

WHO IS THE RECIPIENT OF A SUPPLY FOR VALUE ADDED TAX PURPOSES?

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1 The Problem

A fundamental point of value added tax law is still unresolved: In what circumstances, if any, where A transfers title to goods directly to C and is paid by B does A make a supply of goods to B? In my view, in every case where B is the party contracting with A, yet the High Court, in *Sooner Foods Ltd*,² decided more than a decade ago that the supply is made to C. The decision was an unsatisfactory way of dealing with a loophole in the European Community (and United Kingdom) value added tax legislation which allowed - and still, in my view, allows - tax on certain business gifts to be avoided.

The question is not an academic one. Although A is accountable to the Commissioners of Customs & Excise for payment of the value added tax on the supply, the tax is in reality borne by B. It would be paradoxical and anomalous if B could not deduct the tax as input tax where he had entered into the contract with A for the purpose of making taxable supplies. Yet this result would follow. Moreover, it would appear that C would have the right to deduct the input tax paid by B to A, as well as any paid by C to B! The decision, if correct, derogates from the fundamental purpose and structure of the value added tax as a tax on consumption with tax being ultimately payable only by the final consumer, with additional tax being levied at each stage in the chain of production only on the value added by the producer at that stage and with each producer consequently being able to set-off or recover value added tax incurred by him on his inputs.

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² *Commissioners of Customs & Excise v Sooner Foods Ltd* [1983] STC 376.

2 Importance of the Problem

The Sixth Directive Title XI, Deductions, Article 17.2, Origin and scope of the right to deduct, provides:

"In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax that he is liable to pay:

- (a) value added tax due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person ..."

Three points should be noted. Firstly, article 17 itself contains no definition of when a supply is made "to" a person. Secondly, unless a supply is made "to" a person, he cannot deduct value added tax in respect of goods or services supplied by another, even if he is (primarily) liable to pay and does pay the price of such goods or services, including the value added tax thereon. Thirdly, provided goods or services are supplied "to" a person and used by him for the purposes of his taxable transactions, his right to deduct does not depend on his being liable to pay or in fact paying the price of those goods or services. United Kingdom legislation is in broadly the same terms: see in particular Value Added Tax Act 1994 section 24(1).

3 With Whom is the Contract?

At the outset, two different situations must be envisaged and kept distinct. If A contracts with C to sell goods to C and B merely discharges C's obligation to pay the price to A, then it is clear that A can have made no supply to B. This is the basis of some of the decisions where payment is made using a charge card, voucher or similar mechanism.

Where, however A contracts with B that in consideration of a payment by B to A, A shall vest the title in goods in C, and A does so, does A make the supply to B or to C?³ The common sense view is that, of course, the supply is made to B. In conferring title on C, A is also discharging his obligation to B and it is B who is paying for the performance of that obligation. Moreover it is, at least in English law, B and B alone who has the right to enforce the obligations of A which are ancillary to the obligation to transfer title, such as warranties as to the fitness of the goods. These obligations are also part of what B is paying for. C is indeed

³ The other logical possibilities, that a supply is made to neither or that it is made to both, are not supported by any authority.

an indirect beneficiary of the supply but is not the person to whom the supply is made.

Is the position different if instead of A transferring goods to C, he performs a service for the benefit of C pursuant to a contract with B under which B is to pay for the service? In my view, the service is supplied to B alone and not to C. An example would be a parent who contracts with a music teacher to give his son piano lessons. Such English authority as there is suggests that the supply of services is indeed made to B. While the decision in *Sooner Foods* is technically distinguishable, it does not appear to have been even cited in the key case of *P & O European Ferries*, discussed below. If there is indeed a distinction between goods and services, it is a bizarre one.

4 Anomalies if *Sooner Foods* is Correct

Suppose B has contracted with C for the future supply of a commodity of a given description. Suppose that, to meet his obligations, A agrees with B that, in return for a consideration, he will deliver and pass title to goods satisfying the contract description directly to C. On my view, everything is fine. There have indeed been two supplies, one from A to B and one from B to C. Value added tax is chargeable on each supply in accordance with the consideration. B is accountable for the output tax on his supply to C but can deduct input tax on the supply from A. Whether the supply by A to B is one of goods or services is not, in general, material. In my view, it is a supply of goods, which is also the common sense view, because the supply consists of the transfer of the right to dispose of tangible property as owner. That is the obligation which A has assumed and discharged. The supply is made to B because the obligation is owed to B and B is responsible for and provides the consideration for the supply. It is immaterial that the transfer of title is made by A directly to C.

On the other view, A makes a supply "to" C and not to B. B pays the price which includes input tax. As no supply has been made to him, he is not allowed to recover the input tax. Is C allowed to recover the input tax on the supply made by A, assuming that he is a taxable person and that other conditions of recoverability are satisfied? As stated above, so far as EC law is concerned, he is.⁴ Article 17.2 of the Sixth Directive provides that he is entitled to deduct value added tax "due or paid within the territory of the country in respect of goods ... supplied or to be supplied to him by another taxable person". There is no requirement that he should have paid the tax himself.

