on its business in order to operate within a particular regulatory regime, that can impact on the nature of the supply it makes.

84. In April 2004, the Conduct of Employment Agencies and Employment Businesses Regulations 2003 came into effect. This prohibited employment agencies who had introduced non-employed temps from paying (directly or indirectly) the temp. In order to pay the temp the employment agency had to constitute itself as an 'employment business' which (under Regulation 15) required it to have a contract with the temp under which it was liable to pay the temp whether or not its client paid it. The temp has more rights against an employment business than an employment agency. The thrust of Mr Tagg's evidence when discussing these Regulations was that it was important to clients that the employment businesses had the payment responsibilities for temps and that it was the choice of agencies such as Adecco to constitute themselves as employment businesses rather than employment agencies when supplying services relating to temps.

85. In this case, as I have said, Adecco entered into contracts with the temps which obliged Adecco to pay the temps irrespective of whether it received payment from its own clients. Mr Grodzinski did assert in submissions that the appellant only took on the payment obligation in order to abide by the above mentioned regulations but I had no evidence whether this contractual obligation would have been entered into by Adecco irrespective of the above regulations: certainly there was no evidence from Mr Tagg that it was *because* of these regulations that Adecco agreed to pay the temps whether or not it was paid by its client. On the contrary, his evidence at paragraph 20 of his statement concerned three examples of obligations undertaken by an employment business to its temps that would not have been offered save for these regulations and they do not include payment. In the absence of clear evidence, I will not accept Mr Grodzinski's assertion. (I note in passing that *Reed Employment* concerned a period of about 20 years before the new regulations came into effect and it was clear from the decision in that case that for most of the period in issue Reed had chosen to contract with its temps on the basis that it would pay them irrespective of whether its client had paid it, suggesting, although not evidence in this case, that at least some agencies adopted this obligation irrespective of the regulations).

86. In any event, I do not consider that it matters. It is Adecco's case that its obligation to pay the temps should be disregarded because, it says, it must agree with

the temps to pay the temps because otherwise the regulatory regime means it could not payroll the temps on behalf of its clients. But the fact of Adecco's business is that Adecco chose to enter into contracts with the temps under which it owed the temps the liability to pay the temps for the work performed for its clients. The regulatory regime may (or may well not) explain why the contracts were in the form that they were in but it does not affect the decision. Adecco cannot say (even if it had the evidence, which it does not) that the Tribunal should treat it as if (say) it had not undertaken the obligation to pay the temps as it only did undertook this obligation in order to bring itself within a particular regulatory regime. The fact is that it did undertake the obligation.

Working time regulations

87. One of the clauses in the standard client contract was that Adecco would help the client comply with its obligations under the working time regulations. The clause implies that the client has the obligation under those regulations: HMRC's submissions were that because Adecco had the liability to pay the temp, the regulations put the obligation on Adecco.

88. I do not consider the regulations significant. They do not alter the fact that the contract and liability to pay was between Adecco and the temp, and not between the temp and the client. They cannot determine the VAT question.

Conclusions on the contractual position

89. Even while the contractual position may not determine the direction of the VAT supply, it is the starting point when determining whether and to whom and of what a supply is made (see the discussion on *Tolsma* below at §§224-228). So I will consider the contractual position before I consider the VAT position.

90. However, whether applying English contract law or European VAT law, the whole of the picture must be considered. So Adecco's contract with its clients must be seen in the context of its contract with its temps and seen in the context of the client's legal relationship (or otherwise) with the temps. And I turn to this first.

The legal relationship between the temp workers and the clients

91. It was clear that on assignment the worker did the job that the client asked it to do and all the day to day contact by the temp was with personnel of the client. But both parties accepted that there was no contract, actual or implied, between the temp and the client. HMRC came armed with case law to show that there was no implied contract between the temp and the client (case law such as *James v London Borough of Greenwich* [2008] EWCA and *Tilson v Alstom Transport* [2010] EWCA Civ 1308) but I do not need to consider this in detail as the appellant conceded there was no implied contract.

92. I consider that that concession was correctly made because a contract can only be implied when it is necessary to do so in order to give business reality to a

transaction (per Bingham LJ in *The Aramis* [1989] 1 Lloyds Rep 213, 224). But the arrangements between the temp, Adecco and the client worked perfectly well *without* a contract between the temp and client: the temp contracted with Adecco, and Adecco contracted with the client. There was no need for a contract between the temp and client in order for the client to have the benefit of the temps' work.

93. I find that under its contract with the temp, Adecco was liable to pay the temp the agreed payment for its services in undertaking the assignment for the client. I find that the client had no contractual obligation with either the temp or Adecco to pay the temp for its work in undertaking the assignment. The client's only obligation to pay for the work was an obligation to pay Adecco the agreed fee.

94. In other words, under the contracts, the client was obliged to pay Adecco for the work, and Adecco was obliged to pay the temp for the work.

95. There was no *contractual* relationship between the temp and the client, but the appellant did not necessarily accept that there was no *legal* relationship between the temp and client. In the hearing, Mr Grodzinski suggested, in response to a question from me, that in common law, and in particular under the doctrine of quantum meruit, the arrangements entered into might give the client a legally binding obligation to pay the temp for his/her work.

96. I do not accept that that is right. A claim in quantum meruit is a claim in restitution (There is an exception to this which is where the claim in quantum meruit arises under a contract between the parties, such as where a contract is repudiated, but that is irrelevant in this appeal where there was no contract between temp and client). A claim in restitution, it is well established, requires amongst other things, the claimant to show (1) enrichment of the defendant (2) at the expense of the claimant and (3) that the enrichment was unjust. I do not see how the temp could establish any of these things against the client, even in a case where the temp has performed the work but not been paid by Adecco. Firstly, the client is not enriched by the work performed because the client has either paid or is liable to pay Adecco for the work. The client has not received the benefit of the work for free and so is not enriched. Secondly, any enrichment would not be at the temp's expense as the temp agreed to do the work for a fee, which even if it has not yet been paid, Adecco would clearly owe to the temp. Lastly, even if the temp's claim for payment against Adecco has become (hypothetically) worthless because (hypothetically) Adecco has become insolvent, nevertheless it would be unjust for the temp to sue the client because it was the temp's choice to contract with Adecco and accept Adecco's promise to pay. If the temp succeeded, the client would have to pay twice for the work: it would have to pay Adecco's (hypothetical) liquidator and the temp. So for all these reasons, I find that the temp has no claim in quantum meruit and/or restitution against the client if it performs the work and is left unpaid by Adecco.

97. So I reject the suggestion that there is any kind of legal relationship between the temp and the client arising out of the temp's performance of the work: there is no liability for the client to pay the temp arising out of contract or out of a quantum meruit.

98. The appellant's position was that despite the absence of a legal relationship of any sort between the temp and client, nevertheless as a matter of VAT law, the supply of the temp's work was made direct by the temp to the client. For this proposition they relied on the decision in this Tribunal in *Reed Employment.* And I consider this below. But returning to the question of interpretation of the contracts, my findings are as follows.

The overall view

99. Taking an overview of the tri-partite situation, Adecco owed to its temps the obligation to pay them for all the work undertaken for Adecco's clients, irrespective of whether Adecco's clients had paid Adecco. Contractually, therefore, the temps' obligation to perform the work for Adecco's clients was owed to Adecco, because Adecco provided the consideration.

100. And when one considers the position between the temps and Adecco's client, this is entirely consistent with the standard temp contract. There was, as I have just said, no legal relationship between the temps and Adecco's client: there was no contract and no obligation arising under the law of restitution or otherwise which obliged Adecco's client to pay the temp for the work performed.

101. Therefore, in this context, an interpretation of the standard client contract which meant that Adecco was only paid the commission element of the fee in its own right and was merely paid the wages element of the fee as a disbursement would be quite inconsistent with the legal position between Adecco and the temp on one hand, and the temp and the client on the other hand.

102. Moreover, it seems to me that it would also be quite inconsistent with Adecco's commercial interests. What I mean by this is that *if* Adecco received only the commission element of the fee in its own right, and received the wages element as a disbursement, it would have no legal right to insist on being paid the major part of the charge as that money would never belong to it. So if its client went into liquidation, on this interpretation, Adecco could only prove in the insolvency for the commission and not the disbursement element even though of course, it would still be liable to pay the temp.

103. Bearing these considerations in mind, is there anything in the standard client contract that is actually inconsistent with an interpretation which is consistent with the standard temp contract and the absence of a legal relationship between the temp and client? On the contrary, Adecco's ability to terminate the contract and/or the individual assignments was necessary to protect Adecco *because* it would be liable to pay the temp irrespective of whether its client paid it. And that is consistent with the standard temp contract and inconsistent with any suggestion that under the standard client contract Adecco merely discharged its clients' obligation to pay the temp.

104. If I understood Mr Grodzinski correctly, he accepted that the payment by the client to Adecco might not include a disbursement: his point was that the contractual position did not dictate the VAT supply position. However, I must deal with the

question of whether the payment by the client to Adecco was a disbursement in so far as the temps' wages were concerned because the starting point (and sometimes the end point) of determining to whom and by whom a VAT supply is made is the contractual position.

105. Mr Grodzinski suggested many factors in the contracts meant the reality was that the temps supplied their services direct to the client and I will consider these factors in considering whether the payment representing the wages made by the client to Adecco was a disbursement due to the temp:

Adecco had no control of the temps' work

106. I accept what Mr Grodzinski said on this. Adecco could not and did not tell the temp how to carry out the assignment; it did not appraise or review a temp's performance of an assignment. It did not have a disciplinary procedure. It did not agree to when the temp took holiday and might only know retrospectively if the temp had taken holiday or sick leave or even if the assignment had ended.

107. Mr Grodzinski also emphasised that Adecco put its resources go into finding and vetting and registering temps, and finding clients who wanted temps. It did not put resources into the quality of the work performed by the temps: it did not train or monitor them.

108. But I do not consider any of this inconsistent with a contract where the temps' obligation owed to Adecco was to do what Adecco's client told it to do. On the contrary, it seemed to reflect practical reality whereby the temps were no one's employees and had no job security: the client was best able to determine if the work was performed to its satisfaction and either the client or Adecco (at the client's request) could terminate the assignment if it was not. Indeed, the provisions in the *client* contract which enabled the client to terminate an assignment where the worker was unsatisfactory only reinforces the view that Adecco *was* supplying the temps's work. If Adecco had merely introduced the temp, the client would not need a termination right in its contract with Adecco. And indeed, the contract gave it no such rights in respect of contract workers. They were not needed for contract workers with whom the client had a direct contractual relationship.

Adecco had no control over temps' holidays and when assignments end

109. The contract with the temps required the temp to agree its holidays with Adecco but, as I have said at §41, this clause was honoured only in its breach. The existence of the clause is, of course, inconsistent with a contract of mere introduction as the introducer would not have any interest in the temps' holidays.

110. But the appellant suggests that because it was not enforced, it indicates that Adecco was merely introducing the temps to its clients. I do not accept that. As I have explained, Adecco's failure to enforce it was rational (§42). It was also consistent with a contract for the provision of staff: while Adecco would earn no commission when a temp took a holiday, the temp had a right to holiday and Adecco

could have no interest in refusing to permit the temp a holiday to which the temp was entitled if Adecco's client had already agreed to the dates of it.

Adecco excluded liability for the temps' work

111. As I have recorded, in its contract with the clients Adecco excluded its liability for unsatisfactory work but as I have said this reads as a limitation of liability clause and not a clause which defined the services to be provided. It is consistent with a service of mere introduction but it is also consistent with a contract under which Adecco provided to its clients the services of its temps. This is because the client had an alternative means of redress for an unsatisfactory temp: they could terminate without notice. Moreover, Adecco's contract with its temp required the temp to provide satisfactory work (see §29): this clause ties in with the client's right to terminate in the standard client contract for breach of the temp of its obligation to Adecco. And this aspect is only consistent with a contract under which Adecco provided to its clients the services of its temps and inconsistent with the provision of mere introductory services, as, in the latter case, Adecco would have no interest in the quality of any services provided and the client would not need to rely on the temps' contractual obligation to Adecco in order to terminate.

112. Mr Grodzinski also relied on evidence that Adecco was judged by its clients by the standard of its recruitment services and *not* by the standard of work performed by its temps. I accept that the evidence was that Adecco was largely but not exclusively judged on the number and quality, etc, of temps introduced but it was also judged on performance in that the clients, including Bank A and Bank B, looked at performance and failure to complete by the temp. It was also clear that Adecco accepted it did have reputational concerns if a worker was completely unsuitable and for that reason the contract provided the client with no liability if the assignment was terminated in the first two hours.

113. Even to the extent that the proposition by Mr Grodzinski was true, it does not follow that, because the clients did not see Adecco as entirely responsible for the standard of its temps' work, that Adecco only supplied introductory services. What the contract gave the client was workers carrying out its instructions but to whom the client owed no obligation either to pay or to keep them in work and whose assignment could be ended at will if the work was unsatisfactory or within 7 days for any reason at all. With such termination rights, the client might logically consider that they did not need to assess the agency on the worker's performance.

Temps' wages disclosed

114. While the standard client contract did not disclose the temps wages and Adecco's rate of commission, in many cases the clients would be told this. However, I do not consider this inconsistent with the legal relationship between Adecco and the temp, and the lack of legal relationship between the temp and the client. A requirement for transparent pricing does not necessarily mean that the price is split between a fee and a disbursement.

115. Disclosure is also, of course, consistent with the appellant's position, save to the extent that some clients were not told of the fee split. But I think that this is a minor point: Mr Grodzinski pointed out that such lack of disclosure was not considered decisive in *Secret Hotels2*.

