[2017] UKUT 112 (TCC)

Appeal number: UT/2015/0028

VALUE ADDED TAX - tripartite situation - car hire company arranging for repair of third parties' vehicles damaged in collisions with hired cars - whether car hire company entitled to recover VAT on car repair invoices* - Airtours Holiday Transport Ltd v HMRC *applied - whether economic reality inconsistent with contractual position – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

U-DRIVE LIMITED

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: The Hon Mrs Justice Proudman DBE
Judge Greg Sinfield

Sitting in public at Royal Courts of Justice, Rolls Building, Fetter Lane, London, EC4A 1NL on 14 and 15 November 2016

Michael Conlon QC and Julian Hickey, counsel, instructed by The VAT Consultancy, for the Appellant

Peter Mantle, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. U-Drive Limited ('UDL') carries on a vehicle hire business. When one of its hire vehicles was involved in an accident that caused damage to a vehicle belonging to a third party ('Car Owner or 'Car Owners'), UDL would sometimes agree with the Car Owner that, as an alternative to an insurance claim, UDL would pay for the car to be repaired. UDL contracted with a car repair business ('Repairer or Repairers') to carry out the repairs to the Car Owner's vehicle. There was no contract between the Car Owner and the Repairer. The Repairer invoiced UDL for the repairs and UDL paid the invoice which included VAT. In September 2013, UDL claimed, by way of voluntary disclosure, repayment of VAT of £17,460 incurred on repairs to Car Owners' vehicles in the VAT accounting periods 09/09 - 03/13. The Respondents ('HMRC') refused the claim and UDL appealed to the First-tier Tribunal (Tax Chamber) ('FTT').

2. It was common ground that UDL was only entitled to a repayment of the VAT charged to it by the Repairers if the Repairers supplied their services to UDL because a person only has a right to deduct VAT on supplies made to him. If the Repairers' services were supplied to the Car Owners then UDL would not be entitled to deduct the VAT. The only issue in the FTT was whether the supplies by the Repairers were made to UDL or to the Car Owners. In a decision released on 10 December 2015 with neutral citation [2015] UKFTT 0667 (TC) ('the Decision'), the FTT dismissed UDL's appeal. The FTT held that the Repairers supplied the repair services to the Car Owners and not to UDL. Accordingly, the VAT charged by the Repairers was not input tax of UDL and UDL was not entitled to deduct it.

3. UDL now appeals, with permission of the FTT, against the Decision. Save as otherwise indicated, paragraph references in square brackets in this decision are to the paragraphs in the Decision.

Factual background

4. The background to and facts of UDL's appeal were fully set out by the FTT at [4] to [17], [35] and [100] and [101]. The material facts for the purposes of this appeal are not in dispute and can be summarised as follows:

> (1) UDL's principal business is the hire of self-drive cars and vans. Such supplies are subject to VAT. UDL has been registered for VAT since 1973 and accounts for significant amounts of VAT to HMRC.
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> (2) UDL's customers had to sign a standard form contract before they could hire a vehicle. The standard contract for private customers provided that the customer would be insured against third party risks under UDL's fleet insurance policy. Such cover was optional for commercial customers who already had their own cover. There was no itemised charge for the fleet insurance policy which was included in the hire charge. In the event that UDL's customer damaged a vehicle or other property belonging to a Car Owner while driving the car, the insurer became liable to indemnify the customer and not the Car Owner.
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> (3) Before the events that gave rise to the claim in this appeal, UDL had established a captive insurance company called Parallel Insurance Services Limited ('Parallel') to mitigate the rising costs of insurance with a third party insurer. Parallel provided cover under a fleet insurance policy to UDL in return

for premiums which were set by reference to the claims made: in effect, self-insurance.

(4) Under the arrangements with Parallel, UDL had a direct financial interest in minimising the cost of claims. For this reason, UDL often paid for repairs without any claim being made on Parallel under the insurance policy. Accordingly, UDL actively sought to minimise the cost of repairs to vehicles belonging to Car Owners damaged in collisions with UDL's hire cars as follows:

(a) UDL provided all customers hiring a car with a 'bump card' and told them that, if there was an accident, the bump card should be given to the Car Owner. The bump card set out UDL's contact details and was intended to encourage the Car Owner to contact UDL rather than notify his/her insurer.

(b) If the Car Owner contacted UDL, UDL's accident and repair handling team would negotiate with the Car Owner and with a Repairer with a view to the Car Owner agreeing that the Repairer would carry out the repair and provide a courtesy car to the Car Owner.