⁴ Possibly, a purposive, as opposed to a literal, construction might deny C the right to deduct. The difficulty with a purposive construction is that it would be impossible without doing enormous violence to the language of article 17 to allow B the right to deduct and it can hardly have been the purpose that no one should have the right to deduct.

Does B make a supply to C? There is clearly a transaction between them. *Prima facie* B supplies something to C. There is certainly consideration moving from C to B. Why should there not be a supply? In my view, what B supplies to C is the transfer of the right to dispose of tangible property as owner, it not being necessary that the transfer should be from B provided that B procures that it is made to C, and B thus makes a supply of goods. If that view is wrong, then the supply must be a supply of services. See Article 6.1 of the Sixth Directive. Value added tax is exigible on the supply by reference to the consideration moving from C to B. In principle, C can deduct this input tax too! Thus the result of A making a supply to C in the circumstances envisaged is the injustice of B not being able to recover his input tax but C being able to recover both his own input tax and that paid by B! In my opinion, only the clearest wording in the relevant legislation could compel such a ridiculous conclusion.

To take another example, a company which organises seminars provides delegates with the right to attend a lecture and, for a separate additional price, the right to a picnic box lunch. The seminar company sub-contracts the provision of the lunch to caterers. On my analysis, the caterers provide a supply to the seminar company which in turn makes a supply to the delegates. On the other analysis, provided at least the supply of the meal is principally a supply of goods,⁵ the caterers make the supply directly to the delegates. If that other analysis is correct, the conference organising company would not be able to recover input tax, but the delegates would be entitled to recover twice over.

5 European Community Legislation and Authorities

I shall first examine EC law to see whether it requires one to reject the common sense approach. I shall then consider United Kingdom municipal law and English case law.

EC First Council Directive of 11th April 1967, Article 2 provides:

"The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportioned to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged."

Hence, the basic concept is that tax is borne by the final consumer, any tax on inputs suffered by an intermediate producer being recoverable by him. If *Sooner Foods* is good law, this principle is infringed.

⁵ As the supply would be a composite one, this would depend on whether the provision of food or the service element was to prevail.

The Sixth Council Directive, Article 2 provides:

"The following shall be subject to value added tax:

1. The supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such ..."⁶

Hence, the general rule is that a supply of goods (or services) is subject to value added tax only if effected for consideration. The judgments of the European Court of Justice in the *Apple and Pear* case⁷ and particularly in *Tolsma*⁸ suggest that the word "consideration" bears a meaning very close to its technical meaning in the English law of contract and that thus there can normally be no supply in the absence of a contract. One would naturally conclude from that that the supply is made to the other party to the contract.

Although the facts of *Tolsma* were somewhat remote from the present case - the Court held that an organ grinder who received voluntary contributions from passers-by did not make any supplies liable to value added tax - and one must always be wary about applying judicial dicta uttered in one context in another context, the language of the Court is highly supportive of my view:

"13. In its judgments in *Staatssecretaris van Financiën v Coöperatieve Aardappelenbewaarplaats* (Case 154/80) [1981] ECR 445 at 454, para 12, and *Naturally Yours Cosmetics Ltd v Customs & Excise Comrs* (Case 230/87) [1988] STC 879 at 886, [1988] ECR 6365 at 6389, para 11, the court stated on this point that the basis of assessment for a provision of services is everything which makes up the consideration for the service and that a provision of services is therefore taxable only if there is a direct link

⁶ In EC law, the term "supply" does not have the same meaning as it has in United Kingdom municipal law. Under EC law, the term is much wider and can include something which is not even *prima facie* a taxable supply, such as a gift by one individual in his private capacity to another. By contrast, under United Kingdom municipal law, "supply" is a technical term meaning, in effect, a *prima facie* taxable supply. Hence, "supply" does not in general include anything done otherwise than for a consideration: see section 5(2)(a) of the Value Added Tax Act 1994. Similarly, the phrase "taxable person" bears correspondingly wide and narrow meanings in EC and United Kingdom law respectively.

⁷ *Apple and Pear Development Council v Customs & Excise Commissioners* (Case 102/86) [1988] STC 221, [1988] ECR 1443, [1988] 2 All ER 922, CJEC.

⁸ *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509.

between the service provided and the consideration received (see also the judgment in *Apple and Pear Development Council v Customs & Excise Comrs* (Case 102/86) [1988] STC 221 at 237, [1988] ECR 1443 at 1468, paras 11, 12).

