Appeal number:퀸퀸 TC/2016/02366

VAT – meaning of "consideration" for a supply - two payments under a single contract - first payment of charges for services - second payment of redundancy payments to employees of supplier - whether redundancy payments part of the consideration for the services provided by the supplier

FIRST-TIER TRIBUNAL
TAX CHAMBER

LLOYDS BANKING GROUP **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S **Respondents**

REVENUE & CUSTOMS

TRIBUNAL: JUDGE MARILYN MCKEEVER

MS JO NEILL

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 13-14 September 2017

Mr Andrew Hitchmough QC, instructed by Allen & Overy for the Appellant

Ms Jennifer Thelen, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This case concerns the VAT treatment of certain payments in respect of redundancy costs ("Redundancy Payments") made by Bank of Scotland ("BOS") (a member of the Lloyds Banking Group ("LBG") VAT group), following the closure of its business in Ireland and the transfer of the winding-down operation and its employees to an Irish company, Certus.

2. HMRC's case is that the Redundancy Payments made by BOS to Certus were additional consideration for the services provided by Certus and that BOS ought to have accounted for VAT on those payments under the reverse charge provisions contained in s8 Value Added Tax Act 1994 (VATA). HMRC raised two assessments for underdeclared VAT: the first on 31 March 2016 in respect of the VAT period 03/12 in the sum of £17,025 and the second on 9 September 2016 in respect of the periods 09/14 to 09/15 in the sum of £5,623,000.

3. LBG's case is that although the Redundancy Payments, were made under the Service Agreements with Certus, the obligation to make them derived from negotiations with the employees' union, Unite, which were ultimately embodied in a document called the Legal Framework Agreement. The contractual and commercial reality was that the Redundancy Payments formed no part of the consideration paid for the services provided by Certus and are, accordingly, not subject to VAT. LBG appeals against the two assessments totalling £5,640,425.

4. We had before us numerous bundles of documents. We also heard witness evidence from Mr Duane Davidson, who is Director, Change and Supplier Management at LBG and who has been head of the Irish Supplier Management team since December 2010 and Ms Samantha Ward, who was, at the relevant time, Assistant Supply and Relationship Manager at LBG, reporting to Mr Davidson. Ms Ward has since left LBG.

The Background Facts

5. BOS had a subsidiary, Bank of Scotland (Ireland) Limited ("BOSI"), which carried on a banking business in Ireland. Both companies were within the VAT group of Lloyds Banking Group.

6. In early 2010, LBG decided to close the retail and intermediary business in Ireland. On 19 August 2010, LBG issued a press release announcing that it had carried out a strategic review of BOSI and had decided to close the business in Ireland and transfer it to BOS. BOS would be able to use its extensive resources in the UK to run down the existing Irish lending portfolio in an efficient manner.

7. In order to retain local administrative capability, historic knowledge and continuity of customer relationships, it was proposed that BOS would enter into an

agreement with an independent service company which would carry out administrative functions relating to the BOSI banking business, using its former employees. As part of the proposal, it was intended that the majority of BOSI's employees would be transferred to the service company under the Transfer of Undertakings (Protection of Employment) Regulations 2006 in relation to employees in Northern Ireland and the European Communities (Protection of Employees on Transfer of Undertakings) Regulations 2003 in relation to employees in the Republic of Ireland ("TUPE").

8. BOS considered a number of potential suppliers but decided to engage Certus, a new Irish company formed by six of the existing BOSI directors, including the BOSI CEO.

9. A Services Agreement was entered into between, BOS, BOSI and Certus on 9 November 2010 (the "First Agreement"). Certus agreed to administer and collect on the remaining loan book in Ireland. This involved call centre services for customers, checking information such as changes of address and requesting payment from customers in arrears. The commercial aspects of the agreement were negotiated by a discrete team headed by the Senior Sourcing Manager from Group Sourcing.

10. The proposal involved the transfer of about 722 employees from BOSI to Certus.

11. In parallel with the commercial negotiations, an HR team, led by the Wealth and International HR Director, was carrying out a separate negotiation involving BOS, Certus and Unite, the Union which represented the affected workers.

12. Although Mr Davidson only took up his current role in December 2010, he had discussions with BOS's HR lawyer and the directors of Certus who were present during these negotiations. Unite's standpoint was that all the employees to be transferred were effectively on notice of "deferred compulsory redundancy". LBG had taken the decision to close the retail, intermediary and wholesale business of BOSI in Ireland and Unite therefore anticipated that the business of Certus, which was providing services exclusively to BOS in order to wind down the Irish business, would have a limited duration. As the "run-off' period progressed, fewer employees would be needed and, over time, they would all be made redundant.

13. Unite therefore put great pressure on BOS to ensure that employees who transferred to Certus benefitted from redundancy terms following the transfer which were at least as advantageous to them as the terms which would have applied had they remained employees of BOSI. In particular, Unite required BOS to underwrite the whole of the redundancy costs arising from redundancies made by Certus after the transfer, including costs relating to the respective periods of employment with BOSI and Certus. Unite also insisted that BOS's obligations to pay should apply to all employees of Certus who were engaged in providing

services relating to the BOSI loan book, even those taken on after the transfer. In fact, 76 people were hired in 2011, after the transfer.

14. It is not hard to see the reason for Unite's insistence. The effect of TUPE is to transfer the legal responsibility for satisfying the employment rights of the transferred employees to the transferee employer. The employees' accrued employment rights, in this case to redundancy payments by reference to their employment with BOSI, would be transferred to Certus. Certus would be responsible for making redundancy payments for both the BOSI employment period and the period of employment post transfer, when, as seemed inevitable at the time, the employees were eventually made redundant. Certus was a new company established by former directors of BOSI. We do not know the extent to which the company was capitalised, but Mr Davidson agreed that, to the extent that Certus had costs to meet, ultimately they would have to meet them out of payments from BOS. The approximate total of the Redundancy Payments made by BOS is EURO 80million, of which approximately EURO 900,000 related to employees who were taken on after transfer. It seems inherently unlikely that Certus would have been able to fund this level of payment out of its own resources. Unite therefore wanted BOS to be "on the hook" for the payments.

15. The negotiations took place against the backdrop of a ballot for industrial action taken by Unite. It was of critical importance to BOS to preserve good industrial relations so as to ensure a smooth transition.

16. The negotiations culminated in BOS, BOSI, Certus and Unite entering into the Legal Framework Agreement ("LFA") 21 December 2010. Under the LFA, the redundancy terms for both transferring and future employees was agreed and the liability for the Redundancy Payments was undertaken by BOS. These obligation underwritten by BOS were to continue even if the Services Agreement terminated or a new service provider was engaged.

17. Although the LFA was signed some weeks after the First Agreement, the negotiations for both agreements were, as noted above, proceeding in parallel and the Services Agreement was entered into in the knowledge of the discussions about the LFA and with the intention, that the LFA when completed would be honoured, in good faith, by both parties.

18. During 2011, the directors of Certus decided to expand the business and offer banking support services to the Irish market, seeking clients other than BOS. This required BOS's consent and the Services Agreement was amended and restated on 6 April 2013 (the "Second Agreement").

19. The First Agreement and the Second Agreement provided for payment for the services provided under a cost plus model. In 2014, BOS wished to move to a more normal outsourcing model under which a fixed fee would be paid for the services. This change was reflected in further amendments set out in the "Third Agreement" which was dated 10 April 2014.

20. The Second and Third Agreements also contained consequential amendments to the provisions relating to redundancies.

21. When we refer to "the Agreements" below, we are referring to the First, Second and Third Agreements and references to "the Agreement" or "Service Agreement" means whichever of them is relevant in the context.

22. We will return to consider the Service Agreements and the LFA in more detail below, but we now turn to the relevant law and the approach to its application.

