TAXAdviser

Deal or no deal

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Keith Gordon discusses a case in which HMRC tried to unwind a VAT agreement previously reached with a taxpayer

What is the issue?

HMRC sought repayment of a settlement made to Southern Cross Employment Agency on the basis that the payment had been unjustified in law

What does it mean for me?

The judge supported the First-tier's analysis of the negotiation between HMRC and Southern Cross was of a contractual basis rather than HMRC ascertaining the extent of their liability

What can I take away?

The case highlights that HMRC should act fairly, to act in a high-principled way and on occasions be subject to a stricter duty of fairness than would apply between private citizens

It is often the case that a tax dispute is resolved between HMRC and the taxpayer by mutual agreement; that is, without the matter being formally determined by the tribunals or the courts. Indeed, HMRC's preferred practice is almost invariably for 'contract settlements' to be entered into, with formal assessments to be issued only as a last resort. However, there will be situations in which – after agreement is reached – one of the parties starts to regret the terms of the settlement. One of these is *HMRC v Southern Cross Employment Agency Ltd* [2015] UKUT 122 (TCC), when it was HMRC that had second thoughts.

The facts of the case

The origin of the case can be found in the long-running saga concerning the VAT status of an employment agency's supply of nurses. The underlying question was whether the agency made taxable supplies of personnel or exempt supplies of nursing. This was relevant to Southern Cross because the company supplied dental nurses to dentists.

Historically, the company charged VAT on its supplies, representing an additional cost for most of its clients who, as exempt traders, would have been unable to recover the VAT. However, by the turn of the millennium, the orthodoxy changed and it became widely considered that the company's supplies were exempt. Consequently, in 2001, the company's tax advisers wrote to Customs and Excise (now HMRC) seeking recovery of VAT for a three-year period, which they duly accepted.

The restriction of this claim to a three-year period was based on the statutory cap then in place. However, the House of Lords' subsequent decision in *Fleming (t/a Bodycraft) and Condé Nast Publications Limited v HMRC* [2008] UKHL 2 (Fleming) demonstrated that the company could legitimately have claimed repayment going back to the introduction of VAT in 1973. As a result, the company made a supplementary claim for repayment of £861,000 for the period from 1973 until 1997.

HMRC (as they had now become) rejected this claim, arguing that the repayment sought would have led to Southern Cross being unjustly enriched. This led to a number of exchanges between Southern Cross's adviser and HMRC during which the advisers offered to restrict the claim by 26% – that is, accepting 74% of the amount claimed plus interest. HMRC accepted this proposal and paid Southern Cross £1,371,500 in or around April 2010.

Within three months, however, HMRC wrote to Southern Cross to advise them that assessments had been made seeking repayment of this sum. The basis of these assessments was a view held within HMRC that Southern Cross's supplies were in fact taxable and therefore the earlier repayment claim by the company was unjustified in law. As it happens, the repayment made by HMRC did not reflect the universally held view within the department. That is clear because it was in 2009 that HMRC first refused a repayment claim by Sally Moher (who also made supplied temporary dental staff to dentists) and whose claim was dismissed by the First-tier Tribunal in 2011 and again by the Upper Tribunal in 2012.

Indeed, in view of the Upper Tribunal's decision in *Moher (t/a Premier Dental Agency) v HMRC* [2012] UKUT 260 (TCC) (*Moher*), HMRC considered that they were entitled to recover the sums paid to Southern Cross. So they continued to pursue the assessments by arguing that they were not bound by the prior agreement and repayment made to the company.

HMRC based their case on three arguments. First, they considered that VATA 1994 s 80 precluded HMRC from entering into any binding agreement with Southern Cross in the particular circumstances of the case. Second, they considered that any agreement reached was *ultra vires* (beyond HMRC's legal powers) and therefore void. Third, they disputed that there was in fact a compromise agreement actually reached between HMRC and Southern Cross.

HMRC's case was rejected by the First-tier Tribunal so they appealed at the Upper Tribunal.

The tribunal's decision

The Upper Tribunal's decision was given by Mr Justice Newey. He dismissed all three limbs of HMRC's arguments.

In relation to the first, HMRC had argued that s 80 provided a comprehensive statutory mechanism for the repayment of VAT. The essence of their case was that the section referred to the situation where a formal decision is made, against which an appeal is commenced. However, the judge (partly relying on the direct tax case of *IRC v Nuttall* [1990] STC 194) concluded that there was nothing in the statute, or any policy justification, to support the view that HMRC could settle tax disputes only within the context of an appeal.