14. It follows that a supply of services is effected 'for consideration' within the meaning of art 2(1) of the Sixth Directive, 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, the remuneration received by the provider of the service constituting the value actually given in return for the service *supplied to the recipient*.⁹

What legal relationship is there between A and C? While the transfer of the property in goods from A to C might just about be characterised as a legal relationship, that transfer is itself the performance and thus cannot also be the legal relationship pursuant to which the performance takes place. Moreover, there is no question of reciprocal performance on the part of C, only on the part of B.

Tolsma was admittedly a case where the alleged supplies were ones of services. Is the case of supply of goods any different from that of a supply of services? In my view, it is not, at least so far as concerns the relevance of consideration, who has provided it and to whom the supply is made. Article 2.1 of the Sixth Directive which imposes the necessity for consideration, applies in terms without distinction both to supplies of goods and to supplies of services.

By contrast, Articles 5 and 6 deal with separate questions, in particular (a) whether a supply is a supply of goods or services and (b) when a supply subject to value added tax is deemed to be made, in particular when consideration is deemed to be provided.

Article 5 is headed "Supply of goods". Article 5.1 provides: "'Supply of goods' shall mean the transfer of the right to dispose of tangible property as owner". It is quite clear that under EC law the transfer of the right to dispose of tangible property as owner is¹⁰ subject to value added tax only if effected for consideration. This is the effect of the interaction of Article 2.1 and Article 5.1.

Moreover, Article 5(6) reinforces the point that the transfer of the right to dispose of tangible property as owner is not of itself a supply subject to value added tax. If it were, then Article 5.6 would be completely superfluous. It provides:

⁹ Italics supplied.

¹⁰ Subject to certain express exceptions mentioned below.

"The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration ..."

The Taxable Amount Argument

It has been suggested that Article 11A.1.(a) of the Sixth Directive lends support to the view that where A contracts with B to transfer title to goods to C then the supply is made to C. The Article provides:

"The taxable amount shall be:

- (a) in respect of supplies of goods and services other than those referred to in (b), (c) and (d) below,¹¹ everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies ..."

The argument is where A contracts with B to transfer title to goods to C then the supply is made to C and B is the "third party". Yet even if one begs the question and assumes that the supply is made to C, that surely does not make C "the purchaser" or "the customer". That description can apply only to B. If that is so, then it is difficult to see how B can also be a "third party".

One case where the consideration is provided by a third party is expressly mentioned, namely that of a subsidy. This may simply have been inserted for the avoidance of doubt. If B purchases goods from A and is given by the State a subsidy towards the purchase price, the consideration is clearly the full amount which A receives from B and it is immaterial whence B derived the funds, whether a state subsidy, a loan from a bank, or out of the proceeds of re-sale of goods. Conceivably, the reference to subsidies may enlarge the normal meaning of "consideration" where the purchase price agreed between A and B is £X but where under the applicable law A is then entitled to a further £Y by way of subsidy from the State.

The reference to payment being by third party may also include a situation where payment is directly made by, say, X to A on B's behalf. Technically, this is still

¹¹ Article 11A.1(b),(c) and (d) deal with the special cases where, pursuant to articles 5 and 6, there is a deemed consideration for a supply.

a payment by B. It is possible that the Directive is simply making clear that A cannot escape tax on the grounds that B did not make the payment directly.

I thus conclude that nothing in the European Community legislation or case law compels one to a conclusion inconsistent with common sense. On the contrary, the whole scheme of the value added tax legislation and the jurisprudence of the European Court of Justice strongly support the common sense view.

6 United Kingdom Legislation

I shall now consider the United Kingdom municipal legislation. Section 4(1) of the Value Added Tax Act 1994 provides that value added tax shall be charged on any supply of goods or services made in the United Kingdom where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.¹² Section 5(1) provides: "Schedule 4 shall apply for determining what is, or is to be treated as, a supply of goods or a supply of services." Section 5(2) provides that, subject to any provision made by that Schedule and to Treasury Orders under subsections (3) to (6) (which allow the Treasury to characterise a transaction as a supply of goods, a supply of services or neither):

- "(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;
- (b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services."

Section 5(2) therefore lays down two general rules. Firstly, unless something is done for a consideration, it cannot constitute a supply liable to value added tax. Secondly, anything which is done for a consideration will constitute a supply liable to value added tax.

Schedule 4 has several distinct purposes. The first four paragraphs¹³ deal with cases which are clearly supplies (subject to their being made for consideration). Apart from the opening words of paragraph 1 "Any transfer of the whole property in goods is a supply of goods", which state the minimum content of any concept of "supply of goods", their main and, in my opinion, only effect is to characterise certain supplies as supplies of goods which would not normally be thought of as

¹² The term "supply" and "taxable supply" have a more restricted meaning in the United Kingdom legislation than in the Sixth Directive.

¹³ Including paragraph 2, which was repealed by Finance Act 1996.

supplies of goods (even if they would not be thought of as supplies of services either, for example, the grant of a major interest in land) and to provide that certain supplies concerning goods are not in fact supplies of goods but supplies of services.

