Appeal number: TC/2014/3427

VAT – tripartite situation – car hire company arranging for repair of third parties' vehicles damaged in collisions with hired cars–whether car hire company entitled to recover VAT on car repair invoices -* Baxi, Aimia and WHA *applied - whether economic reality inconsistent with contractual position – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

U-DRIVE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE Barbara Mosedale
Gill Hunter

Sitting in public at the Royal Courts of Justice, the Strand, London on 18 May 2015

Mr J Hickey, Counsel, for the Appellant

Mrs S Spence, HMRC Officer, for the Respondents

DECISION

1. Originally, there were two matters in dispute between the parties. On 14 March 2014 HMRC refused a voluntary disclosure by the appellant dated 30 September 2013 for repayment of input tax of £17,460 relating to the costs of certain vehicle repairs in the period 09/09 to 03/13. Secondly, HMRC refused to accept a voluntary disclosure for repayment of alleged overpaid output tax relating to courtesy cars supplied to third parties.

2. We were only asked to resolve the first issue as the appellant withdrew its appeal on the second matter before the commencement of the hearing.

Facts

3. Mr R Sutton, General Manager of the appellant, gave evidence, although the facts were largely agreed. We find as follows.

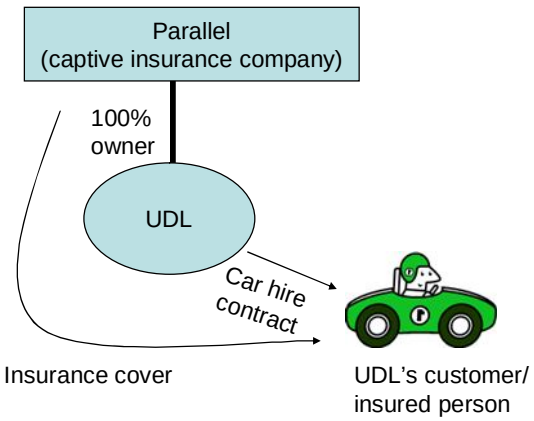
4. The appellant's principal business is the hire of self-drive cars and vans. The appellant ('UDL') has been registered for VAT since 1973. Its business is subject to VAT and UDL accounts for significant amounts of VAT to HMRC.

5. The appellant's customers have to sign a contract with UDL before they can hire a vehicle; UDL's standard contract signed by private customers provided that the customer would be insured by UDL's fleet insurance policy. Some commercial customers opted to be covered by their own insurance policy, but those contracts did not give rise to the issue in this appeal and we make no further reference to them. For the purpose of this appeal, we are concerned with those contracts where UDL supplied its customer with an insured car.

6. There was no itemised charge for the fleet insurance policy; it was effectively rolled up in the overall charge for the hire car. And we are not concerned with how insurance law operates: as we understand it, UDL contracted with its customers to provide an insured car; and UDL contracted with an insurer for a fleet insurance policy. The effect of that arrangement in law is that the insurer became liable to indemnify UDL's customer in the event UDL's customer damaged property belonging to a third party while driving the car.

7. Some years before the issue giving rise to this appeal, UDL had found the cost of its fleet insurance policy with an independent insurer had increased so much that it was more economic to, in effect, self-insure. It achieved 'self-insurance' by incorporating a captive insurance company called Parallel Insurance Services Limited ('Parallel'). Parallel provided the fleet insurance policy to UDL. UDL paid a premium to Parallel but in effect UDL would bear the full cost of any insurance claims as the premium was directly related to claims made: this was in effect self-insurance. For this reason, UDL often paid for the repairs without any claim being made on Parallel.

8. The contractual position can be explained as:



9. As UDL was effectively self-insuring, albeit through a captive insurance company, it therefore had a direct financial interest in minimising the cost of repairs to vehicles damaged in collisions with its hire cars insured by Parallel. So, for sound business reasons, it actively sought to minimise the cost of repairs.

10. In cases where the hire vehicle was involved in an accident with a third party for which UDL anticipated that a claim could be made by the third party against its customer, and thereby against Parallel as the insurer, UDL sought to minimise the claim as follows.

11. All customers were informed when taking the hire car that if there was an accident, UDL's contact details, set out on a 'bump card', should be given to the third party. This 'bump card' would encourage the third party to ring UDL rather than notify their own insurers. UDL's accident and repair handling team would then negotiate with the third party and negotiate with a car repair workshop with a view to the third party agreeing that the car repair workshop appointed by UDL would carry out the work to repair the car owned by the third party and provide a courtesy car.

12. UDL contracted directly with the car repair workshop that it appointed; that workshop issued UDL with an invoice. UDL paid the invoices. It is the VAT on these invoices which it seeks to recover in this appeal.

13. UDL considered that it saved itself expense this way because the costs of repair and courtesy cars were minimised because (a) the garages offered a reduced labour charge (b) the garages might offer further reductions if UDL was able to put a substantial quantity of jobs into the same workshop and (c) UDL had a system whereby parts could be obtained more quickly thus reducing the third party's car's off-road time and therefore the cost of the courtesy car.

14. Nevertheless, the evidence was that it only saved itself some £22,000 over the period in issue. Whether or not the cost saving policy was effective is not, however, in point.

15. The appellant did not claim that it had any contractual relationship with the third party. It accepted that even though it might arrange to have the third party's car repaired, if the third party changed his/her mind, and contacted his/her insurer instead, the matter was out of UDL's hands.

16. If the third party was not happy with the standard of repair work, UDL would seek to negotiate the situation.

17. The one 'fact' which was not agreed with HMRC appeared to be the question of whether UDL received a 'direct benefit' from the supplies made by the garages. The appellant contended, that as it made a saving from its bump card system over what it would have to pay if it just left the third parties to make claims via their insurers, it directly benefited from the garages' services of repairing the cars belonging to the third parties. HMRC did not agree and we address this issue below at §§99-101.

Legal analysis

18. The appellant and HMRC undertook little analysis of the legal relationships between the parties in the above scenario. But we think that this is critical to seeing the full picture of what was actually happening.

19. The first thing to note is that UDL was only paying for the repair of the third party's car in circumstances where there was (or presumably it thought there was) liability on its customer. In other words, this scenario existed where UDL's customer had (or UDL thought that the customer had) committed a tort against the third party. In other words, UDL's customer had negligently damaged a car belonging to someone else and was liable in law to that other person to pay compensation to put right the damage.

20. UDL's customer had the benefit of an indemnity from Parallel against its tortious liability as it benefited from the fleet insurance policy. (There is no need for the purpose of this decision to address whether the supply of the insurance to UDL's customer was by UDL or by Parallel. Only Parallel was an authorised insurer, but it had no direct contractual relationship with UDL's customer. Either way, due to its relationship with Parallel, UDL ultimately had to meet any liability under the insurance issued by Parallel). While UDL did have a contract with Parallel, in reality, when it paid for repairs itself it did this without any agreement with Parallel. Parallel was a captive company and it made no difference to UDL, its owner, whether Parallel paid or UDL paid: ultimately the cost of the damage caused by UDL's customer would be borne by UDL.