Conclusions

116. While there are some clauses in the standard client contract (in so far as it applied to the temps) which are consistent with a reading either that Adecco was supplying an introductory service or that Adecco was supplying the work of the temps, there are no clauses which are actually inconsistent with an interpretation that the client owed Adecco the whole fee in return for the work performed by the temps. And as that interpretation is consistent with Adecco's contract with the temp and consistent with the absence of legal obligation between the temp and Adecco's clients, that is the interpretation to be preferred.

117. Indeed, the appellant's interpretation of the standard client contract is inconsistent with Adecco's standard temp contract and inconsistent with the lack of legal obligation between the temp and Adecco's client.

118. Contracts should be seen in their context. As there is a lot consistent with, and nothing inconsistent with, an interpretation that under the standard client contract, Adecco was providing the work of the temp to its client and its client paying Adecco the full fee for the work in its own right, and as such an interpretation is consistent with the clear obligation in the standard temp contract for Adecco to pay the temp, and the lack of legal obligation on the client to pay the temp, then the standard client contract (in so far as it applied to non-employed temps) should be given that interpretation, even though another interpretation could have been possible if looked at in isolation from its context.

119. Mr Grodzinski's view was that what the appellant actually did was merely introduce the temps to its clients and take on the obligation to the temps of paying them even if the client did not pay Adecco, but that taking on this latter obligation did not convert an introductory service into a contract to provide staff. It did not, in his view, fundamentally change the nature of what Adecco did. I am unable to agree. If Adecco merely introduced the temp to its client, it would be for the client to enter into a contract with the temp to take him on as a worker, and if the client did so, then the client would have a direct obligation to the temp to pay him for the work. It is a very different position where the contracts between Adecco and its clients are such that the client gets the benefit of the work of the temp but without any contractual relationship with the temp and without any obligations to the temp and in particular without the obligation to pay the temp for the work. Instead, the temp's contractual relationship is with Adecco. So Adecco was not merely providing introductory services, indeed it was not really providing introductory services at all: it was not introducing persons with the intention that those persons enter into a legal relationship. What the client got was workers who would carry out the assignments but to whom it owed no responsibilities such as payment; Adecco supplied the work of the workers, not an introduction to them.

120. In some ways it is very difficult to understand the position of the appellant on the contracts. It accepts that there was no contract, express or implied between the temps and the clients. It only suggested there might be a quantum meruit owed by the client to the temp in response to a question from me: it formed no part of its case that there was legal liability on the client to pay the temp. I have in any event concluded that there was no such liability. So the *contractual* position without doubt, in my view, was that the temp worked for payment from Adecco, and Adecco provided that work to its client in return for payment by the client. Contractually, it is impossible to argue that what Adecco did was mere introduction, as that would make a nonsense of the legal position viz-a-viz the client and the temp, and the temp and Adecco. Yet the appellant's case seemed to be not only that the VAT supply position was determined by what it saw as economic reality, but the contractual position was also so determined. So in the appellant's view, because the temp carried out the instructions of the client when working on an assignment, I must see the contract between Adecco and the client as one of introduction only. But if I accepted that, the only logical corollary would be that there was a contractual obligation between the temp and the client for the performance of the work by the temp: but there was not, and the appellant accepts that.

121. The appellant relied on the decision of the Supreme Court in *Secret Hotels2* but it is difficult to see how it helps them. The conclusion of the court on the contracts in that case was that on their true analysis the taxpayer (sitting between the owner of the hotel and the hotel guest, as Adecco could be said to sit between the temp and the client, who consumed the temp's services) effectively merely introduced the hotel owner to hotel guest, acting as an intermediary. But that conclusion is not open to me here: everyone accepted that there was no contract between the temp and the client, and on the facts I agree with that concession. But in *Secret Hotels2* the court was able to and did conclude that the taxpayer acted as an agent and that a contract was thereby created between hotel owner and hotel guest. But here, because there was no contract between temp and client, the only possible contractual route for the temp's services was for them to be supplied by the temp to Adecco and by Adecco to its clients. And I find that this is clearly reflected in the contract between Adecco and the temps (for the reasons explained at §44-46) and the contract between Adecco and the client is also consistent with this analysis even if less clearly stated on the face of the document (see §74-78).

122. I find that the contractual position was that the client was liable to Adecco to pay the full contract fee in return for the work provided by the temp; and that Adecco was liable to the temp to pay it the agreed fee under the temp contract for the work carried out by the temp. There was no contract between the temp and the client.

123. I move on to consider the Bank A and Bank B contracts, which have to be considered by themselves. As I have explained, Adecco, for business reasons, sometimes had to sign up to the client's standard contract and was unable to require that client to sign up to its own standard client contract discussed above. The contracts with Bank A and Bank B were two such contracts.

124. However, wherever the Bank A and Bank B client contracts operated, the appellant accepted that the same legal relationship existed between Adecco and the temp and between the client and the temp as when the standard client contract was used: in other words, the Adecco-temp relationship was governed by the standard temp contract and there was no legal relationship between the temp and the client.

125. Adecco considered that any distinctions between the Bank A and Bank B contract and its standard client contract were immaterial in so far as the questions at issue in this appeal were concerned; HMRC's position seemed to be that despite any differences between the three client contracts, the appeal in respect of all three contracts should be resolved in its favour but if I entertained doubts about this in respect of any one of the contracts, I needed to consider each individually and not assume the same answer applied in all three cases.

The Bank A Contract

126. As with the standard contracts, I am not inclined to place too much weight on definitions clauses in a tri-partite situation where the word 'services' could be used either or both to refer to what the temp did for Adecco, or what the temp did for the client. And sure enough there is ambiguity in the definitions clause where the definition of "assignment" is:

> "… the period in which a Temporary Worker is requested to provide services to [Bank A]

but "services" is then defined as:

...

> Services means services provided by the Preferred Supplier under this Agreement, including without limitation the introduction of Temporary Workers as described in Clause 2 (scope of services) and Appendix 1 (Scope of Services and Service Level Agreement)....

And the definition of Temporary Worker is:

> Temporary Worker means an agency worker or Sub-contractor of the Preferred Supplier who is supplied by the Preferred Supplier to provide Services to [Bank A]

127. So the definition of Temporary Worker not only refers to the temporary worker being supplied to (rather than introduced by) Adecco to the client, the drafter utilised the definition of 'services' to explain what the temp is doing for the bank, even though that definition refers to an introductory service (and the temp, at least, is clearly not supplying an introductory service!) With such ambiguity little reliance can be placed on the definitions.

128. Clause 2 covered scope of services and Adecco promised to supply temporary workers and cooperate with all parties to perform "the Services" to a high standard. The appellant's interpretation of this is that, as the definition of Services referred to introductory services, this is a promise simply to perform introductory services to a

high standard and not a promise that the temps' work will be of a high standard. With both the ambiguities in the definitions clauses, and the reference to cooperating with all parties, I am less than certain that this was its intended meaning.

129. Similarly another clause included the obligation on Adecco as follows:

> All Services shall be performed in accordance with the Agreement, including without limitation the Service Level Agreement, using all reasonable skill and care. The Preferred Supplier undertakes to ensure that performance of the Services will be adequately supervised and managed at all times to ensure that the Services meet the standards required by the Agreement.

This could be read two ways: is it a promise by Adecco that the work of its recruitment consultants (such as Ms Bands) would be adequately supervised and managed or a promise that the temps' work would be adequately supervised and managed?

130. I am not sure it matters. Mr Tagg's evidence was that Adecco managed the situation with temps in the same way whether the contract with the client was standard or bespoke. So in reality Adecco did not manage the temps' work or ensure it met the standard required.

131. The appellant was right to say that largely the contract concentrated on Adecco's obligation to introduce the right candidate. Bank A had a long list of requirements for which Adecco was obliged to screen candidates. Appendix 1 also defined the scope of Adecco's services. This was very detailed, explaining in some detail what Adecco was to do in finding and recruiting temporary staff. It included checking on the temp's length of service with Bank A, handling a grievance procedure with the temps as 'intermediary' for Bank A and having fortnightly meeting with the temps on assignment. There was also a service level agreement which set out Bank A's expectations, such as having responses to emails within 15 minutes. Adecco would be reviewed on its performance measured against a lot of factors, many of them relating to the quality of its introduction of a temp, such as whether the temp's CV was a good match for the role and the percentage of temps introduced who were actually offered an assignment. But Adecco was also judged on factors such as those temps who declined an assignment, those who left an assignment before it was complete *and* (n) the performance of the temps and Adecco's management of the temps.

132. As with temps on assignment with clients who signed the standard client contract, the main method of managing performance which did not meet the client's standard, or where a temp was no longer required, was for the client to terminate the assignment. Bank A could terminate any assignment without notice for any reason.

133. The Bank A contract also differed from the standard client contract in that it included (or purported to include) obligations binding on the temp. Appendix 2 contained conditions for the temps, and commenced with a note saying it was important that the temp adhered to these conditions and that they are supplemental to

any requirement set out in the agreement between the temp and agency. The conditions dealt with matters such as integrity and professionalism; conflicts of interest; money laundering; confidentially; office security and dress code. They can be summarised as a series of standards by which Bank A made it clear that they expected the temps to abide. At the end there was provision for the temps to sign to say that they had read, understood and agreed to comply with the standards and conditions. Adecco agreed in this contract to provide a briefing for all temps on the first morning of an assignment, the form of which was dictated to Adecco in an Appendix, and also to obtain the temp's signature to the obligations in this Appendix 2 before any temp could start the assignment.

134. There was a clause which stated that Adecco acted as an employment business: but this was not in dispute. It also stated that neither Adecco nor the temp were employees or agents of the bank, but it seems to me that this clause was intended to make it clear that, firstly, there was no employment relationship and that secondly, that neither Adecco nor the temp could commit the bank to contracts.

Payment obligation

135. Adecco put a great deal of reliance on clause 17.1 which read

> [Bank A] shall reimburse to the Preferred Supplier the pay rate, holiday pay ...and the national insurance payment .... in addition to a mark-up service fee at 15%

In other words, this clause treated the payment to the temp as a disbursement by Adecco with a fee to Adecco charged at 15% of the total pay.

136. However, clause 17.3 went on to state, that

> "..the preferred Supplier shall charge no fee and make no remuneration to the Temporary Worker on behalf of Bank A if notified by Bank A that the Temporary Worker has performed unsatisfactorily provided that such notification has been communicated to the Preferred Supplier during the first two working days.

I find that this was intended to operate much like the equivalent of the clause in Adecco's standard client which allowed its client 2 hours to reject an unsatisfactory temp without liability, save that in this contract Bank A's better bargaining position has allowed it to specify 2 days rather than 2 hours. Here the drafter has attempted to make this clause consistent with 17.1 by stating that Adecco pays the temps on behalf of Bank A. I discuss below whether this is an effective term.

137. Clause 18 makes even more explicit the premise in the contract that Adecco is paying the temps on behalf of Bank A. It provides:

> [Bank A] will be responsible for payment of the Temporary Worker's remuneration. Unless otherwise agreed in writing, the Preferred Supplier as an agent on behalf of [Bank A] may (and is authorised by

> Bank A to) pay the Temporary Worker on [Bank A's] behalf in which case the Preferred Supplier will be entitled to be reimbursed by [Bank A] for any amounts....The Preferred Supplier shall be exclusively responsible for the payroll function in the payment of remuneration of Temporary Workers on behalf of [Bank A].

138. This is further reiterated in Clause 20 Value Added Tax at 20.1 where it is stated A will invoice Bank A for its fee plus VAT, but that the 'disbursements' paid by A 'in respect of remuneration of Temporary Workers....' shall not be subject to VAT unless the temp was VAT registered.

139. I find it is quite clear that these clauses were written with VAT in mind. Clause 20.4 says that both parties accept the agreement is governed by the staff hire concession under Business Brief 10/04 and that the objective is the VAT efficient supply of workers. BB 10/04 allowed an employment bureaux to chose, for VAT purposes, whether they acted as principle or agent: if they chose to act as agent, VAT was only due on the commission element. The oddity about the contract is that this clause seemed intended to actually make Adecco an agent, whereas BB 10/04 did not require this. It required little more than the agency to separate out the elements of the payment on the invoice.

140. The appellant's case might seem much stronger on the Bank A contract than its own standard client contract. The problem for the appellant is that this contract clearly anticipated that VAT would only be charged on the commission element: if in fact VAT was only charged on the commission element then Adecco has no claim in respect of it because, even on the appellant's case, no VAT was actually overpaid. On the other hand, if VAT was charged on the full fee, then the only conclusion can be that the parties did not in practice fully operate the terms of the contract.

141. This is a preliminary issue on liability: I am not dealing with quantum. As there is no claim if VAT wasn't charged on the full fee, I will assume (without deciding) that VAT was charged on the full fee. If this is not the case, there is no point in me considering the Bank A contract at all. So proceeding on that assumption, where does that leave interpretation of the Bank A contract?

Conclusion on Bank A contract

142. Not only must the Bank A contract be seen in its context of the standard temp contract and the legal relationship (if any) between the temp and Bank A, the contract itself takes some understanding.

143. On the face of this contract, it appears to be one where Adecco clearly agreed with its client, Bank A, that it would act as Bank A's 'agent' in paying the temps on behalf of Bank A. This is on the face of it inconsistent with the clause explicitly stating that Adecco was not an agent of Bank A (§134). I think this contradiction is resolved by understanding that the word 'agent' in the payment clause was not used in the legal sense of agency, giving Adecco the power to bind Bank A to contracts, but merely in the sense that Adecco was acting on behalf of Bank A in paying the temps.