Paragraphs 5 to 8 deal with certain deemed supplies of goods (including land), in particular implementing Article 5 of the Sixth Directive.

Paragraph 1(1) provides:

"Any transfer of the whole property in goods is a supply of goods; but, subject to sub-paragraph (2) below, the transfer:

- (a) of any undivided share of the property; or
- (b) of the possession of goods,

is a supply of services."

With respect to the contrary view of Forbes J in *Sooner Foods*, discussed below, the concern of paragraph 1(1) is clearly to identify when a supply concerning goods is a supply of goods and when it is a supply of services. There is no mention of the person to whom the transfer of the whole property in goods is to be made. It is left completely open whether it is to be made to the customer/purchaser or to a third party. Likewise, it throws no light on the question to whom a supply which consists of the transfer of the whole property in goods is to be made.

Just as in the Sixth Directive, where the basic definition of a supply is laid down by article 2, with article 5 then making further provisions about what is and what is not a supply of goods, so too, the basic definition of a supply is contained in Value Added Tax Act 1994 section 5(2), with Schedule 4 containing further provisions about what is and what is not a supply of goods.

I thus conclude that, case law apart, there is nothing in the United Kingdom value added tax legislation to compel one to a conclusion inconsistent with common sense.

7 The English Authorities

7.1 *Sooner Foods Ltd*

In *Commissioners of Customs & Excise v Sooner Foods Ltd* [1983] STC 376, Sooner Foods Ltd ("Sooner") sold boxes of potato crisps to retailers. Included in each box were coupons which were exchangeable, in sufficient quantities, for

goods. On presentation by retailers of coupons to an 'administrator', title to the goods was passed directly from the administrator to the retailers. The administrator invoiced Sooner, by a prior arrangement, for the cost of the goods and for a service charge for administering the scheme. Value added tax was charged on both supplies. In its value added tax returns, Sooner claimed credit for input tax in respect of both supplies. The Commissioners assessed Sooner to value added tax on the basis that it had supplied the goods directly to the retailers and therefore should have accounted for value added tax on the supply by virtue of what is now Value Added Tax Act 1994 Schedule 4 paragraph 5(1) and Schedule 6 paragraph 6(1)(b), implementing Article 5.6 of the Sixth Directive. On appeal by Sooner against the assessment, the Value Added Tax Tribunal held that since the property in the goods never passed to Sooner, it made no taxable supply and therefore was not liable to output tax. On appeal by the Commissioners to the High Court, Queen's Bench Division, the Commissioners conceded (rightly) that no output tax was due but argued for the first time that Sooner should not have taken credit for input tax in so far as attributable to the cost of the goods supplied by the administrator.

Forbes J found that Finance Act 1972 Schedule 2¹⁴ paragraph 1(1) "Any transfer of the whole property in goods is a supply of goods ..." was conclusive of the matter. Counsel for Sooner argued, in my view correctly, that this statement did not deal with the question of the recipient of the supply but only with the supply itself; there was nothing, therefore, which precluded the result for which he contended, namely that there may be a transfer of the whole property in goods from A to C, but that at the same time the goods may be supplied not by A to C but by A to B. Forbes J flatly rejected this argument. In his view "any transfer" meant "any transfer from one person to another" and "is a supply of goods" therefore meant "is a supply from that person to that other person". His only reasoning was that "to construe these words otherwise would be to rob them of all practical application".

His Lordship thus did not consider the scheme of the legislation. Nor did he consider the Sixth Directive. He clearly had no idea of the extraordinary anomalies which would result if his view were correct. His only reasoning was that to construe the words otherwise would be to rob them of all practical application. I regret that I cannot follow this reasoning. Paragraph 1(1) is clearly performing, in part, the function of determining when a transaction connected with goods is and when it is not a supply of goods. It is giving effect, accurately or otherwise,¹⁵ to Article 5.1 of the Sixth Directive. In my view, therefore, the

¹⁴ Now Value Added Tax Act 1994 Schedule 4.

¹⁵ It is arguable that the transfer of any undivided share in goods is a supply of goods within the meaning of the Sixth Directive.

decision is plainly wrong. At the very least, it provides no reasoned justification for adopting a view which leads to such extraordinary anomalies.

The only thing that can be said in favour of the decision is that it was not an altogether unjust one. Sooner Foods had, by accident or design, discovered a method whereby, if my view of the law is correct, a trader can in effect deduct input tax on business gifts without having to account for output tax on the value of those gifts. Forbes J was no doubt happy to reach a conclusion which defeated that strategy. The efficacy of the strategy, however, turns on a loophole in the drafting of the Sixth Directive. The remedy is to close that loophole through legislation rather than to introduce a principle into the law which patches up the loophole at the expense of causing injustice in *bona fide* cases. This aspect is discussed below.

