[2019] UKUT 221 (TCC)

Appeal number: UT/2017/0181

VAT– supplier receiving payment – subsequently coming subject to an unconditional obligation to repay – actual repayment not made – whether reduction in consideration for taxable supply – no – appeal dismissed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

INVENTIVE TAX STRATEGIES LIMITED (IN LIQUIDATION) (1) **PROFESSIONAL ADVICE BUREAU LIMITED (IN LIQUIDATION) (2)** **STERLING TAX STRATEGIES LIMITED (IN LIQUIDATION) (3)** **BELL STRATEGIES LIMITED (IN LIQUIDATION) (4)**	**Appellants**

-and-

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

TRIBUNAL	**MR JUSTICE MANN** **JUDGE JONATHAN RICHARDS**

Sitting in public at The Rolls Building, Fetter Lane, London on 16 May 2019

Mark Fell, instructed by Moon Beever Solicitors for the Appellants

Hui Ling McCarthy QC instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. After a trader has received payment for goods and services provided, it may become contractually obliged to refund part of that payment. The short, but important, point raised by this appeal is whether the existence of the contractual obligation is itself sufficient to result in a reduction in the consideration subject to VAT (as the appellants argue) or whether, as HMRC argue, the trader also needs to make an actual refund to its customer.

2. The appellants are four companies: Inventive Tax Strategies Ltd ("ITS"), Professional Advice Bureau Limited ("PAB"), Sterling Tax Strategies Ltd ("STS") and Bell Strategies Limited ("Bell"). Between 2008 and 2013, the appellants all carried on tax consultancy businesses which involved them selling tax avoidance schemes to their customers, with a particular emphasis on stamp duty land tax ("SDLT") schemes. In providing advice in relation to such schemes, the appellants were making taxable supplies of services for VAT purposes and the appellants were registered for VAT at all material times.

3. The terms on which the appellants sold their SDLT avoidance schemes were set out in "Letters of Instruction" which provided that the appellants should receive a fee from their customers. The appellants charged VAT at the standard rate on fees that they received and accounted to HMRC for output tax in the normal way.

4. The appellants used various forms of Letters of Instruction in different terms. However, all Letters of Instruction contained an undertaking by the appellants to refund fees to their customers if the underlying SDLT scheme was, to use a highly general term that did not appear in all Letters of Instruction, "unsuccessful". Although the appellants may not have had contractual obligations to make refunds to <u>all</u> their customers, it is common ground that they were contractually obliged to make significant refunds.

5. Facing the prospect of having to make these significant refunds, STS and Bell went into liquidation and ITS and PAB entered administration. At the direction of their liquidators and administrators, all appellants issued credit notes to their customers as evidence of each customer's entitlement to a refund of the fee charged for the SDLT avoidance scheme services. However, no amount was actually paid to those customers at the time the credit notes were issued (or has been paid subsequent to the issue of those credit notes). The appellants considered that there had been a "decrease in consideration" for the purposes of regulation 38 of the VAT Regulations 1995 (SI/1995/2518) (the "VAT Regulations"), they made adjustments to the VAT payable portion of their VAT accounts and claimed repayments of the output tax accounted for on their supplies under s80 of the Value Added Tax Act 1994.

6. HMRC initially paid some of these claims but, having formed the view that repayments of VAT were not due subsequently issued assessments to recover the amounts paid and refused all outstanding claims. The appellants appealed to the First-

tier Tribunal (Tax Chamber) (the "FTT") against both the assessments and their claims for repayment of output tax, and their appeals were joined and heard together.

7. In a decision released on 5 September 2017 (the "Decision") the FTT dismissed the appeals. It concluded first that, to the extent that the appellants' customers had legal entitlements to refunds, that was not sufficient to reduce the taxable amount and give the appellants a right to obtain repayment of VAT from HMRC (the "price reduction issue"). Rather, the right to a repayment would arise only if and when the appellants paid the refund to their customers or their customers actually used credit that the appellants had given them. The core of the FTT's reasoning on that issue was set out at [36] of the Decision as follows:

> 36. In my view, paragraphs 33 to 36 of *Freemans* [i.e. *Freemans plc v Customs and Excise Commissioners* (Case C-86/99) [2001] STC 960 show that a legal entitlement to a refund is not sufficient to reduce the taxable amount and create a right to a repayment of VAT until the refund is paid to the customer or credit given is used by the customer. In paragraph 33, the ECJ states that what is now Article 90 "… requires the member states to reduce the taxable amount whenever, after a transaction has been concluded, part or all of the consideration has not been received by the taxable person". That paragraph shows that the focus in determining whether there has been a cancellation, refusal and total or partial non-payment or price reduction is what has been received by the supplier. That is consistent with the ECJ's approach to the meaning of consideration for the purposes of Article 73 in paragraph 27 of *Elida Gibbs*, namely that it is "the value actually received in each case". In this case, the Appellants have received the full amount of the fees and no amounts have been refunded to the customers. The need for there to be an actual repayment, as opposed to merely conferring an entitlement to one, is clearly seen in paragraph 35 of *Freemans* where the ECJ held that "[i]t is only when the customer uses the … [discount] that the discount is actually paid, so that … the taxable amount for the corresponding purchase must be reduced accordingly." It follows that actual payment of a refund is required, in which case there will be a reduction in the price only to the extent of the amount actually refunded. This is consistent with common sense and commercial reality. It cannot be right that the Appellants receive a repayment of 100% of the VAT where the customers receive a refund of less than 100% of the fees.

8. The FTT's conclusion referred to at [7] above was sufficient for it to dismiss the appeals. However, the FTT went on to conclude that, some of the Letters of Instruction to which the appellants were party did not actually give its customers a contractual right to a refund (the "contractual liability issue"). As part of its decision, the FTT set out relevant parameters that would determine when, if at all, contractual liability to a refund would arise under each of the four versions of the Letters of Instruction that the appellants typically used.

