HMRC v Southern Cross Employment Agency Limited [2015] UKUT 0122 (TCC)

Tarlochan Lall, Monckton Chambers

April 2015

Mr Justice Newey, sitting in the Upper Tribunal, dismissed HMRC's appeal against Southern Cross Employment Agency Limited's victory in the First-tier Tribunal that HMRC could not resile from an agreement to repay VAT. Mr Justice Newey held that:

1. Section 80(7) Value Added Tax Act 1994 did not bar HMRC from entering into a binding agreement with Southern Cross. HMRC could enter into such an agreement under their care and management power.

2. The agreement HMRC entered into was not *ultra vires* and was not void.

3. The FtT was entitled to find that a compromise agreement had been formed between Southern Cross and HMRC on the facts and that such finding could not be disturbed.

Both the FtT and the Upper Tribunal have in essence held that although the initial claim for repayment was made under s80 VATA, HMRC had power to enter into a compromise agreement of that claim and the compromise meant that s80(4A) could not bite.

The Facts

Southern Cross is an employment agency and supplied dental nurses to dentists. The original VAT issue underlying the appeal was whether Southern Cross' supplies were exempt.

Southern Cross had accounted for VAT on the supplies. Considering its supplies to be exempt, it claimed repayment initially for the period 1998 to 2001. HMRC agreed the supplies were exempt and repaid VAT for that period.

In 2009 Southern Cross submitted a *Fleming* claim for repayment for the period

1973 to 1997. HMRC raised the defence of unjust enrichment. Southern Cross's advisers Horwath Clark Whitehill (HCW) strongly disputed HMRC's entitlement to rely on the unjust enrichment defence. Exchanges between HCW and HMRC on unjust enrichment may be described as conjecture based rather than reliant on evidence of whether or not Southern Cross would be unjustly enriched. In March 2010, HMRC's officer communicating with HCW proposed to pay 50% of Southern Cross's claim with interest. HCW, maintaining there was no unjust enrichment, invited HMRC to offer 74% of the amount claimed with interest, which Southern Cross would accept. HMRC's officer accepted 74% of the claim and arranged payment of circa £1.4m in April 2010.

In July 2010 HMRC raised assessments to recover the circa £1.4m from Southern Cross under section 80(4A) and 78A VATA on the grounds that the claim should not have been paid. There was a pending dispute in another case. In May 2011, the FtT in *Moher v R&C Comrs* [2011] UKFTT 286 (TC) held that relevant supplies of staff were to dentists (and taxable) and not to patients. That decision was later upheld by the Upper Tribunal. Southern Cross disputed HMRC's ability to resile from the agreement reached between them.

The FTT's decision

The FTT held that:

1. there was a binding agreement between HMRC and Southern Cross (issue 1) because Southern Cross had given up 24% of the claim in order to achieve settlement. Southern Cross gave consideration for reaching a full and final settlement. Such an agreement was a common law agreement;

2. that agreement was not ultra vires because HMRC did have power to enter into such an agreement with Southern Cross under its care and management power (issue 2). The FtT said that *"Although HMRC have no power to refrain from collecting tax which is due, it does have the power to compromise where actual tax recoverable has not been quantified." [*65]. When HMRC reached settlement with Southern Cross, Moher had not been decided and there was no clarity as to the correct VAT treatment. The agreement reached was a 'genuine and realistic approximation of the actual amount due to Southern Cross, made after detailed discussion and negotiation'. Later discovery that the deal reached was not a good one for HMRC could not render the agreement unlawful as *"it would render HMRC's power to compromise claims virtually worthless"* [67]; and

3. HMRC was not entitled to make assessments under s80(4A) and section 78A(1) VATA to recover the sums paid under a common law agreement (issue 3). At [74] the FtT stated:

"Although ... the repayment was made to Southern Cross the strict legal position was open to doubt that was only subsequently resolved by Moher, the result is that at the time of the repayment Southern Cross was not as a matter of VAT law entitled to it (as it had correctly accounted for VAT on the relevant supplies) and HMRC were not liable as a matter of VAT law to credit Southern Cross."

In s80 VATA terms, strictly, it had not been established at that time that Southern Cross had accounted for output tax "that was not output tax due". The FtT found at [88]:

"...the payment made by HMRC in this case was not simply a voluntary payment in response to a claim under s 80. The claim was the starting-point, but the payment was made because liability to make that payment had been established under a valid and enforceable compromise agreement." Further, that agreement was "an intervening event which itself created a liability, in a way that the mere payment of a claim, or payment of part of a claim, would not."

The Upper Tribunal's decision

The scope of s80(4A)

The Upper Tribunal considered issue 3 on s80 first. The Upper Tribunal held that just in the way s80(4A) is precluded from applying where:

- there has been judicial determination *(R v Customs and Excise Commissioners, ex parte Building Societies Ombudsman Co Ltd [2000] 892);* or

- a deemed judicial determination by the settlement of an appeal under a s85 VATA agreement (R (on the application of DFS Furniture Co plc) v Customs and Excise Commissioners [2003] STC 1)

"the better view... is that, where no appeal is pending, HMRC's liabilities can similarly be fixed for the purposes of s80(1) and (4A) by means of a contractual agreement outside s85" [37(f)].

