TC01463

Appeal number: TC/2009/14272

VAT – output tax – local authority – authority required to supply services to DEFRA relating to foot and mouth outbreak – DEFRA refused to pay sums invoiced in full – whether claim for bad debt relief made within prescribed limit – no- claim for bad debt relief dismissed – whether authority entitled to reduce output tax under reg 38 VAT Regulations 1995 – on facts yes – appeal allowed

FIRST-TIER TRIBUNAL

TAX

CUMBRIA COUNTY COUNCIL **Appellant**

- and -

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

TRIBUNAL: David Demack (TRIBUNAL JUDGE)
Roger Freeston FRICS (MEMBER)

Sitting in public at Manchester on 4 August 2011

Richard Barlow of counsel for the Appellant

James Puzey of counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2011

DECISION

Introduction

1. Early in 2001 an unprecedented outbreak of foot and mouth disease ('FMD') occurred in the United Kingdom. Statutory responsibility for controlling, preventing the spread of and eradicating the disease rested with the Department for Environment Food and Rural Affairs ('DEFRA'), in succession to the Ministry of Agriculture, Fisheries and Food. DEFRA sought help in dealing with the outbreak from the appellant council, Cumbria County Council ('CCC'), a local authority within the meaning of the Local Government Act 1972. CCC used its in-house services provider, Cumbria Contract Services ('CCS') to provide the labour, materials and infrastructure DEFRA required in connection with and/or arising from the outbreak.

2. For convenience we propose throughout our decision to refer to CCC rather than to CCS, except where the particular context requires the use of CCS.

3. CCC invoiced DEFRA for supplies it claimed to have made in connection with the FMD outbreak between March and November 2001, in a sum in excess of £4 million, and accounted for VAT on them. DEFRA did not accept that it was liable for the whole sum invoiced, and refused to make payment of part of it. Proceedings were brought in the High Court to resolve the differences between the parties. They did not go to trial. Rather, on 27 March 2007, following mediation, the parties entered into a settlement agreement ('the Settlement') providing for DEFRA to pay £200,000 to CCC "inclusive of VAT (if applicable) and interest" in "full and final settlement" of any claims each party had against the other, and for the court proceedings to be ended by court order.

4. As CCC had accounted for tax on some £1.1 million more than it received from DEFRA, it believed the terms of the Settlement entitled it to bad debt relief of £222,103. It therefore made a voluntary disclosure for the recovery of that sum.

5. By letter of 17 March 2009 the Commissioners refused to act on the voluntary disclosure maintaining that it did not constitute a valid claim for bad debt relief within the VAT Regulations 1995 (S1 1995/2518) ('the Regulations') as it was made outside the time limit provided for the purpose.

6. Subsequently, on 12 June 2009, CCC's representatives asked the Commissioners to reconsider the matter under as the consideration for the supplies made by CCC had been reduced. That request was made under reg.38 of the Regulations which provides for a taxable person to adjust his VAT account where there is decrease in the consideration for a supply. The representatives also informed the Commissioners that the voluntary disclosure had been re-calculated, and reduced to £192,216.13. In making its reconsideration request, CCC contended that were a time limit to be imposed for the purposes of reg.38, it would amount to a breach of its "basic right to

be taxed on the consideration received", and be incompatible with article 90 of Council Directive 2006/112/EC.

7. By letter of 24 June 2009, after further consideration, the Commissioners confirmed that they would still not act on the voluntary disclosure. They took the
45 view that reg.38 was not apposite as the consideration for the supplies made by CCC had not been reduced by the Settlement, claiming that "the outstanding debt has been settled" and nothing more, and that the payment was expressed to be inclusive of VAT. CCC did not accept the letter of 24 June as the last word on the reg.38 point, and requested yet another review of the matter. The Commissioners acceded
50 to the request but, on 20 August 2009, upheld their earlier decision.

8. CCC appealed the Commissioners' decision of 24 June 2009 on 18 September 2009, but only on the reg.38 issue. Subsequently, in March 2010 it served amended reasons for appealing to add the bad debt relief claim.

9. By email of 12 March 2010, CCC notified the Commissioners that it was
55 processing its 02/10 VAT return, and had adjusted it by £192,316.13 for a credit note issued to DEFRA under reg.38 of the VAT Regulations 1995 which resulted in a "negative" output tax figure. The Commissioners response was to threaten to make an assessment for the amount of the adjustment.

10. Before us Mr Richard Barlow of counsel appeared for CCC and Mr James
60 Puzey, also of counsel, for the Commissioners. They provided us with an agreed bundle of copy documents which included a number of witness statements. But we were referred to only one such statement, that of Paul Rogerson, the System Controller and VAT officer of CCC. Additionally, counsel each provided us with a skeleton argument, and we express our thanks to them for having done so.

65

The facts

11. We make our findings of fact from the documents before us, and from the statements of Mr Rogerson, and Mr Christopher Scott, a specialist officer of the
70 Commissioners with responsibility for local authorities.

12. Amongst the documents is one prepared for CCC in connection with the mediation process. It is entitled "Summary of Case for Mediation" ("the Summary"). Usefully for present purpose, it contains a most useful "Background to the Foot and Mouth epidemic" which we set out in full:

75 "1.14 The following information was extracted from the Cumbria Foot & Mouth Disease Inquiry – An independent Public Inquiry into the Foot and Mouth Disease epidemic that occurred in Cumbria in 2001.

