[2017] UKFTT 94 (TC)

TC05622

Appeal number: TC/2015/4542

VAT – landlord repaid rent to wholly owned company under deal with liquidator – whether an agreed reduction in rent – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TERENCE PATRICK BRADY **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at the Royal Courts of Justice, Strand, London on 16 January 2017

Mr R Maas, of Carter Backer Winter LLP, for the Appellant

Mr A Qureshi, HMRC officer, for the Respondents

DECISION

Facts

1. The facts were only in dispute to the extent stated below. I find from the evidence as follows.

2. The appellant owned a property which was let to a company (Allito Color Group Ltd) in which was both connected to him and controlled by him. The rent was £20,000 per month. The property was opted to VAT and Mr Brady both charged and accounted for VAT on the rent.

3. On 25 February 2011, an administrator was appointed to the company. On 26 April 2012, a liquidator was appointed as the company was insolvent.

4. Section 239 Insolvency Act 1986 ('s 239') permitted a liquidator to apply to court to recover a preferential payment made to an insolvent company's creditor, and permitted the court to make an order 'for restoring the position to what it would have been if the company had not given the preference.' A payment was defined as preferential if was influenced by the desire to put the creditor in a better position than if it had not taken place. A company was presumed, unless the contrary was shown, to have been so influenced if the payment was to a creditor connected with the company.

5. The liquidator initially claimed some £1.4 million was preferentially paid to Mr Brady and recoverable under s 239. This claim related to more than just the payment of rent. Mr Brady was, as I have said, connected to the company. Any prior payments to him by the company, including the payments of rent already mentioned, would, under s 239, be presumed to be preferential unless he could prove that they were not.

6. He appointed a Mr Barclay, chartered accountant, to act for him in negotiations with the liquidator. Negotiations, after a number of years, led to a settlement on 12 February 2015 under which Mr Brady paid £300,000 to the liquidator on behalf of the company, and issued a credit note to the company for £300,125 of rent.

7. What was in dispute between the parties to this appeal was what Mr Barclays and the liquidator actually agreed and in particular to what the payment which Mr Brady made of £300,000 related.

8. Mr Barclay gave the only oral evidence about the agreement. The only other evidence I had was documentary. Surprisingly there was no written agreement other than an email sent on 12 February 2015 by Mr Barclay to the liquidator and the credit note issued by Mr Brady on 13 February 2015.

9. Mr Barclay's evidence was challenged by Mr Quereshi, in particular its reliability was challenged by pointing out that there was a discrepancy in the figures

and the dates. Nevertheless, I find that Mr Barclay's evidence was internally consistent and also consistent with the documentary evidence. It was also credible evidence: while he accepted that there were discrepancies in the figures and dates, I consider they were fairly minor, and his explanation for them, which was that the agreement was done in a rush on 12 February 2015 as the liquidator gave him one hour to accept or reject it, was very plausible.

10. He also explained, as I accept, that it was his view that the only payments to Mr Brady by the company which were arguably preferential were the payments of rent, and his view the liquidator's original claim for £1.4 million had little chance of success. He took the view, reflected in both his contemporaneous email recording the deal, and in the credit note, that the £300,000 related solely to a repayment of rent.

11. From the evidence, I find that the agreement was as follows:

(1) Mr Brady would pay £300,000 to the company;

(2) That £300,000 would relate only to rent paid by the company to Mr Brady;

(3) That £300,000 would be a repayment of that rent paid (including VAT thereon) back to approximately January 2010;

(4) Mr Brady would issue to the company, and the company would accept, a credit note covering the repaid rent.

12. It follows from this that there was an error of £125 on the credit note as it was for £300,125 while the agreement related only to £300,000.

13. The agreement was put into effect: the credit note was issued on 13 February (as I have said) and the £300,000 was repaid shortly thereafter.

14. The appellant made a claim to be repaid by HMRC the VAT shown on the credit note of £45,958.33. HMRC refused by letter dated 26 May 2015. The appellant asked for this decision to be reviewed, and the review officer upheld the original decision on 17 July 2015 (on the basis that the reduction was not to correct a mistake). The appellant then made a claim to be allowed the VAT shown on the credit note as bad debt relief ('BDR'). HMRC refused by letter dated 11 March 2016.

15. The appellant appealed both decisions, although, obviously, accepts that his claims are in the alternative. In other words, that he only wants either the credit note recognised or to be given BDR. He does not expect the payment to be relieved of VAT twice.

