TC04152

Appeal number: TC/2012/10248

VALUE ADDED TAX– repayments - Appellant supplying investment management and administration services to a group pension fund – VAT charged on all services – no over-charge in respect of net of VAT costs themselves - Appellant "refunds" part of payment made by pension fund – whether a decrease in consideration for the supply within regulation 38 Value Added Tax Regulations 1995 – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

RIO TINTO LONDON LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
MS REBECCA NEWNS

Sitting in public at Bloomsbury Place, London WC1 on 14 October 2014

Amanda Brown, KPMG LLP, for the Appellant

George Peretz, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Rio Tinto London Limited ("the Appellant") appeals under section 83 (1) (p) Value Added Tax Act 1994 ("VATA") against an assessment dated 30 July 2012.

2. The issue in this appeal is whether a price adjustment which the Appellant says it made in relation to services which it supplied to a group pension fund is a "decrease in consideration" the purposes of regulation 38 Value Added Tax Regulations 1995 ("the Regulations"). In this decision we shall refer to a "price adjustment" for convenience, but without prejudging the issue.

3. The assessment under appeal is in the amount of £1,064,893 and was issued on the basis of HMRC's view that the Appellant was not entitled to a VAT credit in respect of the above-mentioned price adjustment. The Appellant claimed that for the purposes of regulation 38 (1) (b) and (3) of the Regulations there had been a "decrease in consideration for a supply" resulting from the price adjustment so that it was entitled to make a negative entry in the VAT portion of its VAT account.

The evidence

4. We heard from two witnesses for the Appellant, both of whom produced witness statements, gave oral evidence and were cross-examined. First, Ms Barbara Whent, Global Practice Leader for Employee Benefits for the Appellant and a trustee of some of the Appellant's other pension funds (but not a trustee, as we understood it, of the pension fund involved in this appeal), gave evidence in relation to the operation of the pension fund. Secondly, Mr Yannis Poulopoulos, the Head of the Global Indirect Taxes group at Rio Tinto gave evidence on the VAT background.

5. In addition, a bundle of documents was also placed before us in evidence.

The facts

The services supplied

6. Between 1973 and 2010 the Appellant supplied services to the Trustees of Rio Tinto pension funds established for the benefit of Rio Tinto employees. The various UK Rio Tinto pension funds were reorganised in 1996 and consolidated into one fund ("the Fund").

7. The services supplied by the Appellant to the Fund comprised investment management services and administration and general management of the Fund. In the correspondence and discussions between the parties there was some confusion in relation to these terms. In this decision, however, we shall use the expression "investment management" to describe advice given to the Fund in relation to its investments "Administration and general management" services comprised the

production of pension news updates for employees, legal services, tracing missing beneficiaries, fund administration etc.

8. We were shown VAT invoices issued by the Appellant to the Fund during the period 2005 – 2007. These invoices described the services supplied by the Appellant to the Fund, the cost (excluding VAT) and the relevant VAT. A typical example, which was referred to at the hearing, was the invoice dated 12/05/05 which read as follows: –

	COST(Excluding VAT)	VAT Code	VAT
	£		£
Pension Department Costs	66,671.50		
Salary & Dependant charges	7,149.00		
Pension Investment costs	56,282.43	S*	9849.40

*Indicating a standard-rated supply

9. It can be seen, therefore, that the Appellant charged the Fund no VAT in relation to Pension Department costs and Salary and Dependant charges, but charged VAT at the standard rate on Pension Investment costs."

10. An e-mail from the Appellant to HMRC dated 28 September 2007 explained the categories of services supplied to the Fund detailed on the invoices. The e-mail read as follows:

> "Pension Department Costs: … Input VAT (where charged) is recovered in full on pension department costs on the basis that these costs related to ongoing management of the scheme and are thus the input tax of the employer, Rio Tinto London Limited (per Notice 700/17 Funded pension schemes (2002)….
>
> I performed a review of pension department costs recharged to the fund during the period January 2006 to March 2007 (inclusive). The bulk of costs during this period were invoiced by the vendor is listed below… [The e-mail and sets out a number of third-party service providers providing communications, tracing, actuarial, legal, recruitment, administration, rating agency, consulting, insurance etc. services]

Per my reading of Pensions Notice 700/17, all the above costs are allowable management (as opposed to investment) costs.

As you will see from the procedural guidance issued by the Rio Tinto tax team, investment expenses are recharged separately from management expenses bracket please refer below for full consideration of investment cost recharges).

Salary and Dependent Charges: Selected Rio Tinto employees perform work in relation to the pension fund. Salary and dependent recharges are calculated by adding up monthly basic salary, car allowance, National Insurance charges, accident cover and bonuses payable in relation to these employees. Depending on the time spent by these employees on pension fund issues, a portion of the aforementioned salary and dependent charges costs are disbursed to the fund. No VAT is recovered in relation to salary and dependent charges – these charges are not subject to VAT. Rio Tinto employees perform the following types of service: advertising the fund to new employees and updating existing employees on the fund status, providing information on the fund for statutory disclosures in Rio Tinto corporate accounts, general review of fund's performance (production of statistics et al for employee/Rio Tinto corporate consumption) selection of investment managers, reviewing and advising on legislative/regulatory/tax changes, ensuring that the funds can meet their commitments to beneficiaries etc.

Pension Investment Costs: Stephen Burley was the pension fund investment manager, providing investment services to the fund. The bulk of investment management costs correspond to salary and other incidental costs incurred in the provision of these investment management services. Output VAT is duly charged by RT London Limited on pension investment cost recharges. Note that prior to February 2007, Stephen Burley performed all investment management activity, no external investment managers were engaged by either RT London Ltd all the fund. Stephen Burley had his own cost centre – 227 All investment related costs were posted to this cost centre… At the time of the monthly recharge the pension fund, investment service costs posted to the cost centre 227 are captured in full and included in the Pension Investment Cost line billed to the fund on the monthly recharge invoice.

In February 2007, Stephen Burley left Rio Tinto's employ and all investment management activity was outsourced to 7 external investment managers…. Investment costs (including external fund manager costs) continue to be posted to cost centre 227 for recharge to the fund + VAT."

11. Thus, to summarise, Pension Department Costs (which appear to comprise charges levied by third-party suppliers) gave rise to allowable input tax for the Appellant. Those costs were recharged to the Fund without VAT being charged. Salary and Dependent Charges did not give rise to input tax for the Appellant (because salaries etc. were not themselves liable to VAT) and the relevant proportion of those costs attributable to the Fund were invoiced to the Fund by the Appellant

without VAT being charged. The VAT treatment of these two categories of costs was not in dispute between the parties.

12. The real dispute in this appeal relates to the third category of expenses, viz Pension Investment Costs. These costs were, until 2007 (when Mr Burley retired from the Appellant's employment), incurred by the Appellant in the form of salary and related charges. After 2007, the Appellant outsourced its investment management function to third-party suppliers. However, the Appellant contends that Pension Investment Costs included an element (which the Appellant estimated to be 30%) of administration costs. The Appellant contended that these administration costs should not carry VAT when recharged to the Fund. Nonetheless, for the whole of the period from 1973 to 2010 the Appellant had, in its view mistakenly, charged VAT to the Fund in respect of these expenses. Furthermore, it was in relation to these administration expenses that the alleged price adjustment, which lies at the heart of this appeal, was made.

13. Identifying this category of administration expenses as the expenses in respect of which the price adjustment was made caused some confusion in the exchange of skeleton arguments prior to the hearing. At the hearing, we were asked to assume that the amount of the price adjustment, which we shall explain in more detail below, was not in dispute and that our decision should focus solely upon the question whether the Appellant had made a "decrease in consideration" for the purposes of regulation 38 of the Regulations.

The pension deficit

14. We now set out the background to the price adjustment that was made in 2011.

15. The Fund was a defined benefit scheme until 2005, after which the defined benefits scheme was closed to new members and became a defined contribution scheme. For many years the Fund was in surplus; in other words, the assets of the Fund were sufficient to meet current and anticipated liabilities to members. However, in or around March 2008, with the onset of the global financial crisis, the Fund dipped into deficit. This deficit continued to grow and by March 2009 the Fund's assets represented only 77% of its liabilities.