1.15 The effect of the Foot and Mouth Disease (FMD) in Cumbria was devastating. Firstly, the county, which is rich in natural heritage and one of the
80 most scenically beautiful areas in Britain, has livestock agriculture, tourism and outdoor recreation as economic mainstays. It was the epicentre of outbreak,

suffering 893 FMD cases – almost 44% of the UK total – and was the second longest affected area. The first case was reported on 28 February 2001 and the last on 30 September 2001. From the first outbreak the epidemic increased dramatically peaking at over 140 farms per week by early April with the worst over by mid May. The FMD outbreak continued at around 10 – 20 farms per week throughout the summer months.

1.16 Secondly, the disease eradication policy of livestock destruction on both infected and 'exposed' farms impacted massively on the scale of slaughter and disposal. The numbers of animals concerned was enormous – approximately 1,087,000 sheep, 215,000 cattle, 39,000 pigs and over 1,000 goats, deer and other animals. In addition to the 893 infected premises, a further 1,934 were subject to complete or partial animal eradication. Approximately 45% of Cumbria's farm holdings were subject to animal culls rising to 70% in the North of the County."

13. The work undertaken by CCS is described in Chapter 2 of the Summary. So far as relevant it shows:

"2.1 … CCC was not statutorily bound to deal with the epidemic, this fell clearly within the domain of DEFRA. The County Council, through CCS, was therefore acting only as a contractor.

2.2 Against this rapidly developing crisis CCS was given a clear steer by Politicians to deploy its resources wherever required to assist DEFRA manage the consequences of the outbreak with the ultimate aim of restoring normality as quickly as possible. Our initial involvement with DEFRA on 7 March 2001, came through the Emergency Planning link and was a verbal request from Stewart Brewer of DEFRA to provide a storeman, further requests were received on 14 March 2001 and 15 March 2001. On 15 March 2001 Ian Scott was told by a DEFRA representative (Bob Timmins) to 'charge our standard rates' and directed to another representative (Jason Robinson) to confirm recharge requirements. On 26 March 2001 CCS finally managed an appointment with Jason Robinson where the recharge mechanism was verbally discussed with Ian Scott from CCS and a further order for 10 lagoons provided. Details of the agreement of charges is provided in section 3."

2.3 Irrespective of contractual commitments we were given clear steer by Politicians that FMD support was the number one priority. Over the following weeks as further resources were required we withdrew from all but routine highway emergency works and a small number of contracts in the Copeland and Barrow areas. These continued with skeleton crews, negligible supervision and ultimately we ran over contract periods and incurred considerable costs."

14. In para 2.2 mention is made of the provision of lagoons, such provsion apparently being a major part of CCC's supplies. We were not told of what lagoons

125 consisted or why they were required. Suffice it to say that para 2.5 of the Summary indicates that six weeks after 15 March 2001 100 employees of CCS were engaged in their construction, and a total of 450 lagoons were constructed: "At the peak, the Easter Bank Holiday weekend instructions were arriving at up to 17 a day."

15. As para.2.2 of the Summary reveals, CCC's involvement with DEFRA began on 7 March 2001 and came through what is known as the Emergency Planning link, presumably a provision made bycentral Government to deal with unexpected events of a very serious nature. Following the request to provide a storeman, DEFRA made further requests on 14 and 15 March and, in that made on the latter date, CCC was told by DEFRA representative Bob Timmins to "charge our standard rates", i.e. the Civil Engineering Contractors Association ("CECA") 'Schedule of Dayworks carried out incidental to contract work'. Confirmation of the rate of payment came from another DEFRA representative, Jason Robinson, on 26 March 2001.

130

135

16. At para.3.10 of the Summary the basis of recharge adopted by CCC is set out in the following terms:

> "[The Schedule of Dayworks] proposes hours worked and actual expenditure be the initial basis of agreement linked to established rates for the main elements of the cost which subsequently determining the final re-charge. These CCS proposals, given at the commencement of this work, are set out below:-
>
> - An agreed set of hourly rates for provision of labour based on the CECA instructions was issued detailing all categories of labour expected to be required for the works;
>
> - The CECA schedule of rates for plant hired for the works; and
>
> - All materials would be recharged at cost plus the percentage addition indicated in the CECA schedule"

140

145

17. By the end of March 2001 it was plain that the FMD outbreak was escalating out of control, and it was then that CCC sought to 'formalise the recharge methodology in writing' (see para 3.3 of the Summary). It did so by hand delivered letter of 29 March 2001, Mr R.G. Smith, the commercial manager of CCS, saying:

150

> "Further to your recent meeting with our Mr Scott we have pleasure in confirming our recharge rates will be in accordance with the Civil Engineering Contractors Association 'Schedule of Dayworks carried out incidental to contract work'.
> The labour rates for each category of employee are as attached and the rates for plant hire will be as indicated in the above publication.
> We have not included for VAT, which will be applied at the appropriate rate…….."

155

160

18. CCC received no reply to that letter, nor did it receive any objection to its proposal for remuneration. We note that no provision was made in that letter for terms and conditions of payment.

19. Para 3.4 of the Summary then records: 'By 9 April 2001 the quantity of requests were increasing at an alarming rate and CCS instigated a procedure whereby requests were faxed to what was rapidly becoming a major operational control at Skirsgill, Penrith. In total 1023 individual faxed instructions were received.'

20. It is against that factual background that we are required to determine whether and, if so, on what terms CCC contracted with DEFRA.

21. We observe that determining the terms of a contract concluded in whole or in part by conduct is a question of fact (see *Carmichael v National Power plc* [1999] 1 WLR 2042 at 2049/50*)*, as is the question of whether there is a contract at all. We are in no doubt that in the present case there was a contract between DEFRA and CCC; we find that it was initially formed orally in conversations between Ian Scott of CCS and Bob Timmins and Jason Robinson of DEFRA, and provided for labour; plant and materials to assist DEFRA, as and when required, to manage the FMD outbreak in Cumbria.