21. Neither side contended that UDL had any kind of a contract with the third party. Nevertheless, we find it must have been clear to the third party that UDL was not repairing its car gratuitously: the third party must have understood that it could not

have its cake and eat it. It would not get its car repaired for free and be paid compensation for the damage to the car. It could not, having had the damage to its car repaired satisfactorily by the garage appointed by UDL, in addition make a claim against UDL's customer for compensation for the damage. It was clearly understood, even if not contractually agreed, that the repair work done at UDL's request discharged UDL's customer's liability for the damage thus repaired. As no gift was intended, the repair (to the extent it put right the damage) discharged the tortious liability.

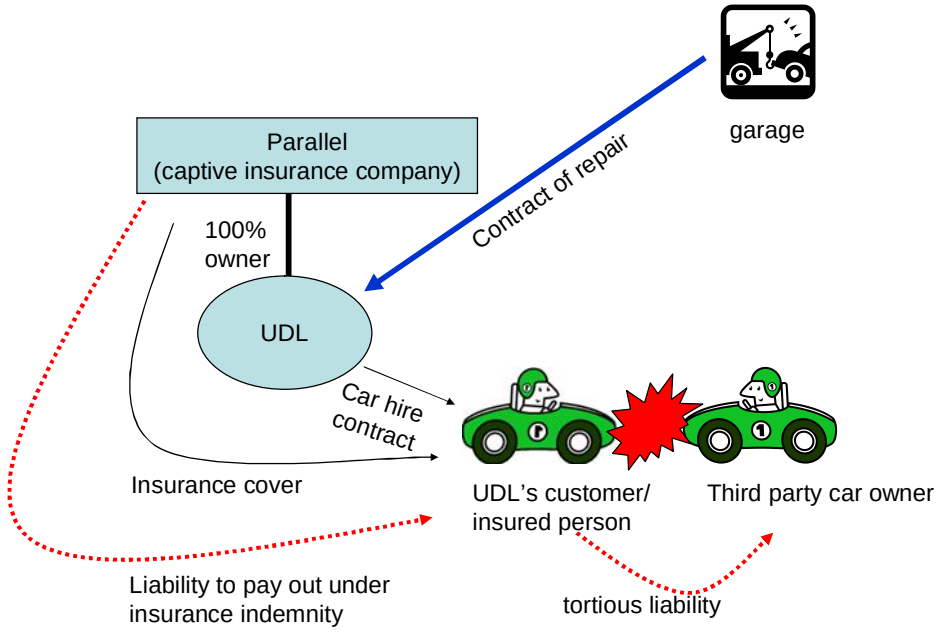
22. As this is what the parties agreed, we proceed on the assumption that there was no contract, not even an implied contract, between UDL and the owner of the car under which UDL agreed to repair the car. However, we are not sure that as a matter of law it is correct that there was no such contract, and we revert to this at the end of our decision: §§118-121.

23. While UDL could not compel a third party to produce its car for repair at UDL's selected garage, if a third party chose to allow UDL's selected garage to make the repair, to the extent that the repair was satisfactory it would discharge UDL's customer's tortious liability. It would therefore also discharge Parallel's liability to indemnify the customer against that tortious liability.

24. The reality is that UDL would pay the cost of the repair to discharge its customer's tortious liability to the third party and thereby to discharge Parallel's liability on its insurance indemnity to the customer, because ultimately UDL would bear the cost of the indemnity given by Parallel. The repair altered the legal relationship between UDL's customer and the third party.

25. UDL's reason for making direct contact with the third party to discharge its customer's liability in tort, and Parallel's resultant liability to the customer, rather than waiting for the third party to make a claim via its own insurance company, was that it believed, as we have explained, it was saving itself money, because it could organise the repair work to be done more cheaply than if organised by the third party's own insurance company. Either way UDL would ultimately have to pay for the work, either by a direct payment to the garage or by the premiums it paid to Parallel.

26. We set the position out diagrammatically:


garage
Parallel
(captive insurance company)
Contract of repair
100%
owner
UDL
Car hire
contract
Insurance cover
UDL's customer/
insured person
Third party car owner
Liability to pay out under
insurance indemnity
tortious liability

The issue

27. The question for this Tribunal was whether UDL was entitled to recover the VAT charged to it by various garages repairing third parties' cars under the arrangements described above.

HMRC's case

28. HMRC's case appeared to be two fold:

(1) There was no supply to UDL by the garages of their services of repair of the third party's vehicle. Therefore the VAT on the supply of the repair services was not input tax on a supply of services to UDL;

(2) Alternatively, if there was such a supply, UDL could not recover the input tax as there was no contract between UDL and the third party car owner.

The appellant's case

29. The appellant's case is that the economic reality was that UDL had incurred the cost of the garage repairs for the purposes of its taxable car hire business and therefore the VAT it incurred on these repairs was properly its input tax; moreover, UDL was the recipient of the supply made by the garages because UDL got a benefit from the repairs (the benefit being either or both that it was obliged to incur this cost in the course of its business and/or overall arranging its business in this way resulted in a reduced amount that it had to pay on repairs to third party cars).

30. While UDL accepted that the owner of the car also got a benefit from the supply made by the garage (its car was repaired), UDL also (said the appellant) benefited. UDL sees the supply as being made to two recipients, of which one was UDL.

31. The appellant also emphasised that UDL instructed the garages and agreed with them what work was to be done; the contractual position was that the garages agreed with UDL to carry out the work in return for an agreed fee to be paid by UDL.

32. In conclusion, UDL sees this as a case where the garage was making a supply to UDL of agreeing to carry out works of repair to a vehicle owned by someone else. And as that supply is (in the appellant's view) used in the appellant's car hire business, it ought to be able to deduct the input tax on it. It sees the garage repair bills as a cost component of its business.

To whom did the garages supply their services?

33. Article 168(a) of the Principal VAT Directive, reflected in s 24(1)(a) Value Added Tax Act 1994 ("VATA") only permits a taxpayer to recover VAT paid "in respect of supplies to him of goods or services".

34. So UDL can only deduct the VAT charged by the garages on their invoices if the supply made by the garages was made to UDL.

35. We are entirely satisfied that the contract to supply the services of repair was between UDL and the garage. There was no contract (and often, it seems, no contact) between the owner of the car (the third party) and the garage.

36. The critical question between the parties appeared to be to whom did the garages supply their services? Did they supply their services to UDL with whom they had a contract, whom they invoiced, and who paid them? Or did they supply their services to the person who owned the car which was repaired?

37. It is a simple question but the answer is much less straightforward. We cannot attempt to answer the question without considering the leading authorities and so we do.