16. The Fund's participating employers were required to make deficit contributions to the Fund from March 2008 in accordance with the terms of a Funding Corridor Framework. To explain the function of this agreement requires a little explanation of the funding and regulation of pension funds.

17. The regulation and funding of UK pension schemes is now largely governed by the Pensions Act 2004. This Act established the Pensions Regulator. The Pensions Regulator's Code of Practice for Trustees contains, in relation to funding obligations, provisions which Trustees should observe. These provisions specify that there should be:

(1) a statement of funding principles specific to the circumstances of each scheme setting out how the statutory funding objective will be met;

(2) periodic actuarial valuations and actuarial reports;

(3) a schedule of contributions; and

(4) a recovery plan where the statutory funding objected is not met.

18. The Funding Corridor Framework set out principles agreed between the Trustees and Rio Tinto to secure that the Fund had sufficient assets to meet its statutory funding objectives over the long-term. Ms Whent, in her evidence, referred to the Funding Corridor Framework as a "glide path", established after the Fund first went into deficit in 2007, to take the Fund out of deficit. The Funding Corridor Framework had been agreed between the Trustees and Rio Tinto after negotiation. In accordance with the Funding Corridor Framework, the participating Rio Tinto employers were required to make deficit contributions from March 2008.

19. Every three years pension fund Trustees must obtain an actuarial valuation of the assets and liabilities of a pension fund to show whether a fund was in surplus or deficit. On the basis of this valuation the Trustees of a fund will then enter into discussions with the employer to agree on the employer's future contributions to the fund. This agreement is embodied in a Schedule of Contributions which is a formal document. Each year a pension fund, including the Fund, is audited and the auditors compare contributions paid to the fund against the relevant Schedule of Contributions. Any difference between the contributions agreed to be made under the Schedule of Contributions and the contributions actually made will be reported to the Trustees and, if substantial, may lead to the pension fund's accounts being qualified and possibly reported to the Pensions Regulator.

20. The Fund entered into a Schedule of Contributions with participating Rio Tinto employers in December 2009, which was attached to the Fund's annual accounts (in fact, we were shown the 2009 Schedule of Contributions that was attached to the Fund's 2012 audited accounts). The Schedule of Contributions shows the percentage of salaries which the participating employers will make to the Fund in respect of various members' benefits.

21. In addition, in December 2008, Rio Tinto PLC ("PLC") entered into a Deed of Guarantee and Agreement with the Fund under which PLC guaranteed the obligations of other Rio Tinto subsidiary employers.

22. With effect from July 2009, the deficit contributions from participating employers required by the Fund were calculated were calculated at £1,925,000 per month. However, on 30 September 2009 a participating employer made an advance deficit payment of £70 million. The Schedule of Contributions states that, as a consequence of the £70 million advance payment, further deficit contributions amounting to £48.3 million would only become due once the £70 million advance payment had been exhausted. At August 2011, the date of the price adjustment, there was a balance of the advance payment remaining of approximately £19.7 million. The advance deficit payment was finally exhausted in June 2012. During the period from

September 2009 to June 2012 participating Rio Tinto employers were only required to make ongoing (rather than deficit contributions) payments to the Fund.

The VAT position

23. As we have explained, the Appellant supplied the investment management and administration services to the Fund from 1973 to 2010 – the period covered by the price adjustment.

24. The deadline for filing historic VAT claims after the ruling in the *Fleming* case (*Customs and Excise Commissioners v Michael Fleming (t/a Bodycraft)* [2008] UKHL 2; [2008] STC 324; [2008] BVC 221) was 31 March 2009. The Appellant instructed KPMG to assist it in identifying appropriate claims. In the course of preparing these claims, KPMG were said to have advised the Appellant that, on the basis of HMRC guidance in Notice 700/17, 30% of the fund management charges (by which we understood this to mean the Pension Investment Costs) were properly costs of the employer rather than costs which should be charged to the Fund. We were not shown KPMG's advice.

25. In the skeleton arguments there was a debate about whether Notice 700/17, provided support for the view reportedly taken by KPMG (and which was advanced by Mr Poulopoulos in his witness statement).

26. As we read the relevant provisions of Notice 700/17, the guidance simply related to the correct attribution of input tax, in respect of outsourced services, between administration services and investment management services, in circumstances where the service provider did not differentiate between the two types of services in its invoice. In summary, administration services gave rise to a right to deduct input tax against taxable supplies made by the employer. The supply of investment management services, however, gives no right to input deduction for the employer because there was no sufficiently direct and immediate link between such services and the employer's taxable supplies. In this context, where the supplier's invoices did not differentiate between administration services and investment management services, paragraph 2.7 of Notice 700/17 suggested a 30% (administration services) and 70% (investment management services) apportionment.

27. We could not find in Notice 700/17 any support for the proposition, attributed to KPMG's advice and put forward in Mr Poulopoulos's witness statement, that this guidance suggested that a 30% attribution in respect of administration services should not be recharged by an employer to its pension fund. The Notice was completely silent on this point and, in our view, on any conceivable interpretation could not fairly be read as having this meaning.

28. Be that as it may, in Mr Poulopoulos's witness statement and the skeleton arguments lodged on behalf of the Appellant, reliance was placed on Notice 700/17 as providing the basis for reaching the conclusion that the Appellant had over-charged the Fund by recharging 100% of Pension Investment Costs, rather than only 70% of those costs. In cross-examination, however, Mr Poulopoulos rather abruptly

abandoned this position. He accepted that the net of VAT amounts charged by the Appellant to the Fund in respect of Pension Investment Costs were correct and that the only element of over-charge related to the VAT on 30% of those costs. He gave no explanation for this change of view.

29. In other words, taking the invoices referred to in paragraph 8, the figures shown in the "COSTS (Excluding VAT)" were accepted by Mr Poulopoulos as being correct. In short, Mr Poulopoulos now took the position that the Appellant should not have charged VAT to the Fund in respect of 30% of the Pension Investment Costs but that this was the only over-charge in question. The Appellant, therefore, abandoned the argument that Notice 700/17 could be used as a justification for the proposition that there had been an over-charge of net of VAT amounts to the Fund by the Appellant. There had been no over-charge by the Appellant to the Fund except in respect of VAT.

30. Mr Poulopoulos took the view that in order to reclaim the over-charged VAT a provisional claim should be filed under section 80 VATA. Accordingly, a claim for the allegedly over-charged VAT was made by the Appellant on 31 March 2009.

31. On 21 March 2010, however, Mr Poulopoulos wrote to HMRC informing the Commissioners that, although the section 80 claim was not being withdrawn, the Appellant intended to make a price adjustment in respect of the services supplied by the Appellant to the Fund during the period 1973 to January 2007.

32. We were informed that the section 80 claim (which does not cover the full period of the regulation 38 claim) has not been pursued pending resolution of the current appeal. Furthermore, we were informed that HMRC have not investigated or formed a view regarding the validity of the section 80 claim and, therefore, do not yet accept that there was an over-declaration of VAT in connection with the Pension Investment Cost recharges. We express no view on the merits of the section 80 claim in this decision.

Discussions with the Fund Trustees

33. Ms Whent's evidence was as follows:

> "20. I understand that in 2009, as a consequence of an opportunity to reclaim certain sums of VAT from HMRC, it was identified that [the Appellant] had, over a considerable period, been overcharging the Fund in connection with the costs of investment management. I understand that in the case of participating employers which had used external investment managers HMRC accepted that 70% of the cost was proper to the pension fund and 30% to the employer. [The Appellant] had passed 100% of the cost to the Fund.
>
> 21. Having identified the over-charge, Yiannis Poulopoulos of the tax Department sought to engage with the trustees through [the Appellant]. Yiannis explained the position they had reached concerning HMRC's guidance based on advice they had taken from KPMG. A briefing paper was prepared for the trustees of the Fund so they could

> understand the issue and it was proposed that it would be discussed at the trustee meeting in September 2010."

34. Thus, it appears from Ms Whent's evidence that she understood, from the Rio Tinto tax department, that the Fund had been over-charged in respect of investment management fees and not just in respect of VAT.