9. With the permission of the FTT, the appellants appeal against the FTT's decision on the price reduction issue. Neither party seeks to disturb the FTT's conclusion on the contractual liability issue. The commercial significance of the decision below is this. As will appear from references given later, it is far from clear that there will be any

distribution to any unsecured creditor even if the VAT refund claim is successful. If that turns out to be the case then the refunds will fund the expenses of the liquidations/administrations. If there are some returns for unsecured creditors, the customers entitled to a refund will only benefit to a small extent from the repayment of the VAT, because they will have to share it with the other unsecured creditors.

Applicable provisions of EU and domestic law

10. Article 73 of the PVD provides as follows:

> **Article 73**
>
> In respect of the supply of goods or services, other than as referred to in Articles 74 to 77 [which are not relevant to this appeal], the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.

11. Article 79 of the PVD is not of direct relevance in this appeal, but it is part of the VAT legislative context and both parties referred to it in submissions (and its predecessor in Article 11A(3)(b) of EC Council Directive 77/388 (the "Sixth VAT Directive) was considered in *Freemans*). Article 79 provides, so far as material as follows:

> **Article 79**
>
> The taxable amount shall not include the following factors:
>
> (a) price reductions by way of discount for early payment;
>
> (b) price discounts and rebates granted to the customer and obtained by him at the time of the supply;

12. Article 90 of the PVD provides as follows:

> **Article 90**
>
> 1. In the case of cancellation, refusal or total or partial nonpayment, 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.

13. Both parties proceeded on the basis that the provisions of the PVD had been accurately transposed into UK domestic law and we will not, therefore, set out the domestic provisions in full. However, since Mr Fell placed some reliance on it, we note that the UK has, as permitted by Article 90(1), set conditions for the reduction of taxable amount in regulation 38 of the Value Added Tax Regulations 1995 (the "VAT Regulations"). Regulation 38 applies where there is a "decrease in consideration for a supply", a term which is defined by regulation 24 of the VAT Regulations as follows:

> "increase in consideration" means an increase in the consideration due on a supply made by a taxable person which is evidenced by a credit or

> debit note or any other document having the same effect and "decrease in consideration" is to be interpreted accordingly;

14. Where a "decrease in consideration" has taken place, Regulation 38 requires adjustments to be made through the VAT account of the supplier and, where relevant, the recipient of the supply in the following terms:

> (3) Subject to paragraph (3A) below, the maker of the supply shall—
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> (a) in the case of an increase in consideration, make a positive entry; or
>
> (b) in the case of a decrease in consideration, make a negative entry,
>
> for the relevant amount of VAT in the VAT payable portion of his VAT account.
>
> …
>
> (4) The recipient of the supply, if he is a taxable person, shall—
>
> (a) in the case of an increase in consideration, make a positive entry; or
>
> (b) in the case of a decrease in consideration, make a negative entry,
>
> for the relevant amount of VAT in the VAT allowable portion of his VAT account.

The arguments of the parties

15. Mr Fell, who appeared for the appellants, and Ms McCarthy who appeared for HMRC both developed their arguments in detailed written and oral submissions. In this section we will summarise the essence of their arguments and will deal with more detailed aspects of them in the "Discussion" section below.

The appellants' case

16. The essence of the appellants' positive case is as follows:

> (1) They argue that, since the appellants became subject to a definitive contractual obligation to repay their customers, as a matter of ordinary English, the "price is reduced" for the purposes of Article 90 of the PVD. (They do not seek to argue that there has been a "cancellation, refusal or total or partial non-payment" for the purposes of Article 90).
>
> (2) The concept of a price being reduced in Article 90 needs to be read together, and construed consistently with, the definition of "taxable amount" in Article 73. The definition of taxable amount has two limbs: first consideration must either be "obtained or to be obtained"; second it must be "in return for the supply". In circumstances where consideration has been "obtained" there can still be a reduction in price for the purposes of Article 90 if the operation of the contract means that sums received by the taxpayers

no longer have the status of consideration for the taxable supply. That was the position in this appeal because the terms of the contracts made it clear that if the SDLT planning was unsuccessful the parties regarded the value of supplies that the appellants made as essentially worthless. The parties' estimation of the value of the supplies, as set out in their contract should be respected applying the "principle of subjective value" that the European Court of Justice (which we will refer to as the "CJEU" together with its successor, the Court of Justice of the European Union) formulated in *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners* (Case 230/87) [1988] STC 879 and subsequent decisions.

17. The appellants argue that the FTT fell into error in the following respects:

(1) The decision of the CJEU in *Freemans* did not, contrary to the FTT's conclusion at [36] of the Decision, "show" that a legal entitlement to a refund was not enough. A close examination of the facts and reasoning in *Freemans* shows that it was not dealing with a situation where a legal entitlement to a refund preceded actual payment of that refund and so *Freemans* does not stand for the broad proposition the FTT identified.

(2) The FTT was wrong to conclude that the CJEU's decision in *Elida Gibbs v Customs and Excise Commissioners* (Case C-317/94) [1996] STC 1387 supported the conclusion that a contractual entitlement was insufficient to result in a reduction to the taxable amount under Article 90. Properly understood, *Elida Gibbs* involved an application of the "subjective value principle" which was supportive of the appellants' case for the reasons outlined at [16(2)].

(3) The FTT was wrong to conclude that considerations of economic reality supported HMRC's case. It was also wrong to rely on considerations of "common sense" and its analysis in this regard was circular.