Contracts not determinative

38. We have dealt with the contractual position at length because the contractual position is the starting point. However, the contractual position does not necessarily determine the question of to whom and by whom and of what the supplies were made. The CJEU said in *Newey* C-653/11 that:

> [42] As regards in particular the importance of contractual terms in categorising a transaction as a taxable transaction, 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…
>
> [43] Given that the contractual position normally reflects the economic and commercial reality of the transactions and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' transaction …have to be identified.
>
> [44] It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.
>
> [45] That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.

39. There is no question, of course, of any artificial arrangements in this case but the requirement to look at economic and commercial reality applies in all cases. In *Secret Hotels2 Limited* [2014] UKSC 16, an even more recent case which involved a tripartite situation where the question was whether the appellant was principal or mere agent, Lord Neuberger said:

> "Where the question at issue involves more than one contractual arrangement between different parties, this Court has emphasised that, when assessing the issue of who supplies what services to whom for VAT purposes, 'regard must be had to all the circumstances in which

> the transaction or combination of transactions takes place' – per Lord Reed in [*Aimia*]. As he went on to explain, this requires the whole of the relationship between the various parties being considered."

40. So if the contractual position is not the whole answer to the question to whom the supply is made, how do we determine to whom the VAT supply is made? The parties referred us to *Redrow, WHA* and *Airtours.* We have considered all the leading authorities in this area in order to discern the principals on which this appeal should be determined.

Redrow [1999] UKHL 4

41. For many years the leading authority on identifying the recipient of a supply in a tripartite situation was the House of Lords' decision in *Redrow.* As Lord Millett said

> "..the nature of the services and the identity of the person to whom they are supplied cannot be determined independently of each other, for each defines the other. Where, then should one begin? (page 171 c per Lord Millett)

42. So how to identify the recipient of the supply? The answer in *Redrow* was simple: a supply is doing something for consideration, so to answer the question the court must follow the money: the person who is liable to pay the consideration receives the supply. Because there is only a supply where there is consideration,

> "… one should start with the taxpayer's claim to deduct tax. He must identify the payment of which the tax to be deducted formed part; if the goods or services are to be paid for by someone else he has no claim to deduction. Once the taxpayer has identified the payment the question to be asked is: did he obtain anything – anything at all – used or to be used for the purposes of his business in return for that payment?"

43. If *Redrow* remained the only authority on the question of direction of supply, what would be the outcome of this case? *Redrow* provided a simple rule: 'follow the liability to pay'. Here UDL has entered into a contractual arrangement with the garage under which the garage agrees with UDL to repair a car belonging to a third party in return for payment by UDL. *Redrow* provides a simple answer: the garage supplies its services to UDL. What were the supplies? The identity of the recipients defines the nature of the supplies. Therefore, the garage's supply to UDL was the supply of agreeing with UDL to carry out the repair to the car belonging to a third party.

44. Redrow would clearly resolve the question of to whom the garage made the supply: under Redrow the supply would be made to UDL. UDL and the garage had a contract. In the contract, UDL agreed to pay for the repair and the garage agreed to undertake the repair. The garage carried out the repair; UDL paid for the repair. UDL obtained a repair that was useful to its business because it discharged the liability of its captive insurance company to the owner of the car that one way or another UDL would ultimately have had to meet.

45. Under *Redrow*, the inescapable conclusion is that the garage supplied the service of repairing a car belonging to someone else to UDL. UDL was the recipient of the supply. But as we explain below, *Redrow* has been qualified by later cases.

The CJEU decision in Tolsma

46. Another relevant early case is *Tolsma*, a case in which a busker was given gratuities by passers by. The national authorities sought to charge him VAT on his receipts. The CJEU said there was no supply

> "[12] The Court has already held…that taxable transactions, within the framework of the VAT system, presuppose the existence of a transaction between the parties in which a price or consideration is stipulated. The court concluded that, where a person's activity consists exclusively in providing services for no direct consideration, there is no basis of assessment and the services are therefore not subject to VAT [citing *Hong Kong Trade Development Council* C89/81]
>
> ….
>
> [14] …a supply of services is effected 'for consideration' within the [PVD], and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance…."

47. Although this case dealt with only a (claimed) bi-partite supply situation, the outcome was entirely consistent with the House of Lords' decision in *Redrow.* The CJEU demanded a legal relationship under which the services were provided for consideration: that is in effect exactly what the House of Lords said in *Redrow:* liability to pay (in other words, consideration) determines whether and to whom there is a supply. *Tolsma* and *Redrow* really say the same thing: but it is now clear that they are no longer a complete statement of the law, as we explain below.

The CJEU's decision in Loyalty Management

48. That leads to the CJEU decision in *Loyalty Management ("LMUK")* (C-53/09). In that case, retailers contracted with LMUK to be a part of the LMUK 'nectar' scheme which gave rewards to loyal customers. Retailers could buy 'points' from LMUK to issue to their loyal customers. LMUK kept its side of the bargain by contracting with 'redeemers' to provide goods and services in exchange for the points cashed in by the retailer's customers.

49. It was accepted that the payments to LMUK by the retailers were subject to VAT as in consideration of a vatable supply of services of participation in the loyalty scheme; the question was whether the payments by LMUK to the redeemers were for a taxable supply made to LMUK.

50. *Redrow* would have indicated that, as LMUK contracted to pay the redeemers, the redeemers' supply was to LMUK.

51. The House of Lords must have been, at least at the time, in some doubt of the application of *Redrow* as they referred the case to the CJEU. The CJEU, perhaps unaware of the *Redrow* analysis, gave an answer without hearing from the Advocate General. They did not identify the direction of the supply by asking "who pays?" but (it seems) by asking "who got ownership of the goods?" (§§44-49). They assumed that (if goods were provided) the nature of the supply was a supply of goods; they did not consider the possibility that the supply might have been the provision of a service of providing goods to third parties. While they did not expressly say so, the CJEU's approach appeared to entirely reject the *Redrow* analysis of identifying the nature of the supply by following the liability to pay.

52. Instead, the CJEU considered the provision of goods to be a supply by the provider of the goods to the recipient; there was, said the CJEU, consideration, because in exchanging the points for the goods and services from the redeemers, the customer gave rise to the redeemer receiving payment from LMUK: §57.

53. There are difficulties with understanding what the Court said. The CJEU was clearly and rightly concerned with the VAT concept that final consumption should be taxed. One major concept enshrined in the Sixth VAT Directive, and later the Principal VAT Directive, is that final consumption should be taxed, so where free gifts are provided, the retailer must account for VAT on that free gift to ensure that final consumption is taxed: see, for example, Article 16 of the Principal VAT Directive.

54. It is clear that this was of concern to the CJEU in *LMUK* as they referred to their much earlier decision in *Kuwait Petroleum* C-48/97 [1999] STC 488, where they had ruled that under a points scheme operated by the retailer, the retailer had to account for VAT on the redemption goods if the customer did not pay for the points when purchasing the original goods (in that case, petrol). In [52-54] of *LMUK* the CJEU referred to *Kuwait* and appeared to elide the question of whether the customer paid consideration for the points when it purchased the original goods/services with the question of the consideration paid to the redeemer for providing the 'free' gifts/services in exchange for the points.