35. Mr Poulopoulos duly submitted a briefing paper to the Fund's Trustees for their meeting in September 2010.

36. The paper stated:

> "Please note that the Tax Department recently undertook a separate review of the recharge of the investment management costs ("IM costs") between [the Appellant] and the [Fund]. The review established that [the Appellant] has over-charged VAT to the [Fund]. Specifically, only 70% of the IM costs should have been charged with VAT. This is because 30% of IM costs are deemed to relate to administration and the associated VAT should be borne by the [Appellant] (not the [Fund]).

37. We note that the only suggestion contained in this paper was that too much VAT had been charged by the Appellant to the Fund. There is no suggestion that the fees themselves charged to the Fund were excessive or in any way unjustified. If KPMG and/or Mr Poulopoulos were concerned that the Appellant might have over-charged management fees to the Fund for 37 years one might have expected this to have been raised with the Trustees on the first occasion where to topic was to be discussed.

38. The paper went on to note the distinction between a trader correcting its VAT returns by means of a voluntary disclosure (which was subject to a three-year time-limit) and making a "Price Adjustment" (which was not subject to a three-year time-limit but could go back as far as 1973).

39. At that time it was calculated that 30% of the Pension Investment Costs charged to the Fund by the Appellant in the period 1973 to 2010 would amount to a gross sum of £10,083,796. In fact, as we shall see, a different basis of the calculation of the Pension Investment Costs was used in the final price adjustment, although it is agreed between the parties that the calculation of this amount is not in dispute for the purposes of this appeal.

40. The September 2010 briefing paper set out two options. The first option was to treat the price adjustment as part of the employer's contribution to the Fund. In other words, the price adjustment would offset the obligation to make contributions for a short period of time. The second option involved an immediate price adjustment which did not reduce pension contributions by participating employers but would, in effect, act as an advance pension contribution under the Funding Corridor Framework.

41. Mr Poulopoulos did not attend the Trustees' meeting in September 2010, but the Trustees (who, according to Ms Whent, found the issue complex and decided to defer the issue until the December meeting) requested a simpler note.

42. Mr Poulopoulos consulted informally between September and December 2010 regarding the nature of the price adjustment (although it was not clear whom he consulted). On the basis of those discussions it was decided (but it is not clear who decided) that the price adjustment would not be treated as a contribution by the participating employer. In other words, it was to be treated as neither part of the participating employers' ongoing contribution liabilities nor was it to be set of against their obligations to make deficit contributions.

43. In December 2010 Mr Poulopoulos submitted a revised paper which was considered at the Trustees' meeting on 9 December.

44. This revised paper explained that prior to January 2007 the Fund's investments had been managed in-house and that all expenses incurred were recharged to the Fund plus VAT. From January 2007 external investment managers were employed by the Fund. Their charges were also recharged to the Fund plus VAT. The paper continued:

> "Rio Tinto Benefits Department on behalf of the Pension Fund has requested that the Tax Department review the VAT treatment of the investment management ("IM") recharges that it suspects may have been over-charged by [the Appellant]."

45. We observe at this point that, in contrast to the September paper, this appears to be the first mention of the fact that the Fund "may have been" over-charged by the Appellant. No explanation is given as to how or why an over-charge may have arisen nor does the paper indicate that there was definitely an over-charge in respect of the Pension Investment Costs themselves.

46. The paper explained that UKVAT legislation entitled taxpayers to adjust VAT errors within a four year period (instead of the three year period mentioned in the September paper). In addition, Mr Poulopoulos explained that UK VAT law also allowed taxpayers to make a "Price Adjustment" outside the four-year limit "going as far back as 1978 [sic]…." The paper stated that:

> "It is estimated that [the appellant] has over-charged the Fund £1.4 million of VAT which has been "over-charged" to the Fund £10,083,796 (Net equals £8,684,225 plus VAT equals £1,399,570).
>
> Mechanism by which [the Appellant] would make Price Adjustment [sic] to [the Fund] applying applicable IM costs:
>
> 1. Potential Price Adjustment period is 1973 to January 2010.
>
> 2. [The Appellant] will issue [the Fund] a credit note for the over-charged about – £10,083,796 (net amount of £8,684,225 plus VAT of £1,399,570).
>
> 3. [The Appellant] will adjust its VAT account to show a reduction in consideration of £10,083,796 (itemising the net and VAT amounts).

> 4. Price adjustment will result in a credit of the VAT to [the Fund] of £1,399,570 from [the Appellant].
>
> 5. [The Appellant] will receive the £1,399,570 VAT credited from HMRC by the adjustment to its monthly VAT return.
>
> (Please note that any Price Adjustment made will have the effect of reducing historic charges made by [the Appellant] to [the Fund])."

47. It will be noted that in the latter part of this extract the emphasis is upon the "over-charge" being VAT which has been over-charged to the Fund. It is possible that paragraph 2. could be taken to suggest that £8,684,225 had been over-charged but we think that, in context, it reads as the mechanism by which the over-charged VAT can be reclaimed

48. The Trustees approved the proposal, pending agreement with HMRC. The minute of the Trustees meeting of 9 December 2010 reads as follows:

> "VAT on Investment Recharges
>
> Directors NOTED the paper produced by Mr Poulopoulos.
>
> Mr Fox explained that the Tax Department had been requested to consider the VAT treatment of a proposed price adjustment to be made by [the Appellant] for the provision of investment management services to the Fund during a selective period. A review of the historic management recharges had revealed that the Fund had been over-charged.
>
> It was AGREED that [the Appellant] should make a Price Adjustment in accordance with UK VAT legislation, subject to approval from the Fund's external auditors, and notification to HMRC of the Price Adjustment and their acceptance of the VAT treatment.
>
> Ms Whent then left the meeting."

49. This minute refers to the Fund being over-charged and, we think, implies that this relates to the costs themselves rather than to VAT charged on those costs, although the point is not entirely clear. There is, however, no written evidence that the Trustees enquired about how this over-charging came about or on what basis the conclusion had been reached that there had been an over-charge.

50. Mr Poulopoulos said that in the early part of 2011 he had had discussions with KPMG who informed him that HMRC were beginning to pay claims to other pension funds in respect of apportionments for investment management charges. Consequently, Mr Poulopoulos felt under some pressure to ensure that the Fund was not disadvantaged in comparison to other pension funds and he decided to revisit the issue of the price adjustment.

51. In early 2011 Mr Poulopoulos recalculated the alleged over-charge. Accurate data only existed for the period 1997 to 2010. Eventually, Mr Poulopoulos took the period 1997 – 2007 and calculated the over-charge as 100% i.e. 100% for approximately 30% of the total period (1973 – 2010). This resulted in a price adjustment of £7,150,000 which, in turn, resulted in an adjustment to the Appellant's

VAT account of £1,064,893 i.e. 17.5% of the price adjustment. As already explained, the quantum of the price adjustment is not in dispute.

52. As we have seen, in his witness statement Mr Poulopoulos indicated that the 30% estimate came from KPMG's advice based on Notice 700/17. Having accepted that Notice 700/17 did not justify the conclusion that the Appellant had over-charged the Fund, Mr Poulopoulos was asked in cross-examination why he had calculated the VAT over-charge as being 30% of the Pension Investment Costs. Mr Poulopoulos, in our view, seemed unable to answer this question. He gave a vague response in which he said that the Appellant had certain information available, had looked at actual costs and considered 30% a fair and reasonable figure. He admitted that there was no "science to this calculation." When asked whether Notice 700/17 had anything to do with the percentage he replied: "Yes, along with other factors."

53. Mr Poulopoulos wrote to HMRC on 10 February 2011 explaining that the Appellant intended to make a price adjustment of £7.15 million and explaining the basis of calculation. The proposed price adjustment was discussed with HMRC at a meeting on 7 March 2011. HMRC indicated that no approval was required from HMRC.

54. The Appellant issued a credit note to the Fund on 10 August 2011 in respect of the price adjustment. The credit note described the credit as "Investment mgt fees as agreed with Trustees". The VAT exclusive amount was £6,085,106.38 and the VAT element was £1,064,893.62 resulting in a VAT inclusive gross amount of £7,150,000. The consequent repayment by the Appellant to the Fund was processed around the same time.