7.2 Philips Exports Ltd

Philips Exports Ltd v Commissioners of Customs & Excise [1990] STC 508 was compromised on appeal to the Queen's Bench Division of the High Court. The Commissioners were evidently so unhappy about one of the grounds upon which the VAT Tribunal had found in their favour that they specially invited Roche J to express an opinion, necessarily obiter, as to its correctness.

Manufacturing companies in the Philips Group entered with the Appellant ('Exports'), an export company, into a Marketing Agreement which provided: "We will sell to you and you will purchase all Goods dispatched by us from time to time for delivery to overseas customers. The property in such Goods shall pass to you immediately before delivery of the Goods to the overseas customer or immediately before the property passes to the overseas customer whichever shall first occur." The sole purpose of this Marketing Agreement was to confer on the Philips group a cash-flow advantage by enabling it to reclaim input tax in respect of the exported items each month instead of each quarter. The Tribunal considered what is now Value Added Tax Act 1994 Schedule 4 paragraph 1 and found that, because the goods passed from the manufacturing company to Exports for an infinitely short space of time, there was no supply of goods to Exports because there had not been a transfer of the whole property in the goods by the manufacturing company to Exports.

The first reason given was that the thing transferred must remain with the person to whom it is transferred for a measurably, albeit, possibly, a very short time. Roche J rejected this. He said expressly that there was "no requirement as to the length of time for which said transfer should endure". He pointed out that in his judgment any other interpretation would lead to uncertainty and offer scope for the evasion of value added tax.

Thus, the views of Roche J, which were concurred in by the Commissioners, will often allow one, by clever drafting, to overcome the problem which *Sooner Foods*

exposes, if it is correctly decided. The solution to the problem is artificial in the extreme. In an era when the English Courts do not look with favour on artificial transactions designed to secure a tax advantage, the Judge must have been heavily influenced, consciously or otherwise, by the anomalies which would result had his opinion been different.

7.3 *Harpur Group Ltd*

Harpur Group Ltd v Commissioners of Customs & Excise was a decision of the Value Added Tax Tribunal of 21st March 1994. It concerned five fuel card schemes operated by companies in the Appellant's VAT Group. In essence, the Appellant¹⁶ provided a card to a customer who would use it, usually through an employee or other agent, the cardholder,¹⁷ to obtain fuel for the tank of the customer's vehicle from an outlet of a merchant. The standard schemes proceeded on the basis that all the fuel belonged to the merchant until the cardholder (the customer or his agent) filled up his vehicle. The agreement between the Appellant and the customer then purported to provide that the cardholder purchased the fuel as agent for the Appellant with property passing on signature of the supply voucher by the cardholder and that the Appellant then sold and transferred title to the fuel to the customer.

The issue for decision was whether the Appellant supplied goods and services to its customers, in which case those supplies would be standard-rated, or whether the goods and services were supplied by the merchants to the customers, with payment being made by the use of the cards issued by the Appellant. The Tribunal decided at the outset:

"It seems to us that, in order to decide that issue, we have to consider the chain of title to the supply to see if and how the property and the supplies are vested in the Appellant before being passed on to the customer."

Having considered the documentation of the standard scheme, the crucial finding of the Tribunal was that property in the petrol passed at the pump, whereas the agreement between the Appellant and the customer was not completed until the supply voucher was signed, so that the agreement was not in force when the car was filled at the pump. While the subsequent signing of the agreement would discharge the cardholder's obligation to the merchant to pay him cash, so that if the Appellant had become insolvent, the merchant would not have been able to look to the cardholder for payment, yet during the period between the filling of the

¹⁶ I refer to the Appellant as including any of the relevant companies in the Appellant's VAT Group.

¹⁷ The customer and the cardholder were effectively treated as one person in the operative part of the decision.

tank and the signing of the voucher, property must have passed from the merchant to the cardholder. The Tribunal decided, rightly in my view, that if there had already been a supply at the pump for the fuel to the cardholder against a personal liability to pay, value added tax must be charged at that supply, whatever subsequently happened to the property in the fuel on the signature of the supply voucher. "This is a matter of the Law of Property, not the Law of Contract."¹⁸

While the decision of the Tribunal was as to the standard scheme at least perfectly correct, it turned on the fact that C (the cardholder) had already obtained title to goods from A (the merchant) before B (the Appellant) had entered into any contract at all with A. Once C had obtained title to the goods, the only agreement which B could make with A was that A would discharge C's personal liability to pay the purchase price in consideration of B undertaking liability to make a payment to A. Had the scheme worked, for example, by the card company insisting that the cardholder presented his card to the merchant *before* filling the tank, it would have done so on the basis of title having passed from A to B to C and the problem of *Sooner Foods* would have been sidestepped as it was in the *Philips* case.