144. Adecco did not even suggest that the word 'agent' in the payment contract should be interpreted as meaning in some way meant that Adecco entered into the individual contracts with the temps as agent for Bank A. I agree it should not be interpreted this way: if it was so read, then this clause would contradict the clause banning agency (§134) and there would be an inherent contradiction within the terms of the contract. Moreover, it would be unnecessary to read the clause in this way: Adecco did not need to be a true agent of Bank A in order to pay the temps on their behalf.

145. So I find that the intention behind this clause was to set out that Adecco paid the wages to the temp on behalf of Bank A, without Adecco being Bank A's agent in the true legal sense. But even given this clause this more limited meaning is problematic: for Adecco to pay the temps on behalf of Bank A, Bank A would have to have a pre-existing obligation to pay the temps. This clause could not create that obligation, particularly as, as I have said, Adecco was not Bank A's agent and did not contract with the temps on behalf of Bank A.

146. I have already explained at length that none of Adecco's clients, including Bank A, had an express contract with the temps. Adecco accepts, rightly so, that there was no implied contract with the temp. I have also found that as a matter of law there was no liability on the clients to pay the temps for the reasons given above at §§91-98. So the conclusion has to be that this clause is inconsistent with the legal-factual reality: a statement in a contract that B pays A on behalf of C, in a situation where C does not owe A any money, is simply a nonsense. A statement that B is paying A on behalf of C does not <u>create</u> an obligation by C to pay A where one does not otherwise exist.

147. The term is ineffective: Adecco could not pay the temps on behalf of Bank A because Bank A did not owe the temps anything.

148. So why is the clause in the contract? The clue is, I think, in the reference to Business Brief 10/04. It seems that someone with an imperfect understanding of BB 10/04 drafted the contract in this way to bring the payments by Bank A to Adecco within the terms of BB 10/04 in order to avoid VAT. The reality is that such a term was quite unnecessary to come within the terms of BB 10/04. Moreover, making the assumption that I am making as explained at §§141-142, the clause was not even implemented in that Adecco invoiced Bank A for the full amount plus VAT.

149. This clause should therefore be disregarded: it did not create a liability for Bank A to pay the temps and in practice it was ignored as (I am assuming) Bank A paid Adecco VAT on the full amount

150. There is one caveat I need to consider. I have said there was no contract between Bank A and the temps and the appellant conceded this. But were they right to concede this where the Bank A contract required the temp to sign Appendix 2? No one in the hearing suggested that this amounted to an enforceable legal contract between the temp and Bank. At its highest, Bank A might be able to prove that it amounted to a contract by temp to abide by the terms of Appendix 2 in return for Bank A permitting the temp to take up the assignment. But it was not given in return

for any promise by Bank A to pay the temp for the work. So even if signing Appendix 2 did amount to a contractual undertaking by the temp with Bank A, it was not a contract under which the temp promised to do the work in return for the payment. So I remain of the view that there was no relevant contract between Bank A and the temp under which Bank A was liable to pay the temp. So this caveat does not change my above conclusion.

151. The terms in the Bank A contract which said Bank A paid Adecco so that Adecco could pay the temps on behalf of Bank A were therefore meaningless. They must be read as an obligation by Bank to pay Adecco the full amount in its own right. And indeed, on the assumption made in §§141-142, that is how the contract was operated in practice.

152. Overall, this means my conclusion on the Bank A contract is exactly the same as my conclusion on the standard client contract. The contract included an obligation on Bank A to pay Adecco the full amount of the charge, both wages and 'commission' element. In its full context, that is consistent with Adecco's obligation to pay the temps an amount equal of the wages element, and the lack of obligation on Bank A to pay the temps anything.

153. Although I accept that Bank A largely measured Adecco's performance by looking at how good Adecco was at putting forward candidates which met Bank A's requirements, rather than by measuring how good the temps were at doing the job required, that made commercial sense when Bank A was able to deal with poor performance by immediate termination of an assignment without any financial liability (other to pay for work already performed). It does not alter the fundamental contractual reality that *only* Adecco was liable to pay the temps for the work, and Bank A was *only* liable to pay Adecco for the work done. In other words, the temp on an assignment owed to Adecco, in return for payment by Adecco, an obligation to do the work Adecco's client told it to do; and Bank A received from Adecco, in return for the payment it made to Adecco, the services of the temps.

154. Fundamentally, the contractual obligations between the parties were the same whether the standard client contract was used or the Bank A contract was used. And I will move on to consider the VAT supply position on that basis, without making a distinction between the standard client contract and Bank A contract.

The Bank B contract

155. What about the Bank B contract? Again I do not consider the definitions particularly helpful when the temp is contracting with Adecco to carry out work for Adecco's client.

156. The contract was similar in effect to the Bank A contract. Adecco had a duty set out in some detail to ensure that the temps it put forward to Bank B were suitably vetted; Bank B had the right to terminate an assignment without notice for any reason; and Bank B would not pay anything for the work performed by the temp if Bank B terminated the assignment within the first two days.

157. The clause on payments varied from that in the Bank A contract. While, as with Bank A, Bank B was only liable to pay Adecco for the work performed if Adecco had provided it with certain information about the exact number of hours worked, it went on to provide that on receipt of payment from Bank B, Adecco would immediately transfer to the temps "all monies due and owing". Unlike the Bank A contract, this was not a clear statement about whether the drafter considered that the wages element of the payment to Adecco was a disbursement on behalf of Bank B or not.

158. It could be read either way: the drafter might have thought that Bank B was liable to pay the temps and therefore this clause was to ensure the money was paid on to them: on the other hand, the drafter might have recognised that it was Adecco's obligation to pay the temps but that Bank B had an interest in insuring prompt payment by Adecco because the temps were unlikely to continue on assignment with Bank B if Adecco did not pay them.

159. Similarly, as with the Bank A contract, Adecco's rate of commission, as a percentage of the temps' salary, was stated in the contract. As I have said before, in relation to the standard client contract, disclosure of Adecco's rate of commission is consistent with either parties' position on the contracts (ie it is consistent with both the client paying Adecco as principle and the client paying Adecco a disbursement on its behalf) so this tells me nothing.

160. The obligation on Adecco to pass the money on directly to the temps was repeated in Schedule 2 "Charges". It referred to:

> "agreed Base Pay rate, any Overtime payments, expenses due and payable by [Bank B]"

My reading of this is that the words "due and payable by [Bank B]" referred to the expenses. It was, in my view, a reference back to an earlier clause under which Bank B was liable to reimburse Adecco only for certain expenses incurred by a temp. I do not read it as a statement that Bank B owed the money itself directly to the temp. My reading is consistent with Clause 12.

161. Clause 12 said it was understood that the temps were not Bank B's employees or agents and that Bank B "shall not be responsible for the payment of remuneration…etc…in respect of any Temps". Adecco also acknowledged it was the employer of the Temps for the purpose of the working time regulations.

162. My overall interpretation of the Bank B contract as it stood is therefore that while some clauses could be read either way, clause 12 makes it clear that the parties to the contract recognised that Bank B had no liability to pay the temps direct. This is consistent with the contract between the temps and Adecco under which Adecco was liable to pay the temps; it was also consistent with the lack of any legal obligation on Bank B to pay the temps. It is therefore the right reading of the contract.

163. As with the Bank A contract, Adecco agreed to procure the signature of the temps to conditions relating to confidentiality. The same comment as made in

relation to Bank A at §150 applies to this. Even if this was a legally binding obligation, and it may well not have been, it was not given in return for any promise by Bank B to pay the temps.

164. Schedule 3 dealt with Adecco's performance indicators. The performance of the temp was not one of them apart from point 2 "number of complaints made against [Adecco] and/or its Temps" and also a key performance indicator included whether a temp had failed to complete an assignment. I accept that, largely, the performance indicators were to do with introduction of suitable temps.

Conclusion on Bank B contract

165. The appellant here relies on Adecco's agreement with Bank B to pay the temps the money Bank B paid to Adecco, the fact that Adecco's rate of remuneration/commission is stated, the fact Adecco was largely reviewed on the basis of its introductions, and the fact the temp was required to sign conditions direct with Bank B. The appellant's position is that all of that supports the economic reality that the temp supplies its services direct to Bank B.

166. But the question here is the interpretation of the contracts. Did the temp agree with Bank B to perform the services in return for consideration? And the answer again is clearly no. As I have said before in respect of the standard client contract and Bank A contract and for the same reasons, there was no legal relationship between Bank B and the temp. Even if the conditions signed by the temp were legally binding on the temp, and I don't accept that they were, at most it would have been a contract by the temp with Bank B to abide by the conditions in return for Bank B giving the temp the opportunity of the assignment under which the temp could earn remuneration from Adecco. Bank B never agreed with the temp to pay the temp at all; it certainly did not agree with the temp to pay them for the services rendered.

167. And unlike the Bank A contract, the Bank B contract does not even clearly purport to say that Adecco was receiving the amount representing the temps' wages as a disbursement on behalf of Bank B. There is therefore no reason whatsoever to give it an interpretation which is inconsistent with its context, its context being the contract by Adecco with the temp for the temp to work in return for payment, and the lack of any legal obligation by Bank B to pay the temp for the work performed. In other words, my interpretation of this contract, is that even though Bank A chose to judge Adecco mostly on the quality of its introductions, no doubt relying on its ability to quickly terminate the assignment of any unsatisfactory temps, Bank A was liable to Adecco to pay it the full fee representing both the money owed to the temp and Adecco's rate of remuneration/commission in return for receiving the services of the temps.

Fundamentally, the contractual obligations between the parties were the same whether the standard client contract was used or the Bank B contract was used. And I will move on to consider the VAT supply position on that basis, as with the Bank A contract, without making a distinction between the standard client contract and Bank B contract.

Contracts not determinative

168. So while the terms of the Bank A and Bank B contracts were different to the standard client contract, so far as this appeal is concerned there are no significant differences between them. The position is the same whether the client contracted with Adecco on the standard client contract, the Bank A contract or the Bank B contract. In other words, under all three client contracts, the client was liable to pay Adecco the full fee (the wages element and commission element) and that was paid to Adecco in Adecco's own right and no part represented any kind of disbursement. Adecco, in its turn, had a separate contract with the temp under which it had the liability to pay the agreed wages to the temp. And the client was not liable to pay the wages to the temp: it had no contractual or other legal liability to make any payment to the temps.

169. But while I have necessarily had to deal with the contractual position at length because the contractual position is the starting point, however, the contractual position does not necessarily determine the question of to whom and by whom and of what the supplies were made. The CJEU said in *Newey* C-653/11 that:

> [42] As regards in particular the importance of contractual terms in categorising a transaction as a taxable transaction, it is necessary to bear in mind the case law of the court according to which consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT…
>
> [43] Given that the contractual position normally reflects the economic and commercial reality of the transactions and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' transaction …have to be identified.
>
> [44] It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.
>
> [45] That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.

170. There is no question, of course, of any artificial arrangements in this case but the requirement to look at economic and commercial reality applies in all cases. In *Secret Hotels2 Limited*, an even more recent case which, as I have said, involved a tripartite situation where the question was whether the appellant was principle or mere agent, Lord Neuberger said:

> "Where the question at issue involves more than one contractual arrangement between different parties, this Court has emphasised that, when assessing the issue of who supplies what services to whom for VAT purposes, 'regard must be had to all the circumstances in which the transaction or combination of transactions takes place' – per Lord Reed in [*Aimia*]. As he went on to explain, this requires the whole of the relationship between the various parties being considered."

171. So if the contractual position is not the whole answer to the question to whom the supply is made, how do I determine to whom the VAT supply is made?

The respective positions of the parties

172. If the answer to the VAT question depended on the question of to whom the liability to pay was owed, then there would be two supplies, one by the temp to Adecco, and another by Adecco to its client. But, as I explain below, contractual liability to pay is not necessarily the determining factor.

HMRC's case

173. HMRC's case is that Adecco makes supplies of staff to its clients and is accountable for VAT on the full amount paid by the client. Their case is that the contracts show that the intention of Adecco's clients was to receive a supply of the personal services of the temps but without taking on, not only any employment liability for them, but any contractual liability for them either; and Adecco agreed to provide that.

174. HMRC accepted that the contractual position was not determinative but relied on the authority of *Tolsma* C-16/93 [1994] STC 509 for the proposition that for a VAT supply to take place there must be a legal relationship between the supplier and the supplied. It is clear that that legal relationship would not have to be contractual, and certainly if contractual, it would not have to be an enforceable contract (*Town and Country Factors Limited* C-498/99 [2002] STC 1263). But there must be a legal relationship and HMRC said that in the absence of a contract between temp and client there was no legal relationship between them. I agree with HMRC that there was no legal relationship between temp and client as explained at §§91-98 above: certainly there was no legal relationship under which the client was liable to pay the temp for the work performed. On this basis, HMRC would consider that *Tolsma* means they must win this appeal.

175. The appellant's case is that the economic reality of what Adecco was doing under the contracts was providing a service of introducing candidates for temporary roles to its clients (together with ancillary services such as (a) briefing the temporary worker before the start of the assignment (b) assisting the client to comply with its obligations under the Working Time Directive and (c) running payroll). Its case is that its consideration for doing this is the commission element of the payment paid by its client: and that that the element which represents wages which the company passes on to the temp is not consideration for any supply made by Adecco.