55. *Kuwait* was a bi-partite business promotion scheme: *LMUK* involved four parties. Instead of applying what is now Article 16 of the Directive and which requires a retailer to account for VAT on free gifts, the CJEU appeared to think it had achieved the same result by deciding that the direction of the supply by the redeemer was to the customer, thus blocking the promoter from recovering that VAT.

56. Yet the promoter wasn't really making any gifts at all: it had contracted (for payment) with the retailer to provide goods to the retailer's customers to discharge the retailer's promise to its customers to give them free gifts. The free gift to the customer was really provided at the expense of the retailer. The failure to address the fact that the taxpayer did not make the free gift was of concern to the Supreme Court when the case returned to it: [38-40] and [46].

The Supreme Court's decision in LMUK/Aimia [2013] UKSC 15

57. At first glance, the decisions in *Redrow* and *LMUK* appear irreconcilable: the analyses applied by the two courts appear mutually exclusive. When the *LMUK* case returned to the Supreme Court ([2013] UKSC 15, which I will refer to as *Aimia* as the taxpayer had by then changed its name), however, the Supreme Court did not accept that *Redrow* was wrongly decided and instead it considered that the CJEU in *LMUK* had been asked, and answered, the wrong question [48], [55-56]:

> "[48]…the court does not appear to have assessed the transactions in question in the context of the arrangements considered as a whole, or determined on that basis what they amounted to in terms of economic reality. Nor is it apparent that the court took into account, in reaching its conclusion, the fact that (1) LMUK had agreed to make a taxable supply when it granted to collectors the right to receive goods and services at no cost or at a reduced cost, and (2) collectors receiving goods and services on that basis were therefore exercising a right for which LMUK had already been paid, and the consideration for which had already been subject to VAT."

58. Nevertheless, the conclusion of the majority of the Supreme Court was that, while *Redrow* itself was correctly decided, Lord Millett's propositions recorded at §42 above did not amount to an absolute rule:

> [66]…those questions should be understood as being concerned with a realistic appreciation of the transactions in question.

Direction of consideration was a relevant consideration but the overall situation had to be considered:

> [67] …it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded a priori. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation the correct analysis is likely to be that the payment constitutes third party consideration for the supply.

59. Decisions of the CJEU must be applied: here the majority in the Supreme Court decided that the CJEU had been asked, and therefore answered, the wrong question [76-77]. The wrong question was the failure to explain LMUK's business model. In particular, as I have explained, LMUK was not in the business itself of giving away "free" gifts. So LMUK should not be made to bear irrecoverable VAT:

> "[79] It is implicit in that approach that the transaction between a redeemer and LMUK involves a taxable supply by the former to the latter. That analysis appears to me to be consistent with economic reality. LMUK carries on a genuine business for its own benefit. It issues the points in its own name and on its own behalf: it is not a mere cipher for the sponsors. As a matter of economic reality, the payments which it makes to redeemers are an essential cost of its business. Its business model is to sell the right to receive goods and services, pay redeemers to provide the goods and services, and derive a profit from the difference between its income from the sponsors and its expenditure on the redeemers.
>
> [80] There is a legal relationship between the redeemer and LMUK pursuant to which there is reciprocal performance….
>
> [81] In these circumstances, it can in my view be said that the remuneration received by the redeemer represents the value to LMUK of the service which the redeemer provides (cf *Tolsma….)*
>
> [82] The approach described in the foregoing paragraphs is consistent with the fundamental principal…that a taxable person is entitled to deduct the VAT payable in the course of his economic activities….
>
> [83] This approach is also consistent with the application of the guidance given in *Redrow.* If one asks whether, when the redeemer accepts points in exchange for the provision of goods or services to a collector, something is being done for LMUK for which, in the course or furtherance of its business, it has to pay a consideration, the answer seems to me to be in the affirmative…"

60. But where does the Supreme Court's decision in *Aimia* leave the appeal in this case? *Redrow* is not overruled, but is no longer an 'absolute' rule; and the CJEU's decision in *LMUK* , while of course good law, as it was a decision of the CJEU, nevertheless must only be understood and applied in the light of the decision in *Aimia.* In other words, I must apply the analysis in *Aimia.*

61. The outcome of *Aimia* was a result consistent with *Redrow* and *Tolsma:* in other words, the direction of the supply was the opposite of the direction of the liability to pay. The legal relationship under which LMUK (the promoter) acted was between itself and the redeemer; LMUK was liable to pay the redeemer: the redeemer was found to have made its supply to the promoter. The economic reality in *Aimia*, so far as LMUK was concerned, was found to be consistent with the contracts into which LMUK had entered. So the VAT analysis followed the contracts.

62. But the implication of the Supreme Court's decision in *Aimia* was that in some tripartite instances the application of economic reality would mean that the direction of the supply would not always follow the contracts and the legal liability to pay. *Redrow* is not an absolute rule.

The CJEU decision in Baxi Group Ltd C-55/09

63. *Baxi Group* was referred by the House of Lords to the CJEU at the same time as *LMUK*. Unlike *LMUK*, it was never re-visited by the Supreme Court, the parties in

Baxi presumably accepting that the CJEU decision was sufficiently clear to resolve the appeal. It is therefore binding on this Tribunal and is as much the law as *Aimia* is.

64. This might be thought to put a later tribunal in difficulties in applying the law as the CJEU's decision in *Baxi* was given in the same judgment, using the same analysis, as the CJEU used in *LMUK*. Only the Supreme Court has determined that in *LMUK* (but not *Baxi)* the CJEU was asked and answered the wrong question. In fact, we do not consider that this does present a problem, because the very matter which the Supreme Court considered significant and which was not made clear to the CJEU in *LMUK* was the one matter on which *Baxi* differed from *LMUK*. And we explain this below.

65. The position in *Baxi* was very similar to that in *LMUK* other than that the roles of promoter and redeemer were both held by a company called @1. In other words, it was a tri-partite and not a 4-party arrangement. Baxi promoted its products and sought customer loyalty by giving its customers 'points' with their purchases. Baxi purchased the points from @1. The customers redeemed the points with @1 who supplied the customers with the goods they selected. Baxi paid @1 a fee for its services which included an amount to reflect the value of the goods given to Baxi's customers.

66. The conclusion of the CJEU was that @1 made two supplies (§62-63); one was a supply to Baxi's customers of the free gifts and the other was a supply of promotional services to Baxi. The fee paid by Baxi was seen by the CJEU as split between these two supplies.

67. In so far as the court concluded that @1 made a supply to Baxi and the money paid by Baxi to @1 was consideration for that supply, the reasoning of the CJEU is consistent with *Redrow* and economic reality. It has little application here as there is no suggestion that the appellant paid for anything other than the repairs.

