[2017] UKUT 113 (TCC)

Appeal number: UT/2015/0028

VALUE ADDED TAX - tripartite situation – whether employment business providing self-employed temporary workers to clients supplies staff for total consideration paid by client or only introductory services for commission retained by employment business – whether temporary workers supply services to employment business or to clients – Airtours Holiday Transport Ltd v HMRC applied - whether economic reality inconsistent with contractual position – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

ADECCO UK LIMITED
AJILON (UK) LIMITED
BADENOCH AND CLARK LIMITED
HY-PHEN.COM LIMITED
LAWSON BISHOP FINANCIAL LIMITED
MODIS INTERNATIONAL LIMITED
ROEVIN MANAGEMENT SERVICES LIMITED
SPRING PERSONNEL LIMITED
SPRING TECHNOLOGY STAFFING SERVICES LTD

Appellants

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: The Hon Mrs Justice Proudman DBE
Judge Greg Sinfield

Sitting in public at Royal Courts of Justice, Rolls Building, Fetter Lane, London, EC4A 1NL on 5, 6 and 7 December 2016

Valentina Sloane, counsel, instructed by Deloitte LLP, for the Appellants

Eleni Mitrophanous and Laura Prince, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellants (referred to collectively as 'Adecco') are all employment businesses that provided temporary staff to clients in return for payment. In relation to certain temporary workers who were not considered, for purposes relevant to this appeal, to be employees of Adecco ('non-employed temps'), the clients paid Adecco an amount representing the payments that Adecco was contractually obliged to pay the workers for the work they had done for the clients and a commission for Adecco's services. Between 1 April 2007 and 31 December 2008, Adecco accounted for VAT on the total amount paid by clients, ie the non-employed temps' remuneration and Adecco's commission.

2. On 24 March 2011, the First-tier Tribunal (Tax Chamber) ('FTT') released its decision in the case of *Reed Employment Ltd v HMRC* [2011] UKFTT 200 (TC) ('*Reed*'), which concerned the VAT treatment of supplies by an employment bureau in relation to the services of non-employed temps. The FTT in *Reed* concluded that the employment bureau was making supplies of introductory services to clients in respect of the placement of non-employed temps. The value of the introductory services was the commission charged to clients for the introduction of the temps and the employment bureau was only required to charge and account for VAT on its commission and not on the non-employed temps' remuneration. The Respondents ('HMRC') did not appeal against the decision in *Reed*.

3. Following *Reed*, Adecco made several claims for repayment of the VAT which it had charged and accounted for in respect of payments representing the non-employed temps' remuneration during the period from 1 April 2007 to 31 December 2008. In a decision dated 14 March 2013, HMRC rejected the claims. One of the reasons given by HMRC for rejecting the claim was that, in HMRC's view, Adecco did not merely supply a service of introducing the non-employed temps to the clients but also supplied the non-employed temps' services. On that analysis, Adecco was liable to account for VAT on the full amount paid by the clients.

4. Adecco appealed to the FTT which decided to deal with the question of liability – which was really a question about the nature of the supply by Adecco – as a preliminary issue. In a decision released on 27 November 2015 with neutral citation [2015] UKFTT 0600 (TC) ('the Decision'), the FTT decided that Adecco was liable to account for VAT on the full amount paid by the clients and dismissed Adecco's appeal. The FTT found that, under the contract between them, the client was obliged to pay Adecco for the work done by the non-employed temp as well as for Adecco's services and Adecco was obliged, under its contract with the temp, to pay the temp for the work. There was no contract between the non-employed temp and the client, which had no obligation to pay the temp. The FTT concluded that the temp was obliged, under the contract with Adecco, to perform work for the client. Adecco was not supplying clients with introductory services but the work of the non-employed temps. As the clients were the consumers and had agreed to pay Adecco the full fee (both wages and commission), there was no question that the contractual flow was inconsistent with economic reality. The FTT considered that its conclusion was not affected by the fact that Adecco could not and did not tell the non-employed temp how to carry out the work for the client and might not know about matters such as holiday or sick leave or even when the assignment ended.

5. Adecco now appeals, with the permission of the FTT, against the Decision. Save as otherwise indicated, paragraph references in square brackets in this decision are to the paragraphs in the Decision.

Factual background

6. The background to and facts of this appeal are not disputed and are fully set out in the Decision. The relevant facts for the purposes of this appeal can be summarised as follows.

7. Adecco provided workers to its clients using one of three different arrangements:

(1) Contract workers are self-employed workers introduced to a client by Adecco. If the client accepts the worker, the client enters into a contract with the worker to provide the work required. Contract workers are not Adecco's employees and are not paid by Adecco. Adecco typically charges the client a one-off fee, normally calculated by reference to the worker's rate of pay and the length of the assignment. The parties agree that contract workers provide their services to the client, Adecco only supplies introductory services to the client and Adecco is only liable for VAT on its fee for the introduction.