(c) If the Car Owner agreed, UDL would contract directly with the Repairer. The Repairer carried out the repair and issued an invoice for the cost of the repair, including VAT, to UDL which UDL paid.

(d) If the Car Owner was not happy with the standard of the repair work, UDL would seek to negotiate the situation.

(5) The contract to supply the repair services was between UDL and the Repairer. There was no contract (and often, no contact) between the Car Owner and the Repairer. UDL did not claim that it had any contractual relationship with the Car Owner.

(6) The bump card arrangements were financially beneficial to UDL because, overall, it cost UDL less money to repair the cars via the bump card system than if the Car Owners had made a claim through their own insurers which would have been satisfied by Parallel. The bump card procedure enabled UDL to reduce the costs of repairs because the Repairers offered reduced labour charges and might offer further reductions if UDL placed a substantial volume of work with a particular Repairer. UDL also had a system whereby parts could be obtained more quickly than would otherwise be the case which reduced the time that the Car Owner's vehicle was off the road and thus the cost of the courtesy car.

5. At [105], the FTT accepted that the bump card arrangements involved "no artificiality" and "the arrangements at issue in this appeal were driven by purely commercial considerations" but held that the VAT analysis did not turn on whether arrangements were artificial or commercial.

Legislation

6. The relevant legal principles governing deduction of input VAT by a taxable person are found in Council Directive 2006/112/EC (the Principal VAT Directive or 'PVD').

7. Article 1(2) of the PVD provides:

> "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. On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT shall be applied up to and including the retail trade stage."

8. Article 9(1) relevantly defines 'taxable person' as any person who, independently, carries out any economic activity in any place, whatever the purpose or results of that activity.

9. Article 63 of the PVD provides that VAT becomes chargeable when the goods or services are supplied and Article 167 states that the right of deduction arises at the time the deductible tax becomes chargeable. Article 168 of the PVD provides:

> "In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> > (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person; …"

10. The provisions of the PVD have been implemented in UK law by the Value Added Tax Act 1994 ('VATA94'). Input VAT is defined by s 24(1) VATA94, in relation to a taxable person, to mean:

> "(a) VAT on the supply to him of any goods or services…,
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> being… goods or services used or to be used for the purpose of any business carried on or to be carried on by him."

11. Section 25(2) VATA94 entitles a taxable person to deduct "so much of his input tax as is allowable under section 26 from any output tax that is due from him". Sections 26(1) and (2) provide that the amount of allowable input tax is that which is attributable to supplies by the taxable person in the course or furtherance of his business which give rise to the right to deduct (i.e. for these purposes, 'taxable supplies').

Issue on appeal

12. The single issue in this case is whether the supplies made by the Repairers in the course of repairing the Car Owners' vehicles were supplies to UDL or to the Car Owners. As the FTT observed at [37], it is a simple question to ask but much less straightforward to answer. Like the FTT, we begin by considering the leading authorities.

Case law

13. Mr Conlon QC, who appeared with Mr Hickey for UDL, said that there are four key authorities which lay down the legal principles for identifying the recipient of a supply, namely: *CCE v Redrow Group plc* [1999] STC 161 ('*Redrow'*); *HMRC v. Aimia Coalition Loyalty UK Limited (formerly Loyalty Management UK Limited)* [2013] UKSC 15, [2013] STC 784 ('*Aimia*'); *WHA Limited v. HMRC* [2013] STC 943 ('*WHA'*); and *HMRC v. Airtours Holidays Transport Limited* [2016] STC 1509 ('*Airtours'*). We did not understand Mr Mantle, for HMRC, to disagree that these were

the relevant authorities, however both parties focussed their submissions on the cases of *WHA* and *Airtours* so we deal with the others only briefly.

14. In *Redrow*, a group of house building companies, Redrow, operated an incentive scheme for prospective purchasers of its houses. Redrow contracted with estate agents to sell the buyer's existing home and paid the agents' fees. Redrow deducted VAT incurred on the fees paid to the estate agents. The Commissioners, considering that the supplies were made to the owners of the houses to be sold rather than to Redrow, issued an assessment to recover the VAT. The matter eventually reached the House of Lords which unanimously allowed Redrow's appeal. The Commissioners had argued that mere payment of the estate agents' fees did not entitle Redrow to deduct the VAT charged; and the fact that Redrow obtained a benefit from the agents' services should be ignored because the main benefit of the supply was enjoyed by the purchasers. The House of Lords held that the supplies had been 'received in connection with the business activities of the taxable person, for the purpose of being incorporated within its economic activities'. Lord Hope observed, at page 166, that:

> "I do not see how the transactions between Redrow and the estate agents can be described other than as the supply of services for a consideration to Redrow. The agents were doing what Redrow instructed them to do, for which they charged a fee which was paid by Redrow. … The fact that someone else, in this case, the prospective purchaser, also received a service as part of the same transaction does not deprive the person who instructed the service and who has had to pay for it of the benefit of the deduction."