HMRC's case

18. HMRC argue that the Decision was correct for the reasons that the FTT gave. In her submissions, Ms McCarthy invited us to accept an overarching theory as to how Article 73 and Article 90 apply which can be summarised as follows:

(1) Article 73 and Article 90 have to be read together and construed consistently with each other.

(2) Article 73 has two aspects: the first dealing with a situation where a supplier "obtains" consideration and the second dealing with a situation where consideration is to be obtained in the future. When the appellants' customers paid them for the provision of tax planning advice, they placed cash freely at the appellants' disposal (as demonstrated by the fact that the appellants spent that cash). That resulted in the appellants "obtaining" consideration from their customers.

(3) Article 90 sets out an inverse position to that set out in Article 73. In order for there to be a price reduction that undoes the effect of an

> "obtaining" of consideration, there would need to be an actual transfer of that consideration back (resulting in the consideration being freely at the customers' disposal). It is for that reason that a mere contractual obligation to return consideration is insufficient and the FTT was correct to conclude that the CJEU had determined this issue in *Freemans*.

Authorities

19. Since both parties referred extensively to authority in support of their respective arguments we will order our discussion first by considering the principles that can be derived from the authorities on which the parties relied.

Economic reality

20. Principle and case law require and demonstrate that the common system of VAT must be applied with a proper eye on the commercial reality. *In HMRC v Newey* [2013] STC 2432 the CJEU said that:

> … 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 (para 42).

21. Matters of commercial and economic reality are of particular importance in this appeal given that the central question at issue is the extent to which the appellants have obtained taxable consideration for their services and the extent to which the price of those services was subsequently reduced. Indeed, commercial and economic reality must have been firmly in the legislator's mind when the predecessor to Article 90 (which was not originally part of the VAT regime) was introduced. It was introduced to fill the gap which existed because the mechanism for adjusting taxable consideration was somewhat limited with the result that taxable persons ran the risk of being taxed on more consideration than they ultimately received. The effect of the predecessor to Article 90 was summarised in *Grattan plc v HMRC* [2013] STC 502 as being that it:

> … requires the member states to reduce the taxable amount whenever, after a transaction has been concluded, part or all of the consideration has not been received by the taxable person. (p520b).

Authorities dealing with Article 73, Article 90 and the relationship between them

22. Subject to the qualification set out at [24] below, we accept Ms McCarthy's submission that, as a general proposition, the definition of "taxable amount" in Article 73 is focusing on the "consideration actually received" for the supply (a concept that is further expanded by the "subjective value principle" discussed in the next section). In *International Bingo Technology SA v Tribunal Económico-Administrativo Regional de Cataluña* (Case C-377/11) [2013] STC 661 the CJEU said:

> 25. Next, it must be borne in mind that it is settled case law that that provision [i.e. Article 11A(1)(a) of the Sixth VAT Directive, now Article 73 of the PVD] must be interpreted as meaning that the taxable

> amount for a supply of services is represented by the consideration actually received for that supply (see, inter alia, *Boots Co plc v Customs and Excise Comrs* (Case C-126/88) [1990] STC 387, [1990] ECR I-1235, para 19, and *Town and County Factors*, para 27).

23. Moreover, the CJEU's decision in *International Bingo Technology* demonstrates that where a supplier receives payment in cash, that can only be treated as having been "actually received" for these purposes where it is freely at the supplier's disposal (see [29] of the judgment). Mr Fell invited us to conclude that the statements in *International Bingo Technology* to this effect should be treated with caution since cases on the treatment of gambling transactions are widely recognised to be specialist in nature. That may well be correct. However, in *Finanzamt Bingen Alzey v Boehringer Ingelheim Pharma GmbH & Co KG* (Case C-462/16) ("*Boehringer*"), the CJEU applied the approach in *International Bingo* outside the context of gambling transactions.

24. Nevertheless, the CJEU's statement in *International Bingo* needs to be understood in context. In that case, the CJEU was addressing a situation where the sum that the taxpayer received could clearly be separated into a part which the taxpayer was entitled to retain and a part which it was not. Therefore, the CJEU's decision in *International Bingo* does not shed any direct light on the question whether a contractual obligation to make a refund engages Article 90.

25. In *Boehringer* the CJEU concluded that Article 73 and Article 90 of the PVD should be construed consistently with each other saying, at [45]:

> As the Advocate General observed in point 42 of his opinion, even though in [*International Bingo*] the Court's analysis concerned the interpretation of Article 73 of the VAT Directive, the interpretation that the judgment provided of the notion of 'consideration' laid down in that provision may apply in respect of the words 'where the price is reduced' used in Article 90 of the directive, given that both that provision and Article 73 of the directive address the components of the taxable amount.

Authorities relating to the "subjective value principle"

26. Both parties considered that the "subjective value principle", outlined in the judgment of the CJEU in *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners* (Case 230/87) [1988] STC 879, and subsequently developed, supported their cases.

27. In *Naturally Yours*, the taxpayer (referred to in the judgment as "NYC") carried on a business as a wholesaler of cosmetic products. It sold its cosmetics at wholesale prices to individuals ("beauty consultants") whose turnover was sufficiently small not to be required to register for VAT. In order to obtain access to potential customers, beauty consultants would approach friends and acquaintances ("hostesses") and ask them to arrange private parties at which the beauty consultants could sell the cosmetics at retail prices and thereby make a profit. Beauty consultants would offer a hostess an inducement (described as a "dating gift") consisting of a pot of cosmetic cream to arrange these parties. Ordinarily, a beauty consultant would have to pay NYC a

wholesale price of £10.14 for a pot of such cream. However, if the cream was to be used as a dating gift, NYC would sell it to the beauty consultant for just £1.50 per pot. The question that arose was whether the consideration that NYC received in such cases was the £1.50 actually paid or some higher value.