22. In our judgment, the contract was one into which no commercial trader would have entered. CCC was required to do precisely what DEFRA instructed it to do, in most cases without any prior notice, to take account of a rapidly escalating very serious situation. We are in no doubt that CCC was simply given instructions to 'get on with it'. Whether CCC had any precedent on which to work, we know not; but even if it had, we doubt that it covered every aspect of the services required, and every eventuality. CCC had to decide "on the hoof", as it were, what was required, and what was not. Not only was CCC under pressure from DEFRA to get on with the work, but also from politicians of all persuasions. It was a most one sided arrangement which CCC could only accept.

23. CCC submitted its first invoice to DEFRA on 17 April 2001. The sum invoiced was calculated in accordance with what CCC believed to be the agreed terms. The invoice was paid in full on 17 May 2001. CCC submitted further invoices in April and May, about half of which, for some £299,000, were paid in full within 30 days. As to the remainder, DEFRA delayed payment explaining its decision to do so as being due to pressure of work in its offices. CCC initially accepted the explanation.

24. CCC then requested a meeting with DEFRA to discuss the terms of the contract. It was held on 4 June 2001. Following it CCC received a fax requesting that all CCC's future invoices be raised per farm per month. That request was immediately acted upon, and was, in CCC's view, the first indication by DEFRA of formalised payment arrangements, (Summary para.4.5). CCC had no reason to believe that any problems relating to payment existed until 14 June 2001 by which time it was owed about £2.2 million.

25. In total, CCC raised 566 invoices for £5,548,886.14, excluding VAT. DEFRA paid only 23 of those invoices in full. However, about 80 per cent by value of the total sum invoiced related to Biosecurity 'Detox' stations which were provided under formal tender and order arrangements towards the end of the crisis.

26. In June 2001 CCC raised further invoices relating to other works carried out in accordance with what it believed to be the agreed basis of remuneration. They were rejected by DEFRA and not paid. DEFRA gave no reason for non-payment of them.

27. CCC considered non-payment of the invoices concerned to constitute a breach of
210 contract and entered into yet more discussions with DEFRA about the matter. DEFRA then made payment of £2.75 million against outstanding invoices of £4,245,081. CCC applied the sum paid to its oldest invoices first, in order to minimise the interest accruing on them. Following payment, since interest on the debt amounting to £354,200 had by then accrued, the sum of £1,849,281 remained
215 outstanding.

28. At this point we record, as noted at 5.19 of the Summary, 'At no stage have DEFRA alleged that the works carried out by CCS have either not been completed or that such works were defective in any way.' No evidence was adduced to deny that claim and, in its absence, we accept it as fact.

220 29. As the parties were unable to resolve their differences, in mid July 2001 CCC agreed that a forensic auditor appointed by DEFRA might inspect and audit all invoices raised. He or she was assisted by two employees of CCC. The three checked every CCC invoice against timesheets, plant sheets, delivery tickets and various other supporting documents. The result was that on 13 September 2001
225 DEFRA sent CCC a 45 page fax setting out queries raised by DEFRA's contract project managers, Gardiner & Theobald, on the auditor's work. The fax was accompanied by 42 pages of amendments to CCC's invoices.

30. CCC addressed all the queries raised but the differences between the parties remained unresolved.

230 31. Attached to the Summary is a Scott Schedule. Amongst other things it reveals some of the differences between CCC and DEFRA. For instance, DEFRA claimed that CCC had charged for the work of subcontracted workers as if they were employed by CCS. In response CCS claimed to have calculated its charges in accordance with the agreement between the parties. DEFRA also required CCS to
235 "submit evidence to identify and prove those employees to which the CCS schedule applies and those to which CECA applies, together with timesheets. Where applicable CCS must also submit evidence of the invoiced cost of subcontracted labour and invoice cost of materials. Until such time as that substantiation is supplied, CCS have not made a valid application for payment. CCS's entitlement in
240 respect of each unsubstantiated issue is zero." CCS claimed to have "supplied full substantiation of their invoices", adding "There is no contractual definition of what a 'valid application for payment' is and therefore DEFRA's statement is meaningless." DEFRA further claimed that "CCS should not apply the rates for plant included in the CECA schedule. The CECA schedule expressly states that
245 those rates are only to be used for plant that is incidental to the main works (i.e. already on site) and are not applicable to a contract carried out wholly on a day works basis (as this case)." To that further claim, CCS observed that "the CECA schedule is only applicable if read in conjunction with the ICE form of contract.

CCS used the rates for plant as agreed, and DEFRA have made various payments for
250 plant in accordance with CECA rates." There was a further dispute between the parties as to whether there was custom and practice in the industry dealing with the provision of protective clothing worn by CCS's employees and subcontractors at DEFRA's insistence, such that it was not liable for the cost of the premium.

32. We were also supplied with a quantum report prepared for DEFRA by Gardiner
255 & Theobald. In it they claimed to have identified examples of overcharging by CCS, arithmetical errors, the use of incorrect CECA rates for the hire of equipment, and differences in charges for equipment made by and to CCS. They further claimed that CCS was not entitled to charge DEFRA separately for supervision and administration costs.

260 33. We believe the examples cited in the last two immediately preceding paragraphs to provide a representative sample of the matters in dispute between the parties. We do, however, record that we make no findings of fact in relation to any of those matters. It is not for us to re-adjudicate the differences between CCC and DEFRA; we are required only to deal with the VAT consequences of the Settlement.