Mr Justice Newey also held, relying on *IRC v Nuttall* [1990] STC 194, that HMRC could enter into a binding agreement outside s85 VATA just as they could enter into binding agreements relating to direct taxes outside s54 Taxes Management Act 1970 (the direct tax equivalent of s85 VATA).

1. Although the decisions of the FtT and Upper Tribunal refer to 24% of the claim given up, it is not clear why they do not say 26% given that the decisions also state that HMRC paid 74% of the claim.

It is also noteworthy that although s80(7) VATA prevents taxpayers from seeking recovery of overpaid VAT by common law claims for restitution or through their tax return, just as it does not apply to judicial determination or deemed judicial determination under s85 VATA agreements, it does not apply to agreements reached under HMRC's care and management power. Mr Justice Newey held that although that section

"... was intended to leave "no room for the co-existence of other remedies for the recovery of overpaid VAT from the Commissioners" it does not follow that it was any part of Parliament's intention to prevent HMRC from settling claims made under section 80" [37(e)].

The agreement was not ultra vires and it was not void

HMRC's argument that even if the compromise agreement was not barred by s80 and outside s80(4A), it was ultra vires and void. Southern Cross did not dispute that if it was ultra vires, it was void, but they argued that it was not ultra vires.

Mr Justice Newey referred to authorities establishing that HMRC have managerial discretion under their care and management powers to enter into agreements for the 'good management' of taxes. Good management of taxes permit *"concessions* [to] *be made where those facilitate the overall task of tax collection"* (*R (Wilkinson) v IRC* [2003] EWCA Civ 814, [2003] STC 1113 at [45] quoted at [44] of Mr Justice Newey's judgment).

The exercise of discretion can only be challenged if it is '*Wednesbury* unreasonable' or 'irrational' (see [48]) or there is "some extraneous or ulterior reason" (see [50]). No improper purpose for entry into the agreement between HMRC and Southern Cross had been identified. Nor could "it be maintained that HMRC acted irrationally" because the VAT status of the supplies had not been established. Mr Justice Newey held

"I do not consider that HMRC can disavow any agreement with Southern Cross simply on the basis that the decision-maker(s) did not know what has since been determined: that supplies of dental nurses to dentists are standard-rated for VAT purposes. The fact that such supplies have now been held not to be exempt need not mean that the decision-maker(s) misdirected themselves in law or failed to have regard to relevant considerations when they agreed to pay Southern Cross."[57]

A compromise agreement was formed on the facts

Mr Justice Newey also rejected HMRC's argument that the FtT ought to have

decided that no contract had been formed.

Firstly, Southern Cross had given good consideration because forbearance of a *bona fide* right to litigate a question of law or fact which is not vexatious or frivolous constitutes giving up something of value (*Miles v New Zealand Alford Estate Co* (1885) 32 Ch D 266) which constitutes good consideration. As such, Southern Cross's giving up the balance of its claim was good consideration.

Secondly, HMRC's argument that there was no evidence of any intention to create legal relations outside the VAT regime (i.e. outside the framework of s80) failed. The FtT was entitled to conclude that the correspondence between HCW and HMRC was not "simply a case of HMRC seeking to ascertain the amount properly due". Competing arguments over unjust enrichment represented negotiations leading to settlement. Mr Justice Newey agreed with Mr Peter Mantle on behalf of Southern Cross that the pattern of correspondence pointed towards "a process of negotiation and, in the end, an intention to conclude a contractual agreement."

Conclusion

This decision exposes limitations on HMRC's ability to make assessments under s80(4A) and (7) VATA. It shows that although the original claim was made under s80, subsequent negotiations lead to a settlement which HMRC had power to enter into under their general care and management power (para 1 Sch 11 VATA). Making such an agreement prevented HMRC raising assessments to recover the amount paid pursuant to such an agreement.

Perhaps most significantly, both tribunals held that the agreement entered into was not ultra vires. Even though the *Moher* case determined that the amount paid to Southern Cross turned out not to be due in VAT law, *at the time the agreement was entered into* HMRC did not make any error of law by entering into the agreement. At that time, the agreement entered into was a reasonable one. It was not ultra vires because it turned out that HMRC had not been liable to repay VAT to Southern Cross. Payment became due to Southern Cross under that agreement. Subsequent clarification of the law did not enable HMRC to disavow the agreement. HMRC could not, therefore, make the recovery assessments.

Such cases may be rare in practice. As such the decision should not open any floodgates to cause HMRC concern. Nevertheless, the case illustrates that there may be merit in closely reviewing whether a compromise agreement has been entered into where a repayment has been agreed by HMRC if they seek to reopen it and recover the repayment.

Peter Mantle acted for Southern Cross Employment Agency Limited.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

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