(a) The accounting treatment of the price adjustment

The price adjustment was recorded in the audited accounts of the Fund for the year ended 31 March 2012. Note 12 to the accounts was headed "Investment management expenses". In the line "Administration, management and custody" was a negative amount of £3,345,000 (the negative amount was caused by the fact that the annual charge payable by the Appellant to the Fund was exceeded by the amount of the price adjustment). Note 12 stated that:

> "Included in the investment management expenses for the current year is a fee adjustment of £7,150,000 (net amount of £6,085,106 plus associated VAT of £1,064,894) from [the Appellant]."

55. In short, therefore, the Fund accounted for the price adjustment as a "fee adjustment" and not as a contribution by the Appellant to the Fund.

56. Ms Whent’s evidence was that if the price adjustment had been paid/received as a contribution rather than as a price adjustment this would have required a negotiation between the employer and the Fund. It would have required the Schedule of Contributions to be rewritten and the payment would have been recorded not in Note 12 to the accounts but rather in Note 3 "Contributions". Note 3 referred to the normal employers’ contributions in respect of accruing benefits and to "Augmentations" which related to specific member augmentations and did not relate to the price

adjustment. In relation to "Deficit funding" Note 3 contained a negative figure of £313,000 reflecting the effect of the £70 million contribution ready paid in an earlier accounting period as described in paragraph 22 above.

57. Ms Whent also referred to the briefing papers prepared by Mr Poulopoulos which we describe in paragraphs 36 – 47 above. Her evidence was that the Trustees of the Fund did not want to receive the price adjustment as a pension contribution. The Trustees had already had lengthy negotiations with the employer about the "glide path" (i.e. the Funding Corridor Framework) which set in place a framework agreement with the employer to enable the Fund to move out of deficit. The Trustees did not want to change that plan and, in any event, the Fund had already received an advance payment of £70 million. Ms Whent said that if any supplier wanted to give money back to the Fund the Trustees would be happy to receive it, but not as a contribution. We observe, however, that according to Ms Whent's evidence, at no stage did the Trustees seem to consider whether there were justifiable commercial reasons for the refund. Instead, they seem simply to have accepted that VAT had apparently been over-charged and that there may have been an over-charge in respect of fees.

(b) Notice of Appeal

58. Mr Poulopoulos was cross-examined on his letter to HMRC dated 28 August 2012 which was attached to the Appellant's notice of appeal and which set out the Appellant's grounds of appeal. This letter was originally sent by Mr Poulopoulos to HMRC requesting a of HMRC's decision £1,064,893 dated July 2012. The letter stated:

> "**Commercial rational [sic] for price adjustment**
>
> As a result of the global financial crisis in 2009, the Fund was in deficit as were most UK pension funds. [The Appellant] as principal employer had an obligation to increase funding requirements and as such, together with the Fund, considered a number of options to deal with the deficit and consequently agreed for a period of time to reduce the level of IM charges previously charged to the Fund. As part of this process, [the Appellant] and the Fund requested that the Rio Tinto Tax Department review the tax treatment (including VAT) of the proposed arrangement."

59. In cross-examination Mr Peretz put it to Mr Poulopoulos that this paragraph of his letter revealed the real reason behind the price adjustment i.e. that it was intended to help deal with the Fund's deficit. Mr Poulopoulos replied that the price adjustment indicated that the Appellant wanted to help deal with the Fund's deficit but that this was the background to a decision to review the tax aspects of the Fund at the same time as considering potential *Fleming* claims to see whether the tax treatment of the Fund was as tax efficient as it could be.

Arguments of the parties

Arguments for the Appellant

60. Ms Brown reviewed the general principles which she argued ought to be applied by the Tribunal. She submitted that it was necessary to look at the economic and commercial reality of the price adjustment (referring to the judgment of the CJEU in *HMRC v Newey (trading as Ocean Finance)* Case C – 653/11 [2013] STC 2432 at [42] – [45] ("*Newey*")).

61. Ms Brown submitted that, unless there was a reason to consider that the contractual and legal relationships between the parties were artificial, those relationships had to form the basis for determining the commercial and economic substance of the relevant transactions.

62. Ms Brown further submitted that in order to determine the nature of a contractual arrangement between different parties it was necessary for regard to be had to all the circumstances in which the transaction takes place and that the whole of the relationships between the various parties needed to be considered – "labels" used by the parties were not themselves conclusive (referring to the judgment of the Supreme Court in *Secret Hotels2 Ltd (formerly Med Hotels Ltd) v HMRC* [2014] UKSC 16 at [30] – [33] ("*Secret Hotels*") and *HMRC v Aimia Coalition Loyalty UK Limited* [2013] UKSC) 15 at [38], [42], [48] and [56]).

63. From these authorities Ms Brown submitted that the guiding principle must be that this Tribunal must consider all the relevant facts and circumstances in reaching a view on the commercial and economic substance of the transaction. Those facts and circumstances included the regulatory environment in which the price adjustment was made as explained in the evidence of Ms Whent, particularly as regards the Funding Corridor Framework and the Schedule of Contributions.

64. Looking at the facts, the price adjustment was a decrease in consideration and not a contribution to the Fund. Ms Whent's evidence was that the Trustees would not accept the payment as a contribution to the Fund.

65. Turning to the case-law on decreases in consideration, Ms Brown referred to the decision of the CJEU in *Elida Gibbs Limited v Customs and Excise Commissioners* Case C – 317/94 [1996] STC 1387 [19], [24] [26] – [33] ("*Elida Gibbs*"). In her submission, the Court accepted that there could be an *ex post facto* decrease in consideration. In this case a manufacturer made a refund to the ultimate consumer and was treated is entitled to an adjustment under what was then article 11 A of the Sixth Directive. The question was: what was the cost, in the end, to the final consumer?

66. In *Almos Agrárkülkereskedelmi Kft v Nemzeti Adó- és Vámhivatal Közép-magyarországi Regionális Adó Főigazgatósága* Case C-337/13 ("*Almos*") article 90 of Council Directive 2006/112/EEC of 28 November 2006 on the common system of value added tax ("the VAT Directive") embodied a fundamental principle of the VAT Directive, according to which a taxable person is taxable only on the amount of consideration actually received and had a direct effect ([22] and [24] – [26]).

67. Ms Brown submitted that the CJEU in *Freemans plc v Customs and Excise Commissioners* Case C-86/99 envisaged that *ex post facto* adjustments could be used to reduce the purchase consideration.

68. Ms Brown referred to the decision of the VAT Tribunal in *British United Shoe Machinery Code Limited v Customs and Excise Commissioners* (1977) VATTR 187. In this case B was a subsidiary of U, both companies being separately registered for VAT. B charged U for intragroup services and charged VAT on its invoices. U mistakenly deducted the whole amount of tax on B's invoices as input tax even though it was partially exempt. The Commissioners claimed payment from U for the wrongly deducted input tax. B then issued credit notes to U cancelling or purporting to cancel the service charges in question. The Commissioners then assessed B for tax in the amount of tax shown on the credit notes. As regards those supplies made by B to U, the Tribunal found that the supplies could not be properly cancelled by credit notes. The Tribunal rejected the Commissioners' contention that the authorisation of a credit note was a matter exclusively within the discretion of the Commissioners and said [192]:

> "… It seems to us that the issue of a credit note is a common and usual commercial method of rectifying an over-charge or giving credit to damaged or returned goods. We can find nothing in the Finance Act 1972 or elsewhere which empowers the Commissioners to say whether or not a credit note should be issued at all – so to hold would bring commercial life to a standstill whilst permissions were being sought. In the judgment of this tribunal the duty of the Commissioners, and of the tribunal on appeal, is to satisfy ourselves that a credit note has been issued bone fide in order to correct a genuine mistake or over-charge, or to give a proper credit. If this test be not satisfied then the credit note is fraud. As and is void as being contrary to public policy, see *Alexander v Rayson* [1936] 1 KB 169 and *Napier v National Business Agency Ltd* [1951] 2 All ER 264."

69. Ms Brown submitted that in this case the Appellant had given "a proper credit" to the Fund and that its credit note should be respected.