16. As I understand it, the appellant's case is that the credit note discharged the company's liability to pay the rent, and that consequently Mr Brady did not prove in the liquidation of the company for the outstanding rent. Nevertheless, if wrong on this, the appellant considers that as he has not been repaid the outstanding rent, there is a bad debt, and he is entitled to BDR.

17. HMRC's position, as I understand it, is that they consider the £300,000 did not relate wholly to rent but was a payment made to the liquidator in consideration for the liquidator not pursuing proceedings against Mr Brady under s 239; it was therefore payment of compensation to settle a claim and outside the scope of VAT. There was, on HMRC's case, no repayment of rent nor bad debt.

Was payment mere compensation/settlement of a legal dispute?

18. In so far as it was HMRC's case that the payment was in consideration of more than the liquidator's claim under s 239 for rent, I reject it on the basis of the findings of fact I have made above. I accept that, although it was not stated expressly, the agreement must have been on the basis that no other claim would be made by the liquidator against Mr Brady, nevertheless the terms of settlement were that the payment of £300,000 related to a repayment of rent of about 14 months and the acceptance by the company of a credit note for that rent.

19. It is well-established that the settlement of a claim between two parties, whether or not legal proceedings have been issued, is outside the scope of VAT, so that the receipt of the £300,000 did not attract VAT in the hands of the company. However, that is not to say a settlement of a claim is without VAT implications where the underlying subject matter of the dispute is a VAT supply. So while Mr Qureshi is correct to say that a settlement of a claim brought against Mr Brady by the liquidator is not by itself something that creates VAT rights and liabilities, nevertheless the Tribunal must look at the VAT supplies underlying the dispute to see what effect the settlement of the dispute had on them.

20. The subsequent settlement of a claim does not alter the fact that Mr Brady did lease a VAT-elected property to the company, did receive rent and then, under the settlement with the liquidator, repaid the last 14 months' worth of rent plus VAT. What are the VAT consequences of this?

Claim that repayment was reduction in rent?

21. Article 90 of the Principle VAT Directive ('PVD') provides, as it predecessor the Sixth VAT Directive ('6VD') did before, that:

> 1.In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.
>
> 2.In the case of total or partial non-payment, Member States may derogate from paragraph 1.

22. Both parties, rightly, accepted that this formed part of UK law. Mr Quereshi's position was that, apart from the part of Art 90 which relates to BDR, it was enacted by Regulation 38; Mr Maas' position was that Art 90 was directly effective and Regulation 38 did no more than state the conditions under which that directly effective right was to be exercised. I consider that it does not really matter whether or not UK law enacted Article 90: article 90 is directly effective.

23. HMRC's position was that Article 90 was of no application because there had not been a cancellation, refusal, non-payment or reduction in price. HMRC's view was, as I have said, that the rent was invoiced and paid, and then there was a later quite separate agreement under which Mr Brady paid the liquidator £300,000 in order not to bring litigation against him.

24. I am unable to agree with HMRC's analysis. My findings of fact are that the £300,000 was a repayment of the rent that had been invoiced. It was not a mere payment in consideration of an agreement not to bring litigation. It was a repayment of rent. The only question that arises from that, it seems to me, is whether it was agreed that

> (a) the rent was being repaid because, although there was a lease under which the company had been liable to pay £20K per month, that rental agreement was to be treated as altered to cancel out the liability to pay the rent for (approximately) the last 14 months; or
>
> (b) the rent was being repaid because, although there was a lease under which the company had been and would remain liable to pay £20K per month, that actual payment to Mr Brady, during the last 14 months as the company approached insolvency, was preferential, so it should be repaid leaving Mr Brady to prove for the rent, with the other unpaid creditors, in the company's insolvency.

25. It was the appellant's case that it did not prove in the insolvency although I had no evidence on this either way. However, I infer from the evidence I do have, and in particular the wording of Mr Barclay's email and the issue of the credit note, that the parties agreed that the position was (a), in other words, that the company's liability to pay the rent was being cancelled.

26. This follows because if the liability to pay the rent was not being cancelled, it would make no sense for Mr Brady to issue a credit note and thereby cancel the invoices. Without the invoices he could not prove in the insolvency.