The law

Relevant legislation

23. It is common ground that if HMRC are correct, VAT is payable by BOS under the reverse charge provisions of s8 VATA.

24. VAT is charged on the "taxable amount".

25. This is defined in Article 73 of the Principal VAT Directive which states:

> *"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…"*

26. Article 73 in enacted in domestic law by s19 VATA which provides:

> *"(1) For the purposes of this Act, the value of any supply of goods or services shall… be determined in accordance with this section…*
>
> *(2) If the supply is for a consideration in money, its value shall be taken to be such amount as, with the addition of the VAT chargeable, is equal to the consideration….*
>
> *(4)Where a supply of any goods or services is not the only matter to which a consideration in money relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it."*

27. Article 78 of the Principal VAT Directive provides:

> *"The taxable amount includes the following factors:*
>
> (a) *taxes, duties, levies and charges excluding the VAT itself*
>
> (b) *Incidental expenses such as commission, packing, transport and insurance costs, charged by the supplier to the customer."*

28. Neither Article 75 nor s19 defines the critical word "consideration". The short point in the present case is whether the Redundancy Payments were part of the

consideration which BOS paid for the services provided by Certus. If they were, they were part of the "taxable amount" and VAT should have been paid on them.

The meaning of "consideration"

29. Case law provides some assistance with how one identifies consideration.

30. Ms Thelen referred to the ECJ case of *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners* (Case 230/87) which dealt with the predecessor provision of Article 73 which was in the same terms. The Advocate General emphasised that consideration included not just money payments but "*everything*" obtained by the supplier for the supplies from the purchaser, customer or third party. He goes on to say "*The fact that the scope of that expression* [consideration] *is not defined shows, of course, that it was intended that term should be given the broadest possible meaning*".

31. Ms Thelen also relies on Article 78 to demonstrate the broad nature of what is consideration.

32. Mr Hitchmough pointed out that section 19(4) VATA contemplates that a single payment may relate partly to consideration for a supply and partly to something else.

33. The leading ECJ case of *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) addresses the criteria to apply in determining whether a payment constitutes consideration. The Court said, beginning at paragraph 13:

> *"…the basis of assessment for a provision of services is everything which makes up the consideration for the service and that a provision of services is therefore taxable only if there is a direct link between the services provided and the consideration received…*
>
> *It follows that 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."*

34. Both parties agree that for a payment to constitute "consideration", there must be a "**direct link**", in the above sense between the payment and the services provided. So in the present case, the making of the Redundancy Payments will only be part of the taxable amount if they were part of the value given by BOS in return for the administration services provided by Certus.

The applicable principles

35. The principles which we must apply in order to determine the issue before us seem to be common ground, although each party reaches a different conclusion when they apply those principles.

36. The first principle is that set out above: was there a direct link between the payment of the Redundancy Payments by BOS and the services provided by Certus.

37. In approaching that question, the Tribunal must consider the economic and commercial reality of the relationship between BOS and Certus.

38. The starting point of the analysis of that reality is to consider the written agreements entered into by the parties.

39. We must construe the contracts in their commercial context, having regard to all the surrounding circumstances insofar as they were known to both parties.

40. We must consider whether the contracts are consistent with the economic and commercial reality of the situation.

41. These principles derive from a series of cases.

42. In *Revenue and Customs Commissioners v Newey (trading as Ocean Finance)* Case C-653/11, the question before the ECJ was "*what weight should a national court give to contracts in determining the question of which person made a supply of services for the purposes of VAT? In particular, is the contractual position decisive in determining the VAT supply position?*"

43. The ECJ's response is at paragraph 42 to 45, where it 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, Revenue and Customs Comrs v Loyalty Management UK Ltd, Baxi Group Ltd v Revenue and Customs Comrs (Joined cases C-53/09 and C-55/09) [2010] STC 2651, [2010] ECR I-9187, paras 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 arts 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."

44. So *Newey* establishes that the starting point in analysing the VAT position is the contractual terms as these normally reflect the economic and commercial reality, but they are not determinative because they may not correspond with economic and commercial reality, especially where the contract creates an artificial arrangement. It is not suggested that the current transactions involve any artificial arrangement.

45. *Newey* was considered in the Supreme Court case of *Secret Hotels 2 Ltd. (formerly Med Hotels Ltd) v Revenue and Customs Commissioners* [2014] UKSC 16. Lord Neuberger set out the correct approach in domestic law at paragraphs 31 to 35 of his judgement.

*"**[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 Commissioners [2009] EWHC 2694 (Ch), [2010] STC 214, para 40, [2009] SWTI 2935, 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] AC 809); or as a fixed or floating charge (as in Agnew v IRC [2001] 2 AC 710), or as a consumer hire agreement (as in TRM Copy Centres (UK) Ltd v Lanwall Services Ltd [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."
***[33]** In English law it is not permissible to take into account the subsequent behaviour or statements of the parties as an aid to interpreting their written agreement – see FL Schuler AG v Wickman Machine Tool Sales Ltd [1974] AC 235, [1973] 2 All ER 39, [1973] 2 WLR 683. The subsequent behaviour or statements of the parties can, however, be relevant, for a number of other reasons. First, they may be invoked to support the contention that the written agreement was a sham – ie that it was not in fact intended to govern the par-*

ties' relationship at all. Secondly, they may be invoked in support of a claim for rectification of the written agreement. Thirdly, they may be relied on to support a claim that the written agreement was subsequently varied, or rescinded and replaced by a subsequent contract (agreed by words or conduct). Fourthly, they may be relied on to establish that the written agreement represented only part of the totality of the parties' contractual relationship.

[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.*

[35] *This is a slightly more sophisticated analysis than the single issue as it has been agreed between the parties, as set out in para 16 above, but, as will become apparent, at least in the circumstances of this case, it amounts to the same thing. In order to decide whether the FTT was entitled to reach the conclusion that it did, one must identify the nature of the relationship between Med, the hotelier, and the customer, and, in order to do that, one must first consider the effect of the contractual documentation, and then see whether any conclusion is vitiated by the facts relied on by either party."*

46. Lord Neuberger's approach was summarised in Hotels4U.com Limited v The Commissioners for Her Majesty's Revenue and Customs in the following terms:

"The important points I take from Lord Neuberger's comments are:

- *One must start with the agreements themselves and identify the rights and obligations of the parties*

- *To do this I must construe the words used in the context of the agreement as a whole and all the surrounding circumstances, but only in so far as they were known to both parties, and the construction must be in accordance with the commercial context.*

- *In the light of that construction, I must characterise the nature of the relationship between the parties, recognising that the labels attached to the relationship by the parties may be of little weight.*

- *One then checks whether the characterisation on that basis is in accordance with the economic realities*

- *If prima facie the circumstances establish a particular relation-*

ship between the parties, one must then consider whether that conclusion is vitiated by facts which are inconsistent with that finding."

47. Lord Neuberger again emphasised the importance of the contractual documentation in determining the correct VAT treatment in *Airtours Holiday Transport Ltd v Revenue and Customs Commissioners* [2016] UKSC 21 ("*Airtours*"). He also reiterated the importance of considering whether the contract represents the commercial reality.

48. The Tribunal must seek to identify the "economic purpose" of the contracts, that is, the precise way in which the performance of the contractual arrangements satisfy the parties' respective interests.

49. The economic purpose is different from the subjective reasons which led the parties to enter into the contract. The subjective reasons are irrelevant.

50. The economic purpose is also different from the economic effect. One can achieve the same commercial result in more than one way and the different options may have different consequences including tax consequences. The economic effect is irrelevant.