70. In *Castle Associates v Commissioners of Customs and Excise* (VATD) 3497 (MAN /87/448) the appellant supplied management services to an associated company which claimed input credit in respect of the VAT charged by the appellant on its invoice. Over a year later, when the associated company was in financial difficulty and had been deregistered for VAT, the appellant's auditors queried the invoice. The appellant decided to issue a credit note for part of the charges on the invoice, maintaining that some of the charges had duplicated earlier charges. The Tribunal refused to reduce consideration stating:

> "In a case where services are supplied for an as yet unascertained consideration, and the parties are at arm's length, the position usually presents little difficulty; the supplier of the services states his charges, the recipient disputes them if he wishes, and after discussion the amount is agreed. If an invoice stating the supplier's original version of the charges has been issued in the meantime, a credit note is issued,

> giving credit for the difference between the charges originally stated and the agreed charges, and no doubt such a credit note would be perfectly acceptable for the purposes of value added tax. Again, if the amount has been agreed, and the invoice erroneously states a higher amount, a credit note is an appropriate method of evidencing the correction of the error. In each of these cases, the invoice misstates the transaction as it was agreed between the parties and the credit note evidences the correction of the error. *But once the parties have agreed the amount of the charges for the services, and the services have been supplied, the value of the supply is ascertained. If thereafter the supplier unilaterally decides, or both parties contract, that the full amount of the agreed charges is not to be payable, in our judgment the decision or the new contract does not alter the value of the supply for the purposes of value added tax, nor does it make any difference if a credit note is issued to evidence the decision or the new contract.*
>
> In the instant case, we are not satisfied that there was any error in the calculation of the Appellant's charges as stated in the Invoice, and in our judgment the credit note represented, not the correction of one or more errors, but a subsequent change of mind on the part of the Appellant. In our judgment that is not a situation in which the issue of a credit note is effective for the purposes of value of value added tax, and it follows that the appeal must be dismissed."[emphasis added]

71. Ms Brown argued that the final two sentences of the first paragraph in the above extract from *Castle Associates* could not be reconciled with *Elida Gibbs*, which was decided after *Castle Associates*. In *Elida Gibbs* the refund to the ultimate customers took place after the supply by the manufacturer. This was no impediment to the application of regulation 38 and article 90.

72. In *Customs and Excise Commissioners v McMaster Stores (Scotland) Limited (in receivership)* [1995] STC 846 the taxpayer landlord sought to exercise its option to tax rents payable to its tenants. The exercise of the option was invalid because it failed to inform the Commissioners. The taxpayer company went into receivership. The receivers issued credit notes to the tenants for the tax charged in error and claimed an adjustment of the company's VAT returns under regulation 7 of the VAT Regulations (now regulation 38). The Court of Session held that no regulation 38 adjustment could be made in the circumstances. Lord Hope said [at 850]:

> “In my opinion reg 7 is concerned only with the making of adjustments to the VAT account to reflect an increase or a decrease in consideration which includes an amount of tax chargeable on the supply. It does not deal with the problem which has arisen in this case, where the supply was an exempt supply and no VAT was due to be paid on it to the commissioners. A claim for the recovery of overpaid tax which arises in these circumstances should be made under s 24 of the 1989 Act. A claim made under that section is the subject of a separate provision which is to be found in reg 6 of the 1989 regulations, which does not require any adjustment to be made to the VAT account kept and maintained under reg 4 of these regulations. In cases to which reg 7

> applies, on the other hand, it is the increase or decrease in the consideration which requires a corresponding adjustment to be made to the account. The VAT forms part of the consideration if the supply was for a consideration in money and it was a taxable supply. Both the maker of the supply and the recipient of it are required by reg 7 to make adjustments which are, in these circumstances, the result simply of a process of arithmetic. The amount of the VAT which was chargeable for the supply must be adjusted at the rate prescribed under s 9 of the 1983 Act to reflect the increase or decrease in the consideration on which the VAT falls to be charged. It is an adjustment which does not depend upon any decision by the commissioners, and where there is a decrease in the consideration no question as to whether the claimant is being unjustly enriched by the adjustment can arise. It is the consideration as a whole which is being adjusted, and the adjustment to the amount of the VAT payable is the inevitable result of an alteration in the amount of the value of the supply on which the tax falls to be charged."

73. Ms Brown submitted that the *McMaster* case could be distinguished because credit notes were issued only in respect of VAT and not in respect of the underlying consideration. In the present appeal, the Appellant issued a credit note for the gross amount of £7,150,000, which included VAT.

74. In *Carlton Clubs Plc* v HMRC [2011] SFTD 1209 (Judge Reid QC and Mr Sheppard), Carlton operated bingo clubs. Customers paid a fixed sum to participate in a session of bingo ('the session fee') consisting of 15 games. The session fee had two components: the participation fee (which was subject to VAT), which was the consideration received by Carlton for the supply to the customer of the right to play bingo for cash prizes; and the stake (which was not subject to VAT), which was the contribution made by the customer towards the cash prizes paid out to the winner of each game in the session. The tribunal found that in 2007 HMRC had changed its published practice on the manner in which the calculation of the split in the session fee between the participation fee and the stake should be calculated. Carlton raised an internal credit note in 2009 to recalculate its output tax liability for the period 1996 to 2003 in accordance with HMRC's new published practice. Thus, a greater proportion of fees collected from customers became attributable to the stake rather than participation fees. HMRC disallowed the adjustment as being 'out of time' under the VAT error adjustment rules (i.e. four years since 1 April 2009 but three years until this date). Carlton, however, argued its claim under regulation 38 (where there was no time bar) and claimed that the internal credit note was adequate evidence to support the adjustment in its VAT account i.e. as a 'decrease' in the consideration for the supply because under the new method of calculation a smaller amount of the session fee was attributable to the participation fee. The taxpayer argued that no error had occurred at the time of the original VAT returns being submitted because the output tax declaration was correct at the time. The tribunal agreed and held that the regulation 38 adjustment was correctly made. A tax adjustment only became appropriate when HMRC subsequently notified its change in practice when it issued Business Brief 7/2007 on 1 February 2007 stating that an alternative calculation basis should be used. The Tribunal stated:

> "[69] ...It does not seem to us to matter how the change in consideration arises as long as it does arise. Regulation 38, which implements art 11C(1), applies inter alia where there has been a decrease in consideration evidenced by a credit note. Any change in the consideration is bound to be retrospective in nature. The appellant has, in accordance with the administrative directions of HMRC, changed the consideration for the supply of the right to participate in cash bingo sessions over the period between 1996 and 2003. On the face of it, such a change falls within the scope of reg 38. It is not an error. The regulation does not restrict its application by reference to the means by which the consideration changes. Thus, a change might arise by operation of law, agreement of the parties to a transaction e.g. a subsequent reduction in the price due to customer dissatisfaction or coupon schemes under a sales promotion campaign (as in *Elida Gibbs*), or by reason of administrative direction by HMRC.
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> …
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> [72] The fact that the amount paid by the customer has not changed is irrelevant because we are examining a payment consisting of two components; one component is the consideration for a supply which falls within the VAT regime; the other component is stake money which falls outwith the scope of the VAT regime. The amount of each component has changed. The stake money becomes greater and the consideration becomes less by equal amounts. This analysis and the application of reg 38 to the circumstances of this appeal are consistent with the general principle that a trader should not pay VAT on a sum which is greater than the consideration ultimately received for the supply in question (*Elida Gibbs* [1996] STC 1387, [1996] ECR I-5339, paras 19–24 and 29–31)."

75. Ms Brown argued that the Tribunal had given a wide meaning, particularly in [69] to the concept of a decrease in consideration.

76. Finally, in *Cumbria County Council v HMRC* [2011] UKFTT 621 (TC) (Judge Demack and Mr Freeston) the Council provided services to the Department Of Environment, Food and Rural Affairs (DEFRA) during the 2001 Foot and Mouth Crisis. The Council invoiced DEFRA the sum of £1.3m plus VAT. DEFRA disputed the Council's invoice. The Council meanwhile had accounted for VAT on the whole of the invoice to HMRC. The dispute resulted in a claim being made in the High Court but eventually, the parties settled on the basis that DEFRA would pay the sum of £200,000. The Council raised a credit note to write down the original invoice to £200,000 using regulation 38. The Council claimed VAT bad debt relief of £222,103 and, in February 2008, made a voluntary disclosure in order to recover this amount. HMRC rejected the claim on the basis that the claim was out of time under the relevant four year limit.