(2) Employed temporary workers ('employed temps') are employees of Adecco who it assigns to its clients on a temporary basis. Under the employment contract between them, the employed temp agrees not to sign up with any other employment bureau and to accept any assignment offered and Adecco guarantees to find a minimum number of paid assignments for the employed temp. The parties agree that Adecco makes supplies of staff when it provides an employed temp to a client and Adecco must account for VAT on the whole fee charged to the client.

(3) Non-employed temps are workers who are not considered to be employees of Adecco. Adecco is not obliged to introduce the temp to clients looking for a temporary worker. If Adecco does so, the non-employed temp is not obliged to undertake the assignment even if accepted by the client. Adecco undertakes with the non-employed temps to pay them for the work they do for the client. Adecco is an employment business for the purposes of Conduct of Employment Agencies and Employment Businesses Regulations 2003 (see below) and is classed as their 'employer' for various regulatory matters, including the working time regulations and payment of PAYE/NIC.

8. This appeal is only concerned with the VAT treatment of the supplies of non-employed temps. If a client wanted a temporary worker to perform an assignment, Adecco would send the CVs of employed and non-employed temps to the client who would select a temp and the temp could choose whether to take on the assignment. The client engaged the temp under a contract with Adecco for temporary placements. A non-employed temp performed an assignment pursuant to a contract for PAYE workers with Adecco. There was no contract at all, express or implied, between the clients and the temps. The parties agreed that, save for immaterial exceptions, the FTT should make its decision on the basis of representative standard contracts used by Badenoch & Clark, a member of the Adecco group and one of the appellants. We were referred to the same contracts. Consistent with our practice so far, we shall refer to 'Adecco' rather than Badenoch & Clark.

9. The preamble to the contract between Adecco and each non-employed temp states:

> "You are engaged by us to undertake an Assignment for a Client. Whenever an Assignment is varied or you are engaged on another Assignment, the details of that Assignment may be set out in a subsequent Confirmation Letter. These Standard Terms apply to all Assignments undertaken by you for us."

10. The contract defines 'Assignment' as "the services to be provided by you to the Client in the form and for the term set out in the Confirmation Letter". 'Client' is defined as "the person, firm or corporate body … requiring your Services through [Adecco] as further defined in the Confirmation Letter". 'Confirmation Letter' means "the letter confirming the Assignment and setting out further terms of the Assignment". The term "you or your" is defined as "the temporary worker to be supplied through [Adecco] on Assignment with the Client …".

11. The main body of the contract starts with the following:

> "We may from time to time offer you an Assignment. Each Assignment shall be on the terms and subject to the conditions of these Standard Terms (subject to the definitions and in *(sic)* any confirmation letter), which you acknowledge you have read and fully understood. The performance by you of any part of an Assignment shall be deemed to be acceptance of the Agreement whether or not these Standard Terms are signed by you. The date of the Agreement is deemed to be the earlier of the date you sign these Standard Terms or the date upon which you first perform any part of an Assignment for a Client …"

12. Clause 1 of the contract sets out what the temporary worker agrees to do and includes the following:

> "1.1 in your capacity as a PAYE worker to perform each Assignment professionally, promptly and efficiently and in good faith using your own skill and expertise and with due care and to the best standards;
>
> …
>
> 1.3 to be subject to the legitimate instructions, monitoring, direction, supervision, management, control of the Client … to the extent required for the proper performance of the Assignment and to abide by the rules and regulations of the Client … and the terms of the Assignment …
>
> 1.4 to keep accurate weekly written records on [Adecco] standard Timesheets (or as otherwise directed) of time spent performing the Assignment for the Client … and at the end of each week to have such records (where applicable) agreed and signed by a person authorised to do so by the Client … and to submit the signed records to [Adecco];
>
> 1.5 to comply with any Special Terms set out in the Confirmation Letter or other relevant document and the procedural rules we may provide to you from time to time relating to processing of contractual matters for temporary workers;
>
> 1.6 to fully indemnify us against any loss, claim or damages (including costs) arising from any breach of this Agreement or any negligent or unlawful acts or omission or wilful misconduct by you …; and
>
> 1.7 to inform us immediately if the Client … fails to provide any facilities to enable you to perform the Assignment, or refuses or fails to sign a Timesheet as required under clause 1.4 or offers you any work, whether temporary or

> permanent, other than under an Assignment through us, or if for any reason you do not consider the work suitable for you."

13. Clause 3 of the agreement specifies what the temporary worker must not do and includes the following:

> "3.4 during an Assignment other than for sickness take any period of absence or leave without our prior agreement and in the case of leave entitlement (please also see clause 4) without having submitted a leave request form in accordance with [Adecco] procedures."