51. The meaning of "economic purpose" and the contrast with economic effect and subjective reasons is considered in the ECJ case of *Cantor Fitzgerald International v Customs and Excise Commissioners* Case C-108/99 (which was heard together with *Mirror Group plc v Customs and Excise Commissioners* Case C-409/98) In that case, Cantor Fitzgerald took an assignment of a lease and sought, unsuccessfully, to argue that it should be entitled to the exemption from VAT which applied to the "leasing or letting of immoveable property".

52. The Advocate General's opinion set out the need to identify the key features of a contract and, in order to do that, to find the contract's economic purpose. He said at paragraphs 26-27:

"In my view, that idea that the characteristics of the lease or let must predominate in a contract in order for it to come within the exemption is highly relevant for our purposes. …
27*In order to identify the key features of a contract, however, we must go beyond an abstract or purely formal analysis. It is necessary to find the contract's economic purpose, that is to say, the precise way in which performance satisfies the interests of the parties. In other words, we must identify the element which the legal traditions of various European countries term the cause of the contract and understand as the economic purpose, calculated to realise the parties' respective interests, lying at the heart of the contract. In the case of a lease, as noted above, this consists in the transfer by one party to another of an exclusive right to enjoy immovable property for an agreed period."*

53.

54. The ECJ observed that *"to facilitate the application of VAT, it is necessary to have regard, save in exceptional cases, to the objective character of the transaction in question… A taxable person who, for the purpose of achieving a particular economic goal, has a choice between exempt transactions and taxable transactions must therefore, in his own interest, duly take his decision…The principle of the neutrality of VAT does not mean that a taxable person with a choice between two transactions may choose one of them and avail himself of the effects of the other"*. In other words, one must objectively analyse the proper VAT treatment of the transaction which actually took place, even if the same economic result might have been achieved in a different way with different fiscal effects.

55. *Cantor Fitzgerald/Mirror Group* was referred to and applied by the Court of Appeal in *Tesco plc v Customs and Excise Commissioners* [2003] EWCA 1367. This case concerned the VAT treatment of the vouchers issued by Tesco to its customers in return for Clubcard points. Jonathan Parker LJ helpfully summarised the applicable principles to the approach the Court or Tribunal should take, and the relevant authorities at paragraph 159 where he said:

> *"So what is the correct approach in the instant case? There are number of pointers in the authorities referred to in Part 3 of this judgment, under heading (a) 'Authorities as to the approach to be adopted in analysing the relevant transaction'. The more significant of such pointers in the context of the instant case seem to me to be these: 1. The resolution of the issue as to the application of para 5 in the instant case depends upon the legal effect of the Clubcard scheme, considered in relation to the words of the paragraph (see British Railways Board especially [1977] STC 221 at 223, [1977] 1 WLR 588 at 591 per Lord Denning MR: see [34] above). 2. In considering its legal effect, the entire scheme must be examined (what is the 'entire scheme' for this purpose being objectively determined by reference to the terms agreed) (see Pippa Dee especially [1981] STC 495 at 501 per Ralph Gibson J: see [33] above). 3. The terms contractually agreed may not be determinative as to the true nature and effect of the scheme (Reed, see [36] to [38] above): it is necessary to go behind the strictly contractual position and to consider what is the economic purpose of the scheme, that is to say 'the precise way in which performance satisfies the interests of the parties' (see the Advocate General's opinion in Mirror Group, para 27: see [41] above). 4. Economic purpose is not the same as economic effect. The fact that two transactions have the same economic effect does not necessarily mean that they are to be treated in the same way for VAT purposes (see Littlewoods especially at para 84 per Chadwick LJ: see [42] above). 5. Equally, the economic purpose of a contract (what the Advocate General in Mirror Group called the 'cause' of a contract: see para 27 of his opinion: at [41] above) is not to be confused with the subjective reasons which may have led the parties to enter into it (in so far as those subjective reasons are not obviously evident from its terms) (see Mirror Group para 28: at [41] above). The Advocate General went on to observe (an observation which seems to me to be particularly apt in the context of the tribunal's decision in the instant case):*

'… failure to distinguish between the cause of a contract and the motivation of the parties has been the source of misunderstandings, … and has complicated the task of categorising the contracts at issue.'"

56. With these principles in mind, we turn to the starting point: an analysis of the contracts between the parties. We then consider the wider circumstances and the economic and commercial reality and whether there are any facts which vitiate the conclusion reached.

Analysis of the Agreements

The First Agreement

57. The first Service Agreement was entered into between BOS, BOSI and Certus on 9 November 2010. The recitals to the Agreement set out the background and provided that Certus was to provide services to BOS from 31 December 2010. The Agreement, including its schedules, runs to several hundred pages. Fortunately, we need to focus mainly on only four provisions. These are Clause 24 which deals with the provision of the Services, Clause 30 which relates to the Charges to be made for the Services, Schedule 5, which sets out the way in which the Charges are to be calculated and Schedule 17 which is headed "Employment" and which includes the terms relating to the Redundancy Payments.

58. The core provisions are Clause 24 by which Certus agrees to provide the "Services" and Clause 30 by which BOS agrees to pay Certus the "Charges" in consideration of the provision of the Services. "Services" and "Charges" are defined terms.

59. Clause 24 sets out the categories of Services to be provided and this is supplemented by certain of the schedules to the Agreement which set out the precise nature of particular Services in some detail. We do not need to set out the Services at length, but note that the broad categories of Services include Transition services which are to do with the production of policies, procedures and manuals, Administration Services, Securitisation Services, Business Continuity and Management Services, Exit Management if the relationship between the parties were to break down and obligations set out in a list of specified clauses and schedules and any other services necessary or incidental to the performance of the Services. The capitalised categories are defined terms and the services comprised in those headings are set out in some detail in the schedules.

60. The Services in relation to obligations set out in specific clauses and schedules include obligations under clause 34, 35 and 36 and schedule 17. These all deal with employment matters. Clause 34 gives BOS some input into the appointment of Key Personnel (a defined term) and sets standards for other employees. Clause 36 relates to equality and diversity requirements. Clause 35 requires the Parties to "comply with the provisions of schedule 17". Schedule 17 includes obligations of the parties in relation to employees and, critically, the obligations on BOS to make the Redundancy Payments and the procedures to be carried out in relation to redundancies. We will return to the detail later, but we note at

this stage that the "Services" to be provided by Certus included services they were to perform in dealing with the redundancies.

61. Clause 30 of the Agreement sets out BOS's obligation to pay for the Services. The material provisions are as follows:

> *30.1 In consideration of the provision of the Services provided by the Supplier* [Certus] *under this Agreement, BOS shall pay to the Supplier the Charges set out in Schedule 5 (Charges) (which include a cost plus methodology as set out in, and subject to the provisions of Schedule 5 (Charges)). The Supplier shall issue invoices for each of the Charges in accordance with this Clause 30…*
>
> *30.3 All Charges and other amounts payable under this Agreement shall be invoiced in accordance with this Clause 30 and Schedule 5 (Charges) and paid in Euro…*
>
> *30.6 All invoices submitted to BOS must… identify the Services for which they are submitted , including whether they relate to Administration Services or Securitisation Services…"*

62. Schedule 5 provides the mechanism for determining the "Charges" which are stated in Clause 30 to be the consideration for the Services. The Charges consist of four elements: the Cost element (including Pass-Through Costs), the Performance Bonus, the Gain Share Incentive and the Profit Margin. All these elements are further explained in the Schedule. The last three items are the ways in which Certus make their profit-the "plus" element of the "cost plus methodology".