28. At [16] of its judgment, the CJEU concluded that the consideration that NYC received for VAT purposes must be determined by reference to a "subjective value" (namely the "consideration actually received and not a value estimated according to objective criteria"). Applying that principle, the CJEU decided that NYC received two forms of consideration when it sold the cream to the beauty consultant: £1.50 in cash and also the beauty consultant's agreement to use the cream as a dating gift to induce a hostess to arrange a party. The monetary value of the second form of consideration could be deduced from the contract to be £8.64, the reduction to the normal wholesale price of the cream. In aggregate, NYC received consideration for VAT purposes of £10.14.

29. In *Lex Services plc v Customs and Excise Commissioners* [2003] UKHL 67, Lord Walker cautioned against a misunderstanding of the principle of subjective value in the following terms:

> The expression "subjective value", to be understood in the sense described above, has been repeated in many later cases before the ECJ, including *Argos Distributors Limited v Customs & Excise Commissioners* [1996] ECR I-5311, para 16, and the other cases cited in that paragraph. Nevertheless the expression continues to cause some difficulty, partly because it naturally suggests a value which is chosen as a matter of individual discretion, and might therefore be expected to be more vague, labile and difficult to ascertain than one determined by objective criteria. But any such impression would be mistaken and would overlook one of the basic strengths of the VAT system. It is a system which is intended to be self-policing in the sense of operating automatically on the economic activities of registered taxpayers and final consumers, with the least possible need for VAT authorities to undertake independent investigation of the facts. In a straightforward case the "subjective value" of non-monetary consideration means the value overtly agreed and adopted by the parties to the transaction in question, just as the price overtly agreed and adopted by the parties is (in most cases) conclusive as to the quantum of monetary consideration. So far from introducing an element of vagueness or obscurity, the concept of subjective value (correctly understood) achieves legal certainty and ease of administration of the VAT system …

30. The subjective value principle was also applied in *Elida Gibbs Ltd v Customs and Excise Commissioners* (Case C-317/94) [1996] STC 1387. In very broad summary, the taxpayer manufactured toiletries which it sold to retailers. To promote retail sales, the company operated a "money-off" coupon scheme and arranged for potential consumers to receive coupons which either entitled them to a discount on the company's products ("discount coupons") or cash back following a purchase of the company's products ("cash back coupons").

31. When purchasing the company's products from a retailer, a consumer could tender a discount coupon, entitling the consumer to, say, a 15p reduction in the price of the goods. If the retailer accepted the coupon, it would receive a reduced sales price from the consumer. The company, however, agreed to reimburse the retailer for the 15p reduction.

32. "Cash back coupons" would be printed on the packaging of a product. After purchasing that product from the retailer, the consumer could cut the coupon off the packaging and send it to the company who would send a cash refund direct to the consumer.

33. The CJEU concluded that the taxable amount when the wholesaler sold products to retailers was equal to the selling price less the amount indicated on the coupons and refunded (whether to the retailer in the case of a discount coupon or the consumer in the case of a cash back coupon). Both parties referred to the following passage from the CJEU's judgment:

> 26. By virtue of art 11A(1)(a) [now Article 73] of the Sixth Directive, the taxable amount for supplies of goods and services within the territory of a state comprises all sums which make up the consideration which has been or is to be obtained by the supplier from the purchaser.
>
> 27. According to the court's settled case law, that consideration is the 'subjective value', that is to say, the value actually received in each specific case, and not a value estimated according to objective criteria [and the CJEU referred to, among other cases, *Naturally Yours*]
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> 28. In circumstances such as those in the main proceedings, the manufacturer, who has refunded the value of the money-off coupon to the retailer or the value of the cash-back coupon to the final consumer, receives, on completion of the transaction a sum corresponding to the sale price paid by the wholesalers or retailers for his goods, less the value of those coupons. It would not therefore be in conformity with the directive for the taxable amount used to calculate the VAT chargeable to the manufacturer as a taxable person, to exceed the sum finally received by him. Were that the case, the principle of neutrality of VAT vis-à-vis taxable persons, of whom the manufacturer is one, would not be complied with.
>
> 29. Consequently, the taxable amount attributable to the manufacturer as a taxable person must be the amount corresponding to the price at which he sold the goods to the wholesalers or retailers, less the value of those coupons.
>
> 30. That interpretation is borne out by art 11C(1) of the Sixth Directive which [now Article 90 of the PVD], in order to ensure the neutrality of the taxable person's position, provides that, 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 is to be reduced accordingly under conditions to be determined by the member states.
>
> 31. It is true that that provision refers to the normal case of contractual relations entered into directly between two contracting parties, which are

> modified subsequently. The fact remains, however, that the provision is an expression of the principle, emphasised above, that the position of taxable persons must be neutral. It follows therefore from that provision that, in order to ensure observance of the principle of neutrality, account should be taken, when calculating the taxable amount for VAT, of situations where a taxable person who, having no contractual relationship with the final consumer but being the first link in a chain of transactions which ends with the final consumer, grants the consumer a reduction through retailers or by direct repayment of the value of the coupons. Otherwise, the tax authorities would receive by way of VAT a sum greater than that actually paid by the final consumer, at the expense of the taxable person.

34. The FTT clearly considered that the reference to the "value actually received" in paragraph [27] of the judgment supported its conclusion that the mere fact that the appellants had a contractual obligation to repay sums received was insufficient to engage Article 90 of the PVD. However, we draw no such inference because, in *Elida Gibbs*, the CJEU was not considering any distinction between mere contractual obligations on one hand and actual payments on the other.