27. I accept that s 239 only gave the court power for 'restoring the position to what it would have been if the company had not given the preference'. On one view, the preference was the payment of rent while, perhaps, other creditors of the company went unpaid. So restoring the position would have required no more than repayment of the rent, rather than cancellation of the company's liability to pay it. However, this was a settlement of a dispute and not a court order and the parties were not restricted to the terms of s 239: they could agree something beyond its terms. Moreover, the liquidator and/or Mr Barclay may have taken the view that the *amount* and not merely the payment of the rent was preferential, in which case restoring the position would require at least partial cancellation of the rent liability. I had no evidence on exactly why the payment was considered potentially preferential and I do not need it: the point is that the parties did agree that the company's liability to the rent for the last 14 months would be cancelled. I do not need to know exactly why they agreed this.

28. So in my view this is a situation where the supply was cancelled after it took place, or at least the price of the supply for the last 14 months was reduced to nil. Either way, the situation is squarely within that envisaged by Article 90 which refers to 'cancellation....or where the price is reduced after the supply takes place.'

29. Article 90 gives Mr Brady directly effective rights. While member states have the power to regulate how Article 90 is given effect, the UK has only done that by enacting Regulation 38. Mr Quereshi did not suggest that the appellant had not met the practical requirements of Regulation 38, such as those that related to adjustment in his VAT accounts. I find that he did meet the requirements of Regulation 38.

30. HMRC were wrong to refuse to repay the VAT to Mr Brady under Article 90 and his appeal against the decision dated 26 May (and the review decision of 17 July) 2015 is allowed.

The British United Shoe case

31. At the same time as accepting, as he must, that Article 90 PVD forms part of UK law, Mr Qureshi relied on the decision in *British United Shoe Machinery Co Ltd* (1977) 1 BVC 1062 where a connected company issued a credit note for rent on an opted property on realising that the tenant company could not recover VAT. The Tribunal ruled that a credit note must be 'issued bona fide in order to correct a genuine mistake or overcharge' and dismissed the appeal against HMRC's decision to refuse to permit the landlord a VAT credit for the amount of VAT shown on the credit note.

32. No reference was made in that case to the 6VD, perhaps not surprisingly in view of its date, but it does means that its persuasiveness is much diminished. I was also referred to *Peter Cripwell and Assoc* (1978), another decision of the VAT Tribunal, which applied *British United Shoe* but again without reference to the 6VD and the predecessor of Article 90.

33. My view is that in so far as the test in *British United Shoe* is narrower than Article 90, it must not be considered good law; and in so far as the case is consistent with Article 90, then there is no need to refer to it. And *British United Shoe* does appear to be narrower than Article 90 as it does not refer to an agreed reduction in consideration.

34. If 'overcharge' is taken as encompassing an agreed reduction in consideration, then the agreement between liquidator and Mr Brady, as set out at §24(a) was that the rent was overcharged, so even applying *British United Shoe,* Mr Brady ought to succeed in this appeal. If 'overcharge' is not taken to encompass an agreed reduction in consideration, then *British United Shoe* and *Cripwell* fail to reflect the law, in particular Article 90, and should be ignored.

35. I was also referred to my own decision in *Barlin* at §§30-31 but my comments there reflect what I have said here and only go to support the appellant's position that he is entitled to issue a credit note where there is an agreed reduction in price.

Claim to Bad Debt Relief

36. That conclusion makes consideration of Mr Brady's bad debt relief claim irrelevant. Obviously, as I have found that the supply was cancelled and/or the price of it reduced to nil, there is no outstanding debt from the company to Mr Brady. Where there is no debt, there is no bad debt.

37. If, of course, I am wrong to consider that the parties had agreed to position (a) in §24 above, then it follows that what they agreed was as described within §24 (b). In other words, the company, having been repaid the rent, still owed it to Mr Brady as the liability to pay the rent was not cancelled. As in this scenario the debt would be bad, and as Mr Qureshi did not suggest that the formal requirements for bad debt relief were not met, I would in this alternative scenario have allowed the appeal against the decision dated 11 March 2016.

38. Either way, having found as a fact that the £300,000 was a repayment of the taxable rent paid by the company, Mr Brady was entitled to repayment by HMRC of the VAT reflected in that figure. I recognise that there was a slight discrepancy in the figures in that Mr Brady only repaid £300,000 whereas the credit note was for some £125 more. The claim which HMRC should pay is therefore for very slightly less claimed. I determine that HMRC should repay £45,933.33.

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

Barbara Mosedale
TRIBUNAL JUDGE

RELEASE DATE: 24 January 2017