15. Lord Millett set out what he regarded as the correct approach to identifying the recipient of a supply and thus the person who, subject to the relevant rules, was entitled to recover the input tax at page 171:

> "... 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?"

16. In *Aimia*, the Supreme Court considered the decision of the Court of Justice of the European Union in *HMRC v Loyalty Management UK Ltd* (Cases C-53/09) [2010] STC 265 ('*LMUK*') on its return to the UK, a reference having been made by the House of Lords. The case concerned the well-known Nectar customer loyalty programme. LMUK was the promoter of the Nectar programme. LMUK entered into arrangements with consumers, retailers and providers of certain goods and services to be used as rewards in the programme known as 'redeemers'. In summary, the programme worked as follows. Consumers who held Nectar cards collected Nectar points when they used their cards in connection with the purchase of goods or services from retailers participating in the programme. The retailers paid LMUK an agreed amount for each point issued. The consumers redeemed the Nectar points for rewards supplied by the redeemers. LMUK paid the redeemers an agreed amount for each point redeemed. The redeemers charged and invoiced that amount, which included VAT, to LMUK. The issue was whether LMUK was entitled to deduct the VAT paid on the amount charged by the redeemers. Before the CJEU, LMUK argued that the amounts paid to the redeemers were consideration for the service supplied to it by the redeemers of agreeing to supply goods or services to consumers without charge or at a reduced price. HMRC contended that the amounts paid by LMUK to the redeemers were third party

consideration for the supplies made by the redeemers to customers. At [39] of *LMUK*, the CJEU observed that "consideration of economic realities is a fundamental criterion for the application of the common system of VAT". The CJEU held, at [42], that the economic reality is that loyalty rewards are supplied by the redeemers to the customers and, at [57], that the payment by LMUK to the redeemers was third party consideration for the supplies of the rewards to the consumers.

17. When the reference returned to the UK, the Supreme Court, by a majority, considered that the CJEU's judgment did not provide the answer to the question of whether LMUK was entitled to deduct VAT charged by the redeemers because the CJEU's decision was based on an incomplete evaluation of the facts. The Supreme Court in *Aimia* held that, on a correct appreciation of the facts, LMUK was entitled to deduct the VAT charged by the redeemers because, as a matter of economic reality, the amounts paid to the redeemers were consideration for the service provided to LMUK by the redeemers and a cost of LMUK's business. Both parties referred us to important passages from the judgments of Lord Reed and Lord Hope in *Aimia* but, as those passages are discussed by Lord Neuberger in his judgment in *Airtours*, which we set out below, we do not reproduce them here.

18. In *WHA*, a UK based insurer, NIG, reinsured the whole of its risk in motor breakdown insurance ('MBI') policies with a Gibraltar-based company, Crystal, which, in turn, retroceded 85% of the risk to another Gibraltar-based company, Viscount. Viscount had responsibility for claims handling in respect of its own risk and that of Crystal. Viscount entered into an agreement with WHA, an English company, to instruct garages to carry out any repairs to vehicles relating to claims under the insurance policies. WHA instructed the garages to carry out the repairs and the garages invoiced the charges, including VAT, to WHA. WHA considered that it was entitled to deduct the VAT charged by the garages but was not liable to charge VAT to Viscount in Gibraltar. Alternatively, Viscount contended that it was entitled to recover any VAT that it had to pay to WHA. Crystal, Viscount and WHA were all part of the same group of companies. In essence, the scheme was intended to enable recovery of VAT charged by garages in relation to car repairs in response to claims under the insurance policies.

19. When the matter came before the Supreme Court, the first issue was whether there was a supply of repair services by the garages to WHA as well as or instead of a supply of such services to the insured. In a judgment with which the other Justices of the Supreme Court concurred, Lord Reed concluded that there was no supply of repair services by the garages to WHA. In the introduction to his judgment, at [3], Lord Reed said:

> "In principle, however, an MBI insurer might undertake not to indemnify the insured in respect of the cost of repair, but to repair the insured's vehicle; and it could then arrange with a garage for the repair to be carried out, and pay the garage's bill. Even in such a case, however, the insurer would not be able to deduct the VAT element of the bill, since, even if the garage were regarded as supplying a service to the insurer for the purposes of its insurance business, the insurer would not be liable to account for any VAT in respect of that business, and would therefore not have received any VAT from which the tax paid to the garage could be deducted."