14. Clause 4 deals with absence and holidays as follows.

> "4 You acknowledge and agree that:
>
> 4.1 you are not entitled to any payment during any period of absence due to any cause except to the extent required by law;
>
> 4.2 because unauthorised absence or absence due to sickness may result in a breach of obligations which we owe to the Client during an Assignment you shall notify us as soon as possible and by 9 a.m. on each day of any absence and give the best indication you are able to of any likely period of absence and the reason for the absence;
>
> 4.3 during periods when you are not engaged on an Assignment your engagement with us is temporarily suspended and … you may work for any other person or company and such periods will not be taken into account in calculating statutory leave entitlement;
>
> 4.4 [entitlement to 24 days paid leave]
>
> 4.5 any unauthorised absence or absence due to sickness not notified to us under clause 4.2 shall be deemed to be annual leave taken by you and will be recorded by us as such;
>
> 4.6 you may not give notice to take annual leave within the first 14 days from the start date of an Assignment. Thereafter you shall give us and the Client no less than 14 days written notice of any intention to take annual leave;
>
> 4.7 if we notify you of a minor amendment to the Agreement such amendment will apply from the date of notification unless you shall within 14 days of receipt of such notification inform us in writing that the amendment is not agreed …"

15. In clause 5 of the agreement, Adecco sets out its obligations:

> "We may from time to time find work for you, but do not guarantee that any such work will be found or provided to you and we do not accept any liability if we do not locate any such work for you; when we have found work we will send to you a Confirmation Letter. Further we accept no liability if the work is not suitable, and we accept no liability for the actions, torts or breach of contract or obligation by the Client …"

16. In clause 6, Adecco agrees, subject to clause 4, that it will pay the temporary worker the rate of pay set out in the Confirmation Letter for work satisfactorily performed by the temporary worker during an Assignment. The clause specifically states that Adecco would pay the temporary worker whether or not the Client paid Adecco.

17. Clauses 7 to 10 provide for termination and suspension of the agreement. Either party may terminate the agreement by serving written notice on the other party giving notice of seven days or such other period as is set out in the Confirmation Letter or with

immediate effect in cases of material breach of the terms of the agreement. Under clause 8, Adecco may terminate the agreement immediately without notice and without any payment in lieu of notice:

> "8.1 prior to the Commencement Date [of the services described in the Confirmation Letter]; or
>
> …
>
> 8.3 if in our reasonable opinion or in the opinion of the Client, you failed to provide a satisfactory service to the Client; or
>
> …
>
> 8.5 if the Client … (in its sole discretion) demands your removal for any reason."

18. Clause 10 of the agreement provides that Adecco may, at its sole discretion, suspend the operation of an Assignment without pay at any time and for any period by informing the temporary worker of the suspension.

19. Clause 11 of the agreement contains the following:

> "11.9 in an Assignment only the Client … has the right to direct, manage, supervise and control your work;
>
> 11.10 we are not your employer, any implied duty on the part of us as if we were your employer is excluded and nothing in this agreement shall imply or is intended to imply that there exists between you and us a contract of employment. This Agreement is a temporary work contract for services only, and in particular neither Party has any obligation to provide to, or carry out work for, the other following completion of an Assignment;
>
> …
>
> 11.16 no third party shall have any rights under the Contracts (Rights of Third Parties) Act 1999 in connection with this Contract …"

20. Adecco also had a contract with each client for temporary placements. The FTT was provided with a standard client contract. There was no dispute that the same client contract was used for contract workers and non-employed temps. Some of the clauses therefore applied to both types of worker, while some only applied to one or the other. Adecco's evidence was that a client would probably not know whether a temporary worker was a non-employed temp or an employed temp. This led the FTT to conclude, in [56], that the same standard contract between Adecco and its clients was used for contract workers, employed temps and non-employed temps with the clauses applying or not applying as appropriate.

21. The preamble to the contract between Adecco and the client for temporary placements states:

> "[Adecco] has been assigned to Supply Workers to the Client on Assignments. Whenever an Assignment is varied, the details of that Assignment or variation may be set out in a subsequent Confirmation Letter. These Standard Terms regulate the Supply of Workers to the Client by [Adecco] only…"

22. 'Assignment' is defined as "the work to be performed by a Worker or intended to be performed by a Candidate under these Standard Terms". 'Temporary Worker' means "a Candidate Engaged by the Client on an Assignment whereby the worker contracts with and is paid by [Adecco]". 'Engage, Engaged or Engagement' means "to

employ, engage, retain or otherwise accept services from a Candidate introduced or otherwise Supplied by [Adecco] whether directly or indirectly in any capacity whatsoever (including as a permanent placement)". The contract defines 'Supply or Supplied or Supplies' as "the provision by [Adecco] to the Client of a Worker to perform an Assignment". 'Services' is defined as "the selection, recruitment and payrolling of a Candidate on assignment with the Client".