176. Its case on economic reality is based on factors including the following:

(1) There was no mutuality of obligation between Adecco and the temp worker; in particular Adecco was not obliged to find work for the temp to carry out and nor was the temp obliged to accept any offered;

(2) Where a temp did accept the work offered, the temp was under the control, direction and supervision of the client and not Adecco;

(3) Other factors such as (a) Adecco did not review appraise or discipline the temp workers; (b) Adecco had no exclusivity over the temp and (c) the client appraised Adecco on the basis of its introductory service and not on the basis of the temp's performance.

In summary, the appellant's position is that it did not 'consume' the supplies of the temp workers and incorporate those services into an onward supply of its own made to its clients. Rather, its position is that it introduced the temp and client, allowing the temp to supply its services direct to the client.

177. It inevitably follows that it is Adecco's position that the temps made a direct supply to Adecco's clients of their services as temps. While it must follow that *if* the appellant is right that it only supplies introductory services to its clients, then the temps must supply their services direct to the client, I am not called upon to decide whether that supply by the temps, if made, would be subject to VAT or not. Nevertheless, it is clear that the entire structure of the arrangement between Adecco and its clients is intended to avoid the clients becoming employers of the temps. If, as a matter of employment law, that arrangement is successful, then it inevitably means that, if Adecco is right in the submissions it makes in this appeal, any temps whose annual earnings exceeded the VAT registration threshold, and assuming their services were not exempt, would have been liable to register and account for VAT on their earnings.

178. In a nutshell, I have found that the contractual position was that (if an assignment was accepted) the temp owed a legal obligation to Adecco (and not the client) to carry out the assignment and Adecco owed the temp the legal obligation to pay the temp for the work; at the same time, Adecco owed the client the legal obligation to have the work carried out by the temp and the client owed Adecco the legal obligation to pay for that work. But the question was whether the economic realities of the whole situation meant that the contracts did not reflect the VAT supply position.

Case law - issue previously determined

179. *Reed Employment Ltd* [2011] SFTD 720 was a recent decision of this Tribunal concerning the same tax issue and similar if not completely identical facts. The Tribunal there concluded that Reed was supplying only introductory services together with certain administrative services to its clients and was entitled to repayment of VAT it had accounted for on the sums which it had received from its clients in respect of the gross wages of its temps.

180. The appellant considers that *Reed Employment* was rightly decided and urges this Tribunal to follow it. HMRC considers that *Reed Employment* was wrongly decided on the point at issue in this appeal. The appellant points out that although HMRC appealed *Reed Employment*, that appeal was on other points at issue in that case and not on the point at issue in this appeal and on which HMRC now contend *Reed Employment* was wrongly decided.

181. On the question of whether the supplies at issue in *Reed Employment* were of introductory services or supplies of staff, the decision was one of this Tribunal. It is not binding on its findings of law, and certainly not on its findings of fact. HMRC's failure to appeal those findings of law in the decision which they now contend were wrongly decided is very strange bearing in mind the sums at issue in that appeal and that they appealed all other aspects of the decision: nevertheless, their failure to appeal those findings of law at issue in this appeal does not elevate the status of the first tier decision in *Reed Employment*. The decision is not binding on this Tribunal. But I agree with the appellant that I ought accord all decisions of this Tribunal respect and only differ from them if satisfied that the earlier Tribunal did not correctly explain the law.

182. The appellant seemed to suggest that HMRC's failure to appeal *Reed Employment* on the one issue to which it is relevant in this appeal was 'not far' from creating some kind of issue estoppel. No authority for this was cited. Issue estoppel certainly exists in this tribunal but only, so far as I am aware, between the same parties. That is obviously not the case here. While I agree that HMRC's conduct in not appealing *Reed Employment* on this point in 2011 and then, a mere three years later, taking the position in a case with a different appellant that *Reed Employment* was wrongly decided, is highly undesirable, it does not create an issue estoppel and I am bound to do no more than accord the decision in *Reed Employment* respect but to decide this case afresh in accordance with what I find the law to be.

183. I will respect the decision in *Reed Employment* by analysing it and considering whether it did correctly apply the law.

Agent/principle

184. Firstly, I agree with the Tribunal in *Reed Employment* that the question is not whether Adecco acts as agent or principle. Adecco made a supply to the client as principle: the question is the nature of that supply. Did it supply the services of staff or did it merely supply an introduction to staff? I go on to consider the conclusion on this question reached by this Tribunal in *Reed Employment.*

The basis of the decision in Reed Employment

185. My reading of the FTT's decision in *Reed Employment* is that the reason the Tribunal concluded that Reed's services were of introduction only (combined with various administrative matters) are really encapsulated in a few paragraphs - [84-85] and [88]:

> [84] "…Whereas Reed undertakes to offer the temp worker opportunities to work, the temp worker is expressly under no obligation to accept any such offer. There is no obligation on the temp worker to provide any services to anyone. It is only after the temp worker has started work at the client's premises that the conditions of work apply. It is wrong, therefore, in our view, for the contractual position to be characterised as a requirement on the part of the temp worker to provide physical services to the client. Not only is that not,

> in our view, the contractual position, it is also contradicted by the evidence we heard as to the day-to-day operations of the business."
>
> [85] '….The making of a supply of staff must, in our view at least, connote a passing of control of staff from the supplier to the person receiving the supply. There is no such passing of control in this case. Absent that factor, Reed was capable only of making a more limited supply, which can in our view be characterised only as a supply of introductory services, along with the ancillary services to which we have referred.

186. The Tribunal reiterated this conclusion in [88]:

> "…in ascertaining the nature of a supply it is relevant to have regard to what it is that the supplier is capable, as a matter of contract, of providing, and on that basis to consider what in economic reality has been supplied. In the case of Reed, at no time did Reed exercise control over its temp workers, such that control could be ceded by Reed to its clients. The obligations owed by a temp worker to Reed did not amount to an ability of Reed to exercise control over the temp worker, and in any event those obligations commenced only after the temp worker had accepted the assignment, and accordingly had come under the control of the client. The making of a supply of staff must in our view, at the least, connote a passing of control of staff from the supplier to the person receiving the supply. There is no such passing of control in this case. Absent that factor, Reed was capable only of making a more limited supply, which can, in our view, be characterised only as a supply of introductory services, along with the ancillary services to which we have referred."

187. Fundamentally, it can be ascertained from these paragraphs that the FTT's decision in *Reed Employment* was based on two factors, both of which are also present in this case:

(1) A lack of mutuality (at least outside an assignment). Reed and the temp owed each other no obligation to offer or to accept assignments.

(2) A lack of control by Reed over the temp's work at any time.

188. I am unable to agree with the appellant that this case was rightly decided on these grounds and I explain why.

189. Lack of mutuality: I agree with Ms Mitrophanous that the lack of mutuality of obligation outside an assignment is quite irrelevant to the question of the nature of the supply during the assignment. The appellant, on the other hand, as I have said, attached great significance to the fact that the contract between Adecco and the temp was a zero hours contract. Perhaps it did so because of the *Reed Employment* decision. But I cannot see any logical reason why this should affect the nature of the supply during the assignment.

190. For example, it is well established that a contract of employment can exist despite a zero hours contract. In other words, a person can enter into an agreement with an employer under which they are only an employee *if* he is offered work and

then only *if* he accepts it and moreover that that employment exists only for as long as he undertakes the work: *McMeechan v Secretary of state for employment* [1997] ICR 549 CA, especially at 469 per Waite LJ. (It appears that this case was unfortunately not brought to the attention of the Tribunal in *Reed Employment)*. The fact that the person is not an employee outside the times he performs work does not prevent him being an employee when he does perform work: here, even though I am not concerned with a contract of employment, I see no reason why in theory the temp can't make a supply to Adecco while performing an assignment even though he makes no supply to Adecco when he is not performing an assignment.

191. I was also referred to *Sherburn Aeroclub* [2009] UKFTT 65 which was a VAT case about whether flying instructors were employed. As in this case, the instructors had a zero hours contract in the sense there was no obligation on the club to offer them work nor on the instructors to accept any work offered. Moreover, the instructors were not told by the club *how* to teach people to fly: the instructors did not consider that Aeroclub could tell them out to teach flying. It was accepted there was no employment outside each individual engagement but was there employment during an engagement? For employment to exist there must be personal service to, and control by, the employer. The Tribunal's conclusion was that there was insufficient control exercised by the club over the instructors so the instructors were not employed. I agree with HMRC that this case shows that lack of mutuality between assignments is irrelevant; as no one suggested that the temps were employees of Adecco the case is not relevant on the question of whether the instructors were employees.

192. I agree with Ms Mitrophanous that, bearing in mind that the question is who made what supplies during the course of an assignment, it is irrelevant that no supplies were made outside the duration of an assignment. I cannot agree with the Tribunal in *Reed Employment* that lack of mutuality was relevant.

193. <u>Lack of control:</u> This lack of mutuality fed into the tribunal's second conclusion. It said:

> at no time did Reed exercise control over its temp workers, such that control could be ceded by Reed to its clients.

This reads as if the Tribunal concluded that because the temp made no supply to Reed *before* an assignment, there was nothing supplied to it by the temp which Reed could on-supply to its client *during* an assignment. Again, if that was the intended meaning, I do not follow the logic here. A person can on-supply something at the very moment that they receive the supply from someone else. A person can agree to buy something only if and when they find someone to sell it to. There is no theoretical reason why that could not happen with services: an agency could agree to buy the services only if and when they find a person wishing to purchase those services from them, and then only if the person selling them still wishes to sell.

194. Another way of looking at the FTT's reasoning was that a supply of staff necessarily meant that the person receiving the services had the right to tell the staff member what it was they were to do and how they were to do it. Reed (in the view of

the Tribunal) did not have this right and therefore could not supply to its clients a right that it did not have. Therefore, all that Reed could do was supply an introduction of the temp to its client so that the temp could agree to supply its services direct to the client.

195. In other words, the rational of the Tribunal may have been simply that during the assignment the temp worked to the client's direction and not Reed's (eg [80]). But I consider that that begs the question: did the temp carry out the instructions of the client because it owed the obligation to do so to the client or to Reed? The answer appears to be the latter as in [80] the tribunal records 'the essential obligation on the part of the temp worker to Reed is to comply with the reasonable requests of the client.' That appears to be the case here too: §29. Moreover, the temp must owe its obligation to the agency as there is no contract or implied contract between the client and temp: nowhere does the temp agree with the client to do what the client tells him to do.

196. Mr Grodzinski reiterated that Adecco (and Reed) never had the power to tell the temp what to do. But fundamentally that is not true. The contractual arrangement between the temp and Adecco (see §29) was that the temp agreed with Adecco to do what the client told it to do. So Adecco had the right to require a temp who accepted an assignment to do what the client told it to do. If the temp, having accepted an assignment, did not do what the client told it to do, it would be in breach of its contract with Adecco (although presumably all that would happen in practice is that the assignment would be terminated).

197. A VAT supply is doing something in return for consideration. If A agrees with B, in return for money, to do what C tells it to do, that is doing something in return for consideration and there is no reason in logic why that cannot be a VAT supply by A to B, even though at no time does A agree to work under B's direction. Yet the conclusion in *Reed Employment* seems to have been that A can't supply its work to B if what A agrees to do for B is to work at C's direction. I simply can't agree.

198. While it is clear that whether something is a VAT supply depends on economic reality, (see below) there is nothing inconsistent with economic reality in A agreeing with B, in return for money, to do what C tells it to do. Whether or not that is the economic reality of the scenario in this appeal, I move on to consider, but for the reasons given above I cannot accept the analysis in *Reed Employment* is correct as a matter of law.

199. So I am unable to accept the reasoning in *Reed Employment* justified the conclusion reached. But that is not to say that the outcome of *Reed Employment* was wrong. I have to address the issue in this case afresh by looking at the leading authorities, albeit none of them are factually similar to this appeal.

Grounds for distinguishing Reed

200. I note in passing that Ms Mitrophanous distinguished *Reed Employment* on a number of grounds, including that (a) the regulatory regime in *Reed* was different to

the later one in force at the time of the events subject to this appeal; (b) the claim in *Reed* covered 20 years over which the contracts changed; and (c) there was no finding that Reed could terminate an assignment.

201. Whether or not it is correct to distinguish *Reed Employment* from this appeal on these grounds does not really matter as I am unable to accept the conclusion in *Reed Employment* and will not, therefore, base my conclusion in this case on the analysis used in *Reed Employment.* But in passing I note that I doubt that the difference in regulatory regime or the earlier contracts would justify a different conclusion, all other factors remaining equal.

202. So far as the right to terminate was concerned, Mr Grodzinski's view was that other cases involving Reed indicated that its standard contract did have a right for it to terminate and commercial good sense would suggest that it ought to have reserved this power to itself; therefore, reasoned Mr Grodzinski, the right to terminate was simply not mentioned in *Reed Employment* as the Tribunal had determined that the point was not important. And therefore I should, in Mr Grodzinski's view, come to the same conclusion here despite Ms Mitrophanous' submissions on the importance of the termination rights.

203. As the point on termination rights was not mentioned in the published decision in *Reed Employment,* I conclude that it was not brought to the attention of the Tribunal. I do consider that the ability to terminate is relevant to the analysis of the contracts, as it is consistent with Adecco's obligation was to pay the temp irrespective of whether the client paid it, which reinforces the view that, on the one hand there were obligations between the temp and Adecco, and on the other between Adecco and the client, and no obligations as between the temp and the client. It is therefore a reason, albeit a more minor reason, for not applying the decision in *Reed Employment.*

Other cases

Having refused to apply the analysis in *Reed Employment,* I need to consider the leading authorities on VAT supplies in tri-partite situations. But before doing so, I note I was referred to a number of other cases involving similar positions to those arising in this appeal. I summarise them here in order to justice to the parties' submissions although ultimately I have decided the case based on the leading authorities mentioned below.