20. Mr Conlon relied on [3] of *WHA* as showing that Lord Reed had recognised that if an insurer providing MBI contracted directly with the garage for the repair of the insured's vehicle then the insurer would be the recipient of the garage's services for

VAT purposes. That, he submitted, is the position of UDL. Mr Mantle pointed out that Lord Reed's comments assumed that the insurer had undertaken to repair the vehicle, instead of indemnifying the insured, which was not the case here: UDL never undertook to repair the Car Owner's vehicle. We agree with Mr Mantle on this point. Further, we consider that, by the use of the words "even if the garage were regarded as supplying a service to the insurer", Lord Reed was careful to indicate that he was not making a decision on that point which was only hypothetical.

21. Lord Reed noted, at [26] of *WHA*, that decisions about the application of VAT are fact sensitive and a small modification of the facts can render the legal solution in one case inapplicable to another. It is therefore necessary to consider the facts and all the circumstances in which the transaction took place carefully before looking at the matter as a whole in order to determine its economic reality. At [27], Lord Reed stated:

> "The contractual position is not conclusive of the taxable supplies being made as between the various participants … but it is the most useful starting point."

22. Lord Reed then analysed the various contracts which gave effect to the scheme before concluding at [33] that, while the agreements were consistent in envisaging the role of WHA as encompassing negotiation, investigation, adjustment, settlement and payment of claims, they gave no indication that WHA's role included undertaking responsibility for carrying out repairs. Lord Reed held, at [37], that there was an agreement between WHA and the garage, implied if not express, under which WHA agreed to pay for the work in so far as it was covered by the policy and authorised by WHA. He also noted that the tribunal had found that there was an agreement between the insured and the garage, implied if not express, under which the insured agreed to pay for work carried out by the garage insofar as it was not covered by the policy.

23. We consider that it is helpful to set out [56] and [57] of Lord Reed's judgment:

> "56. As I have explained, under the contract of insurance NIG undertakes to the insured that it will meet the cost of the repair. It does not undertake to repair the vehicle. If NIG were to perform the contract by itself paying the garage, that would be an example of third party consideration within the meaning of article 11A(1)(a) of the Sixth Directive: that is to say, consideration for a supply which the person providing the consideration does not himself receive, but which he pays for, in this example, in order to discharge an obligation owed to the recipient of the supply. On this hypothesis, the garage supplies a service to the insured by repairing his or her vehicle, and NIG meets the cost of that supply because it has undertaken to the insured that it will do so, and has received premiums from the insured as the consideration for its giving that undertaking. In that situation, the breakdown is a risk: an event insured against. The cost of the repair is the cover: it is not the consideration for a service provided to the insurer.
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> 57. The interposition of reinsurers does not alter that position. Neither, on the facts found by the tribunal, does the interposition of WHA. In economic reality, when WHA pays for the repairs it is merely discharging on behalf of the insurer (via the chain of contracts connecting it to NIG, through Viscount and Crystal) the latter's obligation to the insured to pay for the repair. WHA's role, in relation to the aspect of its business concerned with the payment of the garages, is to act as the paymaster of costs falling within the cover provided by the policies. The interposition of WHA does not, by some alchemy, transmute the discharge of the insurer's obligation to the insured into the consideration for a service provided to the reinsurer's agent."

24. Mr Conlon submitted that the FTT in this case had failed to appreciate that the situation in *WHA* was very different from the facts of this case. In *WHA*, NIG undertook to indemnify the insured for the cost of the repair but not to repair the vehicle. WHA's role was simply to act as the paymaster in meeting the costs on behalf of the insurer which put WHA in funds by means of a cash float to pay the garage. WHA did not obtain anything from the garage that was used for the purposes of WHA's business in return for the payment. Mr Conlon contended that UDL was in an entirely different position from WHA: UDL was not an insurer indemnifying the Car Owner nor was it a mere paymaster contracting with the Repairer as agent of another. Mr Mantle submitted that the FTT were correct to look at and apply the reasoning of the Supreme Court in *WHA* in UDL's case.

Airtours

25. The FTT did not have the benefit of the Supreme Court's judgment in *Airtours* when reaching the Decision which was issued some months before. In *Airtours*, the taxpayer company was in financial difficulties. Before deciding whether to extend Airtours' borrowing facilities, the company's lenders ('the Institutions') had to be satisfied that business restructuring proposals were viable. PwC were commissioned to prepare a report for the Institutions. The terms under which PwC were appointed were contained in a letter of engagement from PwC to the Institutions. It was agreed that Airtours would pay for the report and receive a copy. The report was critical to Airtours' survival and was, therefore, undoubtedly of benefit to it. The issue was whether PwC made a supply of services to Airtours. If so, the VAT charged by PwC would be input tax of Airtours which could deduct it.