63. The Cost element is the actual costs which Certus incur in carrying out the Services and the Pass-Through Costs are listed in paragraph 2.15 of Schedule 5. It covers everything from the expenses of providing Transition Services and conducting audits to legal expenses for dealing with customer complaints and expenses incurred in complying with regulatory requirements. The Costs also include something called the "Cost Based Case" set out in Appendix 1 to Schedule 5. This includes such items as direct staff costs (reducing over time), recruitment expenses and learning and development; in other words, the cost of employing the employees. We were taken through the provisions in some detail in order to confirm that the Actual Costs did not include the Redundancy Payments which are set out in Schedule 17. There was no reference to the Redundancy Payments in Schedule 5 and they do not form part of the Actual Costs. The Redundancy Payments are not therefore part of the "Charges" which are stated to be the consideration for the Services.

64. Schedule 5 also sets out the way in which the Charges are to be paid. The three profit items are calculated and paid after the end of the Contract Year. Payments for the Actual Costs are based on an estimate of the costs which will be incurred

in that Contract Year and are paid monthly in advance. The amounts paid are reconciled with the costs actually incurred after the year end and adjustments made. The estimated costs for the first Contract Year were Euro 105.6 million.

65. Schedule 17 sets out the provisions relating to the Redundancy Payments, among other things. The Schedule is headed "Employment". The first section of the Schedule deals with the transfer of employees to Certus and paragraph 2 acknowledges that, under TUPE, with effect from the date of transfer, the contracts of employment of the transferring employees have effect as if they had originally been made between the employee and Certus. If any contract of employment does not have that effect, Certus is required to offer the employee a new contract on equivalent terms (paragraph 6).

66. Paragraph 9 provides *"Subject to Clause 30 (Charges) of this Agreement and BOS's obligations in paragraph 16 of this Schedule, the Supplier shall…perform and discharge all of the obligations of the employer in relation to the Employees…including any obligation to discharge any bonus or incentive payments, holiday pay and any other remuneration or liability and it shall be the Supplier's responsibility to deduct and account to the relevant tax authorities any income taxes or social security or related contributions in respect of payments made to the Employees…"* By paragraph 11, Certus was required to indemnify BOS in respect of any claims arising because of Certus' failure to comply with paragraph 9.

67. So Schedule 17 expressly acknowledges that, as a result of TUPE Certus is treated as if it had been the employer from the outset and that Certus is liable for all the ongoing costs of employing the Employees. BOS's paragraph 16 obligations (which relate to the Redundancy Payments) are specifically excluded from Certus's liabilities and paragraph 9 is also subject to BOS's obligations to pay the Charges for the Services.

68. The crucial part of Schedule 17 is that headed "Specific Employment Benefits funded by BOS". Paragraph 16 provides:

69. *"During… the Term of this Agreement, BOS shall indemnify or, as may be applicable, fund the Supplier, on written demand and subject to…paragraphs 19 and 21, in respect of:…*

> *(c) any redundancy payments to be made to Employees (including any Employees employed after the Service Commencement Date…that does not exceed the amount the Employee would be entitled to under the terms of the BOSI Severance Scheme."*

70. This is the provision under which BOS agrees to pay the redundancy payments of the Employees who transfer to Certus and any additional Employees who are taken on after the Agreement takes effect provided, in the latter case, that the employment is reasonably necessary to the provision of the Services.

71. In practice, BOS funded the payments in advance rather than indemnifying Certus once it had made the payments.

72. Paragraph 17 required Certus to indemnify BOS against all emoluments and outgoings in respect of the employees which it incurred but excluding the Charges under Schedule 5 (paragraph 17(a)). The indemnity also extends to liabilities in respect of termination of the employment, but excluding the Redundancy Payments provided for in paragraph 16(c) (paragraph 17(c)).

73. Under paragraph 21, Certus was required to provide BOS with satisfactory documentary evidence of the amounts to be paid to employees and to follow other processes before BOS made the paragraph 16 payments. The process for Redundancy Payments was set out in paragraphs 21(c) to (f) of Schedule 17. Certus had to give BOS four weeks notice in advance of giving Employees notice of redundancy and had to provide certain information about the Employees and the amounts payable. BOS was entitled to ask for further information to ensure that the proposed payments complied with Schedule 17 and to ascertain whether there would be any impact on the provision of Services. Certus had to co-operate by providing the information *"in accordance with Clause 30 and Schedule 5 (Charges)"*. Mr Hitchmough suggested that this meant that the information must be provided in accordance with the same administrative processes as apply in relation to the Charges. Ms Thelen submitted that this was more than administrative and that it demonstrated a connection between the Redundancy Payments and the Charges. BOS had four weeks to notify Certus whether the payment was approved.

74. Paragraph 20(e) provides *"Seven days in advance of the proposed termination of employment date, BOS will pay the Supplier…the redundancy payment due to the Employee, in accordance with Clause 30 (Charges)." A*gain Mr Hitchmough and Ms Thelen took different views as to the significance of the reference to Clause 30. The paragraph refers to the "payment due to the Employee" which, Mr Hitchmough suggests, indicates that the money does not in a real sense belong to Certus, but Certus is merely a conduit to pay to the departing Employee the money which is due to him or her. This is reinforced by subparagraph (f) which states "*Within 28 days of any payment under paragraph 16 being made from BOS to the Supplier, the Supplier will provide BOS with written confirmation that the payment has been made to the Employee."* It was confirmed that BOS paid to Certus exactly the same amount as was paid by Certus to the Employee.

75. Paragraph 25 of Schedule 17 provides *"If BOS novates this Agreement…BOS agrees to make arrangements with any successor under the novation for BOS to underwrite future redundancy payments to Employees, if the event that the successor fails to pay such redundancy payments to those Employees in accordance with the BOSI Severance Scheme"*. Paragraph 26 goes on to say *"If BOS appoints a Replacement Supplier and any Employees transfer to the Replacement Supplier under [TUPE] BOS agrees to make arrangements for BOS to underwrite future redundancy repayments to Employees, in the event that the Re-*

placement Supplier fails, and is not capable of, paying Employees redundancy payments in accordance with the BOSI Severance Scheme." These are striking provisions. BOS is, effectively, agreeing with Certus to continue to underwrite the Redundancy Payments even if Certus is no longer involved and not liable. This suggests an intention that the obligation to make the Redundancy Payments is intended to be independent of the Service Agreement itself and to continue whether or not Certus provides any Services. This is consistent with the Legal Framework Agreement which we consider below.

The Second Agreement

76. The Second Agreement was entered into on 16 April 2013 in order to enable Certus to provide its services to third parties other than BOS. New Clause 6.1A disapplies, with effect from 1 April 2012 the provisions in the original clause 6 which restricted Certus' ability to provide services to anyone other than BOS.

77. Schedule 5, relating to the Charges was amended to take account of this. It introduced the concept of a "Relevant Supplier Employee", broadly, an employee of Certus who worked wholly or partly on non-BOS services. Under new paragraph 2.1A, an amount is to be deducted from the Actual Costs payable by BOS in respect of each Relevant Supplier Employee. New Appendix 4A sets out the mechanism for computing the amount of the deduction. We do not need to be concerned with the details but, essentially, the overheads are apportioned between BOS and third parties to reflect the amount of work which is being carried out for each. There is no mention here of the Redundancy Payments.

78. Amendments are, however, made to Schedule 17 to deal with the new situation. Paragraph 16(c) is now subject to new paragraph 20A. Paragraph 20A essentially limits BOS's liability to Redundancy Payments to Supplier Employees on the "2011 Assured Listing". The 2011 Assured Listing sets out the names of 722 employees who were transferred from BOSI and a further 76 employees who were taken on by Certus in 2011, after the transfer. Paragraph 20A(a) expressly provides that Certus is to be responsible for redundancy payments to employees who are not named on the 2011 Assured Listing, including any employees employed on or after 1 January 2012. There are further provisions in paragraph 20A(c) which limits BOS's liability where an employee who is on the 2011 Assured Listing is deployed on work for third parties. There are a few other amendments which are not material.