The Tribunal's decision is not any endorsement of *Sooner Foods*. Although the Tribunal decided it had to consider the chain of title to the supply to see if and how the property in the goods vested in the Appellant before being passed on to the customer, that was simply in order to determine whether the property had already passed to the customer before any contract for the purchase of the goods was entered into between the Appellant (acting through the cardholder as its agent) and the merchant. Given that it had, it was impossible for the Appellant subsequently to obtain the goods from the merchant and make a supply of them to the customer.

7.4 *British Airways Plc*

The VAT Tribunal decision in *British Airways Plc v Commissioners of Customs & Excise* of 21st June 1995 concerned a scheme under which British Airways Plc ("BA") secured that meals were made available by third parties' restaurants to its passengers whose flights at Heathrow Airport had been delayed. Under the basic scheme, passengers were provided with a voucher with a fixed monetary limit which stated that "On presentation of this card the restaurant will provide you with the meal or refreshments marked." Delayed passengers were issued with vouchers and then went to a participating restaurant of their choice. Orders were taken from delayed passengers in just the same way as any other order. The voucher was

¹⁸ I respectfully agree. I do not see how a contract can retrospectively secure that title to property has passed through a person through whom it has never in fact passed.

simply used in payment or part-payment of the price of the meal, although there was no refund if the meal cost less than the face value of the voucher.

It was apparently common ground between the parties that the relevant supplies were supplies of food and of goods, rather than a composite supply of services and goods which might arguably fall to be categorised as a supply of services. It also seems to have been common ground that property in the food passed to the passenger when it was handed over to him.

BA appealed against the decision of the Commissioners that "the supplies of food made by [the restaurants] are made direct to the traveller and not to BA; when the traveller pays using a voucher issued by BA that is the same as paying by cash." It was argued on behalf of BA that the supplies of food and drink by the restaurant were supplies to BA; the contract was made and property passed when the food and drink were handed over to the passenger; they were handed over at the direction BA in return for payment to be made later by BA.¹⁹ It was argued by Customs & Excise that the relevant supplies of food and drink were supplies to the passenger on the grounds that the supply followed the property, which went direct from the restaurant to the passenger.

The Tribunal asked itself *when* the property in the food and drink passed. They formed the view that property in the food and drink passed from the restaurant proprietor at the moment payment was complete.²⁰

The Tribunal, noting that it was the passenger who chose the restaurant and placed the order, stated that the situation was different from that of a host who takes his guest to a restaurant and provides him with food and drink. For it is the host who chooses the venue and when he or the waiter hands the menu or wine list to the guest to choose from, it is the host who places the order even where the guest communicates it to the restaurant. The Tribunal "recognised" that contractual obligations may not necessarily be determinative as to the value added tax position of who supplies what to whom. They relied upon the analysis in the *Harpur Group* case and of the decision of Laws J in *Commissioners of Customs & Excise v Reed Personnel*, since reported at [1995] STC 568. They then said, "The key question is - where does the property and the goods go?"

¹⁹ It is not clear to me why BA supposed it would be advantageous to claim that the restaurants were making supplies to it, given that it would follow that it was making a standard-rated supply to its passengers by virtue of the Sixth Directive Article 5(6), Value Added Tax Act 1994 Schedule 4 paragraph 5(1), so that any recovery of input tax would be matched by an obligation to account for output tax.

²⁰ This analysis would obviously not have been possible except in a self-service system.

The Tribunal nevertheless found it relevant to analyse the contractual position. They noted that nothing in the agreement between BA and the restaurants provided BA with any right to take delivery of food and drink or to direct the restaurant proprietor what food was to be supplied and what passenger was to have it. They analysed the legal relationship between BA and the passenger as one under which BA undertook to the delayed passenger holding a voucher that its voucher would be accepted by the restaurant in satisfaction of the purchase price of the food and drink up to the stated amount. Not surprisingly, they found that the legal relationship between the delayed passenger and the restaurant resulted from the agreement for the sale of the food and drink under which the passenger produced the voucher in complete or part satisfaction for his purchase. They therefore found that there was no sale of food and drink in question by the restaurant proprietor to BA and that the property in the food and drink passed on a principal to principal basis from the restaurant to the delayed passenger. BA merely provided facility for payment. Consequently, there was no supply of goods by the restaurant to BA.

It followed that there was no onward supply by BA of the food and drink to the delayed passenger, being a supply at BA's direction, as contended for by Counsel on their behalf. BA never had the right to dispose of the food and drink in question. Thus, BA never had any such property in the food or drink as could enable it to make an onward supply of them to the delayed passenger.