The decision in Reed Nursing

204. I was referred not only to *Reed Employment* but the much earlier decision in *Reed Personnel Services Ltd* [1995] STC 588, which I shall refer to as *Reed Nursing.* The facts were quite similar to this appeal, although the temps were all nurses.

205. Reed placed temp nurses in NHS hospitals. Reed was liable to pay nurses whether or not Reed was paid by the hospital. Under the then tax provisions, they were deemed to be employees and Reed paid the nurses the agreed rate of pay less PAYE and NIC for which it accounted to HMRC.

206. The question was related but different. HMRC assessed Reed for allegedly overclaimed input tax on the basis that (said HMRC) Reed supplied nursing services to the hospital and that therefore its supplies to its clients were exempt and it was not entitled to recover attributable input tax.

207. The question was not whether the nurses made supplies to the hospital or to Reed; it was not whether Reed only had to account for VAT on only a part of what it received from its client. The question was whether what Reed received from the client was subject to VAT or not, and that could only be answered by deciding whether or not Reed supplied nursing services to the client. The High Court decided that that was ultimately a question of fact, the tribunal having correctly applied the law, and that it would not interfere with its decision that Reed supplied standard rated staff and not exempt nursing services.

208. It is not entirely clear, possibly because the Tribunal was not called on to decide this, whether the whole or only part of Reed's fee was subject to VAT. The FTT's conclusion appeared to be that Reed supplied an introduction to its clients of nurses, while the nurses provided their services direct to the client; yet the High court decision refers to Reed making a supply of nurses, rather than of nursing services.

209. Mr Grodzinski's view was that this case supported his client's position. Indeed he considered it a weaker case than this appeal because in *Reed Nursing* the nurses owed more obligations to Reed than the temps in this case to Adecco. In particular, the nurse had to abide by the instructions not only of the hospital but of Reed as well. His view is that the decision that Reed made a standard rated supply had to be on the basis that the supply was of introductory services and not a supply of staff.

210. I agree with the Tribunal in *Reed Employment* that the issue in this case, as in *Reed Employment*, is different to that in *Reed Nursing* and I can only rely on the general principles set out by Laws J and not the actual conclusion. Moreover, the High decided that the Tribunal had reached a conclusion on the facts on which he had no grounds to interfere: a finding of fact upheld on appeal is nevertheless not binding on anyone other than the parties to that appeal.

211. The general principles set out by Laws J in that case were that in tri-partite situations, the contracts would not necessarily determine the VAT supply position. He said:

> "I certainly accept that where any issue turns wholly upon the construction of a document having legal consequences, the exercise of construction is one of law for the judge. But for the proper resolution of a case of this kind, there are I think two qualifications. The first is that the concept of making a supply for the purposes of VAT is not identical with the performance of an obligation for the purposes of the law of contract, even where the obligation consists in the provision of goods or services. The second is that, in consequence, the true construction of a contractual document may not always answer the question – what was the nature of the VAT supply in the case? [page 591G-H

…..

> …First, …the concept of 'supply' for the purpose of VAT is not identical with that of contractual obligation. Secondly, in consequence, it is perfectly possible that although the parties in any given situation may conclude their contractual arrangements in writing so as to define all their mutual rights and obligations arising in private law, their agreement may nevertheless leave open the question, what is the nature of the supplies made by A to B for the purposes of A's assessment of VAT. In many situations, of course, the contract will on the facts conclude any VAT issue, as where there is a simple agreement for the supply of goods or services with no other parties involved. In cases of that kind there is no space between the issue of supply for VAT purposes and the nature of the private law contractual obligation. But that is a circumstance, no a rule. There may be cases, generally (perhaps always) where three or more parties are concerned, in which the contract's definition (however exhaustive) of the parties' private law obligations nevertheless neither caters for nor concludes the statutory question, what supplies are made by whom to whom. Nor should this be a matter for surprise: in principle, the incidence of VAT is obviously not by definition regulated by private agreement. ….In principle, the nature of a VAT supply is to be ascertained from the whole facts of the case. It may be a consequence, but it is not a function, of the contracts entered into by the relevant parties." [page 595 A-D]

212. The general statement that contracts, in tripartite situations, do not conclude the question of the nature of the VAT supply, has certainly stood the test of time, being reiterated, if worded differently, by the Supreme Court in the much later cases of *Aimia* and *WHA* and others, as mentioned below. Nevertheless, *Reed Nursing* is not a reliable authority on the test to be applied when determining the direction of a supply: not only was that not an issue, the decision pre-dated all the leading authorities discussed below including *Redrow.* While, as the Judge said, all the circumstances in a case do have to be taken into account, some circumstances are more relevant than others: later authorities establish the importance of liability to pay and economic reality. Moreover, while it was clear that the decision was that Reed did not supply nursing services, the conclusion was that it provided staff. It did not make it clear whether that meant merely a supply of introductory services. Ultimately, it made no decision on direction of supply (as that was not in issue) nor on the nature of the supply, other than it was not nursing services, which is not an issue which arises here. Although a High Court decision, it is therefore not binding in the different circumstances of this appeal.

Hays Personnel Services Limited (LON/95/2610)

213. Much the same question arose in *Hays* as in this appeal. The temps were not employed by Hays or by Hays' clients. Hays paid the temps. The clients told the temps what to do. The temp was not obliged to accept an assignment nor was Hays obliged to offer one. Hays could terminate an assignment.

214. This is an old case decided before the various leading authorities referred to above and I accept that its analysis is not reliable. Moreover, the tribunal treated the issue as one of whether Hays was an agent for the temp which is the wrong question. So I gain no assistance from the analysis in this case.

Wendy Lane [2013] UK FTT 521 (TC)

215. This decision is much more recent and applied the decision in *Reed Employment.* To some extent the facts of the case were similar to those in *Reed Employment* and this case. The taxpayer charged its clients an hourly rate for cleaning. It had a contract with cleaners who actually did the work, and under which they were entitled to be paid irrespective of whether the taxpayer was paid by its clients. The cleaners were not obliged to accept any work offered, nor was the taxpayer obliged to offer them work.

216. However, at variance with *Reed Employment* and this case, the taxpayer guaranteed its clients that their properties would be cleaned on changeover day. So it was crystal clear that the taxpayer was providing its clients with cleaning services and not the service of mere introduction to a cleaner. The Tribunal decided that the taxpayer was liable to tax on the full amount paid by the client.

217. Neither side suggested it was wrongly decided, and I agree with the decision. But as I do not accept that *Reed Employment* applied the right test, so in so far as *Wendy Lane* adopted the same reasoning, I do not accept that it was right to do so. I go on to consider the leading authorities to decide what is the correct test to apply to in this appeal.

The cases on multi-party contracts and arrangements

218. Neither side seemed to consider that this appeal could be determined by reference to the leading authorities on the VAT consequences of multi-party contracts and arrangements, and the leading authorities were not originally a part of the bundle, although I directed some post-hearing submissions with particular reference to the CJEU decision in *Baxi*. While I hope that this paragraph does not fail to do justice to their submissions, I understood that largely the two sides were agreed that what I should take from the leading authorities was that the direction of a VAT supply in a multi-party contract would depend on an analysis of the economic realities of the multi-party arrangements and that the terms of the contracts did not necessarily determine the direction of the supply.

219. The parties were not agreed on what were the economic realities of the case: Mr Grodzinski put emphasis on the fact that the client controlled the work done by the temp and Ms Mitrophanous emphasised Adecco's right to terminate any assignment. I have gone back to first principles and analysed the leading authorities in order to understand what is meant by 'economic reality' and when 'economic reality' trumps the contractual position so that I can apply it properly in this appeal. Unlike the parties in this appeal, I consider that the proper determination of this appeal is made plain from the leading authorities as I explain below.

Redrow [1999] UKHL 4

220. For many years the leading authority on identifying the recipient of a supply in a tripartite situation was the House of Lords' decision in *Redrow.* As Lord Millett said

> "..the nature of the services and the identity of the person to whom they are supplied cannot be determined independently of each other, for each defines the other. Where, then should one begin? (page 171 c per Lord Millett)

221. In other words, transposing the comment to this appeal, if Adecco was making a supply of staff to its client, the temp was supplying his/her services to Adecco. But if Adecco was merely supplying introductory and payroll services to its client, then the temp was supplying his/her services direct to the client. The nature of Adecco's supply depended on the identity of the recipient of the temp's services.

222. So how to identify the recipient of the supply? The answer in *Redrow* was simple: a supply is doing something for consideration, so to answer the question the court must follow the money: the person who is liable to pay the consideration receives the supply. Because there is only a supply where there is consideration,

> "… one should start with the taxpayer's claim to deduct tax. He must identify the payment of which the tax to be deducted formed part; if the goods or services are to be paid for by someone else he has no claim to deduction. Once the taxpayer has identified the payment the question to be asked is: did he obtain anything – anything at all – used or to be used for the purposes of his business in return for that payment?"

223. If *Redrow* remained the only authority on the question of direction of supply, what would be the outcome of this case? *Redrow* provided a simply rule: 'follow the liability to pay'. Adecco's client had entered into a contractual obligation with Adecco to pay Adecco: therefore Adecco made its supply to its client. Adecco had entered into a contract with its temps under which it agreed with its temps to pay them for the work performed for its clients. *Redrow* provides a simple answer: the temps supplied their services to Adecco. What were the supplies? The identity of the recipients defines the nature of the supplies. Therefore, the temps' supply to Adecco was the supply of agreeing to do the work the client asked it to do. Adecco's supply to the client was agreeing to provide a person who would work under the client's direction to do the work which the client wanted doing. But as I explain below, *Redrow* does not remain the only authority on tripartite contractual situations and economic reality must now be considered.

The CJEU decision in Tolsma

224. Another relevant early case is *Tolsma,* which, as I have said, was relied on heavily by HMRC in this appeal. *Tolsma* involved a busker who was given gratuities by passers by. The national authorities sought to charge him VAT on his receipts. The CJEU said there was no supply

> "[12] The Court has already held…that taxable transactions, within the framework of the VAT system, presuppose the existence of a transaction between the parties in which a price or consideration is stipulated. The court concluded that, where a person's activity consists exclusively in providing services for no direct consideration, there is no basis of assessment and the services are therefore not subject to VAT [citing *Hong Kong Trade Development Council* C89/81]
>
> ….
>
> [14] …a supply of services is effected 'for consideration' within the [PVD], and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance…."

225. I note that although this case dealt with a (claimed) bi-partite supply situation the outcome was entirely consisted with the House of Lords' decision in *Redrow.* The CJEU demanded a legal relationship under which the services were provided for consideration: that is in effect exactly what the House of Lords said in *Redrow:* liability to pay (in other words, consideration) determines whether and to whom there is a supply.

226. The appellant says *Tolsma* has no application here to a tri-partite situation where it is accepted that a VAT supply took place, and the only question is the direction of the supply. Did the temp supply its services to Adecco or the client?

227. HMRC's point is that there was no legal relationship between the temp and the client so, applying the logic from *Tolsma,* they say that the supply could not be between the temp and the client and so the temp's supply must be to Adecco, and Adecco therefore on-supplied the temp's services to the client.

228. I have found that there was no legal relationship between the temp and the client (see §§91-98) but whether it follows that there was no supply by the temp to the client depends on whether *Tolsma* and *Redrow* are a complete statement of the law, or whether the law is more complex where three or more parties are involved.

Reed Employment and Redrow

229. As I have said, a *Redrow* analysis in this case would lead to me concluding the appeal in favour of HMRC. As I was urged to follow *Reed Employment,* I have considered why the Tribunal in that case chose not apply a *Redrow* analysis.

230. In *Redrow,* a vendor of new houses wanted to sell its houses to second-time buyers, in other words, home owners who had existing property to sell. It promised potential buyers that it would pay the estate agents fees for selling their previous home when they bought a new home built by Redrow. Redrow contracted with the estate agent to pay its fees for selling the buyer's house if the buyer went ahead with the purchase of the new home.

231. The Tribunal in *Reed Employment* regarded the appellant in Redrow as comparable to Reed, the estate agent as comparable to the temp and the home owner

as comparable to the client, and I agree that that was the correct way to start the comparison between the two cases. But I am unable to agree with the conclusion of the Tribunal as I explain below. In *Reed Employment*, the Tribunal decided that *Redrow* could be distinguished factually for a number of reasons:

> "[85] … the supply identified in *Redrow* was the grant of a right to have services rendered to a third party. Redrow chose the agents and instructed them. In return for the payment it made it obtained contractual rights which included overriding any alteration in the agents' instructions which the prospective purchasers might give. Redrow itself bore the economic cost of those services, without reimbursement from the third party. There is no such grant in this case, and the payments of the pay rates by Reed to the temp worker are reimbursed to Reed by the client. Reed does not, we consider, bear the economic costs of the temp worker's services to the client; that cost is not a cost component of Reed's own supply. In our view what Reed pays to the temp worker is not consideration for any supply by the temp worker to Reed. The temp worker has certain contractual obligations to Reed, but the performance of those obligations does not include the provision of services to the client and is not an economic activity of the temp worker in relation to Reed.

232. The factual distinctions in summary were (a) Redrow (comparable to Adecco) chose the agents and gave them their instructions. In *Reed* (and here) the client chose the temp and gave them their instructions; (b) Redrow (comparable to Adecco) could countermand any instructions given by the house owner. In *Reed Employment* (as in this case) only the client gave instructions to the temp; (c) the sum paid by the house owner to Redrow when it purchased the new home did not include any element singled out to represent the fee of the estate agent. In *Reed Employment* (and here) the agency's charges were a percentage on top of the payment to the temp and often the client would have known exactly how much the agency paid to the temp.