68. The relevant part of the CJEU's decision is its conclusion that @1 made a supply of the free gifts to Baxi's customers in return for the rest of the fee paid by Baxi, which it described as third party consideration. As with *LMUK*, *Baxi* reads as if the CJEU applied back-to-front reasoning. The court appeared to say at §§48-49 that *because* @1 transferred property from itself to Baxi's customers it was therefore making a supply *to* Baxi's customers and that *therefore* because the supply was by @1 to Baxi's customers, then @1's receipt of money from Baxi had to be third party consideration for that supply. The CJEU did not even consider the possibility that @1 made a supply to Baxi of the services of giving the free gifts to Baxi's customers in return for the fee paid to it by Baxi. They did not consider, in other words, a *Redrow* analysis. On this, the court's analysis, like its analysis in *LMUK*, appeared to overlook its own decision in *Tolsma*.

69. However, the CJEU, as I have said, was clearly concerned to ensure that, consistent with the clear intention of the Sixth and Principal VAT Directives, input tax on gifts was blocked. It referred to its own decision in *Kuwait.* And as with *Kuwait,* in *Baxi* the points were given to the customers: there was no option to pay a

lower price for the boiler and receive no points: [23]. The effect of the decision in *Baxi* was to block input tax on what must therefore be seen as gifts: Baxi was unable to recover the VAT on provision of the gifts as the CJEU held the supply was made to its customers. The customers, albeit VAT registered, were presumably unable to recover the VAT on the supply to them as it was not attributable to any supply made by their business. Thus, the outcome of *Baxi* was consistent with the Sixth and Principal Directives and with *Kuwait,* albeit it was reached via a different route.

70. Our view is that *Aimia* and *Baxi* are, and must be seen as, consistent decisions. The Supreme Court recognised in *Aimia* that *Redrow/Tolsma* did not always provide the answer in a tripartite situation to the question of to whom the supply was made: economic reality must always be considered. *Baxi* must be seen as an example of a case where economic reality trumped the basic 'follow the liability to pay' rule set out in *Redrow* and *Tolsma.*

71. The economic reality in *Baxi* is that Baxi had arranged for a third party (the promoter/redeemer, @1) on its behalf to provide the free gifts which Baxi had promised to its customers. And this is where it is significantly different to *LMUK.* LMUK was not in the business of giving things away free to anyone: it made, in return for payment, a taxable supply to its customer (the promoter/retailer) of points which would entitle the promoter/retailer's customers to obtain the free gifts for which the promoter/retailer was paying.

72. The Directive prevents recovery of VAT on free gifts by the donor as the economic reality is that otherwise final consumption would not be taxed. So in circumstances where the economic reality is that final consumption will not be taxed if a *Tolsma* analysis is applied, the supply is not seen as made to the donor, even though the donor is liable to pay for it and has the legal relationship with the person providing the free gift to the customer.

73. In other words, the economic reality in *Baxi* was that Baxi sold its customers boilers. It did not sell them the 'free gifts' as well ([23]): it simply gave away points representing free gifts to its customers. It entered into a contract and incurred expenditure on obtaining the right for these points to be redeemed into free gifts. So the economic reality is that the free gifts were consumed by Baxi's customers. As there was no contract under which those free gifts were supplied to Baxi's customers, economic reality did not match the contractual position. So the effect of VAT law, as interpreted by the CJEU, is that where economic reality does not match the contractual position, economic reality trumps the contract, and the VAT supply follows the route of economic reality. The reality was that the customers consumed the free gifts so the VAT supply of the right to the goods was made to the customers and not to Baxi.

74. We think the decision in *Baxi* is explained by the CJEU's reference to *Kuwait* and its clear concern with VAT being blocked on final consumption.

WHA

75. *Aimia* itself was revisited by the Supreme Court in *WHA* [2013] UKSC 24. HMRC rely on *WHA* in this appeal. In that case, an insurance company (NIG) offered breakdown insurance to purchasers of second-hand cars. It arranged its affairs, as part of a complicated scheme to avoid VAT, the details of which we do not need to recite, so that the garages that carried out the repairs when the cars broke down invoiced a UK based claims handling company. The question addressed by the Supreme Court was whether the garages made a supply of their repair services to that claims handling company (WHA) or to the owner of the car.

76. The Supreme Court's conclusion as expressed at [56-60] was that on the particular facts of the case the supply by the garage was made to the car's owner so that [57] WHA's payment of the cost of that supply was no more than third party consideration, discharging NIG's obligation to indemnify the car owner against the cost of the repair.

77. It can be seen why HMRC rely on that decision in this case, which also involves a person connected with the insurance company paying the garage to repair a car which belongs to someone else. There are of course many factual distinctions but on a headline level the cases are similar and the outcome was that the paying party could not recover the VAT on the garage's services.

78. As with the CJEU's decision in *LMUK*, *WHA* is a case where the court's answer resulted in the VAT supply not correlating with the contract. In *WHA*, the contract was between WHA and the garage; but the supply was found to be between the garage and the owner of the car. Yet the owner of the car had no obligation to pay the garage for the repair in so far as it was covered by the insurance policy: following the reasoning in *LMUK* (CJEU) it seems the 'consideration' was the permission by the owner given to the garage to carry out the repair as that enabled the garage to carry out the work and qualify for payment under its contract with WHA. The peculiarity of the parties to the supply not matching the parties to the contract underlying the supply was not discussed by the CJEU or Supreme Court.

79. It is superficially difficult to distinguish *Redrow* from *WHA* on the facts: in both cases there was a tripartite contract under which the "non-owner" was liable to pay for the services, and the owners (in *Redrow* of the house, and in *WHA* of a car) were not liable to pay for the services from which they would benefit. Yet the House of Lords/Supreme Court reached diametrically opposite conclusions on the law. There is no doubt, therefore, that the CJEU's judgment in *LMUK* has qualified *Redrow*. But how does a tribunal know when to apply the 'follow the liability to pay' rule in *Redrow/Tolsma/Aimia* and when to apply the 'economic reality' rule in *Baxi* and *WHA*?

80. The facts in *WHA* are discussed at [48-49] and at [49] Lord Reed clearly considered that there was a tripartite contract in which "the insured…authorised the garage to carry out the repairs to his or her car, and agreed to pay for the work in so far as it was not covered by the policy" . At [56] and [57] Lord Reed put considerable focus on the fact that the insurance policy was an agreement to pay the cost of repair

and not to actually carry out repair. We note that the reasons given for the conclusion include that:

> [58]. … The final consumer of the services supplied by the garage is the insured; and the effect of dismissing this appeal is that VAT is borne on that supply.

Another reason given, which amounts to much the same thing, is that the economic reality was that WHA did not consume the repairs to the car and indeed WHA had no real business:

> "[59]…it is plain that WHA did not obtain anything in return for the payment to the garage which was used for the purposes of its business. On the contrary, ….WHA's business *was* the making of the payment".

In other words, it was an avoidance scheme with the objective of removing final consumption from taxation. So the only result consistent with economic reality was to tax final consumption.