26. The issue in *Airtours* gave rise to two questions. The first was whether PwC were under a contractual obligation to Airtours to supply services, such as providing the report, to the Institutions. If the answer was yes, it was agreed that there was a supply by PwC to Airtours. If the answer was no, however, Airtours contended that there was still a supply to it in the circumstances of the case whereas HMRC considered that there was no such supply. The majority of the Supreme Court held that PwC did not contract with Airtours to provide the report to the Institutions and the contract reflected economic reality and was not in any way artificial.

27. Mr Conlon relied on a passage from [22] of Lord Neuberger's judgment which concerned the first issue:

> "22. The first question, then, is whether, on the true construction of the Contract, PwC contracted to supply services to Airtours. There is no doubt that the Contract imposes an obligation on PwC to supply services to the Institutions. The issue is whether PwC agreed, in addition, with Airtours that they would supply those services. Thus, it is enough for Airtours' purposes if it can establish that PwC were under a contractual obligation to Airtours to supply services, such as providing the Report, to the Institutions. Airtours does not have to show that PwC were under a contractual obligation to supply any services directly to Airtours."

28. Lord Neuberger (with whom Lord Mance and Lord Hodge agreed) held, at [31], that, considering only the express words of the contract, "there is no obligation on PwC, as a matter of contract, to Airtours to provide the Services whether to the Institutions or to Airtours". Lord Neuberger also rejected the argument that the commercial background (in particular, the fact that the report was of vital importance to Airtours,

which had countersigned the engagement letter and undertaken to pay PwC for the report) meant that PwC had a contractual duty to Airtours.

29. Lord Neuberger then turned to consider whether, even though Airtours was not contractually entitled to require PwC to provide the report to the Institutions, the circumstances supported the conclusion that PwC supplied services to Airtours. He began by discussing the approach of Lord Millett in *Redrow* as elucidated by Lords Reed and Hope in *Aimia*:

> "45. However, Lord Millett's observation [at p. 172] cannot be taken at face value. As Lord Reed explained in [*Aimia*], paras 66 - 67:
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> > '[66] [T]he speeches in *Redrow* should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case, that consideration of economic realities is a fundamental criterion for the application of VAT. … [T]he judgments in *Redrow* cannot have been intended to suggest otherwise. On the contrary, the emphasis placed upon the fact that the estate agents were instructed and paid by Redrow, and had no authority to go beyond Redrow's instructions, and upon the fact that the object of the scheme was to promote Redrow's sales, indicates that the House had the economic reality of the scheme clearly in mind. When, therefore, … Lord Millett asked, 'Did he obtain anything - anything at all - used or to be used for the purposes of his business in return for that payment?', [that question] should be understood as being concerned with a realistic appreciation of the transactions in question.
> >
> > [67] Reflecting the point just made, 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.'
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> 46 Lord Hope made the same point at para 110 in remarks which are perhaps particularly germane for present purposes:
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> > 'I think that Lord Millett went too far … when he said that the question to be asked is whether the taxpayer obtained 'anything - anything at all' used or to be used for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole.'"

30. Lord Neuberger then summarised the relevant principles on contractual analysis and economic reality as follows:

> "47. This approach appears to me to reflect the approach of the Supreme Court in the subsequent case of *WHA Ltd v Revenue and Customs Comrs*

[2013] UKSC 24; [2013] STC 943 where at para 27, Lord Reed said that "[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point". He then went on in paras 30 to 38 to analyse the series of transactions, and in para 39, he explained that the tribunal had concluded that "the reality is quite different" from that which the contractual documentation suggested. Effectively, Lord Reed agreed with this, and assessed the VAT consequences by reference to the reality. In other words, as I said in *Secret Hotels2 Ltd v Revenue and Customs Comrs* [2014] STC 937, para 35, when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts.

48. The same approach was adopted by the Court of Justice in *Revenue and Customs Comrs v Loyalty Management UK Ltd and Baxi Group Ltd* (Joined Cases C-53/09 and C-55/09) [2010] STC 2651, paras 39 and 40, where they stated, citing previous judgments, that "consideration of economic realities is a fundamental criterion for the application of the common system of VAT", and added that that issue involved consideration of "the nature of the transactions carried out" in the particular case. To much the same effect, in *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509, para 14, the Court of Justice said that 'a supply of services is effected 'for consideration' … only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance', which it explained as meaning "the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient". In the context of the supply of goods, the Court made the same point in *Primback Ltd v Customs and Excise Comrs* (Case C-34/99) [2001] 1 WLR 1693, para 25, where it described 'the determining factor' as 'the existence of an agreement between the parties for reciprocal performance, the payment received by the one, being the real and effective counter-value for the goods furnished to the other'.