35. The appellants argue that the reference to "contractual relations" in the context of a discussion of Article 90 in paragraph [31] of the judgment supported their arguments that their contractual obligation to refund fees did engage Article 90. However, paragraph [31] does not bear the weight the appellants seek to place on it. First, as we have already noted, *Elida Gibbs* is not concerned with a distinction between contractual rights and actual payments. Moreover, in paragraphs [30] and [31] the CJEU is not expressing a concluded view on the scope of Article 90; it is "sense-checking" the conclusion it has reached by noting that the scheme of the directive as a whole is to adjust taxable amounts by reference to events taking place after the time of supply in order to ensure that a taxable person's position is neutral even though Article 90 itself typically applies only to adjustments in consideration made between two parties who are in a contractual relationship.

36. Overall, therefore, we view *Elida Gibbs* as a decision that restates the importance of considering, when applying Article 73, the "value actually received" by a supplier. However, it sheds little light on the distinction, if any, between contractual obligations and actual payments for the purposes of Article 90.

Freemans

37. The CJEU's decision in *Freemans* can only be understood by reference to the facts of that case and the arguments that the various interested parties deployed in it.

38. Freemans carried on a mail-order business. It sent catalogues to individuals (referred to as "agents") who made purchases both for themselves (referred to as "agents own purchases" or "AOP") and as agents for others. The agents paid for their purchases in instalments. Freemans created a separate credit account for each agent. Each time an agent made a purchase for herself, an AOP discount equal to 10% of the

purchase price was credited to that account. Each time an agent made a purchase on behalf of another, a 10% commission was credited to that account.

39. At [10] and [11] of its Decision, the CJEU summarised aspects of the credit account as follows:

> 10. The agent may withdraw the amount credited to her account at any time by cheque, by post office giro or by national lottery vouchers; she may also set off that amount against outstanding balances owed by herself or a customer, or use it against new purchases, which will entitle her to a further 10% discount. However, agents are not entitled to pay, from the outset, the catalogue price less the AOP discount.
>
> 11. If an agent does not pay an instalment due, the total balance owing on her account becomes immediately due and payable. In such a case, in principle, the AOP discount or commission cannot be paid out until the account is put in order.
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> 12. Where the amount credited to the agent's account is not claimed over a certain period, it is written off in Freemans' books. However, in practice, even where agents delay in claiming their right to AOP discount and where that right is technically time-barred, they do not lose their entitlement to that right. In fact, a substantial amount of AOP discount remains unclaimed and is retained by Freemans.

40. It is not clear whether, in paragraph [12] of its judgment, the CJEU was stating that only the AOP discount could be lost if not positively claimed, or whether the 10% commission could similarly be lost. However, it is evident that the amount standing to the credit of an agent's account did not quite represent an unconditional right to payment in the same sense as would an amount standing to the credit of a current account with a bank.

41. At [18] of its judgment, the CJEU referred to the questions that had been referred to it. It is evident from those questions that the CJEU was being asked to comment on the application of both Article 11A of the Sixth VAT Directive (which included both what is now Article 73 and Article 79 of the PVD) and Article 11C of the Sixth Directive (which now appears as Article 90 of the PVD) to determine what the "taxable amount" was when an agent ordered goods from Freemans. The following possible taxable amounts were identified in the reference: (i) the full catalogue price less the AOP discount; (ii) the full catalogue price with a reduction as and when the AOP discount is credited to the agent's account; (iii) the full catalogue price with a reduction as and when the AOP discount is withdrawn or otherwise used or (iv) some other amount. (Again, for reasons that are not entirely clear, the reference to the CJEU referred only to the AOP discount and not the 10% commission).

42. In approaching the questions referred, the CJEU started by considering whether there was a price reduction falling within Article 11A(3)(b) of the Sixth VAT Directive (now Article 79 of the PVD) because its decision in *Boots Co Plc v Customs and Excise Commissioners* (Case C-126/88) decided that the specific provision in Article 11A(3)(b) fell to be considered before the more general provision set out in what is now Article 90 of the PVD. The Commission submitted (see [20] of the judgment) that

the 10% AOP discount did fall within what is now Article 79 because it was a "price discount and rebate allowed to the customer and accounted for at the time of the supply".

43. On that first issue, the CJEU concluded that there was no discount or rebate falling within what is now Article 79 for the following reasons:

> 23. If, at the time of that transfer, the customers paid a reduced price, they would receive a discount; if the seller refunded to them part of the price already paid, the customers would receive a rebate within the meaning of art 11A(3)(b) of the Sixth Directive [now Article 79 of the PVD] (see, to that effect, the judgment in *Boots Co* [1990] STC 387 at 408, [1990] ECR I-1235 at 1266, para 18).
>
> 24. However, that is not the case here. At the time of that transfer, agents must pay the full catalogue price in instalments, and Freemans is required to credit a separate account with a sum equal to 10% in respect of each payment which agents make. The sums which will thus have to be credited as and when those payments are made do not yet constitute discounts within the meaning of art 11A(3)(b) of the Sixth Directive.
>
> 25. Contrary to the Commission's submissions, for art 11A(3)(b) to be applicable, it is not sufficient that the customer acquires at the time of the purchase, as in the main proceedings, a discount which she has a legal entitlement to receive.

44. Therefore, the CJEU concluded that what is now Article 79 did not apply to reduce the taxable consideration by the amount of AOP. The CJEU then went on to consider whether what is now Article 90 operated to reduce the taxable amount either on the basis that there was a reduction in price when sums were credited to an agent's account or at the later point when an agent actually used those sums.