81. So it is clear that the Supreme Court was concerned with what it saw as the economic reality of the situation. It is tempting to conclude that the factors above referred to by Lord Reed were significant because a scheme was put in place the outcome of which was intended to be that VAT on final consumption would be recovered, which was inconsistent with the Directive. The Supreme Court in *WHA* was concerned that the scheme enabled recovery of input tax on repairs that were clearly consumed by a private individual.

82. Our analysis of the situation is that the *Tolsma/Redrow/Aimia* 'follow the liability to pay' rule is the default rule under which the VAT supply will follow the contracts and that rule applies in tripartite situations unless the economic reality is inconsistent with the contractual position. And the economic reality will be inconsistent with the contracts where final consumption takes place *without* a contract supplying the thing to be consumed to the final consumer.

83. That explains the decisions in *Baxi* and *WHA*. In other words, in *Baxi*, the final consumer of the 'free gift' was Baxi's customer but there was no contract under which the free gift was supplied to Baxi's customer. (This is an application of *Kuwait:* contractually Baxi agreed to supply the points with the boiler, but that did not amount to a supply of the points for the reasons given in *Kuwaiti).* So economic reality did not match the contracts, so the VAT supply route did not match the contracts either. The supply was found to be to Baxi's customer even though Baxi's customer had no liability to pay for the free gift. In *WHA*, the final consumer of the repair work was the owner of the car, the insured party. But there was no contract with the insured under which the work of repair was carried out. So economic reality did not match the contracts, so the VAT supply route did not match the contracts either. The VAT supply route followed economic reality, so the supply was found to be to the insured party and not to WHA, who had the contractual liability to pay for it.

84. In passing we note that, had HMRC refused the retailers' recovery of input tax charged to them by LMUK, then the application of economic reality ought to have

decided the case in HMRC's favour: so in LMUK/Aimia, HMRC attacked the wrong party to the 4-party scenario. They should have refused the *promoter/retailers'* recovery of VAT on the supplies made to them by LMUK. This is because so far as the promoter/retailer was concerned, economic reality did not match the contracts. The promoter/retailer had a contract under which they had the liability to pay for the provision of the free gifts, but the promoter/retailer neither consumed the free gifts in its business nor did it (unlike LMUK) on-supply the rights to another person. In other words, the promoter/retailer bore the cost of the free gifts which were consumed by others. So their economic reality did not match their contracts so the supply apparently to the retailer/promoter should have been seen as a supply to the consumers, and the promoter/retailer denied input tax recovery.

Airtours

85. The final case in this summary of leading decisions on tripartite supply situations is the recent decision of the Court of Appeal in *Airtours Holidays Transport Ltd* [2014] EWCA Civ 1033, which the appellant relied on in this appeal. In that case, a company (in financial difficulties and owing banks large sums of money) entered into an arrangement under which a professional services firm (PWC) agreed to supply the service of reviewing the company's restructuring plan and to provide a report on it to creditor banks. The company was liable to pay PwC's contract fee.

86. The question the Court of Appeal considered was that of to whom PwC's professional services were supplied? The decision of the majority was that as a matter of fact the company did not engage with PwC to provide a report to the banks; on the contrary the banks contracted with PwC to provide them with the report (see [83], [87] and [98]). The company acted as no more than provider of third party consideration.

87. The dissenting judgment essentially disagreed with the legal analysis of the contract, finding that the company "had a contractual right to require" PWC to provide the services to the banks ([46]). And on that basis considered that that meant that there was a supply of services to the company by PwC: the agreement to provide something to someone else.

88. It is difficult to understand the majority as they appeared to find there was no contract: this is because they said PwC owed no liability to the company to provide the report to the bank, yet nevertheless the company was liable to pay for the report. Reciprocity is a fundamental requirement of a contract and yet here the majority said that there wasn't any. While the majority decision is binding on this Tribunal, it is therefore clearly distinguishable because there was a clear contract in this case between UDL and the garage for the repair to be carried out.

89. The minority judge found that there was reciprocity: In return for the payment by the company, PwC owed the company the obligation to provide the report to the bank. She then went on to consider whether the contracts were consistent with the economic reality: [54]. Her conclusion was that Airtours very much benefited from

the report as it led to the banks continuing to support the company: [55] and so Airtours ought to have been allowed to recover the VAT.

90. What effect does this decision have on this appeal? The majority decision is distinguishable. We are concerned with economic reality but what the minority judge said on this is not binding and the majority did not really address it and in so far as they did, their conclusion was that the economic reality was that the banks consumed PwC's services.

91. Our view is that the CJEU would agree with the view of the majority that the economic reality was that PwC's services were really consumed by the banks. While it was in the company's best interests to contract with PwC to provide the report, it was in a comparable position to Baxi when it contracted for free gifts to be provided by another company to Baxi's customers. It was in Baxi's interests for free gifts to be received by its customers because this promoted its business and was intended to generate customer loyalty and in that sense it 'consumed' @1's service of agreeing to give away goods to Baxi's customers; but the economic reality is that the free gifts themselves were consumed by the customers, in the same way that PwC's report was directly consumed by the bank. And in such a case the CJEU has said the supply must be seen as made to the person who finally consumes the goods or services. The decision of the majority in *Airtours* is therefore entirely consistent with *Baxi*, *Aimia* and *WHA*.

Conclusion on the legal principals to be applied

92. We take from consideration of all these cases that a VAT supply, ordinarily at least, requires a legal relationship between the supplier and recipient under which the supplier is obliged to make the supply and the recipient is liable to pay for it: *Tolsma* and *Redrow*. Nevertheless, where the economic reality of the legal relationship is such that it results in final consumption of goods or services by a consumer in circumstances where in effect there is no VAT charge on that consumption then this normal rule is overridden because the ultimate purpose of the Principal VAT Directive is to tax final consumption:

> **Article 1(2)**
>
> The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

Where final consumption would otherwise be untaxed, the CJEU and Supreme Court in the cases of *Baxi* and *WHA* have seen the supply for VAT purposes as being to the final consumer even thought the legal relationship with reciprocity has not been with the final consumer.

93. In *Aimia*, the Supreme Court said the reciprocity rule in *Redrow* was not an absolute rule, because regard must be had to economic reality, but the three judges of the majority in *Aimia* appeared to consider that *Redrow* was correctly decided on the

facts of that case ([65]) although there was no detailed analysis. Is our above analysis with consistent with the outcome of *Redrow?* Our analysis of case law is that *Redrow* would still be decided the same way under the *Baxi/WHA* line of cases unless final consumption would go untaxed. Did final consumption go untaxed in *Redrow?* The Lords did not appear to think so. In Lord Millett's final paragraph he referred to the estate agent's services having a direct and immediate link to the sale of the taxable (albeit zero-rated) Redrow home. In any event, the basis of the decision in *Aimia* was that *Redrow* is not an absolute rule and where a business meets:

> "the cost of a supply of which it cannot realistically be regarded as the recipient …."

it may be seen as only providing third party consideration.