Is this decision any support for the decision in *Sooner Foods*? In my opinion, it is not. The crucial finding was clearly that BA was not purchasing the food at all but merely, rather like a credit card company, making an arrangement for the satisfaction of the traveller's obligation to pay the purchase price. The key question was "Where does the property and the goods go?" only because that was the way in which BA had argued its case. BA had argued that the supply of goods was made to it and it in turn made a supply of goods to the customer. If BA had simply contended that it contracted with the restaurant for the restaurant to provide to the customer such meal, not exceeding the value of the face amount of the voucher, as the customer should select, but had not contended that it made any transfer of the title to the goods to the customer, then the question which arose in *Sooner Foods* would have arisen for decision.²¹

If anything, the implication of the Tribunal's decision is that *Sooner Foods* cannot be right. For the Tribunal expressly distinguished the case where a host takes his guest to dinner and himself places the order. If my view is correct, this distinction is crucial yet, if *Sooner Foods* is correct, it matters not that the host places the

²¹ On the basis that *Sooner Foods* is wrongly decided, BA would apparently have secured a tax advantage in that they would have been able to deduct input tax attributable to supplies made to them but would have not have made any supplies to the customers on which value added tax was exigible.

order. The restaurant makes a supply of the food consumed by the guest to the guest and not to the host.

The Tribunal dismissed an alternative contention of BA, that the food outlet contracted both with BA and with the passenger, in reliance on the principle underlying the decision in *P & O European Ferries (Dover) Ltd v Commissioners of Customs & Excise* [1992] VATTR 221, on the ground that it was concerned not with the supply of goods but with the supply of services.

7.5 *P & O European Ferries*

P & O European Ferries (Dover) Ltd v Commissioners of Customs & Excise [1992] VATTR 221, was a decision of the London VAT Tribunal, His Honour Stephen Oliver QC, Chairman. The Appellant and certain of its employees were prosecuted for manslaughter. The Appellant entered into agreements with the solicitors acting for the employees and undertook to pay their costs. The Commissioners of Customs & Excise wished to disallow the Appellant relief from VAT on these costs on the grounds that the Appellant was simply the paymaster. The Tribunal held that although each individual employee was a client of the particular solicitor, the Appellant was a client as principal in relation to each solicitor because it not only approved the choice of solicitor but it also instructed and agreed to pay him and it was from the company, not from the employee, that the solicitor would have had the right to recover costs. The solicitors' services were therefore provided to the Appellant, notwithstanding that the individual employee also received the benefit of those services.

The Tribunal also found that although the financing of the legal representation by the company conferred substantial benefits on the individual employees, that did not prevent the expenditure from having been incurred for the purposes of the Appellant's business, in the circumstances of the case.

The case was a stronger one than that of the hypothetical case where A contracts with B that he shall transfer goods to C or perform a service for the benefit of C in that it was the individual defendant and not the Appellant who gave the instructions to the solicitor in question and gave the proof of evidence, if any, and it was the individual defendant who had the final say as to whether he would be represented by that particular firm of solicitors.

Not just the decision, but the reasoning too, are not only consistent with but entirely support my view. The crucial question which the Tribunal asked in determining whether a supply had been made to the Appellant was: Was it contractually obliged to pay for the services? While *Sooner Foods* was technically distinguishable on the grounds that it involved a supply of goods - the authority does not appear to have been cited; it is certainly not mentioned in the decision - the same test should in principle be applicable whether the supply is one of goods or services.

7.6 Reed Personnel Services Ltd.

In *Commissioners of Customs & Excise v Reed Personnel Services Ltd* [1995] STC 588, it was the submission of the Commissioners of Customs & Excise that, the contractual documents not being ambiguous, and there being no materials outside those documents which defined the parties' relationships, the construction of the contracts necessarily provided the answer to the question what was the nature of the supplies made by Reed to various hospitals - in particular, whether it provided nurses or nursing services to various hospitals. In my respectful opinion, that submission was correct. In this context, Laws J made some general statements, unsupported by any express citation of authority, which must, in my view, be treated with some reserve. The first was that the concept of "supply" for the purposes of value added tax is not identical with that of contractual obligation. While I agree that the concept of "supply" it is not "identical" with that of contractual obligation, it very heavily depends on it.

Secondly, in consequence, he stated, it is perfectly possible that although the parties in any given situation may conclude their contractual arrangements in writing so as to define all their mutual rights and obligations arising in private law, their agreement may nevertheless leave open the question what is the nature of the supply made by A to B for the purposes of A's assessment to value added tax. So far, I would not disagree with his Lordship on this second point. It may be that as a matter of private law it is of no consequence to the parties whether one of them is making what is characterised as a supply for value added tax purposes and whether that supply is one of goods or one of services.

His Lordship went on to state, however, that there might be cases, generally (perhaps always) where three or more parties are concerned, in which the contract's definition (however exhaustive) of the parties' private law obligations nevertheless neither caters for nor concludes the statutory question what supplies are made by whom to whom.