45. At [32] of the judgment, the CJEU considered an argument that what is now Article 90 did not apply at all (on the basis that it was concerned with amendments to a contract <u>after</u> the time of supply but the agent had a contractual entitlement to be credited with an AOP discount "from the very beginning"). At [33], the CJEU rejected that argument saying:

> 33. In that regard, it suffices to state that the wording of art 11C(1) of the Sixth Directive [now Article 90 of the PVD] does not presuppose such a subsequent modification of the contractual relations in order for it to be applicable. In principle, it requires the member states to reduce the taxable amount whenever, after a transaction has been concluded, part or all of the consideration has not been received by the taxable person (see *Goldsmiths (Jewellers) Ltd v Customs and Excise Comrs* (Case C-330/95) [1997] STC 1073 at 1086–1087, [1997] ECR I-3801 at 3822–3823, paras 16, 17 and 18). Moreover, there is no indication that in its judgment in *Elida Gibbs* the court wished to restrict the scope of application of that provision. On the contrary, it is apparent from the facts of the *Elida Gibbs* case that there had been no modification of the contractual relations. Nevertheless, the court held that art 11C(1) of the Sixth Directive was applicable.

46. At [34], the CJEU considered an alternative argument that Article 90 applied at the point at which the AOP discount was credited to the agent's account. It rejected that argument at [35] saying:

> 35. However, at the time when it credits the amount in question to the agent's account established in its books, Freemans has not yet actually paid the AOP discount to the agent. Where the agent does not use that amount, Freemans disposes of it by adding it to its profit and loss account. It is only when the customer uses the AOP discount that the discount is actually paid, so that, as art 11C(1) of the Sixth Directive provides, the taxable amount for the corresponding purchase must be reduced accordingly under conditions to be determined by the member states.

47. That left the possibility that Article 90 applied at the point at which the agent withdrew or used the amount credited to her account. The CJEU adopted that interpretation at [31] of its judgment.

48. Ms McCarthy invited us to conclude that paragraphs [24] and [25] of the CJEU's judgment were significant as they set out an express rejection of the proposition that a "legal entitlement to receive" the discount was on its own sufficient to fall within Article 90. However, the impact of that point is somewhat diminished by the fact that, at [24] and [25] of its judgment, the CJEU was dealing with what is now Article 79 of the PVD (which is not argued to apply in the context of this appeal) and not Article 90. Moreover, the CJEU's reasoning at [24] clearly attaches significance to the fact that an agent making a purchase could not use her AOP discount "there and then" by reducing the cost of that very purchase and this was entirely understandable since Article 79 requires a price discount to be allowed <u>at the time of the supply</u>.

49. Similarly, Ms McCarthy submitted that it was significant that, at [33] of the judgment, the CJEU observed that Article 90 is dealing with situations where "part or all of the consideration has not been <u>received</u>" (emphasis added). However, in [33], the CJEU was not considering any distinction between a contractual right and actual fruition of that contractual right. Rather, as we have observed, at [33], the CJEU was dealing with an argument, entirely different from any raised in this appeal, that reduction in price pursuant to a contractual right present in a contract "from the very beginning" could never fall within Article 90.

50. It is at [35] of its judgment that the CJEU comes closest to dealing expressly with the issue raised in this appeal. However, even in that paragraph, the CJEU does not determine that, where consideration has been obtained, a contractual obligation to repay all or part of that consideration is necessarily insufficient to meet the requirements of Article 90. The CJEU does not draw any distinction of principle between "contractual rights" on one hand and "actual payments" on the other. Rather, the CJEU concludes that because an agent could still lose the amounts credited to her account (for example if she did not claim them in time) there is no payment of the AOP discount to her at that point. There is no express analysis in paragraph [35] of <u>whether</u> an agent acquired any contractual right to a credit before the point at which she used that credit. That perhaps suggests that a contractual right in itself would not be enough to engage Article 90

since, if it were, the CJEU might be expected to refer to the precise time when the contractual right came into existence. However, while that offers tangential support for HMRC's arguments, we do not consider *Freemans* to be determinative of this point.

Other authorities

51. The parties referred in their oral arguments to other authorities which we can deal with briefly.

52. We did not consider that the decisions of the CJEU in *Goldsmiths (Jewellers) Ltd v Customs and Excise Commissioners* (Case C-330/95) [1997] STC 1073 or the decision of the Inner House of the Court of Session in *Revenue and Customs v KE Entertainments Ltd* [2019] CSIH 78 added much to the analysis set out above. Both those authorities contained references to consideration being "received" or "not received" which, read in isolation, might be seen as supporting HMRC's arguments in this appeal. However, neither of these authorities is concerned with the distinction between actual repayments and contractual rights to repayment that arises in this appeal and therefore neither authority sheds much light on that issue.

53. A similar point can be made about the decision of the CJEU in *T-2, družba za ustvarjanje, razvoj in trženje elektronskih komunikacij in opreme, d.o.o., in insolvency v Republika Slovenija* (Case C-396/16). That decision was concerned with input tax credit, rather than output VAT liability. The result of the decision was that an insolvent company's entitlement to input tax credit was restricted when an insolvency process had the effect of reducing the amount of its obligations to 44% of their face value. However, a close examination of the decision reveals that it was not concerned with a situation where the company had actually paid the full amount of consideration for a taxable supply. Rather, it dealt with the situation where, having not yet paid any consideration, the company found that its liability to pay consideration was reduced. The case, therefore, does not deal, even by analogy, with the situation of the appellants who have actually received fees, but are arguing that a contractual obligation to repay those fees is sufficient to engage Article 90.

54. Finally, in *Grattan plc v Revenue and Customs Commissioners* (Case C-310/11) [2013] STC 502, the CJEU analysed the effect of discounts given by a mail order company to sales agents that was not dissimilar to that considered in *Freemans*. However, Grattan involved an analysis of the position under the Second VAT Directive which contained no analogue of Article 90 of the PVD. We therefore consider that, beyond confirming the legislative background to Article 90, this decision provides little direct guidance as to how Article 90 should apply in the circumstances of this appeal.