77. The Council appealed against HMRC's decision. This tribunal allowed the appeal, finding that the evidence showed the Council expected DEFRA to settle the whole amount of the invoice (the tribunal concluded that the Council had been entitled to recover for its services on a *quantum meruit* basis) and had, therefore, overpaid VAT to HMRC when it had accounted for VAT on the whole invoiced

amount. When the Council and DEFRA settled the High Court claim which reduced the amount due to £200,000 this reduced the consideration for the supply. Regulation 38 was therefore satisfied and the Council was entitled to recover the overpaid VAT. The tribunal rejected HMRC’s argument that because no fixed consideration had initially been agreed, no adjustment could be made under regulation 38.

78. Ms Brown argued that the payment by the Appellant to the Fund of £7,150,000 (inclusive of VAT) was made by way of a repayment of consideration. It was not made as a contribution to the Fund. At the time the payment was made there was an acceptable plan to reduce the Fund's deficit and the balance of the £70 million advance payment was still standing to the credit of the Fund. Ms Whent’s evidence was that the Trustees of the Fund did not want the payment as a contribution. A price adjustment was a different transaction from a contribution to the Fund (and, in this context, Ms Brown referred to the comments of Lord Walker of Guestingthorpe in *Lex Service plc v HMRC* [2003] UKHL 67 at [29] to the effect that it was to be expected that where transactions had been structured differently they would have different VAT consequences). In Ms Brown's submission the Appellant remedied the over-charge of VAT to the Fund by giving a "proper credit" (to borrow the language of *British Shoe*) for the gross sum of £7150, which included VAT. The Appellant was, therefore, entitled to a regulation 38 adjustment to ensure fiscal neutrality.

Arguments for HMRC

79. Mr Peretz agreed that it was necessary to look at the commercial and economic reality of the transaction to determine its correct VAT treatment.

80. In his submission, however, the commercial and economic reality of the price adjustment was that it was not a decrease in consideration. The consideration (the Pension Investment Costs) for the supply of investment management services by the Appellant to the Fund had been invoiced and paid without query for over 30 years.

81. Moreover, on the Appellant's own evidence, it was now accepted that the charges made by the Appellant to the Fund in respect of Pension Investment Costs were correct. The only element of over-charge, according to the Appellant, related to VAT. In other words, the correct services had been supplied for the correct consideration but it was now considered that VAT should have been accounted for differently. At no stage over the preceding 37 years had the parties considered that the Appellant had over-charged for its services and the Fund had never queried the charges made by the Appellant for its services.

82. In Mr Peretz's submission the fact that the price adjustment had accounted for as a reduction in consideration and had not been accounted for as a contribution was not determinative. Labels attached by the parties are transactions did not necessarily reflect the true nature of the underlying transaction Moreover, it was clear from Mr Poulopoulos's letter to HMRC dated 28 August 2012 which was attached to the Appellant's notice of appeal was that the Fund's deficit was the underlying reason for the price adjustment.

83. Mr Peretz referred to the decision of the House of Lords in *Lex Service plc v HMRC* [2003] UKHL 67, a case involving the quantification of non-monetary consideration for the purposes of VAT, where Lord Walker said [18]:

> "The expression "subjective value", to be understood in the sense described above, has been repeated in many later cases before the ECJ, including *Argos Distributors Limited v Customs & Excise Commissioners* [1996] ECR I-5311, para 16, and the other cases cited in that paragraph. Nevertheless the expression continues to cause some difficulty, partly because it naturally suggests a value which is chosen as a matter of individual discretion, and might therefore be expected to be more vague, labile and difficult to ascertain than one determined by objective criteria. But any such impression would be mistaken and would overlook one of the basic strengths of the VAT system. It is a system which is intended to be self-policing in the sense of operating automatically on the economic activities of registered taxpayers and final consumers, with the least possible need for VAT authorities to undertake independent investigation of the facts. In a straightforward case the "subjective value" of non-monetary consideration means the value overtly agreed and adopted by the parties to the transaction in question, just as the price overtly agreed and adopted by the parties is (in most cases) conclusive as to the quantum of monetary consideration. So far from introducing an element of vagueness or obscurity, the concept of subjective value (correctly understood) achieves legal certainty and ease of administration of the VAT system (just as a subjective apportionment of the consideration for a package of taxable goods and exempt services may achieve those results: see *C R Smith Glaziers (Dunfermline) Ltd v Customs & Excise Commissioners* [2003] STC 419, especially the speech of my noble and learned friend Lord Hoffmann at p 426, para 21)."

84. In the present appeal, the parties had agreed on the correct price for the Appellant's services and that had never been queried – the only question of debate was whether the VAT had been correctly charged – and this was the “subjective value” of the services.

85. Mr Peretz referred to the *Castle Associates* decision referred to above and to the extract quoted in paragraph 70 above. In that case the tribunal was looking for what the parties had actually agreed as the price for the appellant's services. This was the "subjective value".

86. In this case, the "subjective value" was, Mr Peretz submitted, what appeared under the heading “COST” in the invoices referred to in paragraph 8 above. Mr Poulopoulos accepted that this was the correct statement of the consideration.

87. Mr Peretz also referred to the decision of the CJEU in *Newey* (above) at [42] – [45]:

> "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 (see, to that effect, Joined Cases C-53/09 and C-55/09 *Loyalty Management UK and Baxi Group* [2010] ECR I-9187, paragraphs 39 and 40 and the case-law cited).

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 within the meaning of Articles 2(1) and 6(1) of the Sixth Directive 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."

88. In this appeal Mr Peretz urged us to conclude that the label of "decrease in consideration" attached to the transaction by the parties was artificial and did not reflect the economic and commercial reality. The consideration for the supply of the Appellant's services had never been challenged and the payment of £7,150,000 had been made solely to obtain a reduction in VAT.

89. Mr Peretz referred to the decision of the Supreme Court (above) in *Secret Hotels* and referred to the passage in the judgement of Lord Neuberger at [31]-[32] where, after referring to the passages in *Newey* quoted above, Lord Neuberger emphasised that:

"31.Where parties have entered into a written agreement which appears on its face to be intended to govern the relationship between them, then, in order to determine the legal and commercial nature of that relationship, it is necessary to interpret the agreement in order to identify the parties' respective rights and obligations, unless it is established that it constitutes a sham.

32. When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense. When deciding on the categorisation of a relationship governed by a written agreement, the label or labels which the parties have used to describe their relationship cannot be conclusive, and may often be of little weight. As Lewison J said in *A1 Lofts Ltd v Revenue and Customs Comrs* [2009] EWHC 2694 (Ch), [2010] STC 214 at [40], in a passage cited by Morgan J:

'The court is often called upon to decide whether a written contract falls within a particular legal description. In so doing the court will identify the rights and obligations of the parties as a matter of

> construction of the written agreement; but it will then go on to consider whether those obligations fall within the relevant legal description. Thus the question may be whether those rights and obligations are properly characterised as a licence or tenancy (as in *Street v Mountford* [1985] 2 All ER 289, [1985] AC 809); or as a fixed or floating charge (as in *Agnew v IRC* [2001] UKPC 28, [2001] 2 AC 710), or as a consumer hire agreement (as in *TRM Copy Centres (UK) Ltd v Lanwall Services Ltd* [2009] UKHL 35, [2009] 4 All ER 33, [2009] 1 WLR 1375). In all these cases the starting point is to identify the legal rights and obligations of the parties as a matter of contract before going on to classify them.
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> 34. In the present proceedings, it has never been suggested that the written agreements between Med and hoteliers, namely the Accommodation Agreements, were a sham or liable to rectification. Nor has it been suggested that the terms contained on the website ('the website terms'), which governed the relationship between Med and the customers, namely the Terms of Use and the Booking Conditions, were a sham or liable to rectification. In these circumstances, it appears to me that (i) the right starting point is to characterise the nature of the relationship between Med, the customer, and the hotel, in the light of the Accommodation Agreement and the website terms ('the contractual documentation'), (ii) one must next consider whether that characterisation can be said to represent the economic reality of the relationship in the light of any relevant facts, and (iii) if so, the final issue is the result of this characterisation so far as art 306 is concerned."