265 34. We were provided with no information about the negotiations leading to the Settlement or documents associated therewith, so that beyond the contents of the Scott Schedule and the Gardiner & Theobald report, we know nothing of the dispute between the parties, the attempts made to resolve their differences, and the reasons why those differences were resolved in the terms of the Settlement. And the terms of
270 the Settlement itself contain nothing to help in filling that vacuum. So far as relevant, the operative parts of the Settlement are in these terms:

> (1) The terms of this Settlement Agreement are in full and final settlement of any claims DEFRA has or may have against CCC relating to the FMD outbreak (for the avoidance of doubt including those set out in the proceedings, Claim
> 275 Number LS 40003 in the Leeds District registry).
>
> (2) The terms of this Settlement Agreement are in full and final settlement of any claim CCC has or may have against DEFRA relating to the FMD outbreak.
>
> (5) DEFRA shall pay to CCC the total sum of £200,000 (two hundred thousand pounds) inclusive of VAT (if applicable) and interest such sum to be paid within
> 280 14 days of the execution of this Settlement Agreement.
>
> (6) Each party shall pay its own legal and associated costs of any description whatsoever incurred as a result of the claims and/or disputes to which this Settlement Agreement relates
>
> (7) DEFRA and CCS shall use their best endeavours to secures a Court Order in
> 285 the following terms:
>
> 'By Consent of the Parties it is Ordered that these proceedings shall be discontinued with no Order for Costs.

35. We might add that para 8 of the Settlement, in making provision for a press statement about the terms of settlement refers to the sum of £200,000 as being paid “for works carried out”.

36. CCC, having some years earlier made provision for the sums outstanding from DEFRA to be written off, did not in fact write them off until 11 April 2008.

37. There is one final factual matter to which we must refer. Mr Scott was the Commissioners’ officer who wrote their letters of 17 March 2009 and 24 June 2009. At para 11 of his statement, dealing particularly with CC’s review request of 16 June 2009, he said:

> “…Based on the information available to me, the [reg.38] claim did not concern a reduction in the consideration for the supply. It concerned invoices which were issued with a value attached to the supply for which consideration was expected from DEFRA. There was an outstanding debt which was then settled, with the remainder written off in the Council’s accounts. I consider it factitious to suggest that a combined, invoiced supply (running to around 8 pages of listed invoices) with a value of over £1M[illion] would be reduced to £200,000 and therefore was not covered by regulation 38 argument…”

The legislation and submissions

The bad debt relief claim

38. It is against that factual background and the legislative provisions to which we refer in the context of counsels’ submissions that we are required to decide the appeal.

39. Mr Barlow opened his submissions by claiming that bad debt relief was dependent upon the existence of three facts set out in section 36 of the Value Added Tax Act 1994 (“the1994 Act”). That section provides for bad debt relief in the following terms:

> (1) Subsection (2) below applies where,
> (a) a person has supplied goods or services and has accounted for and paid VAT on the supply,
> (b) the whole or any part of the consideration for the supply has been written off in his accounts as a bad debt, and
> (c) a period of 6 months (beginning with the date of the supply) has elapsed.
>
> (2) Subject to the following provisions of this section and to regulations under it the person shall be entitled, on making a claim to the Commissioners, to a refund of the amount of VAT chargeable by reference to the outstanding amount.

40. Subsection (5) of s.36 makes provision for regulations dealing with claims for relief, and the regulations applicable since 1 May 1997 are those numbered 165 to 172B of the Regulations.

41. Regulation 170 reads as follows:

> "(1) Subject to regulation 170A below, where
> (a) the claimant has made more than one supply (whether taxable or otherwise) to the purchaser and
> (b) a payment is received in relation to those supplies, the payment shall be attributed to each such supply in accordance with the Rules set out in paragraphs (2) and (3) below.
>
> (2) The payment shall be attributed to the supply which is the earliest in time and, if not wholly attributed to that supply, thereafter to supplies in the order of the dates on which they were made, except that attribution under this paragraph shall not be made to any supply if the payment was allocated to that supply by the purchaser at the time of payment and the consideration for that supply was paid in full.
>
> (3) [Not relevant]"

42. It is common ground that reg. 170A is irrelevant, but reg 170(2) is in point. It provides:

> "The payment shall be attributed to the supply which is the earliest in time and, if not wholly attributed to that supply, thereafter to supplies in the order of the dates on which they were made, except that attribution under this paragraph shall not be made to any supply if the payment was allocated to that supply by the purchaser at the time of payment and the consideration for that supply was paid in full."

43. Mr Barlow accepted that reg. 170(2) was "confusingly worded", but maintained that its effect in the present case was that when DEFRA paid the early invoices in full its payments should be treated as having been made in respect of those invoices, and the £200,000 paid by DEFRA under the Settlement should be deemed to relate to the later invoices on the basis that the sum paid was attributable to the earliest unpaid invoice or invoices with the consequence that nothing had been paid on the later invoices. Mr Barlow maintained that those rules did not really accord with the reality of the present situation which was, in effect, that DEFRA paid all the invoices pro rata at about three quarters of the sums originally invoiced. However, he contended, that it was not to CCC's detriment that that rule applied for bad debt relief because, if it had any effect, it was that the claim was less, rather than more, likely to be made out of time.

44. The Commissioners' main objection to CCC's bad debt relief claim was founded on the ground that it was out of time under reg 165A.. So far as relevant, that regulation provides:

"(1)… a claim shall be made within the period of 3 years and 6 months following the later of –

(a) the date on which the consideration (or part) which has been written off as a bad debt becomes due and payable to or to the order of the person who made the relevant supply; and

(b) the date of the supply."