233. I agree that (with the exception of point (c)) that these are real distinctions between the cases: but I don't agree that they are significant distinctions in a VAT analysis of who supplied what to whom. Considering point (b) first, the legal analysis in *Redrow* was that the direction and nature of the supply was determined simply by looking at who had the liability to pay. *If* the supply here was by Adecco to the client then by definition the supply was a supply of staff who were to do what the client instructed them to do. Another way of looking at this is that the 'instruction' in the sense of the commitment made in return for the promise of payment, was the 'instruction' by Adecco to its temp to do what the client told them to do (recognising, of course, that as this was a zero hours contract, this commitment by the temp to Adecco only arose at the moment the temp took on the assignment). It is this 'instruction' which should be compared to the instruction given by the house-builder in Redrow to the estate agent to sell the house, and not the individual day to day commands.

234. At (b) the Tribunal mentioned Redrow's rights to countermand day to day instructions given by the home owner to the estate agent. Neither Reed nor Adecco had this right. Day to day instructions to the temp could only be given by the client.

My view is that this is not a significant difference, for the same reasons as with point (a). What is significant is that in *Redrow*, the House of Lords were noting that Redrow kept overall command of the contract with the estate agent albeit the agent was in practice doing something for the home owner; the same could be said in Adecco where Adecco had termination rights over the assignment. While Adecco had no right to interfere in day to day instructions, and no one suggested any economic reason why Adecco would have wanted to, ultimately Adecco could end an assignment and would do so if it was in their interests to do so. So far from a point of distinction with Redrow, this suggests on the contrary that they can not be distinguished.

235. I actually find it difficult to understand what the Tribunal meant by point (c). The Tribunal, when it said 'Reed does not, we consider, bear the economic costs of the temp worker's services to the client' cannot have meant that because Reed charged its clients more than it was liable to pay its temps, the payment to the temp was not an economic cost to it. It is quite normal for a business to buy in a product at one price, and sell it on at a higher price. That does not mean the purchase was not an economic cost to it. Nor does it seem relevant that the cost of the estate agent was not (at least not transparently) a part of the purchase price of the house. In other words, Redrow did not charge a price of £Y for the house, where £Y was expressed to comprise £X for the real property and £Z for the estate agent's fee for selling the buyer's old house. Clearly, in VAT terms, the cost of the estate agent was a cost component to Redrow of selling its new houses. And clearly, *if* the temps supply their services to Adecco, then the cost to Adecco of the temps is a cost component in VAT terms of its supply to its clients. So I simply do not understand, and certainly do not agree, with what the Tribunal said about this in *Reed Employment.*

236. I do not consider that any of these grounds are good reasons for distinguishing the case here from that in *Redrow.* If *Redrow* remained the leading authority on tripartite supply situations, I would have to conclude, contrary to what was said in *Reed Employment,* that because the liability to pay the temp for his services lay with Adecco, the temp supplied its services to Adecco. And because the temp's services were supplied to Adecco, it follows that Adecco on-supplied these services to its client. In any event, applying *Redrow* to the Adecco-client relationship, because the client was liable to pay the full amount and not just the commission to Adecco, Adecco was making a supply to the client in return for the full amount and not just the commission. Applying *Redrow,* I would be bound to dismiss this appeal.

The CJEU's decision in Loyalty Management

237. That leads me to the CJEU decision in *Loyalty Management ("LMUK")* (C-53/09). In that case, retailers contracted with LMUK to be a part of the LMUK 'nectar' scheme which gave rewards to loyal customers. Retailers could buy 'points' from LMUK to issue to their loyal customers. LMUK kept its side of the bargain by contracting with 'redeemers' to provide goods and services in exchange for the points cashed in by the retailer's customers.

238. It was accepted that the payments to LMUK by the retailers were subject to VAT as in consideration of a vatable supply of services of participation in the loyalty scheme; the question was whether the payments by LMUK to the redeemers were for a taxable supply made to LMUK.

239. *Redrow* would have indicated that, as LMUK contracted to pay the redeemers, the redeemers' supply was to LMUK.

240. The House of Lords must have been, at least at the time, in some doubt of the application of *Redrow* as they referred the case to the CJEU. The CJEU, perhaps unaware of the *Redrow* analysis, gave an answer without hearing from the Advocate General. They did not identify the direction of the supply by asking "who pays?" but (it seems) by asking "who got ownership of the goods?" (§§44-49). They assumed that (if goods were provided) the nature of the supply was a supply of goods; they did not consider the possibility that the supply might have been the provision of a service of providing goods to third parties. While they did not expressly say so, the CJEU's approach appeared to entirely reject the *Redrow* analysis of identifying the nature of the supply by following the liability to pay.

241. Instead, the CJEU considered the provision of goods to be a supply by the provider of the goods to the recipient; there was, said the CJEU, consideration, because in exchanging the points for the goods and services from the redeemers, the customer gave rise to the redeemer receiving payment from LMUK: §57.

242. There are difficulties with understanding what the Court said. The CJEU was clearly and rightly concerned with the VAT concept that final consumption should be taxed. One major concept enshrined in the Sixth VAT Directive, and later the Principle VAT Directive, is that final consumption should be taxed, so where free gifts are provided, the retailer must account for VAT on that free gift to ensure that final consumption is taxed: see, for example, Article 16 of the Principle VAT Directive.

243. It is clear that this was of concern to the CJEU in *LMUK* as they referred to their much earlier decision in *Kuwait Petroleum* C-48/97 [1999] STC 488, where they had ruled that under a points scheme operated by the retailer, the retailer had to account for VAT on the redemption goods if the customer did not pay for the points when purchasing the original goods (in that case, petrol). In [52-54] of *LMUK* the CJEU referred to *Kuwait* and appeared to elide the question of whether the customer paid consideration for the points when it purchased the original goods/services with the question of the consideration paid to the redeemer for providing the 'free' gifts/services in exchange for the points. It seems the CJEU were looking at the economic reality that the customer got something that was paid for by someone else.

244. *Kuwait* was a bi-partite business promotion scheme: *LMUK* involved four parties. Instead of applying what is now Article 16 of the Directive and which requires a retailer to account for VAT on free gifts, the CJEU appeared to think it had achieved the same result by deciding that the direction of the supply by the redeemer was to the customer, thus blocking the promoter from recovering that VAT.

245. Yet the promoter wasn't really making any gifts at all: it had contracted (for payment) with the retailer to provide goods to the retailer's customers to discharge the retailer's promise to its customers to give them free gifts. The free gift to the customer was really provided at the expense of the retailer. The failure to address the fact that the taxpayer did not make the free gift was of concern to the Supreme Court when the case returned to it: [38-40] and [46].

The Supreme Court's decision in LMUK/Aimia [2013] UKSC 15

246. At first glance, the decisions in *Redrow* and *LMUK* appear irreconcilable: the analyses applied by the two courts appear mutually exclusive. When the *LMUK* case returned to the Supreme Court ([2013] UKSC 15, which I will refer to as *Aimia* as the taxpayer had by then changed its name), however, the Supreme Court did not accept that *Redrow* was wrongly decided and instead it considered that the CJEU in *LMUK* had been asked, and answered, the wrong question [48], [55-56]:

> "[48]…the court does not appear to have assessed the transactions in question in the context of the arrangements considered as a whole, or determined on that basis what they amounted to in terms of economic reality. Nor is it apparent that the court took into account, in reaching its conclusion, the fact that (1) LMUK had agreed to make a taxable supply when it granted to collectors the right to receive goods and services at no cost or at a reduced cost, and (2) collectors receiving goods and services on that basis were therefore exercising a right for which LMUK had already been paid, and the consideration for which had already been subject to VAT."

Nevertheless, the conclusion of the majority of the Supreme Court was that, while *Redrow* itself was correctly decided, Lord Millett's propositions recorded at §222 above did not amount to an absolute rule: [66]:

> [66]…those questions should be understood as being concerned with a realistic appreciation of the transactions in question.

Direction of consideration was a relevant consideration but the overall situation had to be considered: [67]:

> [67] …it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded a priori. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation the correct analysis is likely to be that the payment constitutes third party consideration for the supply.

247. Decisions of the CJEU must be applied: here the majority in the Supreme Court decided that the CJEU had been asked, and therefore answered, the wrong question [76-77]. The wrong question was the failure to explain LMUK's business model. In particular, as I have explained, LMUK was not in the business itself of giving away "free" gifts. So LMUK should not be made to bear irrecoverable VAT:

> "[79] It is implicit in that approach that the transaction between a redeemer and LMUK involves a taxable supply by the former to the latter. That analysis appears to me to be consistent with economic reality. LMUK carries on a genuine business for its own benefit. It issues the points in its own name and on its own behalf: it is not a mere cipher for the sponsors. As a matter of economic reality, the payments which it makes to redeemers are an essential cost of its business. Its business model is to sell the right to receive goods and services, pay redeemers to provide the goods and services, and derive a profit from the difference between its income from the sponsors and its expenditure on the redeemers.
>
> [80] There is a legal relationship between the redeemer and LMUK pursuant to which there is reciprocal performance….
>
> [81] In these circumstances, it can in my view be said that the remuneration received by the redeemer represents the value to LMUK of the service which the redeemer provides (cf *Tolsma….)*
>
> [82] The approach described in the foregoing paragraphs is consistent with the fundamental principle…that a taxable person is entitled to deduct the VAT payable in the course of his economic activities….
>
> [83] This approach is also consistent with the application of the guidance given in *Redrow.* If one asks whether, when the redeemer accepts points in exchange for the provision of goods or services to a collector, something is being done for LMUK for which, in the course or furtherance of its business, it has to pay a consideration, the answer seems to me to be in the affirmative…"

248. But where does the Supreme Court's decision in *LMUK* leave the appeal in this case? *Redrow* is not overruled, but is no longer an 'absolute' rule; and the CJEU's decision in *LMUK*, while of course good law, as it was a decision of the CJEU, nevertheless must only be understood and applied in the light of the decision in *Aimia.* In other words, I must apply the analysis in *Aimia.*

249. The outcome of *Aimia* was a result consistent with *Redrow* and *Tolsma:* in other words, the direction of the supply was the opposite of the direction of the liability to pay. The legal relationship under which LMUK (the promoter) acted was between itself and the redeemer; LMUK was liable to pay the redeemer: the redeemer was found to have made its supply to LMUK. The economic reality in *Aimia*, so far as LMUK was concerned, was found to be consistent with the contracts into which LMUK had entered. So the VAT analysis followed the contracts.

250. But the implication of the Supreme Court's decision in *Aimia* was that in some tripartite instances the application of economic reality would mean that the direction of the supply would not always follow the contracts and the legal liability to pay.

The CJEU decision in Baxi Group Ltd C-55/09

251. *Baxi Group* was referred by the House of Lords to the CJEU at the same time as *LMUK*. Unlike *LMUK*, it was never re-visited by the Supreme Court, the parties in *Baxi* presumably accepting that the CJEU decision was sufficiently clear to resolve the appeal. It is therefore binding on this Tribunal and is as much the law as *Aimia* is.

252. This might be thought to put a later tribunal in difficulties in applying the law as the CJEU's decision in *Baxi* was given in the same judgment, using the same analysis, as the CJEU used in *LMUK*. Only the Supreme Court has determined that in *LMUK* (but not *Baxi)* the CJEU was asked and answered the wrong question. In fact, I do not consider that this does present a problem, because the very matter which the Supreme Court considered significant and which was not made clear to the CJEU in *LMUK* was the one matter on which *Baxi* differed from *LMUK*. And I explain this below.

253. The position in *Baxi* was very similar to that in *LMUK* other than that the roles of promoter and redeemer were both held by a company called @1. In other words, it was a tri-partite and not a 4-party arrangement. Baxi promoted its products and sought customer loyalty by giving its customers 'points' with their purchases. Baxi purchased the points from @1. The customers redeemed the points with @1 who supplied the customers with the goods they selected. Baxi paid @1 a fee for its services which included an amount to reflect the value of the goods given to Baxi's customers.

254. The conclusion of the CJEU was that @1 made two supplies (§62-63); one was a supply to Baxi's customers of the free gifts and the other was a supply of promotional services to Baxi. The fee paid by Baxi was seen by the CJEU as split between these two supplies.

255. In so far as the court concluded that @1 made a supply to Baxi and the money paid by Baxi to @1 was consideration for that supply of promotional services, the reasoning of the CJEU is consistent with *Redrow* and economic reality. It has little application here as the appellant accepts that even if it wins this appeal, it is liable to account for VAT on the "commission" element of its fees to reflect what it sees as its introductory services.

256. The relevant part of the CJEU's decision is its conclusion that @1 made a supply of the free gifts to Baxi's customers in return for the rest of the fee paid by Baxi, which it described as third party consideration. As with *LMUK, Baxi* reads as if the CJEU applied back-to-front reasoning. The court appeared to say at §§48-49 that *because* @1 transferred property from itself to Baxi's customers it was therefore making a supply *to* Baxi's customers and that *therefore* because the supply was by @1 to Baxi's customers, then @1's receipt of money from Baxi had to be third party consideration for that supply. The CJEU did not even consider the possibility that @1

made a supply to Baxi of the services of giving the free gifts to Baxi's customers in return for the fee paid to it by Baxi. They did not consider, in other words, a *Redrow* analysis. On this, the court's analysis, like its analysis in *LMUK,* appeared to overlook its own decision in *Tolsma*.