79. The only other change we would note is in paragraph 21(e) which is dealing with the process for making payments and now provides "*…BOS will pay the Supplier…the payment due to the Supplier Employees in accordance with Clause 30 (Charges)* ***as though a proper invoice had been issued for the said payment****…*" The words we have emphasised are new and Mr Hitchmough submits that this supports his contentions in that the wording makes plain that the document requesting payment is not a real invoice but an administrative convenience employing the mechanics of Clause 30.

The Third Agreement

80. The Third Agreement was entered into on 10 April 2014 and made more radical amendments to the method of charging. The 2014 amendments abandoned the cost plus model and replaced it with a fixed cost model. Mr Davidson explained that the cost plus model had been used initially because of the level of transparency provided and the insight into the costs. The Third Agreement moved to a more normal outsourcing model. Paragraph 2.2 of Schedule 5 now provides for BOS to pay a fixed amount of Euro 100 million (for the 2014 Contract Year) plus incentive amounts if Certus earns them. Reducing fixed amounts are specified for future Contract Years and Certus are also entitled to additional payments calculated by reference to the volume of customers of different types, together with the incentives if earned.

81. The Redundancy Payments are not referred to in the new definition of "Charges" in paragraph 2.2. Further, paragraph 2.4 (i) provides for BOS to pay additional amounts to Certus in respect of continued employment costs where BOS has failed to meet its obligations to make Redundancy Payments under Schedule 17. So if BOS complies with its obligations, there is no adjustment to the fixed cost Charges. Paragraph 2.15 provides that any employment costs paid in these circumstances will be a pass-through cost.

82. There is no change to paragraph 16(c) of Schedule 17 in the Third Agreement, but there are changes to the process for selecting employees for redundancy and to the machinery for making payment and an overall cap is placed on the amount of the Redundancy Payments. Various provisions of paragraphs 19 and 21 discussed above are no longer to apply. The paragraph 19 provisions requiring consultation with BOS no longer apply. Nor do the provisions in paragraph 21 setting out the procedure for making the payments. The new provisions, beginning at paragraph 31 of Schedule 17 are headed "Planned Redundancies". Paragraph 31 provides for Certus to implement a "Redundancy Programme" to reduce its workforce over the following four years. Paragraph 33 requires Certus to provide certain information to BOS in relation to the Redundancy Programme including the numbers of employees affected and the timing, but *"the obligation on the Supplier to discuss the Redundancy Programme does not create any right or entitlement for BOS to interfere with or approve the Redundancy Programme or fetter the independence of the Supplier in respect of its redundancy process"*. So Certus now has autonomy over the redundancy process and can decide who to make redundant and when.

83. Paragraph 37 provides for a maximum amount payable by way of Redundancy Payments in each of the years 2014, 2015, 2016 and 2017. The "Funding Limit" is set by reference to the number of full time equivalent employees expected to be made redundant.

84. Paragraph 41 provides a new mechanism for payment. Certus will request funding on a monthly basis calculated by reference to the number of employees to be made redundant and the severance costs. It must provide BOS with information

to support those requests. BOS must then provide the funding within certain time limits. After the end of the year, Certus must provide details of all the Redundancy Payments made and how they were calculated and any adjustments are then to be made.

The Legal Framework Agreement

85. The final document we need to consider is the Legal Framework Agreement ("LFA") which was entered into by BOS, BOSI, Certus and Unite on 21 December 2010 which provides the background against which the First Agreement was negotiated.

86. It has already been noted that the LFA was signed after the First Services Agreement, but the recitals indicate that BOSI had been in negotiations with Unite concerning the terms and conditions which would apply to the employees transferring to Certus from the date of BOS's announcement that it was closing the Irish business on 19 August 2010.

87. Certus undertook, by Clause 1, not to impose any compulsory redundancies within two years from the transfer. Clause 2 sets out enhanced terms which would apply to those made redundant from 1 January 2013. Clause 3 gave an early retirement option which included a non actuarially reduced pension. Clause 4 provides that any redundancy which arises because an employee is no longer required to work on the "transferred loan book" is to be made on the terms of the LFA set out at paragraphs 2 and 3 and that those terms would be part of the employees' contract of employment with Certus.

88. The critical provision of the LFA is the next part of Clause 4 which says:

> *"These terms and the payments to be made under Clauses 2 and 3 above are hereby unconditionally and irrevocably underwritten and guaranteed by the Bank* [BOS] *(on behalf of LBG) whether or not the Service Agreement between the Bank and the Transferee* [Certus] *remains in force or a Service Agreement with a new service provider is put in place."*

89. So BOS's obligation to underwrite the redundancy costs is not confined to the Certus agreement. It is intended to survive it and continue if the Certus agreement is terminated or if the services are transferred to a new service provider.

The Appellant's submissions

90. In summary, the Appellant's case is that that there is no direct link between the Redundancy Payments and the services provided by Certus so that the Redundancy Payments do not constitute consideration for those services. Consequently, no VAT is due on the payments under the reverse charge scheme.

91. In order to understand the economic reality, one must start by construing the contracts and Mr Hitchmough contends that the detailed terms of the contracts make it clear that the Redundancy Payments are not part of the consideration for

the Services. They are funded in accordance with a free-standing contractual obligation.

92. Not every payment made by a business in the course of that business is consideration for a supply to the business. This follows from the *Airtours* case. In that case, Airtours paid the accountants PwC for a report on the ongoing viability of its business which was required by a number of lenders who were threatening to withdraw their lending unless they received reassurance on the financial status of the business. Airtours argued that it was the recipient of the supply by PwC as it wanted to deduct the input VAT which PwC had charged on the supply. A majority of the Supreme Court decided that, on a proper construction of the tripartite agreement between Airtours, PwC and the lenders, viewed in its commercial context, the supply of services by PwC was made to the lenders alone, even though Airtours had paid for the supply and had sound commercial reasons for doing so. Lord Neuberger considered whether Airtours had received a supply in the following terms:

> *"**44** Some support for that proposition may arguably be found in the speech of Lord Millett in Customs and Excise Comrs v Redrow Group plc[1999] 1WLR408, 418g, where he said "Once the taxpayer has identified the payment the question to be asked is: did he obtain anything—anything at all—used or to be used for the purposes of his business in return for that payment?" If one takes that question at face value, then it can be said with some force that Airtours obtained a substantial benefit from paying PwC's invoices, namely the potential (and, as it turned out, the eventual actual) financial support of the Institutions for its restructuring.*
> ***45** However, Lord Millett's observation cannot be taken at face value. As Lord Reed explained in Revenue and Customs Comrs v Loyalty Management UK Ltd [2013] UKSC 15; [2013] 2All ER719, 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 … the judgments in Redrow cannot have been intended to suggest otherwise.… 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 in para 110 in remarks which are perhaps particularly germane for present purposes:*
"I think that Lord Millett went too far at p 418g 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."

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] 2All ER907 where at para 27, Lord Reed JSC said: "The 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". …In other words, as I said in Secret Hotels2 Ltd v Revenue and Customs Comrs [2014] UKSC 16; [2014] 2All ER685, 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 *… To much the same effect, in Tolsma v Inspecteur der Omzetbelasting Leeuwarden (Case C-16/93) EU:C:1994:80; [1994] ECRI-743; [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". …*
49 *In Revenue and Customs Comrs v Newey (trading as Ocean Finance) (Case C-653/11) EU:C:2013:409; [2013] STC 2432, para 40, the Court of Justice …*
In para 41, the court went on to explain:
"the term 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."*

93. This passage contains a number of relevant points derived from the authorities already mentioned. Whilst the contractual provisions are not determinative they are a useful starting point. The contract will normally reflect the economic and commercial reality which is fundamental to the application of the VAT system. A payment made for the discharge of an obligation owed to a third party should not be treated as consideration for a supply to the payer. In the present context, Mr Hitchmough argues that the Redundancy Payments were made to discharge BOS's obligations to Unite and should not be treated as consideration for the supply by Certus to BOS of the Services.