45. The period of 3 years 6 months provided for in reg. 165A(1) was increased to 4 years 6 months with effect from 1 April 2009.

46. As CCC's bad debt relief claim was made on 26 February 2009, we are required to decide whether its claim became time barred under the 3 years 6 months rule because reg 170 (2) makes it plain that, if it had become time barred, it would not have been revived by the extended time period of 4 years 6 months when that was introduced.

47. Mr Barlow submitted that the time limit was the later of the two set out in sub-reg.170 (1)(a) and (b), and maintained that it was clear that the date of supply was considerably before the 3 years 6 months allowed: CCC relied on (1)(a) rather than (1)(b).

48. Because no amount of consideration was agreed contractually between CCC and DEFRA, Mr Barlow submitted that there was a *quantum meruit* to determine CCC's reasonable remuneration for the services provided to DEFRA. And that determination formed the consideration from which the amount paid by DEFRA had to be deducted to produce the bad debt. He contended that the debt was not 'due and payable' until the Settlement was entered into on 27 March 2007. Consequently, he submitted that when the claim was made on 26 February 2009 it was well within the 3 year 6 month period, and was not out of time.

49. Mr Barlow accepted that there was a possible argument that the statutory time limit infringed the VAT Directives, and that *Goldsmith (Jewellers) v Customs and Excise Commissioners* [1997] [STC] 1073 gave some support to that argument because it was there held that the time limit on bad debt relief should be justifiable only to the extent that it was strictly necessary for achieving the object intended (as per *EC Commission v Belgium* [1984] ECR 1861). However, he added, in principle the basis of assessment for VAT should always be the consideration actually received (as per *Naturally Yours Cosmetics v Customs and Excise Commissioners* [1988] [STC] 879).

50. But, as the Court of Justice of the European Communities ("the ECJ") had recognised, in the litigation about the introduction of the three year capping provisions, that time limits were not inherently wrong and so, given that there was no retrospection in the introduction of the 3 year 6 months time limit, it may not have been open to challenge in general. Mr Barlow contended that, as that time limit had not been exceeded, those arguments were unnecessary: the bad debt relief provisions did apply.

51. Mr Puzey maintained that the evidence of Mr Rogerson coupled with a chronology of CCC's involvement with DEFRA made it plain that CCC considered a debt to be due and owing as a result of the invoices unpaid by DEFRA in 2001-2. He maintained that there was no question of the consideration for the services provided being unascertained: CCC considered it had agreed terms with DEFRA, and made provision for bad debts arising from the invoices as early as March 2002. In those circumstances, there had been nothing to prevent CCC seeking bad debt relief within the 3 years 6 months time limit prescribed by reg. 165A.

52. He contended that CCC's argument that the bad debt became due and owing in 2007 after the Settlement was made was both erroneous and illogical. If, as CCC maintained, the consideration for the supplies to DEFRA was not established until the Settlement was made on 27 March 2007, Mr Puzey questioned how there could be a debt of any sort after the Settlement had been signed and satisfied.

53. As CCC conceded, it was possible in EU law to place time limits on the recovery of tax overpaid and the period of 3 years 6 months from the date that the debt became due was not open to it to challenge in general. It had not made its relied claim within the time limit provided. Consequently, Mr Puzey submitted that the claim should be rejected.

<u>The regulation 38 claim</u>

54. We then turn to consider CCC's reg. 38 claim in detail, first rehearsing the relevant regulations. Regulation 38(1) and (3), which deal with adjustments in the course of business, provide as follows:

> "38(1) …. This regulation applies where–
>
> (a) there is an increase in consideration for a supply, or
>
> (b) there is a decrease in consideration for a supply, which includes an amount of VAT and the increase or decrease occurs after the end of the prescribed accounting period in which the original supply took place.
>
> (3) [Subject to paragraph (3A) below] the maker of the supply shall –
>
> (a) in the case of an increase in consideration, make a negative entry, or
>
> (b) in the case of a decrease in consideration, make a positive entry, for the relevant amount of VAT in the VAT payable portion of his VAT account"

Regulation 24 defines an increase or decrease in consideration as follows:

> "24. In this Part –
> "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;"

55. Mr Barlow observed that reg.24 only referred to the need to issue a credit note "or other document having the same effect", and did not fully define what a decrease in consideration meant.

56. He maintained that there was a decrease in consideration when CCC and DEFRA settled CCC's claim. It might be argued that as no amount of consideration had been agreed at the outset, there had been no decrease as such. But reg. 38 was intended to cover a case where a taxpayer had accounted for too much (or too little) VAT and needed to make an adjustment accordingly. In that context, he submitted that a decrease or increase in consideration must be intended to cover a situation where the taxpayer realised he had accounted for too much or too little consideration without giving the term consideration a technical meeting.

57. It was well established that consideration was not to be interpreted as that word should be understood in English law because VAT was payable in accordance with EU Directives, and must be applied throughout the European Union in the same way. Because the Commissioners would sometimes be seeking to claim that the taxpayer had accounted for too little, it was not in their interests to seek a narrow interpretation of the phrase "decrease in consideration" as, by parity of reasoning, that would also restrict the meaning of an increase. Mr Barlow submitted that the consideration "decreased" was the invoiced sum of £4,245.081. He maintained that as that sum was never agreed as the consideration for CCC's supplies, it was not that consideration.

58. Paragraph (1A) and (1B) of reg.38, which introduced a three year time limit for adjustments from 1 May 1997, were repealed with effect from 1 April 2009, and so did not apply on 12 June 2009 when the Commissioners were asked to consider the alternative ground for relief.