257. However, the CJEU, as I have said, was clearly concerned to ensure that, consistent with the clear intention of the Sixth and Principle VAT Directives, input tax on gifts was blocked. It referred to its own decision in *Kuwait.* And as with *Kuwait,* in *Baxi* the points were given to the customers: there was no option to pay a lower price for the boiler and receive no points: [23]. The effect of the decision in *Baxi* was to block input tax on what must therefore be seen as gifts: Baxi was unable to recover the VAT on provision of the gifts as the CJEU held the supply was made to its customers. The customers, albeit VAT registered, were presumably unable to recover the VAT on the supply to them as it was not attributable to any supply made by their business. Thus, the outcome of *Baxi* was consistent with the Sixth and Principle Directives and with *Kuwait,* albeit it was reached via a different route.

258. Both Ms Mitrophanous and Mr Grodzinski agreed that *Baxi* indicated that VAT supplies did not always follow the contract. They did not agree on any deeper analysis that could be drawn from the case.

259. My view is that *Aimia* and *Baxi* are, and must be seen as, consistent decisions. The Supreme Court recognised in *Aimia* that *Redrow/Tolsma* did not always provide the answer in a tripartite situation to the question of to whom the supply was made: economic reality must always be considered. *Baxi* must be seen an example of a case where economic reality trumped the basic 'follow the liability to pay' rule set out in *Redrow* and *Tolsma.*

260. The economic reality in *Baxi* is that Baxi had arranged for a third party (the promoter/redeemer, @1) on its behalf to provide the free gifts which Baxi had promised to its customers. And this is where it is significantly different to *LMUK.* LMUK was not in the business of giving things away free to anyone: it made, in return for payment, a taxable supply to its customer (the promoter/retailer) of points which would entitle the promoter/retailer's customers to obtain the free gifts for which the promoter/retailer was paying. Baxi, on the other hand, gave away the points free.

261. The Directive prevents recovery of VAT on free gifts by the donor as the economic reality is that otherwise final consumption would not be taxed. So in circumstances where the economic reality is that final consumption will not be taxed if a *Tolsma* analysis is applied, the supply is not seen as made to the donor, even though the donor is liable to pay for it and has the legal relationship with the person providing the free gift to the customer.

262. In other words, the economic reality in *Baxi* was that Baxi sold its customers boilers. It did not sell them the 'free gifts' as well: it simply gave away points representing free gifts to its customers. It entered into a contract with @1 and incurred expenditure on obtaining the right for these points to be redeemed into free

gifts. So the economic reality is that the free gifts were consumed by Baxi's customers. As there was no contract under which those free gifts were supplied to Baxi's customers, economic reality did not match the contractual position. So the effect of VAT law, as interpreted by the CJEU, is that where economic reality does not match the contractual position, economic reality trumps the contract, and the VAT supply follows the route of economic reality. The reality was that the customers consumed the free gifts so the VAT supply of the right to the goods was made to the customers and not to Baxi.

263. So I accept that Ms Mitrophanous was right to distinguish *Baxi* even though I distinguish it for rather different reasons. I think the decision in *Baxi* is explained by the CJEU's reference to *Kuwait* and its clear concern with VAT being blocked on final consumption. Those concerns do not apply here as, while the final consumption of the temps' services is by Adecco's client, those services are fully paid for by Adecco's client when they pay Adecco the fee (calculated as wages plus 'commission) due under the contract. In other words, economic reality is reflected in the contracts in this appeal.

WHA

264. *Aimia* itself was revisited by the Supreme Court in *WHA* [2013] UKSC 24. In that case an insurance company (NIG) offered breakdown insurance to purchasers of second hand cars. It arranged its affairs, as part of a complicated scheme to avoid VAT, the details of which I do not need to recite, so that the garages who carried out the repairs when the cars broke down invoiced a UK based claims handling company. The question addressed by the Supreme Court was whether the garages made a supply of their repair services to that claims handling company (WHA) or to the owner of the car.

265. The Supreme Court's conclusion as expressed at [56-60] was that on the particular facts of the case the supply of the garage was made to the car's owner so that [57] WHA's payment of the cost of that supply was no more than third party consideration, discharging NIG's obligation to indemnify the car owner against the cost of the repair.

266. As with the CJEU's decision in *LMUK*, *WHA* is a case where the court's answer resulted in the VAT supply not correlating with the contract. In *WHA* the contract was between WHA and the garage; but the supply was found to be between the garage and the owner of the car. Yet the owner of the car had no obligation to pay the garage for the repair in so far as it was covered by the insurance policy: following the reasoning in *LMUK* (CJEU) it seems the 'consideration' was the permission by the owner given to the garage to carry out the repair as that enabled the garage to carry out the work and qualify for payment under its contract with WHA. The peculiarity of the parties to the supply not matching the parties to the contract underlying the supply was not discussed by the CJEU or Supreme Court.

267. It is superficially difficult to distinguish *Redrow* from *WHA* on the facts: in both cases there was a tripartite contract under which the "non-owner" was liable to pay for

the services, and the owners (in *Redrow* of the house, and in *WHA* of a car) were not liable to pay for the services from which they would benefit. Yet House of Lords/Supreme Court reached diametrically opposite conclusions without the Supreme Court overruling the earlier decision of the House of Lords. Both decicisons represent the law but there is no doubt therefore that the CJEU's judgment in *LMUK* has qualified *Redrow*. But how does a tribunal know when to apply the 'follow the liability to pay' rule in *Redrow/Tolsma/Aimia* and when to apply the 'economic reality' rule in *Baxi* and *WHA?*

268. The facts in *WHA* are discussed at [48-49] and at [49] Lord Reed clearly considered that there was a tripartite contract in which "the insured…authorised the garage to carry out the repairs to his or her car, and agreed to pay for the work in so far as it was not covered by the policy" . At [56] and [57] Lord Reed put considerable focus on the fact that the insurance policy was an agreement to pay the cost of repair and not to actually carry out repair. I note that the reasons given for the conclusion include that:

> [58]. … The final consumer of the services supplied by the garage is the insured; and the effect of dismissing this appeal is that VAT is borne on that supply.

Another reason given, which amounts to much the same thing, is that the economic reality was that WHA did not consume the repairs to the car and indeed WHA had no real business:

> "[59]…it is plain that WHA did not obtain anything in return for the payment to the garage which was used for the purposes of its business. On the contrary, ….WHA's business *was* the making of the payment".

In other words, it was an avoidance scheme with the objective of removing final consumption from taxation. So the only result consistent with economic reality was to tax final consumption.

269. So it is clear that the Supreme Court was concerned with what it saw as the economic reality of the situation. The factors above referred to by Lord Reed were significant because a scheme was put in place the outcome of which was that VAT on final consumption would be recovered, which was inconsistent with the Directive. The Supreme Court in *WHA* was concerned that the scheme enabled recovery of input tax on repairs that were clearly consumed by a private individual. (I note that the Court appeared to assume that *if* the supply was to WHA then WHA had no corresponding output tax liability: see [3] and [60]. Whether that assumption is correct does not matter here).

270. My analysis of the situation is therefore that the *Tolsma/Redrow/Aimia* 'follow the liability to pay' rule is the default rule under which the VAT supply will follow the contracts and that rule applies in tripartite situations unless the economic reality is inconsistent with the contractual position. And the economic reality is inconsistent with the contracts where final consumption takes place *without* a contract (or other legal relationship) supplying the thing to be consumed to the final consumer.

271. That explains the decisions in *Baxi* and *WHA*. In other words, in *Baxi* the final consumer of the 'free gift' was Baxi's customer but there was no contract under which the free gift was supplied to Baxi's customer. So economic reality did not match the contracts, so the VAT supply route did not match the contracts either. The supply was found to be to Baxi's customer even though Baxi's customer had no liability to pay for the free gift. In *WHA*, the final consumer of the repair work was the owner of the car, the insured party. But there was no contract with the insured under which the work of repair (for which the insured was indemnified) was carried out. So economic reality did not match the contracts, so the VAT supply route did not match the contracts either. It followed economic reality, so the supply was found to be to the insured party and not to WHA, who had the contractual liability to pay for it.

272. In passing I note that, had HMRC refused the retailers' recovery of input tax charged to them by LMUK, then the application of economic reality ought to have decided the case in HMRC's favour: so in LMUK/Aimia, HMRC attacked the wrong party to the 4-party scenario. They should have refused the *promoter/retailers'* recovery of VAT on the supplies made to them by LMUK. This is because so far as the promoter/retailer was concerned, economic reality did not match the contracts. The promoter/retailer had a contract under which they had the liability to pay for the provision of the free gifts, but the promoter/retailer neither consumed the free gifts in its business nor did it (unlike LMUK) on-supply the rights to another person. In other words, the promoter/retailer bore the cost of the free gifts which were consumed by others. So their economic reality did not match their contracts so the supply *to* the retailer/promoter should have been seen as a supply to the consumers, and the promoter/retailer denied input tax recovery.

Airtours

273. The final case in this summary of leading decisions on tripartite supply situations is the recent decision of the Court of Appeal in *Airtours Holidays Transport Ltd* [2014] EWCA Civ 1033. In that case, a company (in financial difficulties and owing banks large sums of money) entered into an arrangement under which a professional services firm (PWC) agreed to supply the service of reviewing the company's restructuring plan and to provide a report on it to creditor banks. The company was liable to pay PwC's contract fee.

274. The question the Court of Appeal considered was to whom did PwC's supply their professional services? The decision of the majority was that as a matter of fact the company <u>did not</u> engage with PwC to provide a report to the banks; on the contrary the banks contracted with PwC to provide them with the report (see [83], [87] and [98]). The company acted as no more than provider of third party consideration.

275. The dissenting judgment essentially disagreed with the legal analysis of the contract, finding that Airtours "had a contractual right to require" PWC to provide the services to the banks ([46]). And on that basis considered that that meant that there was a supply of services to the company by PwC: the agreement to provide something to someone else.

276. It is difficult to understand the majority as they appeared to find there was no contract: this is because they said PwC owed no liability to the company to provide the report to the bank, yet nevertheless the company was liable to pay for the report. Reciprocity is a fundamental requirement of a contract and yet here the majority said that there wasn't any. While the majority decision is binding on this Tribunal, it is therefore clearly distinguishable because in this appeal, as I have found that there was a contract between Adecco and the client under which the client was liable to pay Adecco for the temps' services, and a contract between Adecco and the temp under which Adecco was liable to pay the temp in full for his/her services.

277. The minority judge found that there was reciprocity: In return for the payment by the company, PwC owed the company the obligation to provide the report to the bank. She then went on to consider whether the contracts were consistent with the economic reality: [54]. Her conclusion was that Airtours very much benefited from the report as it led to the banks continuing to support the company: [55] and so Airtours ought to have been allowed to recover the VAT.

278. What affect does this decision have on this appeal? The majority decision is distinguishable. I am concerned with economic reality but what the minority judge said on this is not binding and the majority did not really address it and in so far as they did, their conclusion was that the economic reality was that the banks consumed PwC's services.

279. My view is that the CJEU would agree with the view of the majority that the economic reality was that PwC's services were really consumed by the banks. While it was in the company's best interests to contract with PwC to provide the report, it was in a comparable position to Baxi when it contracted for free gifts to be provided by another company to Baxi's customers. It was in Baxi's commercial interests for free gifts to be received by its customers because this promoted its business and was intended to generate customer loyalty and in that sense it 'consumed' @1's service of agreeing to give away goods to Baxi's customers; but the economic reality is that the free gifts themselves were consumed by the customers, in the same way that PwC's report was directly consumed by the bank. And in such a case the CJEU has said the supply must be seen as made to the person who finally consumes the goods or services. The decision of the majority in *Airtours* is therefore entirely consistent in outcome (if not reasoning) with *Baxi, Aimia* and *WHA.*

280. The appellant relies on the decision as strongly supporting its contentions in this appeal. It sees the economic reality as being that the temps' work was actually consumed by the client, as indeed it was. But I think the appellant misses the point: economic reality only 'trumps' the *Tolsma* rule that supplies follow the same route as the legal liability to pay where that route differs from the economic reality. In *Baxi, WHA* and *Airtours,* the person who had the liability to pay for the thing consumed was not the person who consumed the thing. So the legal liability to pay differed from the economic reality of consumption. Here, on the contrary, the client consumed the temps' work, but <u>also</u> had the liability to pay for the temps work. It does not matter that that liability to pay was owed to Adecco and not to the temps: there is nothing inconsistent with the Principle VAT directive in the thing to be consumed being

supplied to the ultimate consumer through a number of middlemen. That is a normal incident of business. Properly understood, *Baxi, WHA* and *Airtours* do not assist the appellant.

Conclusion on the legal principles to be applied

281. I take from consideration of all these cases that a VAT supply, ordinarily at least, requires a legal relationship between the supplier and recipient under which the supplier is obliged to make the supply and the recipient is liable to pay for it, whether or not that liability arises under an enforceable contract (*Tolsma, Redrow, Town & Country Factors)*. Nevertheless, where the economic reality of the legal relationship is such that it results in final consumption of goods or services by a consumer in circumstances where in effect there is no VAT charge on that consumption then this normal rule is overridden because the ultimate purpose of the Principle VAT Directive is to tax final consumption:

> **Article 1(2)**
>
> The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

In such a case, the CJEU and Supreme Court in the cases of *Baxi* and *WHA* have seen the supply for VAT purposes as being to the final consumer even thought the legal relationship with reciprocity has not been with the final consumer.