49. In *Revenue and Customs Comrs v Newey* (Case C-653/11) [2013] STC 2432, para 40, the Court of Justice again emphasised that 'that a supply of services is effected 'for consideration', within the meaning of article 2(1) of [the Sixth] directive, 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, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient'. In para 41, the court went on to explain that 'the supply of services is therefore objective in nature and applies without regard to the purpose or results of the transactions concerned and without its being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person'. The court then observed in paras 42-43 that 'consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT' and that 'the contractual position normally reflects the economic and commercial reality of the transactions'. An exception to the normal rule that the contractual relationship is central was then identified by the court as being where 'those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions' (para 45).

50. From these domestic and Court of Justice judgments, it appears clear that, where the person who pays the supplier is not entitled under the contractual documentation to receive any services from the supplier, then, unless the documentation does not reflect the economic reality, the payer has no right to reclaim by way of input tax the VAT in respect of the payment to the supplier."

31. Later Lord Neuberger observed at [55] - [57]:

> "55. … The Court of Justice has spoken of reciprocal performance as a critical component of the concept of supply, but it has never confined the consideration to that provided by the recipient of the supply. Thus in *Tolsma* at para 14, the court stated:
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> > 'a supply of services is effected 'for consideration' … 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, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient.'
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> 56. This formulation demonstrates the need for a direct link between the service provided and the consideration received which the court had previously articulated in *Staatssecretaris van Financiën v Association Coöperatieve Aardappelenbewaarplaats GA* (Case C-154/80) [1981] ECR 445, para 12, *Apple and Pear Development Council v Customs and Excise Comrs* (Case C-02/86) [1988] STC 221, paras 11 and 12, and *Staatssecretaris van Financiën v Hong Kong Trade Development Council* (Case C-89/91) [1982] ECR 1277, para 10. The Court of Justice's later statements of the test have followed *Tolsma* in not requiring the recipient of the services under the arrangement itself to be the provider of the consideration or to have legal responsibility for its provision - see *Primback Ltd*, para 25 and *Newey*, para 40, and see also *Dixons Retail plc v Revenue and Customs Comrs* (Case C-492/12) [2014] Ch 326, paras 31 and 32.
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> 57. When the Court of Justice speaks of 'reciprocal performance' it is looking at the matter from perspective of the supplier of the services and it requires that under the legal arrangement the supplier receives remuneration for the service which it has performed. It is not necessary that the recipient of the service is legally responsible to the supplier for payment of the remuneration; it suffices that the arrangement is for a third party to provide the consideration. Were it otherwise, taxpayers could structure their transactions so as to escape liability to pay VAT, so long as they could meet the economic reality test."

Principles derived from the cases

32. Mr Conlon submitted that four key principles for determining who is the recipient of a supply could be derived from the cases and, in particular, *Airtours*. They were:

(1) A supply of services is effected "for consideration" only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance (see Case C-16/93, *Tolsma v. Inspecteur der Omzetbelasting Leuwarden* [1994] STC 509 ('*Tolsma'*)).

(2) The transaction should, at least normally, be characterised for VAT purposes by construing the contract.

(3) Where the person who pays a supplier is not entitled, under the contract, to receive any services from the supplier then, unless the documentation does not reflect the economic reality of the transaction, the payer cannot deduct any VAT charged by the supplier.

(4) Regard must be had to all the circumstances in which the transaction or combination of transactions takes place

33. The first principle is well established. Mr Mantle submits that this principle is of no assistance to UDL in this appeal. He submits, by reference to [57] of *Airtours*, that

the reference to third-party consideration does not necessarily require that the recipient of the service is legally responsible to the supplier for payment of the remuneration but it is enough that a third party is to provide the consideration. We agree. In our opinion, *Tolsma* does not mean that the recipient of the service can only be the person required, under a legal relationship, to pay the consideration to the supplier. It does not mean that a supply is not effected for consideration where the consideration, ie the remuneration received by the supplier, is not given by the recipient of the supply but by a third party (see *Airtours* at [56] and [57]). Further, we consider that *Tolsma* states what is necessary in order for there to be a supply for VAT purposes but does not assist, at least in a case such as this one, in determining to whom the supply is made.