23. Clause 2.3 of the contract states that all workers supplied by Adecco are engaged by Adecco under contracts for services. In clause 3.1, Adecco undertakes to use its reasonable endeavours to ensure that Temporary Workers are efficient, honest and reliable. Clause 3.2 provides that, during the period of an Assignment, each Temporary Worker is under the Client's direction, supervision, management and control as to the manner in which they perform the Assignment.

24. The payment of fees in relation to Temporary Workers is dealt with in clause 4.1 of the agreement which includes the following:

> "4.1.1 The Client shall pay [Adecco's] fee (as specified separately in writing to the Client, or as otherwise agreed) for each hour actually worked by a Temporary Worker. [Adecco] will pay each Temporary Worker. [Adecco] will invoice the Client weekly for all fees due. If the Temporary Worker proves wholly unsatisfactory to the Client at the commencement of an Assignment then, provided the Client notifies [Adecco] within the first two hours of the Temporary Worker's assignment (time to be of the essence), no charge or fee will be payable for the hours worked by the Temporary Worker up to the time of the notification.
>
> …
>
> 4.1.4 It is hereby acknowledged that where there is a supply of PAYE workers, [Adecco's] fee will incorporate a figure for employers national insurance and holiday pay which shall be calculated at the statutory rate from time to time in place. Any subsequent statutory adjustments shall adjust the fee accordingly."

25. Clause 7 of the contract deals with termination of the Assignment and only applies to Temporary Workers, ie employed and non-employed temps. Clause 7.1 provides that the Client may terminate the Assignment by serving written notice on Adecco giving notice of seven days or such other period as is set out in the Confirmation Letter. Clause 7.1 is subject to clause 7.2 which provides that the Assignment is terminable by either party with immediate effect in the event of a material breach of the contract between Adecco and the Client or a material breach by the Temporary Worker of the agreement between Adecco and the Temporary Worker or there was any breach of the duty of care owed by the Temporary Worker to the Client. Clause 7.3 and 7.4 provides that the contract may be terminated by either party on giving the appropriate notice and subject to the continuation of any terms intended to survive termination. Clause 8 provides for certain post termination restrictions and also that the Client would pay Adecco a transfer fee if the Client engaged the Temporary Worker other than pursuant to the contract.

Legislative framework

26. There was no dispute that the nature of the supply made by Adecco must be determined by reference to Council Directive 2006/112/EC (the Principal VAT Directive or 'PVD'). The provisions of the PVD are implemented in the United Kingdom by the Value Added Tax Act 1994, which must be interpreted as far as

possible so as to comply with the PVD. Neither party suggested that there was any material difference between the provisions of the 1994 Act and those of the PVD so we confine ourselves to consideration of the provisions of the PVD.

27. Article 1(2) of the PVD states:

> "The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.
>
> On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.
>
> The common system of VAT shall be applied up to and including the retail trade stage."

28. Article 2(1) of the PVD provides that VAT is charged on, among other things, supplies of goods and services for consideration by a taxable person acting as such. Article 9(1) of the PVD provides as follows:

> "'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.
>
> Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity."

29. Article 10 of the PVD provides:

> "The condition in Article 9(1) that the economic activity be conducted 'independently' shall exclude employed and other persons from VAT in so far as they are bound to an employer by a contract of employment or by any other legal ties creating the relationship of employer and employee as regards working conditions, remuneration and the employer's liability."

30. Article 24 of the PVD defines the "supply of services" as "any transaction which does not constitute a supply of goods."

31. Article 73 of the PVD defines, so far as relevant, the taxable amount as follows:

> "In respect of the supply of goods or services, … 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, …"

32. With effect from April 2004, the Conduct of Employment Agencies and Employment Businesses Regulations 2003 prohibited employment agencies who had introduced a non-employed temp to a client from paying (directly or indirectly) remuneration arising from the work for the client to the temp. In order to pay the non-employed temp, the employment agency had to reconstitute itself as an "employment business". Under Regulation 15 of the 2003 regulation, the employment business was required to have a contract with the non-employed temp under which the employment business was liable to pay the temp whether or not its client paid it.

Issue on appeal

33. The issue for us, as it was for the FTT, is simple to state: what did Adecco supply to its clients? Adecco contends that the answer to that question determines the amount of VAT for which Adecco is liable to account: if Adecco did not supply the non-employed temps' services to the clients then Adecco should not be liable to account for VAT on that part of the client's payment that related to the temps' services. The FTT stated that the question was logically indistinguishable from the question of whether the temps supplied their work to Adecco or the clients but that is simply another way of putting the first question. Another way of expressing the issue in this case is to ask whether the client's payment was consideration for two separate things, namely the introduction and payment services supplied by Adecco and the work performed by the non-employed temps, or solely for a supply by Adecco that included the provision of the temps to carry out work for the client and the introduction and payment services?