55. Other authorities were referred to in the parties' written and oral submissions which we have decided we do not need to address in this decision.

Discussion

56. None of the authorities to which we were referred of themselves provide a clear answer to the present appeal, or a single line of reasoning which can be followed

through. Accordingly, we consider we have to approach this matter by extracting relevant principles from the legislation and the cases in order to arrive at an answer. It seems to us the route to the correct decision is as follows.

57. The starting point is, obviously, Article 90 itself. It is accepted that it is that Article that governs the question which arises in this case although, as *Boehringer* makes clear, Article 90 needs to be read together with Article 73. It is also accepted, correctly in our view, that Article 90 could only apply in the circumstances of these appeals if the obligations of the appellants to make refunds, having received payment from their customers results in a situation where "the price is reduced" for the purposes of Article 90. If there is such a reduction, it reduces the taxable amount, which is measured by reference to the consideration – see Article 73. It is necessary to keep an eye on those concepts.

58. We have already observed at [21] that considerations of economic and commercial reality are of particular importance in a case such as this. Therefore, we consider that the task is, as the CJEU put it in *Grattan*, to identify whether, because of a reduction in price, part or all of the consideration has not been received by the taxpayers. That formulation requires a little adjustment when considering a post-contract and post-payment agreement to reduce the price, but it indicates that what one is looking for are the relevant circumstances which result in a recipient receiving, and a payer paying, a lower amount with an eye to the commercial realities.

59. The observation of the commercial realities can be seen, on analysis, to be achieved in the reported cases to which we were referred, though not all those decisions expressly reason in that way. Thus in *Freemans*, they are reflected in the CJEU's decision that, because the agent had to perform some further act in order to claim the 10% AOP discount, and because that act might never be performed (leading to Freemans being able to keep the 10%) the total price fell to be treated as consideration and VAT charged (and accounted for) accordingly. That was the factual, legal and commercial reality at the point Freemans received payment although the CJEU recognised that, if an agent actually used the AOP discount the commercial reality would change and the taxable consideration should be reduced at that point. In *International Bingo* VAT was chargeable only in relation to that part of the stake money which, in reality, was the taxpayer's. The fact that the rest of the stake was not truly its money to be dealt with as it thought fit meant that that part did not fall to be treated as consideration. This reinforces the emphasis on commercial realities. One could also form the same view of the end result in *Elida Gibbs*. In that case the Court held that the amount for which the taxpayer should account should not reflect receipt of more than the taxpayer actually received, though the principle expressly invoked was neutrality, not the principles we are considering. In the *T-2* case, when considering whether a Slovenian insolvency process resulted in "total or partial non-payment" for the purposes of Article 90, the CJEU had express regard to a consideration of economic and commercial reality (see [43] and [44] of the judgment).

60. We consider that this gives a strong steer in the present case. Speaking generally, it could be said that there is a price reduction in the sense that the appellants' customers have a contractual entitlement to repayment. But what are the commercial realities?

The commercial realities, in this case, are that the appellants have made no actual refunds (see [36] of the Decision). Moreover, there will in fact be no repayment of the price, or at least it cannot be demonstrated that there will be. Judge Sinfield accepted the evidence given by one of the liquidators to the effect that there was no way of knowing what would be paid to unsecured creditors, but he was hopeful that recoveries other than the VAT recovery would allow a dividend to be paid (see [17]). That is a vague indication (understandably so, in the circumstances) but it certainly does not indicate any probability that the customers would receive any refund at all. From the point of view of the customer there would, in practice, be no reduction in the price, and while the viewpoint of that customer does not, per se, govern the question, it is a relevant consideration if one is considering the commercial realities underpinning the VAT system.

61. The commercial reality, therefore, is that there neither has been, nor will be, any refund of the price, or at least that it cannot presently be demonstrated that there will any such refund. We consider that that means that there is no reduction in price for the purposes of Article 90. The purported reduction is just a paper one in the circumstances with no commercial substance. That means that no adjustment falls to be made under Article 90.

62. HMRC's case is that, where as in this case, there has been an actual payment of consideration (by the appellants' customers when they received advice on the SDLT avoidance schemes), there can only be a price reduction for the purposes of Article 90 if and when there is an actual repayment of the price. In order to determine this appeal, we do not need to determine whether this broad proposition is correct. Without deciding the point, we can see that it may be possible in a particular case that it will be sufficiently clear that there will be an actual repayment (or some genuine commercial equivalent) to justify the conclusion that there is a real reduction of the price prior to that repayment actually being made, so as to justify (and require) adjustments under Article 90. However, this is not such a case. As we have observed, there has not been an actual repayment and it is not at all clear that there will be any repayment at all. In those circumstances, it is not possible to say that the "price has been reduced" in any commercially or economically real sense and, accordingly, in the facts of this appeal, Article 90 is not engaged. We have considered whether this approach introduces unacceptable uncertainty into the question of whether Article 90 applies or not. We do not consider that it does. The present case presents clear facts with no uncertainty. There may be less clear cases but in any rules-based system there will always be less clear cases, and that is not a reason for concluding that the rules are wrong.

63. In arguing for a contrary conclusion, Mr Fell submitted that the making of outright payments back from the appellants to their customers was just one possible way of reversing the effect of Article 73. Article 90 would also reverse the effect of Article 73 if, having due regard to the subjective value principle, the sums that the appellants received ceased to be "in return for the supply" as required by Article 73. He submitted that this was the case here. By entering into the contracts that they did, the parties demonstrated that they regarded the appellants' supplies of tax advice to be worthless unless the underlying SDLT planning was successful. Therefore, once that planning proved to be unsuccessful, sums that the appellants had received from their customers

lost their character as being paid "in return for" a supply of tax advice so that the requirements of Article 73 were undone.