94. In conclusion, in a situation where B agrees to pay A to provide goods and/or services to C, and C agrees with B to pay for the goods and/or services provided by A, then a *Redrow* 'follow the liability to pay' analysis applies to decide to whom A's supply is made. This is because the legal relationships reflect the economic reality and the outcome is consistent with the Principal VAT Directive because final consumption is taxed. In other words, A's supply is to B, and B makes an on-supply to C.

95. But where a *Redrow* 'follow the liability to pay' analysis does not lead to tax on final consumption, because although A makes a supply to B (of providing goods/services to C), B does not on-supply A's services to C, then C's consumption will be untaxed, and, applying *Baxi/Aimia/WHA*, economic reality requires the supply to be seen as made to the final consumer.

Third party consideration

96. The Directive and the cases refer to third party consideration. The normal meaning of third party consideration is where one person discharges the liability of another person. But that clearly cannot be the meaning that it carries in the Principal VAT Directive as interpreted in *Baxi* and the other cases. In *Baxi* the CJEU said the payment by Baxi to @1 was third party consideration for the supply to Baxi's customer of the free gifts: but its contract with @1 made Baxi liable to pay that sum to @1. It was not third party consideration in the normal meaning of the phrase. But it seems to us that when economic reality has defined the direction of the supply to be the direction of final consumption, then the contractual payment by the person not a party to that supply must be referred to as 'third party consideration' for VAT purposes.

97. The terminology is confusing but that is not surprising when the case law makes it quite clear that VAT supplies do not have to be identical to contractual supplies, so that the recipient of the supply in the VAT world is not the recipient under the contract, and the person who is liable to pay for the supply is, in the VAT world, seen only as providing third party consideration. It is probably easier to understand if the phrase is not used.

98. As we have also noted, the CJEU's analysis in *LMUK/Baxi* and the Supreme Court's in *WHA* is that, where economic reality requires the supply to be seen as made direct to the final consumer and not to the person with liability to pay for it, then the consideration required under *Tolsma* is seen as the opportunity for the supplier to earn the third party consideration: see §52. This type of analysis of 'opportunity' consideration only applies where economic reality did not match the contractual analysis, in other words where final consumption was by a person who did not have the liability to pay for it. In other words, there is only this 'opportunity' consideration where there is a mismatch between economic reality and the contracts: the analysis has not been applied in any other situation. It was not, for instance, applied in *Aimia*.

Conclusions on appellant's case

99. In summary, it was the appellant's case that it (at least in part) consumed the services provided by the garages. This was because the arrangement was of financial benefit to the appellant and/or because ultimately the appellant was bound to pay for the repair.

100. We will take these two points one at a time. We accept that the bump card arrangement was financially beneficial to the appellant because, overall, it cost UDL less money to repair the cars via the bump card system than if it had simply waited for the third parties to make a claim against Parallel via their own insurers.

101. But that is not the same as saying that UDL consumed the services of the garage and/or that both the owner of the car and UDL were the recipients of the services of the garage. The repair of the car could only be consumed by the owner of the car. UDL got no direct benefit from the repair of the car: it neither owned nor used the car. The position was simply that UDL had a financial liability to pay for the repair (because ultimately it was liable under its arrangement with Parallel to do so) and it chose this method to meet that liability rather than another because it was cheaper. It benefited because the bump card method resulted in a lower repair bill than if the repairs were arranged after a claim via the third party's own insurance company: that is not the same as actually benefiting from the services of repair. It did not use the services of repair in its business. It did not benefit from the services of repair: it benefited from it being cheaper to pay the garage direct than paying the insurance claim.

102. Being bound to pay for the repair does not mean that a person consumes the repair: insurance companies are bound to pay for repairs under insurance contracts, but that does not mean that the service of repair is supplied to them. UDL was not an insurance company, but in this it acted like one: Parallel was the insurance company, but it was a captive company and that meant (to ensure it remained solvent) UDL had to reimburse it the costs of any claim or ensure that a claim was not made by repairing the car itself. UDL saw itself as bound to discharge Parallel's liability to pay an amount equal to the cost of the repair: paying directly for the repair would be a business expense but it did not mean that UDL consumed the repairs.

103. This appears to be a case with significant similarities to *WHA:* UDL like WHA paid for the repair but the repair was consumed by the owner of the car. The contractual situation did not match the economic reality and therefore the direction of supply should follow economic reality.

104. The appellant does not agree. It distinguishes the case of *WHA.* In particular, it says that WHA wasn't really carrying on a business: it was established simply to enter into the contracts with the garages and pay them out of monies provided by NIG. Here, UDL had a very real business and the arrangements with the garages and the third party owners of the car were not motivated by tax avoidance. The arrangements were commercial, driven by financial and not tax considerations.

105. We accept that there was no artificiality in the arrangements in this appeal and that the arrangements at issue in this appeal were driven by purely commercial considerations. But the doctrine explained in *Baxi* and *WHA* was not one which turned on whether the arrangements were artificial or commercial. Our explanation is that the CJEU and Supreme Court were concerned with the question of taxation of final consumption as that is a fundamental doctrine underlying the Principal VAT Directive. The fact that UDL's arrangements were driven purely by commercial considerations does not alter the significance of the fact that, although UDL contracted with and had the liability to pay the garages for the repairs, nevertheless UDL would not itself consume the services of repair, either by using the cars in its business or by on-supplying the repair service to someone else. UDL should be compared to Baxi in the eponymous case: Baxi was acting purely in its own commercial interests in paying for a business promotion scheme under which its customers received free gifts. Its purpose was to promote customer loyalty to generate more business in the future. There was nothing artificial in its arrangements with @1 nor were any steps inserted to avoid tax. But, nevertheless, the CJEU decided that on a proper interpretation of the Directive, the supply was to the customer and not to Baxi, who was liable to pay for it, because the customer consumed the goods.

106. We think the same analysis applies here. *WHA* cannot be distinguished on the basis that it involved an artificial tax avoidance scheme as that was not the basis of the decision. The basis of the decision was that economic reality did not match the contractual position as the consumer of the services did not have any liability to pay for them. So the VAT supply was seen as made to the consumer of the service and not the person (WHA) who had the liability to pay for them. And that is the correct result here: the owner of the car consumed the repair services even though UDL was contractually liable to pay for them and the owner of the car, rather than UDL, must be seen as the recipient of the supply made by the garage.

107. The appellant also sought to distinguish *WHA* on the basis of what Lord Reed said at §3:

> "In principal, however, an MBI insurer might undertake not to indemnify the insured in respect of the cost of repair, but to repair the insured's vehicle; and it could then arrange with a garage for the repair

> to be carried out, and pay the garage's bill. Even in such a case, however, the insurer would not be able to deduct the VAT element of the bill, since, even if the garage were regarded as supplying a service to the insurer for the purposes of its insurance business, the insurer would not be liable to account for any VAT in respect of that business, and would therefore not have received any VAT from which the tax paid to the garage could be deducted."