Summary of parties' positions

34. In summary, Adecco's position is that the non-employed temps provide their services to the clients and not to Adecco. Adecco does not receive or consume the temps' services for the purposes of making an onward supply of secretarial etc services. As it does not receive the temps' services, Adecco cannot supply those services to the clients. Ms Sloane, who appeared for Adecco, acknowledged that the temps had obligations under the agreement with Adecco and owed certain duties to Adecco in respect of the work they undertook for a client. If that could be seen as a supply by the temps to Adecco, Ms Sloane contended that it was distinct from the services provided by the non-employed temps to the clients for the payments at the agreed hourly rates. Adecco supplies clients with the services of the introduction of non-employed temps as candidates for an assignment and, if the temp is accepted by the client, paying the temp. The consideration for that service is the commission element of the payment made by the client to Adecco for the assignment. The rest of the payment is the non-employed temp's remuneration for the services provided by the temp to the client.

35. HMRC take the view that the non-employed temp supplied his or her work for the client to Adecco and Adecco supplied this to the clients in return for the total amount paid by the clients. There was no contract between the non-employed temps and the clients and no supply, in the VAT sense, by the temps to the clients. The non-employed temps were contractually obliged to Adecco to perform the work for the clients that the clients required them to do. In return, Adecco undertook to pay the temps, at the agreed hourly rate, for the work they carried out for the clients. The client agreed to pay the agreed fee to Adecco. The client had no obligation to pay the non-employed temps. The fee charged by Adecco to the client was not broken down into hourly rate and commission (although, in practice, the commission was often negotiated and thus known to the client).

Case law

36. Courts in the United Kingdom and Luxembourg have had to consider the issue of whether there is a supply and, if so, what is supplied to whom on a number of occasions. Fortunately, our task is made easier by the judgment of Lord Neuberger in *Airtours Holiday Transport Ltd v HMRC* [2016] UKSC 21, [2015] STC 61 which contains an analysis of the principles to be derived from previous decisions on the issue of whether there was a supply and, it follows, who made and received it. The FTT did not have the benefit of the Supreme Court's judgment as the Decision was issued some

months before. In our view, it is not necessary to subject earlier authorities, on which we received submissions from both parties, to detailed examination when that task has already been so clearly and comprehensively carried out by Lord Neuberger.

37. The facts of *Airtours* are that Airtours was in financial difficulties. Before deciding whether to extend its borrowing facilities, the company's lenders ('the Institutions') had to be satisfied that certain business restructuring proposals were viable. PwC were commissioned to prepare a report for the Institutions. The terms under which PwC were appointed were contained in a letter of engagement from PwC to the Institutions. It was agreed that Airtours would pay for the report and receive a copy. The report was critical to Airtours' survival and was, therefore, undoubtedly of benefit to it. The issue was whether PwC made a supply of services to Airtours. If so then the VAT charged by PwC would be input tax of Airtours which could deduct it.

38. The issue in *Airtours* gave rise to two questions. The first was whether PwC were under a contractual obligation to Airtours to supply services, such as providing the report, to the Institutions. If the answer was yes, it was agreed that there was a supply by PwC to Airtours. If the answer was no, however, Airtours contended that there was still a supply to it in the circumstances of the case whereas HMRC considered that there was no such supply. The majority of the Supreme Court held that PwC did not contract with Airtours to provide the report to the Institutions and the contract did reflect economic reality and was not in any way artificial.

39. Lord Neuberger (with whom Lord Mance and Lord Hodge agreed) held, at [31], that, considering only the express words of the contract, "there is no obligation on PwC, as a matter of contract, to Airtours to provide the Services whether to the Institutions or to Airtours". Lord Neuberger also rejected the argument that the commercial background (in particular, the fact that the report was of vital importance to Airtours, which had countersigned the engagement letter and undertaken to pay PwC for the report) meant that PwC had a contractual duty to Airtours.

40. Lord Neuberger then turned to consider whether, even though Airtours was not contractually entitled to require PwC to provide the report to the Institutions, the circumstances supported the conclusion that PwC supplied services to Airtours. He began by discussing the approach of Lord Millett in *CCE v Redrow Group plc* [1999] STC 161 ('*Redrow*') as elucidated by Lords Reed and Hope in *HMRC v. Aimia Coalition Loyalty UK Limited (formerly Loyalty Management UK Limited)* [2013] UKSC 15, [2013] STC 784 ('*Aimia*'):

> "45. However, Lord Millett's observation [at p. 172 of *Redrow*] cannot be taken at face value. As Lord Reed explained in [*Aimia*], paras 66 - 67:
>
> > '[66] [T]he speeches in *Redrow* should not be interpreted in a manner which would conflict with the principle, stated by the Court of Justice in the present case, that consideration of economic realities is a fundamental criterion for the application of VAT. … [T]he judgments in *Redrow* cannot have been intended to suggest otherwise. On the contrary, the emphasis placed upon the fact that the estate agents were instructed and paid by Redrow, and had no authority to go beyond Redrow's instructions, and upon the fact that the object of the scheme was to promote Redrow's sales, indicates that the House had the economic reality of the scheme clearly in mind. When, therefore, … Lord Millett asked, 'Did he obtain anything - anything at all - used or to be used for the purposes of his business in return for that