90. The approach of Lord Neuberger, Mr Peretz argued, was to ignore the use of labels – structuring the payment is a reduction in consideration could not be conclusive – and, instead, to look at the commercial and economic reality. In this case neither the Appellant nor the Fund was really concerned about the price, because there was no over-charge, but rather their concern was a perceived overpayment of VAT. The purpose of the parties in making the payment was relevant to the question of the commercial and economic reality of the transaction.

91. As regards the other main cases relied on by the Appellant, Mr Peretz argued that *Carlton Clubs* (above) provided no support for the Appellant. Mr Peretz explained that, in HMRC's view, *Carlton Clubs* had been wrongly decided. HMRC did not accept that it had changed its practice in 2007. The tribunal found at [73] that there had been a decrease in the consideration for the taxable supply. In this case there had been no change in the consideration and Mr Poulopoulos's evidence was that the only matter which the Appellant sought was wrong was the amount of VAT charged.

92. In relation to *Cumbria County Council* (above), Mr Peretz submitted that the settlement agreement between the Council and DEFRA amounted to a genuine reduction in price and that the original invoice had incorrectly shown the consideration.

93. Mr Peretz observed that Mr Poulopoulos had been unable to explain why he thought 30% represented the correct percentage for the over-charge. This was simply an attempt to re-write history. The correct consideration had been agreed and paid for 37 years. The price adjustment should be regarded as a contribution to the fund. Although it was not accounted for as a contribution, the accounting treatment of the price adjustment could not determine the true VAT treatment.

94. In answer to a question from the Tribunal, Mr Peretz confirmed that HMRC were not advancing any argument based on the doctrine of abuse of rights. HMRC's case was that the price adjustment did not for within the letter of regulation 38 as correctly interpreted.

Discussion

95. It is important to be clear on the question before the Tribunal in this appeal. First, we are not being asked to determine whether the view formed by the Appellant that it had over-charged the Fund VAT in respect of Pension Investment Costs was correct. Furthermore, we were not asked to form a view on whether the quantum of the price adjustment was correct. The only issue we have to decide is whether the price adjustment constituted a "decrease in consideration for the purposes of regulation 38."

96. The relevant legislative provisions can be briefly stated.

97. Article 90 of the VAT Directive provides:

> "1. In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.
>
> 2. In the case of total or partial non-payment, Member States may derogate from paragraph 1."

98. Under article 73:

> "the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply."

99. "Consideration" for the purposes of VAT has been held by the CJEU to be the "subjective value", that is to say, the value actually received in each specific case, and not a value estimated according to objective criteria (see e.g. *Elida Gibbs* at [27] and the cases referred to therein).

100. The domestic provisions relating to a reduction in consideration are contained in regulation 38 (read together with regulation 24) of the Regulations. They provide, so far as relevant, that where there is a decrease in consideration for the supply which included an amount of VAT then the taxpayer must adjust his VAT account by making a negative entry for the relevant amount of VAT. A decrease in consideration,

for these purposes, is recognised only if it is evidenced by a credit note or other document having a similar effect.

101. Although the article 90 speaks of the "price" being "reduced" and regulation 38 speaks of a "decrease in consideration" neither party, correctly in our view, suggested that there was any practical difference between the two provisions in this respect.

102. Article 90 and regulation 38 reflect a fundamental principle of VAT, viz that VAT is intended to tax only the final consumer. Consequently, as the CJEU said in *Elida Gibbs* at [19]:

> "… the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him."

103. Article 90 ensures fiscal neutrality of the taxable person's position by providing that where the price is reduced after the supply takes place, the taxable amount is to be reduced accordingly (see: *Elida Gibbs* at [30] in relation to article 11 C (1) of the Sixth Directive – the predecessor to article 90). Article 90 has direct effect (*GMAC UK plc v HMRC* C – 589/12 at [32]).

104. Both parties were agreed that in reaching its decision the Tribunal had to consider the economic and commercial reality of the price adjustment (*Newey* at [42] and the authorities cited therein). The parties, however, disagreed on the application of this test.

105. In our view, *Newey* is also authority for the proposition the contractual terms are a relevant factor in ascertaining the economic and commercial reality of the relevant transaction. The CJEU said:

> "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 (see, to that effect, Joined Cases C-53/09 and C-55/09 *Loyalty Management UK and Baxi Group* [2010] ECR I-9187, paragraphs 39 and 40 and the case-law cited).
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> 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 within the meaning of Articles 2(1) and 6(1) of the Sixth Directive have to be identified.
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> 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."

106. Therefore to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration but contractual terms which are part of an artificial arrangement may not correspond with the economic and commercial reality of the transaction. Plainly, therefore, the decision that the VAT inclusive amount of £7,150,000 should be paid by the Appellant to the Fund in the form of a repayment of the fees already paid by the Fund is a relevant, but not the only, consideration in determining the economic and commercial reality of the transaction.

107. As we have explained, the Appellant initially put forward an argument that Notice 700/17 justified the price adjustment i.e. justified the payment of £6,085,107 plus VAT of £1,064,893. This justification formed part of Mr Poulopoulos's witness statement and Ms Brown's skeleton argument. In cross-examination, however, Mr Poulopoulos accepted that the net of VAT charges recharged by the Appellant to the Fund had been correct all along. The seemingly hopeless argument based on the meaning of Notice 700/17 was abandoned without explanation. It was only the VAT amount on those charges which the Appellant now questioned.

108. In these circumstances, therefore, it seems hard to understand why, as a matter of economic and commercial reality, the Appellant considered that it was necessary to refund £6,085,107. There was no dispute about this amount which, as we have said, had been correctly charged. The only conclusion that we could draw was that £6,085,107 had been repaid by the Appellant to the Fund in order to present the price adjustment as a decrease in consideration for the purposes of regulation 38 and, possibly, to confer a gratuitous benefit on the Fund.

109. As a preliminary point, we consider that a decrease in consideration for the purposes of regulation 38 can be made by a subsequent (i.e. after the supply has been made) agreement between the parties. In *Elida Gibbs* the manufacturer, under both "money off" discount schemes considered by the Court, invoiced its immediate customer (a wholesaler or a retailer) at a price determined irrespective of any present or future promotion scheme. The Court said:

> "7. … Thus, the wholesaler or retailer may not know, when purchasing goods from the company, that those goods are or are to be, the subject of a money-off coupon promotion scheme. At that stage it may be that no scheme is in existence or even planned."

110. Nonetheless, in that case the subsequent presentation of a coupon by the ultimate consumer had the effect of decreasing the consideration for the supply made by the manufacturer.

111. Thus, it seems clear to us that regulation 38 can apply to situations where, after the agreement for the supply has been made and performed, the consideration for the supply is subsequently changed.

112. However, in *Castle Associates v Commissioners of Customs and Excise* (VATD) 3497 (MAN /87/448) the Tribunal stated:

> "In each of these cases, the invoice misstates the transaction as it was agreed between the parties and the credit note evidences the correction of the error. But once the parties have agreed the amount of the charges for the services, and the services have been supplied, the value of the supply is ascertained. If thereafter the supplier unilaterally decides, or both parties contract, that the full amount of the agreed charges is not to be payable, in our judgment the decision or the new contract does not alter the value of the supply for the purposes of value added tax, nor does it make any difference if a credit note is issued to evidence the decision or the new contract."

113. In the light of the decision in *Elida Gibbs*, we agree with Ms Brown's submission, that it is hard to see how this statement by the Tribunal in *Castle Associates* can now stand without qualification.