59. In Mr Barlow's submission, the Settlement had the "same effect" as a credit note: the amount due on the supply was the amount due on the invoices raised.

60. It was common ground that there was no time limit on the making of a claim for a change in consideration. It was also agreed that s.80(4) of the 1994 Act, which imposed a 3 year time limit on certain claims, did not apply because it was limited to cases where an amount which was not output tax due had been brought into account.

61. Mr Barlow submitted that the legislation, in its own terms, clearly provided for the propositions for which CCC contended, but he relied on a number of authorities to prove the correctness of his argument. For the basic principle that VAT was chargeable on the amount actually received by the supplier, which should not be restricted by any member State's definition of consideration, Mr Barlow relied first on [13] of Advocate-General da Cruz Vilacàs opinion, in *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners* (Case 230/87) [1988] [STC] 879 where he said:

"13. From that judgment [*Apple and Pear Development Council v Customs and Excise Commissioners* (Case 102/86) [1988]STC 221] (paras 8 to 14) the following interpretative criteria can be deduced: (a) The term to be interpreted ('consideration') appears in a provision of Community law which does not refer to the law of the member states for determination of its meaning and scope, and therefore its interpretation cannot be left to the discretion of each member state. (b) As is stated explicitly under para 13 of Annex A to the Second Directive (of which it forms an integral part by virtue of art 20), consideration should be understood as meaning 'everything received in return for the supply of goods or the provision of services, including incidental expenses (packing, transport, insurance, etc.) *that is to say not only the cash amounts charged but also, for example the value of the goods received in exchange…'* (c) As a result of the combined provisions of arts 8(a) and 2(a) of the Second Directive (which correspond respectively to arts II(A)(i)(a) and 2(i) of the Sixth Directive), as a rule only supplies of goods and the provision of services *against payment* are subject to tax. (d) For those conditions to be regarded as fulfilled, there must be a direct link between the goods supplied (or the service provided) and the consideration received. (e) It is apparent from the use of the terms 'against payment' and everything received in return', and from art 9 of the Second Directive (art 12(3) of the Sixth Directive) concerning the standard rate of tax, that the consideration for the supply of goods (or the provision of services) must be capable of being expressed as an amount of money; it also follows that the consideration is a 'subjective value', since the basis of assessment is the consideration actually received and not a value assessed according to objective criteria."

62. Secondly, Mr Barlow relied on [11] of the judgment of the ECJ, where the court held:

"11. According to *Staatssecretaris van financien v Cooperative Aardappelenbewaarplaats GA* (Case 154/80) [1981] ECR 445 the basis of assessment for a service is everything which makes up the consideration for the service; there must therefore be a direct link between the service provided and the consideration received if the supply of a service is to be taxable under the Second Directive. "
(The Second Directive was, of course, later replaced by the Sixth Directive).

63. Mr Barlow further submitted that, in determining what amounted to the relevant payment for a supply, the agreement and intention of the parties was the determining factor. As Millett LJ observed in *Customs and Excise Commissioners v British Telecom plc* [1996] [STC] 818 at 822:

"Accordingly, the question which falls for decision in the present case is whether, where there is a continuous supply of services, the amount of an inadvertent overpayment by a customer in excess of the amount for which he has been invoiced, which is retained by the supplier and credited to the customer on his next invoice, falls to be treated as paid 'on account of' or received 'in respect of' future services.

Conclusion

In my judgment the answer to this question is plain. There is nothing in the Sixth Directive or in the [Value Added Tax Act 1983] which requires it to be given an affirmative answer. In the absence of an express provision to this effect, the legal characterisation of the overpayment is a question of English domestic law and, as such, depends upon the intentions of the parties. The inadvertent overpayment of a present debt is not a payment on account of a future liability. So far as the excess is concerned, it is simply a payment made under a mistake of fact. It is not paid on account of or in respect of future supplies; the customer intends it in payment for past supplies; and since it is not due when made, it is made for no consideration. Under English law, the recipient is under a legal obligation to repay the amount of the overpayment immediately it is received.

The existence of this legal obligation is conceded by the commissioners and is, in my judgment, destructive of their claim. If the money is repayable notwithstanding the continuation of the supply, then it cannot be a payment made on account of or in respect of the continuing supply. To counsel's rhetorical question, 'If the payment is not in respect of future services, what is the nature of the payment?' the judge, in my view correctly, answered that it is simply a payment made by mistake."

64. Mr Barlow further claimed that the judgments of the ECJ supported the proposition that, where a party acting in good faith had erroneously issued an invoice showing tax due which was not in fact due, then the member States should ensure they had made provision for the overpayment to be refunded. For the purpose, he relied on the ECJ judgment in *Staatsecretaris van Financien v Stadeco BV* [2009] STC 1622 citing [34] to [51] of the judgment. As a useful summary of those paragraphs, we cite the second part of the headnote dealing with the court's judgment. It reads:

"(2) As the Sixth Directive did not make express provision for the case where VAT was mentioned erroneously on an invoice when it was not due, it was for the member states to provide for the possibility of refunding any tax improperly invoiced, provided that the person who issued the invoice showed that he had acted in good faith. However, where the issuer of the invoice had in sufficient time wholly eliminated the risk of any loss in tax revenues, the principle of the neutrality of VAT required that improperly invoiced VAT could be adjusted without that being made conditional on the issuer of the invoice having acted in good faith. Moreover, the refund could not be entirely at the discretion of the tax authorities. Domestic measures for the correct levying and collection of tax and for the prevention of fraud could not go further than was necessary to attain such objectives. Since both a corrected invoice and a credit note would clearly indicate to the beneficiary of the services supplied that no VAT was due to the member state in question and, therefore that that beneficiary did not have any right in that regard to deduct VAT, those measures could in principle ensure the