> payment?', [that question] should be understood as being concerned with a realistic appreciation of the transactions in question.
>
> [67] Reflecting the point just made, it is also necessary to bear in mind that consideration paid in respect of the provision of a supply of goods or services to a third party may sometimes constitute third party consideration for that supply, either in whole or in part. The speeches in *Redrow* should not be understood as excluding that possibility. Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded a priori. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as the recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation, the correct analysis is likely to be that the payment constitutes third party consideration for the supply.'
>
> 46 Lord Hope made the same point at para 110 in remarks which are perhaps particularly germane for present purposes:
>
> 'I think that Lord Millett went too far … when he said that the question to be asked is whether the taxpayer obtained 'anything - anything at all' used or to be used for the purposes of his business in return for that payment. Payment for the mere discharge of an obligation owed to a third party will not, as he may be taken to have suggested, give rise to the right to claim a deduction. A case where the taxpayer pays for a service which consists of the supply of goods or services to a third party requires a more careful and sensitive analysis, having regard to the economic realities of the transaction when looked at as a whole.'"

41. Lord Neuberger then summarised the relevant principles on contractual analysis and economic reality as follows:

> "47. This approach appears to me to reflect the approach of the Supreme Court in the subsequent case of *WHA Ltd v Revenue and Customs Comrs* [2013] UKSC 24; [2013] STC 943 where at para 27, Lord Reed said that "[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point". He then went on in paras 30 to 38 to analyse the series of transactions, and in para 39, he explained that the tribunal had concluded that "the reality is quite different" from that which the contractual documentation suggested. Effectively, Lord Reed agreed with this, and assessed the VAT consequences by reference to the reality. In other words, as I said in *Secret Hotels2 Ltd v Revenue and Customs Comrs* [2014] STC 937, para 35, when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts.
>
> 48. The same approach was adopted by the Court of Justice in *Revenue and Customs Comrs v Loyalty Management UK Ltd and Baxi Group Ltd* (Joined Cases C-53/09 and C-55/09) [2010] STC 2651, paras 39 and 40, where they stated, citing previous judgments, that "consideration of economic realities is a fundamental criterion for the application of the common system of VAT", and added that that issue involved consideration of "the nature of the transactions carried out" in the particular case. To much the same effect, in *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509, para 14, the Court of Justice said that 'a supply of services is effected 'for consideration' … only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal

performance', which it explained as meaning "the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient". In the context of the supply of goods, the Court made the same point in *Primback Ltd v Customs and Excise Comrs* (Case C-34/99) [2001] 1 WLR 1693, para 25, where it described 'the determining factor' as 'the existence of an agreement between the parties for reciprocal performance, the payment received by the one, being the real and effective counter-value for the goods furnished to the other'.

49. In *Revenue and Customs Comrs v Newey* (Case C-653/11) [2013] STC 2432, para 40, the Court of Justice again emphasised that 'that a supply of services is effected 'for consideration', within the meaning of article 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'. In para 41, the court went on to explain that 'the supply of services is therefore objective in nature and applies without regard to the purpose or results of the transactions concerned and without its being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person'. The court then observed in paras 42-43 that 'consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT' and that 'the contractual position normally reflects the economic and commercial reality of the transactions'. An exception to the normal rule that the contractual relationship is central was then identified by the court as being where 'those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions' (para 45).

50. From these domestic and Court of Justice judgments, it appears clear that, where the person who pays the supplier is not entitled under the contractual documentation to receive any services from the supplier, then, unless the documentation does not reflect the economic reality, the payer has no right to reclaim by way of input tax the VAT in respect of the payment to the supplier."

42. Later Lord Neuberger observed at [55] - [57]:

"55. … The Court of Justice has spoken of reciprocal performance as a critical component of the concept of supply, but it has never confined the consideration to that provided by the recipient of the supply. Thus in *Tolsma* at para 14, the court stated:

> 'a supply of services is effected 'for consideration' … 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.'