The appellant says that, unlike the hypothetical MBI insurer in this paragraph, UDL did arrange with the garage for the repair of the car *and*, says the appellant, carried on an economic activity and was (says the appellant) entitled to input tax deduction.

108. We find it quite difficult to understand the distinction the appellant is trying to make: in §3 Lord Reed was explaining the legal position if the complicated tax avoidance scheme had not been entered into. He was explaining why an MBI insurer could not reclaim VAT on the garage bills for the repair of the insured's vehicle. Normally it is because the MBI insurer indemnifies the insured against the cost of the repair: the garage supplies its services to the insured. In §3 Lord Reed was contemplating the possibility of the MBI insurer seeking to get around this by entering into a direct contract with the garage for the repair. He said, as quoted above, that even if the supply was seen as made to the insurance company, that supply was not consumed in the business of the insurance company. That is what Lord Reed meant when he said "…the insurer would not be liable to account for any VAT in respect of that business and would therefore not have received any VAT from which the tax paid to the garage could be deducted". This is another way of saying the services of the garage were not used to make any on-supply and therefore were not consumed in the business.

109. So far from being a point of distinction, it can be seen that this hypothetical case has clear parallels with UDL's position. While the cost of the repair is clearly a business expense, it is not consumed in the business in the sense that it was not used to generate any supply. So if what Lord Reed said in §3 in relation to a hypothetical case is right, it does not help the appellant.

110. And in any event, was what Lord Reed said here a part of the ratio and if not, was it right? As he is here explaining what he perceived to be NIG's thought processes in setting up the scheme that was the subject of the appeal and §3 is therefore entirely background, it seems to us that this is not a part of the ratio and not binding. And if not binding, we can consider whether it was right.

111. And it seems to us that Lord Reed didn't consider the possibility that the cost of the repair might be seen as a business overhead: something which was not used to make an on-supply but was consumed in the business. It is common for a business to have business expenses which are not directly attributable to particular supplies. However, the distinction between such business expenses which support the making of supplies, and the expense of car repair is that the service is not consumed in the business at all: neither in making a particular supply nor in general business overheads (cf *Midland Bank* C-98/98 where the bank clearly consumed the overhead of legal expenses arising in respect of past supplies).

112. So if Lord Reed ought to have considered the possibility that the expense was an overhead, in line with the decision actually reached in *WHA*, it seems his conclusion would have been the same: even if paying for the car repair was a business expense in the accounting sense, economic reality did not match the contractual position because the service of repairing the car was not consumed by the person with the liability to pay for it and therefore the supply was not made to the person with liability to pay for it.

113. Another possibility that Lord Reed did not consider was that the service of car repair might, on the hypothetical facts of §3, have been seen as supplied by the insurer to the insured in that the assumption Lord Reed made in this paragraph was that the insurer actually undertook in the insurance policy to repair any damage to the car. It was not a policy to provide an indemnity: it was a policy to carry out any repairs needed. In such a case, the supply by the garage would have been consumed by the insurer in carrying out its contractual liability to repair the car. So the tax on the supply by the garage would have been input tax of the insurer's, attributable to the supply by the insurer of the policy. But that is of no help to the insurer in recovering the VAT on the garage's services: if the supply of the policy was exempt, then the input tax is irrecoverable. If the supply of the policy was, at least in so far as it was a promise to repair the vehicle, subject to VAT, then the insurer would have output tax to account for which would offset its input tax recovery.

114. So, in summary, if Lord Reed's analysis in §3 is right, it does not help the appellant; and if it was wrong, it does not help the appellant either. In other words, even if the garage repair cost was a business expense in the accounting sense, it was not consumed by the business and *Baxi* and *WHA* apply to mean that the supply must be seen as made to the owner of the car and not UDL at all. But if UDL could say that it did consume the services of the garage, then it could only have done so by on-supplying the repair service to the owner of the car. And if it did so, that would have been a standard-rated supply the output tax liability on which would cancel out the input tax rights (see *MDDP* C-319/12 and *Taylor Wimpey* [2015] UKFTT 74 (TC)).

Decision

115. Our view is that the appellant is in the position explained by Lord Reed in *Aimia* at [67]:

> "A business may….meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply."

116. Our conclusion in this case is that, applying *WHA* and *Baxi*, the economic reality is that the repair services were consumed by the car owner, albeit that the contract to deliver the services was with UDL. Economic reality did not match the contractual position, and therefore the VAT supply route follows economic reality rather than the contractual position. The supply must be seen as made to the owners of the cars and not to UDL.

117. While we accept that paying for the garages' services was done in the course of UDL's business, that does not, applying *Baxi*, entitle UDL to recover the VAT. If UDL were able to recover the VAT then final consumption of the services of the garages would be untaxed, and that is contrary to the Principal VAT Directive and to what was said by the CJEU in *Baxi*, and inconsistent with the need to look at economic reality of consumption as expressed in *Aimia* and *WHA*. *Baxi* and *WHA* apply so that the supply of the services of the garages must be seen as made to the owners of the car so the appellant has no entitlement to recover the VAT and the appeal must be dismissed.

Postcript – an alternative analysis

118. The above analysis is on the basis that the parties were correct to agree that there was no contract between UDL and the owner of the car. As we have said at §22, we are not entirely sure that that is necessarily correct, in that, as we have said, it was everyone's clear understanding that if UDL got the damaged car repaired, then that would discharge its customer's liability to the owner of the car in tort.

119. Proceeding on the assumption that there was an implied contract between UDL and the owner of the car under which they agreed that to the extent UDL repaired the car, the owner's claim against UDL's customer would be satisfied, would that lead to a different outcome in this appeal?

120. It seems to us that it would have a radical impact on the application of *Baxi* and *WHA*. And that is because if there was such a contract, UDL must be seen as making a supply to the car's owner of the repair of the car: under the contract it would be agreeing to carry out the repair of the car in return for discharge of the customer's tortious liability (for which UDL has ultimate responsibility via the insurance policy and its relationship with Parallel). And if UDL must be seen as supplying the services of car repair to the owner of the car, then it must be seen as consuming the repair services which the garage had contracted with it to provide. So the case would be analogous to *Redrow* or *Aimia.*

121. But that would still not alter the outcome of the appeal. Because if this analysis is right, UDL should have, but failed to, account for VAT on its contract with the car owner to repair their car. As we have said, the claim for input tax must be set against the related unpaid output tax: *MDDP* and *Taylor Wimpey*. So under normal valuation rules for barter situations, the value of the output tax liability would equal UDL's costs in making the supply. The cost of the supply which would be what it paid to the garage, so UDL's output tax liability would equal its input tax claim and so that claim should be reduced to nil. Either way, UDL is not entitled to the VAT it reclaimed and which was the subject of this appeal.

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

"Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

Barbara Mosedale

TRIBUNAL JUDGE
RELEASE DATE: 10 DECEMBER 2015