94. We must also consider the surrounding circumstances so far as these were known to both parties and these include the role of Unite and the LFA.

95. Certus is, in economic terms, merely the conduit through which payments are made to redundant employees and the clear separation between the Redundancy Payments and the Charges stated to be consideration for the Services contained in the contracts reflects the economic reality and is not artificial.

96. It is irrelevant that the parties might have structured their agreement in a different way which would have made the Redundancy Payments part of the consideration. They did not do so and one has to analyse the arrangements which were actually put into effect.

97. Mr Hitchmough acknowledged that, as a matter of law, the TUPE provisions meant that the legal liability to make the Redundancy Payments fell upon Certus. However, the economic substance of the arrangements was that, whatever the effect of the TUPE Regulations, the redundancy costs would be borne by BOS.

The Respondent's submissions

98. HMRC's case is that there was and is a direct link between the Redundancy Payments and the Services so that those payments were part of the consideration for the performance of the Services.

99. Looking first at the contracts, Ms Thelen points out that the payments pass under the Service Agreements and the Agreements represent the whole of the bargain between the parties as to how the Services are going to be performed and as to how BOS is going to pay for those Services. Ms Thelen submits that the fact that the Redundancy Payment provisions are contained in the Service Agreements goes some way to establishing the direct link required.

100. She goes on to say that there is sufficient interlinking and interweaving of the detailed provisions of the contract that one cannot, as the Appellants seek to do, say there is a clear distinction between the Redundancy Payments on the one hand and the Charges on the other.

101. The economic reality is that BOS agreed to fund fully the Redundancy Payments, the liability for which in law, under TUPE, lay with Certus in order to obtain the Services; it was a cost of the structure.

102. On the economic reality point, Ms Thelen found support in the comments of Lord Reed in *Revenue and Customs Commissioners v Loyalty Management UK Limited* [2013] UKSC 15. Lord Reed said:

> *"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."*

103. So as a matter of commercial and economic reality the costs of the Redundancy Payments are directly linked to, and consideration for, the supply.

104. She also argued that we should not take account of the LFA because this relates only to the subjective intentions of the parties in entering into the agreement, which *Tesco*, applying *Cantor Fitzgerald* tells us is not relevant. The LFA does not go to the economic purpose of the Service Agreements which are the contracts we have to consider. Even if it can be taken into account, it offers little insight into the economic reality as it outside the Service Agreements and was only signed two months after the First Agreement.

105. The Redundancy Payments must have been taken into account when setting the charges to be paid for the Services. As a matter of commercial common sense it would have been taken into account in determining the overall price for the contract.

106. The description of terms used by the parties are not conclusive. In *Secret Hotels 2*, Lord Neuberger commented at paragraph 32 *"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."* The present case is not about the relationship between the parties, but the contracts label some items as "consideration" and other payments as something else. The Tribunal must consider the substance of the nature of the payments and not merely the labels attached to them.

107. Mr Hitchmough had referred to *Airtours* as authority for the proposition that a payment could be properly made by a business for the benefit of its business which was not consideration for a supply to the business. Ms Thelen distinguished *Airtours* on the basis that that case turned on the fact that Airtours was not entitled under the relevant contract to receive any services, whereas, in this case, BOS is entitled to receive a supply of services under the same contract as provides for the payment of the Redundancy Payments. She submitted that where two types of payment are made under a single contract for services it is harder to argue that one of the payments is for the services and one is not.

108. The Supreme Court in *Airtours* said, at paragraph 50 *"…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…VAT in respect of the payment to the supplier."* Ms Thelen draws from that the suggestion that where a party to a contract is not entitled to anything under it, its role is not relevant or of limited relevance to the VAT analysis. Ms Thelen submits that the Unite's role in the present case is, on this basis, not relevant.

109. Ms Thelen further submitted that where a supply may benefit more than one person, the correct approach is to focus on the transaction and to look and see whether there is consideration passing which is directly linked to the supply, even if the supply and payment of the consideration may also involve a third party, in this case, Unite. Ms Thelen relied on *Loyalty Management* for this also. Paragraph 24 of the Supreme Court decision quoted Chadwick LJ's guidance in the Court of Appeal:

> *"Chadwick LJ, in a judgment with which the other members of the Court of Appeal agreed, regarded the decision of the House of Lords in Customs and Excise Comrs v Redrow Group plc [1999] STC 161, [1999] 1 WLR 408 as authority for two propositions: first, that a supplier could be treated as making, in the same transaction, both a supply of services to one person and a supply of different services to another person; and secondly, that in addressing a claim for input tax by one of those persons, the relevant questions were (1) whether that person had made a payment to the supplier, (2) whether the payment was consideration for the services supplied to him, and (3) whether the services were used or to be used in the course of a business carried on by that person."*

110. A transaction must be looked at as a whole and should not be artificially dissected. Authority for this is found in the High Court case of *Revenue and Customs Commissioners v Pippa Dee Parties Limited* [1981] STC 495, which was approved in *Customs and Excise Commissioners v Diners Club Limited* [1989] W.L.R. 1196. Ralph Gibson J in *Pippa Dee* stated:

> *"It is clear therefore that a technical analysis of one part of a transaction, or of one set of obligations within a contract, even though accurate in legal*

principle, which is capable of explaining the service supplied, or the consideration given, in a restricted way, is not necessarily the right answer in law to the application of the provisions of this statute. I accept counsel for the Crown's submission that this approach does indicate that taxable transactions should not be artificially dissected so as to demonstrate as being the service provided, or the consideration given, something other or less than that which appears to have been the service provided or consideration given upon examination of the entire transaction. The meaning of 'entire transaction' for this purpose must be objectively determined upon the facts of the transaction by reference to the terms agreed."

111. On this basis, Ms Thelen argues that it would be artificial to distinguish between the Redundancy Payments and the other Charges under the Service Agreement.

112. Ms Thelen summarised the economic purpose of the Agreements as being that BOS would pay Certus, who in turn would have the funds to discharge its own obligations under its contracts of employment, so that the Redundancy Payments were simply another cost of the supply which was funded by BOS. In this context, TUPE forms the backdrop against which the parties approached the transaction. The TUPE Regulations impose legal responsibility for the Redundancy Payments on Certus which is why the parties entered into the arrangements requiring BOS to pay Certus so that Certus could pay the employees.

Discussion

113. The fundamental question is whether BOS made the Redundancy Payments *in return for* the Services provided under the Service Agreements so that there was that "direct link" between the supply of services and the payment for them, required by the authorities in order to render the payment "consideration" for the supply for VAT purposes.

114. The authorities tell us we must start with the terms of the contract and we have set out above the relevant provisions and how they changed as Certus' business evolved.

115. The crucial provisions of the Service Agreement are:

- Clause 24 which deals with the Services
- Clause 30 and Schedule 5 which set out the Charges
- Clause 35 and Schedule 17 which deal with employee issues and specifically with the Redundancy Payments.