585 elimination of the risk of loss of tax revenue. In addition, that requirement clearly did not make the reimbursement of the tax dependent on the discretion of the tax authority. It was for the national court to assess in the present case whether S [Stadeco] had demonstrated that it had itself completely eliminated in sufficient time the risk of the loss of tax revenue. In the instant case, the risk of loss of tax revenue was only eliminated because EDV [a body established in the Netherlands attached to its Ministry of Economic Affairs]was a public body and it used S's services exclusively for activities that were not subject to VAT in the Netherlands. In such circumstances, it did not in principle go beyond what was necessary to achieve the objective of completely eliminating all risk of loss of tax revenue, to make the refund subject to the requirement of correcting the invoice. Further, in so far as the Netherlands tax authorities had also made the refund of the VAT subject to the payment by S to EDV of the amount of tax incorrectly paid, Community law did not prevent a national legal system from disallowing repayment of charges which had been levied but were not due where to allow such repayment would lead to unjust enrichment of those having the right. Accordingly, the principle of fiscal neutrality did not generally preclude member states from making the refund of VAT due in that member state merely because it was erroneously mentioned on the invoice subject to the requirement that the taxable person had sent the beneficiary of the services performed a corrected invoice not mentioning that VAT, if the taxable person had not completely eliminated in sufficient time the risk of the loss of tax revenue."

65. Finally, Mr Barlow contended that the judgment of Field J in *Customs and Excise Commissioners v General Motors Acceptance Corporation (UK) plc* [2004] STC 577 fully supported CCC's contentions. That case was concerned with the early determination of hire purchase agreements where the hirer was required by cl .9 of the agreement to pay arrears of instalments and remaining payments less the proceeds of selling his car on his breach of the agreement.

66. At [21] of the judgment, the learned judge held:

"[21] Like the tribunal, I uphold Mr Prosser's [counsel for General Motors] submissions. The effect of cl 9 is that the consideration for the supply of goods is reduced by agreement from the cash price to the cash price less any outstanding instalments and the resale proceeds. It matters not that the agreement providing for the reduced price was contained in the original agreement and was not the subject of a separate, subsequent agreement. The resale proceeds are not paid by the hirer; still less are they paid by the hirer as consideration for the supply. Nor is he redelivery of the car any part of the consideration for the supply. Further, to hold that the effect of art 11C(1) [of the Sixth Directive]is that the sale proceeds are part of the consideration for the supply of the goods would involve breaching the fundamental principle that the taxable party is only accountable for the amount of VAT paid by the consumer, in this case the hirer. This is so because, where the agreement terminates and cl 9 applies, the hirer does not pay the full VAT element of the cash price but only the VAT element of the instalments paid or payable at the time of termination

630 and of that part of the outstanding instalments that remains after the resale proceeds have been deducted. "

67. The company was, therefore, entitled to adjust its VAT account by making a negative entry therein in respect of the decrease in the consideration for the supply.

635 68. Mr Puzey opened his submissions on the reg. 38 claim by noting that in *Brunel Motor Co. Ltd v Commissioners of Revenue and Customs* [2009] EWCA Civ 118 at [24] the Chancellor indicated that "due" in the context of reg. 38 connoted a legal entitlement to a decrease in consideration; such an entitlement could arise from the original contract of supply or a subsequent rescission, novation or variation agreed

640 between the parties. The credit note itself did not have the effect of altering the consideration; it was only evidence of an entitlement to a decrease.

69. Mr Puzey noted that, in the present case, the credit note was not issued by CCC in 2007 at the time of the Settlement: it was only issued in 2010 after CCC had appealed the Commissioner's decision to refuse the adjustment. He maintained that

645 in those circumstances its evidential value was marginal at best, and appeared to have been something of an afterthought.

70. The vires for reg.38 was derived from Article 11C(1) of the Sixth Directive which provided as follows:

> "1. In the case of cancellation, refusal or total or partial non payment or where
>
> 650 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. However, in the case of total or partial non-payment, Member States may derogate from this rule."

655 71. Mr Puzey observed that in *Mannesman Demag Hamilton Ltd v Customs and Excise Commissioners* [1983] VATTR 156 and *Re: Liverpool Commercial Vehicles Ltd* [1984] BCLC 587, the repossession of goods pursuant to retention of title clauses in the supply contract did not have the effect of nullifying the original supply. There had been no agreed cancellation or reduction of consideration even

660 though in the former case a settlement had been reached on the basis of the supplier retaking possession of the goods. In his submission, the same position prevailed in the present case.

72. It followed, in Mr Puzey's further submission, that the fact that DEFRA paid CCC £200,000, and that each party agreed to make no further claim against the other

665 did not alter the fact that there had been a contract for the supply of services under which sums became due, and that contract was not cancelled, nor was the price reduced. Indeed, he claimed that Mr Rogerson described the sums outstanding as a bad debt. Assuming that claim to be correct, Mr Puzey maintained that CCC's remedy was to claim bad debt relief within the prescribed time limit.

670 73. It was a question of fact as to whether there was an agreed contractual variation or cancellation (see [36] of the judgment in *Brunel Motor Co.*), and in the present

case, in Mr Puzey's submission, there was no evidence of any such agreement. He maintained that the terms of the Settlement were entirely consistent with a decision by each party to 'cease' its claim against the other, rather than agreeing a new price for services supplied.