56. This formulation demonstrates the need for a direct link between the service provided and the consideration received which the court had previously articulated in *Staatssecretaris van Financiën v Association Coöperatieve Aardappelenbewaarplaats GA* (Case C-154/80) [1981] ECR 445, para 12, *Apple and Pear Development Council v Customs and Excise Comrs* (Case C-02/86) [1988] STC 221, paras 11 and 12, and *Staatssecretaris van Financiën v Hong Kong Trade Development Council* (Case C-89/91) [1982] ECR 1277, para 10. The Court of Justice's later statements of the test have followed *Tolsma* in not requiring the recipient of the services under the arrangement itself to be the provider of the consideration or to have legal responsibility for its provision - see *Primback*

> *Ltd*, para 25 and *Newey*, para 40, and see also *Dixons Retail plc v Revenue and Customs Comrs* (Case C-492/12) [2014] Ch 326, paras 31 and 32.
>
> 57. When the Court of Justice speaks of 'reciprocal performance' it is looking at the matter from perspective of the supplier of the services and it requires that under the legal arrangement the supplier receives remuneration for the service which it has performed. It is not necessary that the recipient of the service is legally responsible to the supplier for payment of the remuneration; it suffices that the arrangement is for a third party to provide the consideration. Were it otherwise, taxpayers could structure their transactions so as to escape liability to pay VAT, so long as they could meet the economic reality test."

Principles derived from the cases

43. We consider that it is clear from *Airtours* that determining the nature of a supply and who is making and receiving it is a two-stage process. The starting point is to consider the contractual position and then consider whether the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from the other or a third party then there is, subject to the question of economic reality, a supply to the other person for VAT purposes. If the person who provides the consideration is not entitled under the contractual documentation to receive any services from the supplier then, unless the documentation does not reflect the economic reality, there is no supply to the payer. The contractual position normally reflects the economic reality of the transactions but will not do so where, in particular, the contractual terms constitute a purely artificial arrangement.

Application of principles to Adecco

44. In the light of Lord Neuberger's comments in *Airtours*, we consider that the FTT was right to say, at [89], that the contractual position is the starting point when determining whether and to whom and of what a supply is made.

45. There was no contract between a non-employed temp and the client. The temp did not give any undertaking to the client to perform the work and the client did not have any contractual obligation to pay the temp for any work done. In the agreement with Adecco, the temp agreed to perform each Assignment that the temp accepted under the control, direction and supervision of the client for the duration of the Assignment. The temp did not need to be concerned about the fact that the client was not obliged to pay him or her because, under clause 6 of the agreement between Adecco and the temp, Adecco agreed to pay the temp for all work performed satisfactorily during an Assignment. Further, Adecco agreed to pay the temp whether or not the client paid Adecco. Subject to one minor exception, Adecco is protected from being out of pocket by clause 4.1.1 of the contract between Adecco and the client under which the client agrees to pay Adecco an agreed amount for each hour worked by the temp. The exception is that, if the temp proves wholly unsatisfactory at the commencement of an Assignment then, provided the client notifies Adecco within two hours, Adecco will bear the cost of the hours worked by the temp up to the time of the notification. In the same clause, Adecco undertakes to pay the temp (but not at the same hourly rate paid by the client) which reflects Adecco's obligation to pay the temp in clause 6 of their agreement.

46. In summary, there were contracts between the non-employed temps and Adecco and between Adecco and the clients. The temps agreed to perform each Assignment in

return for payment by Adecco at an agreed hourly rate. That seems to us to be a legal relationship between the temp and Adecco pursuant to which there is reciprocal performance. Ms Sloane, at least in her alternative argument, did not disagree with that analysis but argued that the temp's services were not actually provided to Adecco but to the client and the client bore the cost of those services. Ms Sloane's primary argument was the same as had been accepted by the FTT in *Reed*, namely that Adecco could not supply the temps' services to clients because Adecco did not consume those services and could not make an onward supply of them to the clients. Adecco merely provided introduction and payment services for which it was paid the commission. Adecco had no obligation to find work for the temps and the temps had no obligation to take up any assignment which was offered. When a client selected a non-employed temp and that temp took on that client's assignment, the non-employed temp was under the control, direction and supervision of the client for the duration of the assignment. Adecco could not and did not tell the temp how to carry out the assignment; it did not appraise or review a temp's performance of an assignment. In practice, Adecco did not agree when the temp took holiday and might only know retrospectively if the temp had taken holiday or sick leave or even if the assignment had ended.