115. Among the many Services to be provided are the obligations set out in Clause 35 and Schedule 17. So Services are provided under Schedule 17 which deals with the Redundancy Payments. For example, Paragraph 19 of Schedule 17 requires Certus to provide BOS with satisfactory evidence of the amount to be

paid to Employees, to try and redeploy employees before they are made redundant and to provide BOS with evidence that they have done so and obtaining BOS's prior written approval before admitting liability or making any payments. Under Paragraph 21(c) Certus must submit a notice containing certain information in order to claim the Redundancy Payments. Clause 21(d) entitles BOS to request any further information reasonably necessary to ascertain whether or not the requested payment complies with the payment provisions and whether or not there will be any impact on the provision of the Services. We heard evidence from Miss Ward about how she would check the figures to make sure the amounts claimed were correct and would check with the heads of the relevant departments that the departure of particular employees would not cause a problem in terms of service delivery. Paragraph 21(d) continues *"The Supplier will co-operate with any such reasonable request by providing or facilitating access to such information…in accordance with Clause 30 and Schedule 5 (Charges)."*

116. Paragraph 21(e) provides *"…BOS will pay to the Supplier…the redundancy payments due to the Employee in accordance with Clause 30 (Charges) and if there is any outstanding dispute, the parties shall address that in accordance with Clause 30.10."*

117. Ms Thelen submits that these cross-referrals and interweaving of the provisions relating to the Services, the Charges and the Redundancy Payments show that there are clear links between the provisions dealing with the Redundancy Payments and the parts of the Agreements which which it is accepted are about payment of consideration and the supply of services.

118. Mr Hitchmough submits that the references to things being done i"n accordance with Clause 30" is mere administrative machinery and this is supported by the amendment to paragraph 21(e) contained in the Second Agreement which provided that BOS was to pay to the Supplier the payment due *"in accordance with Clause 30 (Charges)* ***as though a proper invoice had been issued*** *for the said payment"*. (our emphasis)

119. Ms Thelen argues that it is artificial to suggest that the Services to be performed by Certus under Schedule 17 are entirely remote from the payments to be made to Certus under the same schedule.

120. We now return to the provisions of Clause 30 which provide that BOS shall pay Certus the Charges set out in Schedule 5 in consideration of the provision of the Services. It is common ground that the definition of the "Charges" and in particular, the pass-through costs which are the "cost" part of the cost plus methodology do not include the Redundancy Payments. Ms Thelen made the point that a cost passed through without any margin can be a cost of a supply and the Redundancy Payments are analogous with the pass-through costs and in substance are not really distinguishable.

121. Clause 30.3 states *"All Charges and other amounts payable under this Agreement shall be invoiced in accordance with this Clause 30 and Schedule 5 (Charges) and paid in Euros."* . Clause 30(6) goes on to say *"All invoices submitted to BOS must …30.6.1 identify the Service for which they are being submitted, including whether they relate to the Administration Services or the Securitisation Services"*. So the Agreement contemplates that all Charges are attributed to one Service or another. Ms Thelen submits that the way the supply is going to be paid for is an important component of the Agreement and that this points away from it being merely administrative as contended by Mr Hitchmough.

122. Mr Hitchmough has emphasised that the provisions dealing with the Charges for the Services are completely separate from the provisions relating to the Redundancy Payments and the latter do not form part of the consideration for the services supplied by Certus. Ms Thelen suggests that the fact that the two streams of payments are dealt with separately can be explained as being a result of the parallel negotiations by the commercial and HR teams of BOS and that to treat them as separate would be to dissect the transaction artificially which the *Pippa Dee* case warns against.

123. The changes in the Second Agreement were relatively minor. The Third Agreement included substantial amendments and in particular, the replacement of the cost plus model with a fixed fee basis and the transfer to Certus of greater control over the redundancy process. The revised Schedule 17 sets out further Services to be provided in connection with the Redundancy Payments including the provision by Certus of a redundancy programme for approval (paragraph 33), the provision of information (paragraph 41) and co-operation in the event of an employment claim (paragraph 46). The redundancy programme had to ensure that the staffing levels were sufficient to continue to provide the Sevices.

124. One element of the Charges provided for at paragraph 2(4)(i) of Schedule 5 are *"costs and expenses incurred by the Supplier in continuing to employ individuals in respect of whom the Bank has failed to meet its obligations to fund redundancy costs in accordance with Schedule 17."* Ms Thelen considered that this represented a direct link between Schedule 17 and costs that are paid, which it is accepted constitutes consideration (the ongoing employment costs). Also, that it is another example of the interlinking and the interweaving of the Schedule 17 provisions relating to redundancy and the provisions relating to payment. Mr Hitchmough on the other hand contend it strengthens his contentions in that ongoing employment costs are undoubtedly part of the Charges, but in this case are only payable if the Redundancy Payment obligation has not been met. They are alternatives. The one is a "Charge". The other is not.

125. The Redundancy Payments have been referred to as an "indemnity" and Ms Thelen reminded us that we should not rely on the labels attached to provisions and that a payment is not prevented from being consideration merely because it is called an "indemnity".

126. We have considered the various Agreements in some detail and the submissions on the different constructions placed upon those provisions by the parties.

127. The term "consideration" though undefined is intended to have the broadest possible meaning (*Naturally Yours Cosmetics*). But however wide the scope of the term, a payment can only be consideration if it is paid "for" a supply of goods or services. As it was put in *Tolsma* -"*the remuneration received by the provider of the service [must constitute] the value actually given* ***in return for*** *the service supplied to the recipient."* (our emphasis). It is this which constitutes the "direct link" which turns a mere payment into consideration. If a payment is made in return for, or by reference to, something other than the supply of goods or a service it cannot be consideration for that supply and cannot be subject to VAT.

128. It is not disputed that Certus provided Services under Schedule 17. We also accept that there was a significant degree of cross-referencing and interweaving between the provisions relating to redundancy and those relating to Charges and Services. This is hardly surprising. The employees are Certus' employees, Certus is the party which knows what level of activity is required to provide the Services and how many employees it needs to carry out that level of activity. It knows how many employees it needs to make redundant. BOS for its part wants to ensure that the staffing levels are sufficient to provide the standard of Service it expects and Certus committed to and BOS needs access to information to satisfy itself that any payments it makes are in accordance with the Agreements and are calculated correctly so it pays only the right amount. This requires a process, a mechanism, to provide those assurances and this in turn requires employees of Certus to work at providing the necessary information and administration. The employment costs of those employees are part of the "Costs" in respect of which the "Charges" are made and we do not consider that it makes any difference whether those employment costs relate to the provision of Services in relation to the transferred loan book or the Redundancy Payments.

129. It does not, however, follow that the Redundancy Payments must be consideration for the Services provided under Schedule 17 or any other Services.

130. The Charges paid under Clause 30 and Schedule 5 provided Certus with full recompense for all of the Services it provided. The Redundancy Payments were not part of the Charges. They were paid to satisfy BOS's undertaking which was contained in the LFA and reflected in the Service Agreements which set out the mechanism for payment.

131. This is reinforced by the Third Agreement which moved from a cost plus basis to a fixed fee. An annual amount was agreed to be paid in return for the Services, not specifically related to the actual costs incurred by Certus. This made no difference to BOS's obligation to continue to fund the Redundancy Payments. Of course adjustments had to be made, as Certus took on work for other customers, to ensure that BOS's liabilities only related to employees who were working on providing Services to it but this did not change the fundamental dis-

tinction between the payment of the Charges in return for the Services and the separate payment of the Redundancy Payments to the employees via Certus.

132. Ms Thelen submitted that the redundancy obligations must have been taken into account as part of the overall cost of the transaction; that they were anticipated and taken into account when the fees for the Services were set in the Agreements. The Redundancy Payments were a pre-planned and integral part of the contract and it must follow from this that they were therefore part of the consideration for the Services. With respect, we do not consider that this follows. One might expect that BOS would have added the Redundancy Payments to the Charges when considering how much the transaction was going to cost overall but that does not mean that *ipso facto* the Redundancy Payments became payments in return for the Services. BOS and Certus could have entered into an agreement under which there was a combined payment of redundancy costs and other costs in return for the Services, but they did not do so. Under the First and Second Service Agreements the Charges to be paid were calculated by reference to specified costs (which did not include the Redundancy Payments) plus a profit element. Under the Third Service Agreement, the Services were paid for by way of a fixed fee agreed between the parties. Under all the contracts, the Redundancy Payments were dealt with separately as sums due to redundant employees, paid by BOS to discharge Certus' legal liability to pay those sums. They had nothing to do with the Services. To treat them as part of the overall remuneration paid to Certus in return for its services would be to create a different agreement from the one which was actually entered into. We have to construe the actual agreement between the parties, not a hypothetical alternative.