74. In his judgment in *Brunel Motor Co.* the Chancellor made plain that the requirement for any change in the level of consideration had to be based on a contractual or other lawful right (see [31]) which had its foundation in freely given and accepted rights and responsibilities rather than the unilateral action of one party (see [37]). In the present case, even CCC did not see the Settlement as a variation of consideration until two years after the event, and then only following the rejection of its claim for bad debt relief.

75. Mr Puzey submitted that, in all the circumstances, CCC's failure to claim bad debt relief timeously could not be remedied by a subsequent assertion that the consideration was varied by agreement or otherwise.

<u>Conclusion</u>

76. Although we have given full rein to the submissions of the parties and the authorities to which we were taken, we find ourselves quickly and easily to reach our decisions on the alternative cases advanced by Mr Barlow for CCC.

77. We entirely agree with Mr Puzey that CCC's claim that a bad debt arose after six months from the date of the Settlement (because it was only then that the consideration was determined) is erroneous and cannot be sustained. If, as CCC maintains, the sum due and owing by DEFRA was established by the Settlement, which the parties acted on, there could not have been a bad debt, or indeed any debt, thereafter. The question of whether the claim became time barred under the 3 years 6 months rule, thus does not arise. It follows that we dismiss CCC's claim to be entitled to claim bad debt relief.

78. It will be recalled that, in relation to CCC's claim to be entitled to adjust its VAT account for a reduction in consideration, i.e. its reg.38 claim, Mr Barlow submitted that its claim was based on a *quantum meruit*. *Quantum meruit* is a long established common law remedy to cover a situation where a party to a contract seeks, not a precise sum alleged to be due to him, but rather reasonable remuneration for services rendered. His claim is then said to be based on a *quantum meruit*. Consequently, the remedy may be used to recover a reasonable price or reasonable remuneration where a contract has been made for the supply of goods or services, and no precise sum has been fixed by the agreement, see e.g. *Powell v Braun* [1954] 1 All ER 484.

79. We earlier found that a contract was made between DEFRA and CCC. In our judgment, CCC assumed that DEFRA had implicitly agreed to pay CCC for works carried out as invoiced. However, since DEFRA clearly claimed that it had not so agreed and acted accordingly, we proceed on the basis that CCC was entitled to reasonable remuneration for the services it in fact rendered; it had a *quantum meruit* claim.

80. In his witness statement, Mr Scott dismissed the terms of the Settlement as "factitious", justifying his conclusion in that behalf by saying that no trader would accept £200,000 in settlement of a claim worth some £1.4 million. The import of the word "factitious" is contrived, or at least artificial. We are not here dealing with dubious parties where contrivance or artificiality might be expected; we are dealing with an arm of central Government on the one hand, and a major local authority on the other. To suggest that in those circumstances, seemingly without any evidence whatsoever to support such a statement, the Settlement was "factitious" is in our view totally unjustified and looking far outside the reality of the situation in which CCC found itself. The evidence before us contains no indication of anything other than that the terms of the Settlement were arrived at by genuine negotiation, and proved acceptable to both parties. Since everything points to CCC having initially believed that DEFRA agreed to pay the sums invoiced, in our judgment, CCC made an "inadvertent overpayment" of tax; it simply made the payment under a mistake of fact. And, since the payment was not due when made, it was made for no consideration (see the judgment of Millett LJ in *British Telecom*).

81. Further, the Settlement was reached, and the High Court action settled, on the plainest possible terms. DEFRA was to pay CCC the sum of £200,000. That sum was to be paid in full and final settlement of the latter's claim against the former. No further sum was to be paid to cover any VAT liability; no sum was to be paid by way of interest; and each party was to bear its own costs. In our judgment, in those circumstances not only was the litigation settled, the consideration for CCC's supplies was reduced. The conditions contained in reg. 38 were satisfied. CCC is therefore entitled to recover the VAT it overpaid on the sums invoiced to DEFRA.

82. In so deciding we have taken account of an observation by Mr Puzey that since CCC failed to produce a credit note until some two years after the claim was made that fact is somehow to reflect adversely on its claim. He did not elaborate on that observation and, since in our judgment it does not take matters further, we ignore it. DEFRA did not need a credit note to adjust its own VAT account. In any event, as Mr Barlow submitted, we believe the Settlement itself had the same effect as a credit note or similar document. However, if we are wrong in so saying, since CCC did belatedly issue a credit note, in so doing it satisfied the statutory requirement.

83. In the real commercial world, there must be many *quantum meruit* claims, quite a number of which will be the subject of litigation to determine their consideration, and in which the consideration invoiced will in fact be reduced. That being so, CCC's claim was not unusual. What was unusual was CCC's relationship with DEFRA and, in particular, the speed at and conditions under which it was expected to react to an out of control, very serious situation, demanding immediate attention such that its principal, DEFRA, had no time properly to instruct it, or even to consider and determine what instructions were appropriate. On the basis of the argument advanced by Mr Puzey, any *quantum meruit* claim ultimately determined at a figure less than that invoiced, and on what we believe to be the more or less standard terms for the settlement of litigation to be found in the Settlement, could not be adjusted under reg. 38. In our judgment, reg.38 is the means whereby any claim settled similarly to that of CCC is to be adjusted as a reduction in

consideration. It follows that we allow the appeal on the basis of the reg.38 claim. We might add that in arriving at that conclusion, we have taken full account of the submissions of both parties, but essentially rely on those of Mr Barlow.

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

TRIBUNAL JUDGE

RELEASE DATE: 15 September 2011