282. In *Aimia,* the Supreme Court said the reciprocity rule in *Redrow* was not an absolute rule, because regard must be had to economic reality, but the three judges of the majority in *Aimia* appeared to consider that *Redrow* was correctly decided on the facts of that case ([65]) although there was no detailed analysis. Is my above analysis with consistent with the outcome of *Redrow?* My analysis of case law is that *Redrow* would still be decided the same way under the *Baxi/WHA* line of cases unless final consumption would go untaxed. Did final consumption go untaxed in *Redrow?* The Lords did not appear to think so. In Lord Millett's final paragraph he referred to the estate agent's services having a direct and immediate link to the sale of the taxable (albeit zero rated) Redrow home. In any event, the basis of the decision in *Aimia* was that *Redrow* is not an absolute rule and where a business meets:

> "the cost of a supply of which it cannot realistically be regarded as the recipient …."

it may be seen as only providing third party consideration.

283. In conclusion, in a situation where B agrees to pay A to provide goods and/or services to C, and C agrees with B to pay for the goods and/or services provided by A, then a *Redrow* 'follow the liability to pay' analysis applies to decide to whom A's supply is made. This is because the legal relationships reflect the economic reality and the outcome is consistent with the Principle VAT directive because final

consumption is taxed. In other words, A's supply is to B, and B makes an on-supply to C.

284. But where a *Redrow* 'follow the liability to pay' analysis does not lead to tax on final consumption, because although A makes a supply to B (of providing goods/services to C), B does not on-supply A's services to C, then C's consumption will be untaxed, and, applying *Baxi/Aimia/WHA*, economic reality requires the supply to be seen as made to the final consumer.

Disbursement

285. That legal analysis deals with one issue raised by HMRC. Ms Mitrophanous suggested that Adecco could only win this case if it could demonstrate that the amount it paid to the temps was paid to the temps as a disbursement on behalf of its clients. In other words, she was saying that to succeed Adecco had to show that its clients actually were the ones liable in law to pay the temps, and that in giving the money to Adecco, the clients were doing so on the understanding that Adecco would pass it on to the temps on behalf of the clients.

286. As a matter of fact, Adecco cannot demonstrate this. It is quite clear that the contract between Adecco and its clients clearly intended that the client would not have a direct obligation to the temps. They had no obligation to pay the temps. See §§91-98.

287. As a matter of law, however, I do not agree with the proposition made by Ms Mitrophanous. It is clear from the authorities, such as *Baxi* and *WHA* that supplies do not have to follow the contractual route. *If* the *Baxi/Aimia/WHA* type analysis applies in this case then the VAT supply route will be different from the contractual route. The question is whether (as per *Aimia)* the *Redrow* analysis applies because it is consistent with economic reality, or whether the *Baxi/WHA* analysis must apply because only that would be consistent with economic reality, irrespective of the contractual position.

288. I agree with Mr Grodzinski that the appellant does <u>not</u> have to show that Adecco acted as an intermediary for its clients when paying the temps; it is clear that the entire fee paid by the client to Adecco belongs to Adecco, and that when it pays the temps it does so to discharge its own legal liability to the temps. That is the contractual position but as I have explained at length the contractual position does not necessarily determine the VAT supply position. It is possible, that if economic reality means a *Baxi*-type analysis should be applied then, to the extent that the fee paid to Adecco equals the amount Adecco pays the temp, it must be regarded as 'third party consideration' in the sense intended by the Principle VAT Directive even though it is does not represent a disbursement in contract law.

Third party consideration

289. The Directive and the cases refer to third party consideration. The normal meaning of third party consideration is where one person discharges the liability of

another person. But that clearly cannot be the meaning that it carries in the Principle VAT Directive as interpreted in *Baxi* and the other cases. In *Baxi* the CJEU said the payment by Baxi to @1 was third party consideration for the supply to Baxi's customer of the free gifts: but its contract with @1 made Baxi liable to pay that sum to @1. It was not third party consideration in the normal meaning of the phrase. But it seems to me that when economic reality has defined the direction of the supply to be the direction of final consumption, then the contractual payment by the person not a party to that supply must be referred to as 'third party consideration' for VAT purposes.

290. The terminology is confusing but that is not surprising when the case law makes it quite clear that VAT supplies do not have to be identical to contractual supplies, so that the recipient of the supply in the VAT world is not necessarily the recipient under the contract, and the person who is liable to pay for the supply is, in the VAT world, seen only as providing third party consideration. It is probably easier to understand if the phrase is not used.

291. As I have also noted, the CJEU's analysis in *Baxi* and the Supreme Court's in *WHA* is that, where economic reality requires the supply to be seen as made direct to the final consumer and not to the person with liability to pay for it, then the consideration required under *Tolsma* is seen as the opportunity for the supplier to earn the third party consideration: see §241. However, this is a minor matter. While the appellant could say that offering an assignment to a temp gave the temp the opportunity to earn money from Adecco and that this was 'consideration' for the temps' supply of work which the appellant sees as made direct to the client, that would be a wrong analysis. This type of analysis of 'opportunity' consideration only applies where economic reality did not match the contractual analysis, in other words where final consumption was by a person who did not have the liability to pay for it. In other words, there is only this 'opportunity' consideration where there is a mismatch between economic reality and the contracts: the analysis has not been applied by the CJEU or Supreme Court in any other situation. It was not, for instance, applied in *Aimia*.

Importance of control?

292. The appellant gave many reasons, based on the terms of the contract (see §§105-115), why I should find that Adecco's client, and not Adecco itself, controlled what an individual temp did.

293. HMRC sought to challenge that case by showing that ultimate control rested with Adecco because Adecco could terminate any assignment. The facts were that (apart from where requested by a client to do so) Adecco would virtually never exercise this power of termination and would only exercise it when seriously concerned that its client might not pay. Nevertheless, it did have this power.

294. I considered that the termination rights were significant in the sense that they reiterated what other provisions of the contract made clear which was that as a matter of contractual obligation Adecco was liable to pay the temps irrespective of whether

its clients paid it: otherwise I do not see the rights to terminate as particularly significant.

295. But similarly I do not consider that control is significant to the question of economic reality. This is because the Sixth/Principle VAT Directive is concerned with consumption. While the appellant is right to say that their clients controlled the work of the temps, I think that the Principle VAT Directive, as shown by the case law discussed above, is concerned with consumption rather than control. For instance, in *Redrow* and *WHA* control appears to have been with someone other that the person who consumed the services, on the one hand of an estate agent and the other of the garage, yet the results of the cases were opposite. Moreover, in *Aimia*, the customer chose the free gift and therefore had 'control' over the supply yet the outcome of the appeal, so far as LMUK was concerned, was that nevertheless economic reality was consistent with the contracts and the supply was to LMUK and not the customer. So control is not significant by itself: it does not determine economic reality. VAT looks at consumption, and at whether the contracts reflect the consumption. All these cases make sense, and only make sense, if one looks at whether the person who consumed the goods/services had the legal liability to pay for them.

296. So while I accept that the clients controlled the work of the temps, I don't think it significant. Economic reality looks at who *consumed* the work of the temps. Here it is quite clear that the final consumer of the work of the temps was the clients: but the client also had the legal liability to pay for what they consumed.

Conclusions

297. HMRC's position is that the economic reality in this case is consistent with a *Redrow* 'follow the liability to pay' analysis. In their eyes, the temps (on taking up an assignment) provide to Adecco the service of agreeing to carry out the assignment as instructed by Adecco's client in return for payment by Adecco; Adecco then makes a supply of the temp's services to its client. The VAT position is identical to the contractual one.

298. The appellant has the opposite view. They do not consider that economic reality is consistent with the contracts, or at least with the contracts as I have found them to be. On the basis that the obligation to pay the temp lay with Adecco and not with the client, as I have found, the appellant's position is that the economic reality is (in summary) that the temps do what the client tells them to do and Adecco has absolutely no involvement in giving them instructions or reviewing their work. Therefore, the appellant reasons, economic reality is not consistent with the temps' service being provided to the client by Adecco.

299. I accept that the economic reality is that the temp carries out the client's instructions during the assignment and does not work under Adecco's control, but I do not accept that that economic reality is inconsistent with the legal liability to pay and the contractual position.

300. The contractual position is that the temp has agreed *with Adecco* to do what the client tells it to do. Therefore, when the temp carries out the assignment doing exactly what the client tells it to do, economic reality is consistent with the temp's contract with Adecco. The temp is doing what its contract required it to do.

301. Adecco's position seems to be predicated on the basis that an agreement by A with B to provide goods or services to C as a matter of economic reality must be seen as a supply by A to C as the goods/services effectively move directly from A to C. But that is a wrong legal analysis. As I have already said, where something is supplied by A to B, and then B to C, even though that thing moves directly from A to C, the contracts are consistent with economic reality as final consumption is taxed.

302. It is wrong to say that the supply must be by A to C because the economic reality is that the goods/services in reality move directly from A to C. It is clear that 'economic reality' means something else. I have already considered its meaning and concluded that in all cases where a *Tolsma/Redrow* 'follow the liability to pay' analysis has not been applied, it was because the contractual analysis was inconsistent with the economic reality, in that the final consumer of the goods and services was not the person with the legal liability to pay for those goods/services.

303. But if the contractual position is that there is a contract for the supply of the services or goods from A to B, and B to C, where C is the final consumer, then the VAT supply route is consistent with economic reality and there is no authority which requires deviation from the rule in *Tolsma/Redrow.* On the contrary, where economic reality is consistent with the contracts, the VAT supply route will be the contractual supply route, as it was in *Aimia,* where LMUK, the middleman like Adecco, neither consumed nor controlled the thing supplied.

304. But if the VAT supply is only A to B, and there is no on-supply by B to C, C being the final consumer, then economic reality is not consistent with the contracts and then the *Baxi/WHA* analysis will apply and the VAT supply will be A to C. But that is not the position here. Here, the clients were the final consumer of the work of the temps but also had the obligation to pay Adecco for that work. There is nothing in *WHA, Baxi, LMUK* that would require any deviation from the rule in *Tolsma* on these facts.

Decision

305. The appellant gave many reasons for saying that the economic reality was the temp supplied its services direct to Adecco's client, and I have summarised these (in the context of an analysis of the contracts) at §§1-5-115, but I find these submissions missed the point.

306. The point is that the economic reality which matters for VAT purposes is the identity of the final consumer. If the final consumer is not the person with liability to pay for the thing consumed, whether goods or services, then economic reality does not match the contractual position. Here Adecco's client is the final consumer of the work undertaken by the temps, for all the reasons give by the appellant: but under the

contracts Adecco's client does have liability to pay for the work it consumes. So economic reality is consistent with the contracts. And so *Tolsma/Redrow* apply and Adecco, as it was entitled to be paid by its clients, including Bank A and Bank B, for the full fee (wages plus commission) for the temps' work, so Adecco must account for VAT on the full fee. Its claim for repayment is refused as it did not account for more VAT than it was liable to account for.

307. I therefore decide the preliminary issue against the appellant and that means that all other grounds on which the appellant's claim is resisted do not need to be decided. The appeal therefore stands dismissed.

308. I appreciate that this is an unfortunate outcome in the sense that two tribunals have reached diametrically opposed conclusions on the same issue, potentially giving one competitor in the same market a financial advantage over another, assuming Reed and Adecco are in competition: but I must apply the law as I see it and I am for the reasons given unable to follow *Reed Employment.* I am consoled by the fact that my decision, at least, will no doubt be appealed and higher authority will clarify the VAT obligations of employment bureaux.

Postscripts

309. Both parties made the assumption that *if* the temp supplied their services direct to the client, then Adecco would only be liable to VAT on that element of the monies paid to it by its clients as represented its 'commission', in other the words Adecco would only be liable to account for VAT on that element of the monies as exceeded the amount it owed the temps for their work. This assumption was not explored at the hearing.

310. The assumption is based in logic: if the temp supplies their services direct to the client then logically Adecco is not supplying the temps' services to the client so to the extent it passes on the consideration received to the temps, that cannot be treated as consideration paid in respect of a supply made by it and so Adecco should not be liable for VAT on it.

311. However, the position may not be that simple. In *LMUK/Aimia* it was assumed that LMUK would remain liable to account for VAT on the entirety of the consideration it received from its client (the retailer/promoter) even if the outcome of the case was that the supply of the free gift was seen as made direct to the final consumer rather than to LMUK. So the assumption made by the appellant in this case is not necessarily correct in any event.

312. Another postscript is that at the start of this decision I referred to Adecco having three business models (§3):

(1) Employed temps;

(2) Self-employed temps, or "PAYE workers";

(3) Contract workers.

313. The second category was the category with which this appeal was concerned. The appellant's case was that economic reality was the self-employed temps "really" provided their work direct to the clients as the clients, and not Adecco, told them what to do. I have accepted that as a matter of fact but said it is irrelevant as a matter of law. I also make the point that the economic reality is that so far as the client was concerned, employed temps were indistinguishable from the self-employed temps in that the client paid Adecco for the work they performed; the client only entered into a direct legal relationship with contract workers. For employed temps, the appellant accepted it had liability to account for VAT on the full fee paid. My decision is therefore also consistent with this economic reality that so far as its clients were concerned there was little or no difference between offering assignments to employed or self-employed temps and the outcome is that for both employed and self employed temps Adecco must account for VAT on the full charge, including the amount it will use to pay the temps. But contract workers are in a different position. So far as the client is concerned it must pay them direct and so far as Adecco is concerned, the VAT position is also very different as Adecco only charges commission and therefore only has to account for VAT on the commission.

314. This document contains full findings of fact and reasons for the preliminary decision. Any party dissatisfied with this preliminary 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.

Barbara Mosedale

TRIBUNAL JUDGE
RELEASE DATE: 27 NOVEMBER 2015