133. We also regard the payment mechanism as significant. Under the cost plus basis, the Charges were estimated annually in advance and paid monthly with adjustments made after the end of the year to reflect the actual costs incurred. The fixed cost Charges were also based on an annual amount paid monthly with certain adjustments made after the year end. In contrast, the Redundancy Payments were initiated by a process which started only when Certus had decided that redundancies were necessary. Once agreed, the payments by BOS were made shortly before Certus was due to make the payments to the employees affected. The amount paid was no more and no less than the actual amounts of the redundancy payments to be made and Certus had to confirm that the onward payments had in fact been made. We consider that this supports Mr Hitchmough's argument that the Redundancy Payments were, in substance, sums due to the employees and Certus was the conduit for payment, as it had the legal liability to make them. Legally, of course, they were payments due to Certus.

134. Section 19(4) VATA referred to in paragraph 25 above itself contemplates that that a single payment may relate partly to consideration for a supply and partly to something else.

135. We also considered the principles set out in the *Airtours* case and and it is clear from this that a payment made by a company under a contract which is properly made for commercial reasons for the benefit of its business is not necessarily

consideration for a supply. We do not consider that the present case can be distinguished because BOS received a supply under the contract and Airtours did not. The question remains whether the payment was consideration for that supply.

136. Having considered the Service Agreement in its several iterations and taken into account the relevant legislation and authorities, it is clear that the Charges represent the total and only consideration paid in return for the Services. Although there may have been links between the provisions relating to the Redundancy Payments and the provisions relating to the Charges and the Services, there was no "direct link" in the sense required by *Tolsma*; the Redundancy Payments were not value given in return for the supply of any services. The Redundancy Payments were part of a separate, stand-alone obligation arising out of the negotiations with Unite.

137. Ms Thelen cautioned us against artificially dissecting the transaction, but it seems to us that there is no artificiality in analysing the Redundancy Payments and the Charges separately; they are, as a matter of fact and commercial reality, separate. To argue otherwise is to seek artificially to amalgamate distinct strands of an overall transaction which should be avoided as much as artificial dissection.

138. We conclude that on a proper construction of the Service Agreements, the Redundancy Payments do not constitute consideration for the Services and are accordingly not subject to VAT.

139. We must now consider whether the contract is consistent with the economic and commercial reality, bearing in mind the comments of Lord Neuberger in *Airtours* that the contractual terms will normally reflect the economic and commercial reality unless those terms constitute a purely artificial arrangement. As explained, also by Lord Neuberger, in *Secret Hotels 2*, we also need to look at the agreement as a whole in the light of all the circumstances so far as they were known to both parties. We must distinguish from the economic *purpose*, and the economic *effects* of the arrangements and the subjective *reasons* for the arrangements.

140. The economic purpose of the Agreements was to enable BOS to close down its separate business in Ireland whilst ensuring an orderly transition to a third party which would deal with the management and running down of its remaining book of business in return for a fee. That is, in the terms expressed in *Cantor Fitzgerald* and other authorities, *"the precise way in which performance satisfies the interests of the parties"*. BOS gets its Irish business run off. Certus gets a fee for running it off.

141. In considering the structure of that contract and its interpretation we are also required to look at all the surrounding circumstances so far as they were known to both parties. The central circumstance here is the role of Unite and the LFA.

142. Ms Thelen submitted that BOS had to pay for the redundancy costs to achieve the desired commercial results. We agree. We heard from Mr Davidson about the pressure brought to bear by Unite and the likelihood that the transaction would have been disrupted by industrial action had the accrued rights of the employees not been safeguarded. Pausing there, we note that the Service Agreements also provided, in substance, the same safeguards for employees taken on by Certus after it commenced its activities who had never worked for BOSI. This does not affect our conclusions. At the time of the negotiations it was thought that the Services Agreement would be of limited duration and that the employees transferred to Certus would inevitably be made redundant over a period of time. It was recognised that, initially, there might be a need to hire some additional staff, but that their days at Certus too would be numbered. Unite was concerned to protect all the employees current and potential. BOSI could have made all its employees redundant in 2010 and paid them off then. It did not and in consequence of the TUPE regulations, the liability, for what were seen as the inevitable redundancies, was transferred to Certus. Unite wanted to ensure that those substantial redundancy costs would be underwritten by a major bank rather than relying on an untested start up business whose only source of income was the contract with BOS.

143. Ms Thelen also sought to argue that the LFA was of little relevance to the economic reality as firstly, it goes to the subjective intentions of the parties which is an impermissible enquiry and second, even if one can consider it, it is irrelevant as it is outside the supply transaction in question. She pointed out that the LFA was signed after the First Agreement under which BOS was already committed to make the Redundancy Payments and so the LFA was different in kind from the Service Agreement as it was about what happens in the event that the Service Agreement is not in existence.

144. In our view, the LFA was a central feature of the surrounding circumstances which were known to both parties. Although it was signed after the First Agreement, Unite had been involved from the time that BOS first announced it was planning to close BOSI and the LFA was being negotiated throughout that period. We doubt that the Service Agreement would have contained the provisions relating to Redundancy Payments which were included had it not been for this background. We do not find it surprising that the obligations imposed by the LFA were reflected in the Service Agreement. Certus and BOS were going to have to implement the arrangements in practice and it was necessary to have in place an appropriate procedure to safeguard the interests of both parties: Certus would have wanted to be sure that the payments would be available when they had to make staff redundant and BOS would have wanted to retain some control over the process to ensure that service levels would be maintained and the amounts they had to pay were correctly calculated. This could have been contained in a separate agreement, but it was, no doubt, convenient to include it in the Service Agreement, not least because there was a degree of interweaving in terms of administration and processes. The work done by Certus employees in dealing with these matters was part of the Services and was paid for as part of the Charges.

145. We find it particularly significant that the LFA imposed continuing obligations on BOS which were independent of the First Agreement and capable of surviving it. As we have already noted, Clause 4 of the LFA provided:

> *"These terms and the payments to be made under Clauses 2 and 3 above are hereby unconditionally and irrevocably underwritten and guaranteed by the Bank [BOS] (on behalf of LBG) whether or not the Service Agreement between the Bank and the Transferee [Certus] remains in force or a Service Agreement with a new service provider is put in place."*

146. To our minds this reinforces our conclusion that the obligation imposed on BOS to underwrite the redundancy payments was a stand-alone agreement quite separate from the terms dealing with the provision of, and payment for, the Services.

147. There was nothing artificial about these arrangements. No-one was trying to label a transaction as anything other than what it in reality was. Nor is there anything in the circumstances surrounding the making or implementation of the Agreements to suggest that the contractual terms were inconsistent with the economic and commercial reality. On the contrary, the Agreements reflected that reality.

Decision

148. We have found that on a proper construction of the terms of the Agreements, taking account of the surrounding circumstances so far as they were known to both parties, the Charges defined in the Agreements represented the totality of the consideration given for the Services. There was no "direct link" between the Redundancy Payments and the Services in the sense discussed in *Tolsma*. The Redundancy Payments were not made in return for the supply of services and accordingly were not "consideration" for the supply for the purposes of VAT.

149. The reverse charge provisions in section 8 VATA do not therefore apply.

150. This construction is entirely consistent with the economic reality of the arrangements and there are no other facts or matters which might vitiate that conclusion.

151. We therefore allow the appeal.

152. 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 re

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

MARILYN MCKEEVER
TRIBUNAL JUDGE

RELEASE DATE: 22 November 2017