On the second argument, HMRC pointed out that the *Moher* decision confirmed that they should not have authorised the decision to repay Southern Cross. This argument focused on HMRC's statutory duty to apply the law as it stands, the right to exercise managerial discretion at the margins and the question of so-called '*Wednesbury* unreasonableness' (being the high threshold needed to show that a public authority has acted beyond its powers). The judge dismissed HMRC's case on this point because the correct nature of Southern Cross's supplies was not confirmed until sometime later – that is, the date of the Upper Tribunal's decision in *Moher*.

The judge then considered, albeit hypothetically, what the outcome would have been had HMRC's views, when making the repayment to Southern Cross, been that the repayment might not have been due. However, relying on the House of Lords decision in Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349, the judge endorsed the view that a state of doubt is different from that of mistake. The judge continued his thought process and considered the possibility that HMRC might have had in mind the view that Southern Cross's supplies were in fact taxable. The clear implication was that the judge might have considered any repayment in those circumstances to be ultra vires. However, given the lack of evidence from HMRC on this point, there was nothing that would have justified the tribunal finding for HMRC in relation to this argument.

HMRC's final argument (that no binding agreement had been reached) was two-pronged. First, HMRC said there had been no 'consideration' given by Southern Cross as necessary to form a contract. Second, there had been no intention to create legal relations – another condition underlying any enforceable contract. The judge again had no hesitation in rejecting both of HMRC's arguments.

In the judge's mind, it was clear that the decision to abandon 26% of the company's claim amounted to consideration, although it is my view that any acceptance by HMRC for the full amount originally claimed should also have enabled the company to show that it had given consideration. In particular, the company was in effect abandoning its right to make any further claims for the relevant periods.

On the second point, the judge supported the First-tier's analysis of the negotiation between HMRC and Southern Cross. 'Viewed objectively,' he held, 'such matters seem to indicate contractual negotiation rather than HMRC doing no more than ascertain the extent of their liability.' As a result, HMRC's third argument also failed.

For these reasons, HMRC's appeal was dismissed.

Commentary

This case should cause those at HMRC to start asking some serious questions. How on earth did it ever seem right that the department should renege on its deal with Southern Cross? This was not a case that was decided at a local level, but one that would have been supported by the Solicitor's Office which instructed Queen's Counsel. And, having had their wrists slapped at the First-tier Tribunal, it was nevertheless decided to proceed to the Upper Tribunal for a second bite at the cherry.

In the end, HMRC's stance has probably cost the country dear because the usual outcome in Upper Tribunal decisions is that the victor recovers the costs from the other side. Therefore, the general body of taxpayers has not only had to pay for HMRC's legal costs but also those of Southern Cross. There is of course the possibility that HMRC's loss in a case such as this is atypical and that most taxpayers would have thrown in the towel much earlier. Taking a purely commercial attitude then, it might be possible to say that HMRC's actions are justified even if the public hears only part of the story.

But, is it right to focus on the commercial outcomes only? I would say not. HMRC are undoubtedly under pressure to comply with sometimes conflicting obligations. However, I consider that the obligation to act fairly should override them all. Indeed, as Lord Justice Simon Brown (as he then was) said in the case of *R v Inland Revenue Commissioners ex parte Unilever plc* [1996] STC 681: 'Public authorities in general and taxing authorities in particular are required to act in

a high-principled way, on occasions being subject to a stricter duty of fairness than would apply as between private citizens.' That case was decided less than 20 years ago, but its message appears to have been forgotten by HMRC. I am planning to ensure that it will always be remembered.

Update on recent case analyses

In the June 2015 issue of Tax Adviser, I wrote about the case of *Joost Lobler v HMRC* [1] [2015] UKUT 152 (TCC).

I understand that HMRC are not proposing to appeal against the Upper Tribunal's decision to the Court of Appeal.

In the July 2012 and October 2013 issues, I wrote about the case of *Healy v HMRC* [2] [2012] UKFTT 246 (TC) concerning the actor Tim Healy and his claim for accommodation expenses when appearing in a West End production. The case was remitted to the First-tier Tribunal, which dismissed Mr Healy's appeal on the particular facts of his case.

Links

[1] https://www.taxadvisermagazine.com/article/joost-busters

[2] https://www.taxadvisermagazine.com/article/once-more-unto-breach