47. We do not accept the argument that the fact that Adecco did not receive and use or consume the secretarial and other services provided by the temps leads to the conclusion that Adecco cannot make a supply of the temps to the clients. That would be inconsistent with one of the early cases in this area: *C&E Commissioners v Reed Personnel Services* [1995] STC 588. That case concerned the provision of temporary nurses to hospitals. Reed contended that it supplied introduction and ancillary services while the nurses supplied their services directly to the client hospitals. The VAT Tribunal held that Reed had supplied the nurses who in turn had supplied their services to the hospitals. On appeal, Laws J, as he then was, accepted that, taken as a whole, the contractual documents indicated that Reed was supplying nurses, not nursing services. We take the same view in this case. In our opinion, the contractual arrangements clearly show that Adecco supplied the temps to the clients and the temps agreed with Adecco to be so supplied (albeit with the right to refuse an Assignment). The preamble to the agreement between Adecco and the client states that the temp is "engaged by [Adecco] to undertake an Assignment for a Client [and the] Standard Terms apply to all Assignments undertaken by [the temp] for [Adecco]". The definition of 'Client' in the agreement shows that the temp provided the services to the client "through [Adecco]". The fact that the client is not obliged to pay the temp and Adecco is obliged to pay the temp for work done for the client whether or not the client pays Adecco is also consistent with the analysis that Adecco is providing the temp (and not secretarial and other services) to the client. Laws J also said, however, in a well-known passage that the concept of 'supply' for the purposes of VAT is not identical with that of contractual obligation and thus the contracts do not necessarily determine the nature of the supply or what supplies are made by whom to whom. The nature of a VAT supply is to be ascertained from the whole facts of the case. That is, of course, consistent with the approach taken by Lord Neuberger in *Airtours*. Having analysed the contractual arrangements, we must now consider whether they are consistent with the economic reality of the transactions.

48. As the Court of Justice observed in *Newey* at paragraphs 43 – 45, the contractual position normally reflects the economic and commercial reality of the transactions but will not do so where, in particular, those contractual terms constitute a purely artificial

arrangement which does not correspond with the economic and commercial reality of the transactions. In our view, there is nothing artificial about the agreements between the temps and Adecco and Adecco and the clients and neither party suggested that there was. As the use of the words "in particular" by the Court of Justice in *Newey* show, artificiality is not the only test of economic reality.

49. It seems to us that Lord Reed was right when he said, at paragraph 67 of LMUK, that:

> "Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded *a priori*."

50. What then was the economic and commercial reality of the transactions in this case? It seems to us that, looking at all the circumstances, Adecco agreed to provide temps, who would carry out work, to the clients. The temps agreed with Adecco that, in return for payment by Adecco, they would work for the clients in relation to whom they accepted an Assignment. Although the temps were, of course, the only ones who could provide their secretarial, administrative or technical services to the clients, that is nothing to the point. Only Adecco could supply the temps to the clients and, absent or in breach of the agreements, the temps could not work for the clients except through their agreement with Adecco. The definition of 'supply' in the contract between Adecco and the clients makes clear that what Adecco was supplying was the provision of a temp to perform an Assignment. Further, clause 4.2 of the agreement between the temp and Adecco recognises that any unauthorised absence or absence due to sickness could result in Adecco breaching its obligations to the client during an Assignment. If Adecco's obligations to the client were merely to introduce the temp to the client and then make payments to the temp for work done, it is difficult to see how absence by the temp could be a breach of Adecco's obligations under its contract with the client. Absence would only be a breach if Adecco was obliged to provide the temp to the client. That Adecco was supplying the temps is also shown by the fact that Adecco had rights to suspend an Assignment and termination rights in the contracts with both the temps and the clients. We consider that the fact that the client paid Adecco, as a principal, a fee which was calculated by reference to the temp's hourly rate and a commission indicates that the client considered that it was paying Adecco for the provision of the temp. Finally, our analysis puts the non-employed temps and the employed temps in the same position for VAT purposes. There was no dispute that, in the case of the employed temps, Adecco made a supply of the temps. It appears to us that the economic and commercial reality should be the same in the case of supplies of both types of temp, especially as the client would not necessarily be able to distinguish between them, and that supports the view that, in economic reality, Adecco supplied the temps.

51. For the reasons set out above, we have decided that Adecco made a supply of the provision of the non-employed temps to the clients in return for the total fees paid by the clients.

Application of this decision to other cases

52. The FTT considered that its conclusion was inconsistent with that of the FTT in *Reed* and expressed the hope, at [308], that a higher authority would clarify the VAT obligations of employment bureaux. We hope that our decision is clear but we doubt

that we have provided guidance – except at a very high level - that will enable the VAT liability of other employment businesses to be determined without a thorough analysis of the contracts and an assessment of the economic reality of the particular transactions. The liability in any particular case depends on the construction of the contractual provisions and the interpretation of the facts. Such matters are always open to debate and as Lord Reed said in paragraph 26 of *WHA:*

> "… decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal solution in one case inapplicable to another."

It is for that reason that we have refrained from commenting on the FTT's decision in *Reed* which was not the subject of any appeal before us. Accordingly, we consider that our decision in this case should be read in the context of and confined to its own facts and circumstances.

Disposition

53. For the reasons given above, Adecco's appeal against the Decision is dismissed.

Costs

54. Any application for costs in relation to this appeal must be made in writing within one month after the date of release of this decision. As any order in respect of costs will, if not agreed, be for a detailed assessment, the party making an application for such an order need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Tribunal Procedure (Upper Tribunal) Rules 2008.

The Hon Mrs Justice Proudman DBE

Judge Greg Sinfield

Release date: 17 March 2017