64. However, for the reasons set out below, we consider that analysis is contrary both to the contracts and to economic and commercial reality.

65. The FTT's findings at [9] and [10] of the Decision were:

> (1) The appellants provided "SDLT tax avoidance services" in return for a specified fee set out in the Letter of Instruction.
>
> (2) The fee was a percentage of the SDLT saving that was intended, or sometimes a percentage of the purchase price of the property.
>
> (3) The Letter of Instruction included an undertaking that the fee charged for the SDLT avoidance scheme would be refunded if that scheme was unsuccessful.

66. There is no suggestion from those findings that customers had a contractual obligation to pay only if the SDLT planning was successful. Indeed, if there was no obligation to pay if the scheme was unsuccessful, there would be no point including an undertaking to refund the fee in such a case. Therefore, commercial and economic reality demonstrates that customers thought they were obtaining a valuable supply, of tax advice, for which they were willing to pay. Recognising the risk that the advice might not achieve the desired result (a reduction in SDLT), they required the fee to be repaid in those circumstances. As events turned out, the SDLT saving did not materialise and the appellants became obliged to return the fee. However, that does not alter the fact that (i) the appellants had still provided tax advice and (ii) they had received payment for that tax advice. In short, under the Letters of Instruction, the appellants provided, and received payment for, the provision of tax <u>advice</u> even though that tax advice never produced the desired tax <u>result</u>.

67. The "subjective value principle" does not alter this conclusion. As Lord Walker's cautionary words in *Lex Services plc* referred to at [29] above demonstrate, the task is not to identify a customer's subjective views on how much he or she thought the appellants' tax advice was worth if no SDLT saving materialised. Rather, the task is to identify the consideration that the appellants "actually received". In return for providing tax advice, the appellants actually received cash which was unconditionally at their disposal. They never reversed the effect of that unconditional payment in any commercially or economically real way (for example by paying sums back to their customers). The "subjective value principle" does not, therefore, alter the conclusion that the consideration they "actually received" was the cash sums their customers paid which were never refunded in an economically real sense.

68. The conclusion we have reached on economic reality is reinforced by considering the position that would apply if the appellants' customers were themselves registered for VAT and entitled to input tax credit for the VAT they suffered on the appellants' fees. In that case, on the appellants' argument, the mere existence of the appellants' potentially worthless contractual obligation to make a refund coupled with the issue of a credit note would require VAT registered customers to adjust their VAT account

under Regulation 38(4) of the VAT Regulations resulting in their input tax credit being clawed back. The resulting position would be contrary to all economic and commercial reality. Despite having paid the appellants for advice that they received, the appellants' business customers would obtain no input tax credit. By contrast, the appellants would, despite having received and retained payment for the advice they gave, have their output tax liability reduced.

69. Mr Fell also made detailed textual points on the wording of the PVD and domestic legislation when arguing against the interpretation that we favour. He submitted that in Title VII of the PVD generally, the notion of a "price reduction" is used in a way that expressly captures cases where there need not be an actual repayment. For example, Article 79 provides that "price reductions by way of discount for early payment" are not to be included within the "taxable amount". Such a price reduction would seldom involve any actual payment by a supplier to a customer. More broadly, he submitted that where the text of the PVD wishes to make payment critical it tends to say so expressly. For example, Article 206 of the PVD provides that a person must "make payment" of VAT when submitting a VAT return. Article 65 provides for VAT to be chargeable on receipt of a payment on account. However, none of those textual points bears directly on what we see as the crucial inter-relationship between Article 73 and Article 90 which means that only commercially and economically real price reductions falling within Article 90 are capable of reducing taxable consideration that has already been received for the purposes of Article 73.

70. The appellants make similar textual points in relation to Regulation 24 and 38 of the VAT Regulations, pointing out that a "decrease in consideration" as defined in Regulation 24 can only arise if there is a reduction in the "consideration due", which they submit is consistent with a variation in contractual obligations. They also argue that the requirement in Regulation 24 that a reduction in consideration be evidenced by a credit note points in favour of a contractual reduction in price being sufficient since a credit note could not evidence that the supplier had actually repaid any particular sum. However, these points are matters of highly detailed inference. The appellants are not arguing that Regulation 24 and Regulation 38 fail to implement the PVD or have a meaning inconsistent with the PVD. In those circumstances, the appellants' textual points on those regulations do not alter what we regard as the clear effect of the interaction between Article 73 and Article 90 which means that only commercially and economically real price reductions will adjust taxable consideration already received for the purposes of Article 73.

71. In his written submissions, Mr Fell dealt with questions of "common sense". In essence, he argued that if only actual payment was sufficient to trigger a reduction in consideration for the purposes of Article 90, liquidators of the appellants would have to make an infinite series of distributions in the liquidation: the cash they use to make actual refunds would trigger a VAT repayment, which would provide them with further cash to make refunds to customers thereby generating further VAT repayments and refunds in an iterative process. However, we do not consider that this appeal can be determined by reference to "common sense" (and we regard the FTT's reference to common-sense in [36] of the Decision as nothing more than a "sense check" of its overall conclusion). Moreover, the fact that liquidations governed by UK domestic law

may be difficult is no aid to the construction of Article 90 of the PVD which is of general application throughout the EU and does not just apply to companies in liquidation.

72. Overall, therefore, despite Mr Fell's clear and helpful submissions to the contrary, we have come to the conclusion that the FTT was correct to conclude that Article 90 of the PVD was not engaged in the circumstances of this appeal.

Disposition

73. The appeal is dismissed.

MR JUSTICE MANN

JUDGE JONATHAN RICHARDS

RELEASE DATE: 22 July 2019