Wide and general dicta must always be read in the context of the specific case. Yet even applying that rule of interpretation, there remains the difficulty of the application of dicta to the case itself. It was accepted that Reed was making a supply to the hospital; the dispute lay as to the nature of that supply. Was Reed supplying nursing services or was Reed merely supplying nurses, the nurses supplying their services directly to the hospitals? Given that the nurses would no doubt be performing precisely the same functions in either case, it would, with respect, to my mind turn entirely on the documentation, provided this was adequate and complete, as to what the nature of the relationship was and thus what service each was providing and to whom. His Lordship's approach seems to me, with respect, to be in conflict with that of the European Court of Justice in *Tolsma*.

In any event, the decision does not touch the question as to whether a transfer of goods made by A to C under a contract entered in to with B constitutes a supply to B or not.

8 A Lacuna in the Anti-Avoidance Legislation

If Sooner Foods had obtained title to the goods and then gifted them, they would have been entitled to recover input tax but would have been liable for output tax under Sixth Directive, Article 5.6 and what has now been consolidated as Value Added Tax Act 1994 Schedule 4 para 5 combined with Schedule 6 para. 6(1)(b). That would have been a perfectly just outcome.

On the actual facts, then, if my view of the law is correct, A (the administrator) made a supply to B (Sooner Foods) and B was in principle able to deduct input tax. While B would in general terms have supplied something to C (the retailers), through the agency of A, B would not have made a supply liable to value added tax, on the assumption that the retailers provided no consideration.²² Although the Sixth Directive, Article 5(6) requires supplies for no consideration to be treated in certain cases as made for a consideration and thus rank as 'supplies' within the meaning of the United Kingdom legislation, it is not wide enough to cover the case where the goods gifted never form part of the assets of the donor but the diminution in the business assets of the donor is attributable to cash, paid to the third party who transfers the goods to the donee. Similarly, Value Added Tax Act 1994 Schedule 4 and in particular paragraph 5 is inadequate to deal with the case.

By deciding that A made no supply to B, Forbes J was preventing Sooner Foods from recovering input tax on the goods which, in practical terms, was just as satisfactory from the point of view of the Commissioners of Customs & Excise as deeming Sooner Foods to have made a supply for a consideration equal to the price it was paying for the goods.²³ While Forbes J may have been subconsciously influenced by the fact that he was producing a just result in the instant case, inadequacy of anti-avoidance legislation can never, it is respectfully submitted, justify an interpretation of legislation which leads to injustice and anomaly in other cases.

²² If the retailers did provide consideration, the position is more complex. *Prima facie*, the price they paid for the crisps should be apportioned between the crisps and the vouchers/goods. The retailers would then not be able to deduct that part of the input tax attributable to the vouchers/goods, so the overall result would be a just one.

²³ As required by Sixth Directive Article 11A.1.(b) and Value Added Tax Act 1994 Schedule 6 paragraph 6.

The problem thus lies in the defective drafting of the Sixth Directive, especially article 5.6, which provides:

"The application by a taxable person of goods forming part of his business assets for his private use or that of his staff, or the disposal thereof free of charge or more generally their application for purposes other than those of his business, where the value added tax on the goods in question or the component parts thereof was wholly or partly deductible, shall be treated as supplies made for consideration ..."

Either Article 5.6 should be altered so it does not refer simply to goods forming part of the business assets of B, or Article 6.2 should be enlarged so as to treat as supplies of services for consideration not only supplies of services carried out free of charge by the taxable person for his own private use or that of his staff or more generally for purposes other than those of his business, but by way of gift. The difficulty, however, is in knowing where to draw the line. Indeed, Article 5 is arguably already drawn too wide.

For example, suppose a retailer obtains fuel oil and consumes it in order to heat his shop, he has literally disposed of the oil so that it no longer forms part of the business assets. Yet this clearly should not result in a supply. It may be possible to square this with the Sixth Directive Article 5(5) on the grounds that there is only a "disposal" of goods free of charge where there is a transfer of title to the goods and not in every case where goods are disposed of. The same escape is not possible in the case of the corresponding United Kingdom legislation, Value Added Tax Act 1994 Schedule 4 paragraph 5(1), which provides:

"Subject to sub-paragraph (2) below,²⁴ where goods forming part of the assets of a business are transferred or disposed of by or under the directions of the person carrying on the business so as no longer to form part of those assets, whether or not for a consideration, that is a supply by him of goods."

9 Conclusion

In conclusion, my own view is that the decision in *Sooner Foods* is clearly wrong and that the only sensible application of the value added tax system would result in A making a supply to B, and not to C, in the circumstances envisaged. Given the present state of English law, however, and in particular the decision in *Sooner Foods*, which still stands, prudent taxpayers will not doubt wish to side-step the problem by the highly artificial device of a transient passing of property. They will no doubt be encouraged by the willingness of the Commissioners of Customs

²⁴ Which provides exceptions for certain small business gifts and samples.

& Excise and the Courts to allow the problem to be so overcome. They will take heed from the taxpayers' defeats in *Harpur* and *British Airways* that there is no substitute for meticulously drafted documentation.