34. The second of Mr Conlon's principles, derived from [22] and [31] of *Airtours*, is that the issue of whether a person seeking to deduct VAT is the recipient of a supply (or even whether there is a supply at all) is normally determined by analysing the obligations under the contract. If there is no obligation, there can be no supply. The construction of the contract, as is well established, is a matter of law. Mr Mantle accepts that the second principle is broadly correct although he considers that it is too crude a summary. He points out that, in this appeal, unlike in *Secret Hotels2 Ltd* and *Airtours*, there is no written contract between UDL and a Repairer. In our view, when read as a whole, Lord Neuberger in *Airtours* was not saying that it is sufficient simply to establish that a party is under a contractual obligation to another person in return for consideration in order for that other person to be seen as the recipient of a supply. Although establishing that there is a contractual obligation will often indicate that there is a supply, we consider that it is necessary to consider the issue of economic reality (which we discuss below) in all cases as it is a fundamental criterion for the application of VAT (see [48] and [49] of *Airtours* and the cases cited therein).

35. The third principle is taken from Lord Neuberger's conclusion at [50] of *Airtours* that a person who pays the supplier but is not entitled under the contractual documentation to receive any services from the supplier has no right to deduct any VAT charged by the supplier unless the documentation does not reflect the economic reality of the transaction. Mr Mantle submitted that this principle has no relevance or application to UDL's appeal because UDL's case is that it was entitled under the contract with the Repairer to receive services. In our view, Lord Neuberger's reasoning in [50] of *Airtours* is not to be confined to cases where there is no supply on analysis of the contractual obligations but applies with equal force where the contract supports the existence of a supply but that does not reflect the economic reality. That was the analysis of the CJEU in *LMUK*, albeit on an incomplete evaluation of the facts. It follows that where a person who pays a supplier is contractually entitled to require the supplier to provide goods or services then the payer has the right to treat any VAT charged by the supplier as his input tax and deduct it in accordance with the normal rules unless the contract does not reflect the economic reality.

36. Mr Conlon submitted, by reference to *Redrow* and *Aimia*, that the test of economic reality is not based, as the FTT stated in [92], on whether final consumption is taxed but on whether the contractual terms constitute a purely artificial arrangement. UDL's case was that the FTT conflated economic reality with final consumption and that was an error of law. Mr Conlon submitted that the CJEU's decision in *Newey* showed that economic reality was only lacking where there was some artificiality. He argued that the FTT were wrong to say that the provisions of the contract were trumped by economic reality in this case and contended that the FTT should have said that there

was no scope for applying economic reality in the absence of artificiality. We do not accept that submission. As the CJEU observed in *Newey* at paragraphs 43 – 45, the contractual position normally reflects the economic and commercial reality of the transactions but will not do so where, in particular, those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions. It was common ground in this case that the contracts between UDL and the Repairers were not artificial but we do not consider that to be the end of the inquiry. As the use of the words "in particular" by the CJEU in *Newey* show, artificiality is not the only test of economic reality.

37. The fourth principle, namely that regard must be had to all the circumstances in which the transaction or combination of transactions takes place, is not controversial. Where there are multiple contracts and participants, it is necessary to look at the transactions as a whole in order to determine their economic reality. HMRC's position is that the FTT did have regard to all the circumstances in this case.

38. In conclusion, we consider that it is clear from *Airtours* and the cases referred to in that case that determining who is receiving a supply is a two-stage process. The starting point is to consider the contractual position and then consider whether, taking account of all the circumstances, the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from that person or a third party then there is, subject to the question of economic reality, a supply to that person for VAT purposes. It is clear from Lord Neuberger's comments in [50] of *Airtours* that where a person who provides the consideration is not entitled under the contractual documentation to receive any services from the supplier then, unless the documentation does not reflect the economic reality, there is no supply to the payer. We consider that, similarly, where a contract shows that one party is obliged to provide services to another person but, on consideration of all the circumstances, it is found that the contractual analysis does not reflect the economic reality of the transactions then there will not be a supply to the other person.

Application of principles to UDL

39. The starting point is to consider the contractual position. Any such analysis must necessarily be limited by the fact that no written contractual terms between UDL and the Repairers were produced in evidence before the FTT or us. It may be that the terms were never reduced to writing. The FTT found that there was a contract between UDL and each Repairer under which the Repairer agreed to repair the Car Owner's vehicle and, in return, UDL agreed to pay the Repairer for the repair. Mr Conlon said and we accept that the facts, as found by the FTT, showed that UDL negotiated prices with the Repairers and controlled their work. By contrast, the FTT found that the Car Owner had no contract (and often no contact) with the Repairer. It was also agreed that there was no contract between UDL and the Car Owner. On the basis of the FTT's findings, we consider that, viewed in isolation, the contracts between UDL and the Repairers show that there was a legal relationship between the Repairers and UDL pursuant to which there was reciprocal performance and thus that the Repairers supplied services to UDL.