114. We also note that our misgivings about the correctness of the decision in Castle Associates have been confirmed in the decision of this Tribunal in *Barlin Associates v HMRC* [2014] UKFTT 957 (TC) (Judge Mosedale). This case was decided after the hearing in the present appeal but before our decision was issued and it was drawn to our attention by Ms Brown. In that case, Barlin performed work for a company called Autonomy. The price for the work was not agreed at the outset and when Barlin invoiced Autonomy, Autonomy refuse to pay. Legal proceedings for the recovery of the invoice amount were eventually settled at a lower amount. Judge Mosedale held this was a decrease in consideration within regulation 38. Judge Mosedale cast doubt on the correctness of the decision in *Castle Associates* saying:

> "23. I do not find that this case supports HMRC's position because I do not accept that it was correctly decided. The chairman gave no authority for the view which I have recited above. It is in direct conflict with the clear provisions of the 6VD which was in force at the time, and which provided, as Art 90 of the PVD now provides, as recited at §9 above, that VAT is reduced "where the price is reduced after the supply takes place". Yet the chairman above said that the VAT was not reduced where the parties agreed to a reduction in the price after the supply. That is clearly wrong.
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> …
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> 31. The intention is to charge VAT on the price of the services; so Art 90 must be read as including a situation where the supplier unilaterally issues an invoice and then agrees the price in a lower amount. Reg 38 is the UK's enactment of that part of Art 90 which refers to cancellation or subsequent reduction in price and must similarly be read as including a situation where the supplier unilaterally issues an invoice but then agrees that the actual price is lower than that shown on the original invoice. Such a situation is envisaged by Art 90 when it refers to 'the price is reduced after the supply takes place' and this situation is envisaged by what Reg 38 refers to as a 'decrease in consideration for a supply'. And that is effectively the conclusions of

> the Tribunal decisions in *Cobojo Ltd* and *Cumbria CC*. I consider they are right. "

115. We respectfully agree with the comments of Judge Mosedale. Indeed, a decrease in consideration for the purposes of regulation 38 will often, perhaps usually, occur after the original supply has been made but where for various reasons the parties agree between them that the original price has to be varied. We further note that this conclusion gives effect to the wording of article 90 which refers to the price being reduced after the supply takes place.

116. Thus, for example, if an art dealer sells a painting to a regular customer for an agreed price and charges VAT (disregarding the application of the margin scheme for the purposes of this example), but subsequently the customer is unhappy with the price (having seen similar paintings in other galleries at lower prices) and asks the dealer for a rebate, the dealer may well repay part of the original price to the customer in order to preserve the customer's goodwill. His agreement to repay part of the price occurs after the original supply has been made. It seems to us that such an agreement to repay part of the purchase price constitutes a reduction in consideration for the purposes of regulation 38, assuming a credit note has been issued.

117. Having thus established that the decision or agreement to reduce consideration can take place after the original supply has been made, we think it also follows from the decision in *Elida Gibbs* that the reduction in consideration need not necessarily flow from a term or breach of a term in the original supply agreement. In *Elida Gibbs*, the eventual retail customer was not a party to the agreement between the manufacturer and the wholesalers or retailers. The reduction in price did not, therefore, take place under the terms of the original contract of supply between those parties.

118. A few examples may make this clearer.

119. Taking the art dealer example above, there may be no legal obligation on the art dealer to reduce the price – the terms of the original agreement to supply the painting were enforceable, contained no misrepresentation and the repayment was purely voluntary in order to preserve the customer's goodwill. Nonetheless, we think it is plain that regulation 38 should apply to decrease the consideration for VAT purposes in this case even where the decrease in consideration results from something happening after the event outside the terms of the original supply contract.

120. Another example would be an agreement between a professional services firm and its client to provide services at an agreed hourly rate on a particular project. At the end of the project the firm renders an invoice to its client. There is no dispute about the number of hours charged or the rate. Nonetheless, the client is dissatisfied, saying that the final number is "too big". Such an event is a commonplace of professional life. If the firm then reduces its total charges by agreement with the client (and issues a credit note), then a regulation 38 decrease in consideration occurs because the original agreement for the supply of services has been varied and this is so even though there may be no legal obligation on the firm to make the reduction.

121. A further example might be the common occurrence, in recessionary times, of a landlord offering voluntarily to reduce the rent charged to a struggling anchor tenant for a specified period of time, where the landlord had opted to tax the rent. The landlord does not want the anchor tenant to become insolvent and therefore offers a reduction in the rent. A regulation 38 adjustment would be justified even though there was no legal obligation on the landlord to vary the terms of the original lease.

122. We therefore consider that a valid regulation 38 decrease in consideration can occur, *inter alia*, where the price adjustment:

- takes place after the supply has been made,

- is not provided for in or arises from a breach of the terms of the original agreement for the supply, and

- is voluntary or agreed between the parties.

123. But what all these examples (and the cases in which a regulation 38 adjustment has been upheld) have in common is that there has been some change in circumstance or the occurrence of an event (other than a mere change in view of the correct VAT treatment of the supply) after the supply has been made which leads or obliges the supplier (or the supplier and customer) to consider that the original invoiced consideration should be altered.

124. In this case, however, there has been no change in circumstance and there has been no event which leads the parties to think that the original (net of VAT) consideration was either wrongly calculated or should be reduced. Whatever may originally have been in his witness statement, Mr Poulopoulos accepted that the Pension Investment Costs had been correctly charged by the Appellant to the Fund. Over a period of approximately 37 years no queries had been raised and no dissatisfaction with the level of charges was expressed by the Fund. Indeed at the meetings of the Trustees in September and December 2010 no enquiries seem to have been made as to whether and how the Fund had been over-charged in respect of investment management fees. The September paper prepared on behalf of Mr Poulopoulos seemed to indicate that the only over-charge related to VAT. The December paper indicated that the Fund "may have been" over-charged in relation to the fees themselves (although the remainder of the paper seems to focus on the over-charge of VAT) – a proposition which Mr Poulopoulos now accepts was incorrect.

125. Instead, what was wrong, at least in the Appellant's view, was that VAT may have been over-charged on some of the supplies. The price adjustment was simply an artificial mechanism used by the Appellant effectively to procure a VAT credit of £1,064,893 and resulted in the Fund receiving a “windfall” benefit of £6,085,107 for no apparent reason other than to procure this credit (and possibly to boost the assets of the Fund). Certainly the price adjustment did not seem to have been made because there was anything wrong with the consideration paid or the services supplied. Although calculated by reference to the consideration paid in respect of the Pension Investment Costs over a 37 year period the price adjustment did not really seem

genuinely to be related to the consideration or to the supplies of services it was simply a vehicle to reclaim VAT. In our view, therefore, that is not a situation which falls within regulation 38. Accordingly, looking at the economic and commercial reality of the artificial price adjustment we conclude that it was not a decrease in consideration for the purposes of regulation 38. In our view, the appropriate mechanism for re-claiming overpaid VAT is a claim by the Appellant under section 80 VATA, not under regulation 38.

126. We should add four further comments.

127. Whether a price adjustment constitutes a decrease in consideration within regulation 38 is, in our view, a matter to be determined on an objective view of the facts but taking account of the economic and commercial reality. In reaching our decision we have treated the reason for the adjustment as relevant insofar as it sheds light on those economic and commercial realities. Moreover, whilst the terms or labels attached to the price adjustment by the Appellant and the Fund are relevant, they cannot change the true economic and commercial substance of the arrangement.

128. Secondly, we have been mindful of the evidence of Ms Whent (which was given before that of Mr Poulopoulos, in which he adandoned the view that the Pension Investment Costs had been incorrectly charged). We accept her evidence that the Trustees did not want the price adjustment to be paid as a contribution but were happy for it to be made as a repayment of charges already made. Nonetheless, she did not indicate that it was not possible for the price adjustment to be a contribution but rather that it was inconvenient in the sense that it would result in the need for further discussions with the employer. It did not seem to us, therefore, that the commercial realities made it imperative that the price adjustment had to be by way of a reduction in consideration. It was more convenient but it was not necessary. We therefore did not consider that the Trustees' preference that the price adjustment should take the form of a reduction (which in any event seems to have no justifiable basis) in previously paid charges made by the Appellant changed the reality of the situation that this was not, in substance, a reduction in consideration.

129. Thirdly, we do not consider that the accounting treatment of the price adjustment can be determinative of its correct VAT treatment. We heard no evidence as to the basis on which the auditors considered this treatment to be correct. Whether they would have reached the same conclusion had they appreciated that it was now accepted that the Pension Investment Costs had throughout been correctly recharged to the Fund is a matter of speculation.

130. Finally, whilst our decision relates only to questions of VAT, we would observe that the Fund has received a (net of VAT) payment from the Appellant which appears to be gratuitous payment of £6,085,107 since it was not paid under any legal obligation nor was it paid for any other commercial reason, as far as we are aware, than to procure a VAT credit. Whether this amounts *de facto* to a contribution for pensions regulation purposes is for others to decide.

131. For these reasons, we dismiss this appeal.

132. 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.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 27 November 2014