40. It was common ground that the contracts between UDL and the Repairers were not artificial but that, as we have already explained, does not mean that the economic

reality of the transactions should not be considered. What then was the economic and commercial reality of the transactions in this case?

41. Mr Conlon submitted that the FTT's findings as to the contract between UDL and the Repairers showed that there was a supply by the Repairers to UDL and that was consistent with the economic reality of the transactions. The FTT did not make any findings of facts that vitiated the contractual analysis which should therefore apply. Mr Conlon also criticised the FTT for equating UDL's situation with that of WHA. He submitted that WHA was merely an intermediary responsible for paying the bills on behalf of the insurer. The bills were, in reality, cost components of the business of the insurer in *WHA* but that is not the situation in this case. UDL accepted that the Car Owner received a benefit from the vehicle being repaired but Mr Conlon submitted that the same could be said of the prospective purchasers in *Redrow*. He contended that the supply for which UDL contracted with the Repairers was a *Redrow* type supply and that UDL obtained a benefit from it. Further, as UDL was a party to the contract with the Repairers, the payment by UDL could not be considered to be third party consideration.

42. Mr Mantle submitted that the economic reality of the transactions could be ascertained from the fact that the Car Owners owned the vehicles and benefited from the repairs. The arrangements for the repair of the vehicles arose because UDL's customer (the hirer) was liable to compensate the Car Owner for the damage that necessitated the repair. The customer was entitled to be indemnified by Parallel under UDL's fleet insurance policy. In turn, UDL would pay Parallel the amount of the indemnity as part of the premium for the policy. Mr Mantle submitted that, as in *WHA*, there was no obligation or undertaking by Parallel or UDL to repair the Car Owner's vehicle. Mr Mantle said that the FTT had been right to compare UDL's situation with that of WHA and to take account of the position of Parallel.

43. In approaching the question of determining whether UDL was the recipient of supplies by the Repairers we bear in mind what Lord Reed said, at paragraph 67 of *LMUK*:

> "… 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 a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply."

44. On the facts as found by the FTT, we conclude that UDL agreed to pay for the repair of the Car Owner's vehicle in order to discharge Parallel's liability to indemnify the hirer who was liable to compensate the Car Owner for damage to the vehicle. UDL did not have any liability to pay for the repair until after the damage had already occurred and the Car Owner had agreed to use the bump card procedure rather than make an insurance claim. This distinguishes UDL's situation from the hypothetical MBI insurer referred to by Lord Reed in [3] of *WHA* which we discuss in [20] above.

UDL agreed with the Car Owner that UDL would pay for the repairs to the Car Owner's vehicle and courtesy car because UDL calculated that, by doing so, it would ultimately pay less (even disregarding the VAT) than if the Car Owner made a claim through his or her insurer. In the event of such a claim, the Car Owner (or the insurer) would arrange to have the vehicle repaired and Parallel (and thus indirectly UDL) would bear the cost of that repair. In such circumstances, there would be no question of Parallel or UDL being entitled to deduct the VAT included in the cost of the repair. Taking account of all the circumstances, it appears to us that, in economic reality, UDL simply agreed to pay for the repair of the Car Owner's vehicle. UDL had no interest in the repairs other than as a means by which to meet (at reduced cost) a liability that would otherwise be incurred through Parallel. The fact that UDL contracted to pay the Repairers direct did not, in all the circumstances, make UDL the recipient of any supply by the Repairers.

45. We reach our conclusion on the facts and circumstances of this case. Our approach to it should not be taken as establishing any general rule in relation to other apparently similar cases. We are mindful of the comments (with which we respectfully agree) of Lord Reed in *Aimia* at [68]:

> "It is … important to bear in mind that decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another. I would therefore hesitate to treat the judgments in *Redrow* as laying down a universal rule which will necessarily determine the identity of the recipient of the supply in all cases. Given the diversity of commercial operations, it may not be possible to give exhaustive guidance on how to approach the problem correctly in all cases."

Disposition

46. For the reasons given above, UDL's appeal against the Decision is dismissed.

Costs

47. Any application for costs in relation to this appeal must be made in writing within one month after the date of release of this decision. As any order in respect of costs will, if not agreed, be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

The Hon Mrs Justice Proudman DBE

Judge Greg Sinfield

Release date: 17 March 2017