Neutral Citation Number: [2012] EWCA Civ 1571

Case No: A3/2011/2750

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
MR JUSTICE MORGAN
Case No UT/FTC/56/2010

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 3rd December 2012

Before:

LORD JUSTICE WARD
LORD JUSTICE McFARLANE
and
SIR JOHN CHADWICK

BETWEEN:

SECRET HOTELS2 LIMITED (formerly Med Hotels Limited)	**Respondent**
- and –	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellant**

Mr Sam Grodzinski QC and **Ms Eleni Mitrophanous**, instructed by the Solicitor's Office, HMRC, for the Appellant
Mr David Milne QC and **Miss Nicola Shaw QC**, instructed by McGrigors LLP, for the Respondent

Hearing dates: 3 and 4 July 2012

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Approved Judgment

Sir John Chadwick:

1. At all material times the respondent, formerly known as Med Hotels Ltd and to which, for convenience, I will refer in this judgment as "Medhotels", operated a website (www.medhotels.com) through which it marketed hotel, villa and apartment accommodation in resorts throughout the Mediterranean and the Caribbean. In December 2007, following discussions as to the correct analysis of the nature of that business for the purposes of value added tax, the appellant, the Commissioners for Her Majesty's Revenue and Customs, issued a Notice of Assessment to Value Added Tax in respect of the accounting period 12/04. A further Notice of Assessment was issued in respect of the periods 12/05, 3/07 and 6/07. The total amount of VAT assessed under those Notices (after an adjustment) was in excess of £7 million. The assessments were made in respect of output tax for which, as the Commissioners contended, Medhotels was liable to account under the Tour Operators Margin Scheme.

2. The Tour Operators Margin Scheme was introduced, pursuant to Article 26 of the Sixth Council Directive on the harmonisation of the laws of Member States relating to turnover taxes (77/388/EEC) by section 37A(1)-(2) of the Value Added Tax Act 1983, and the Value Added Tax (Tour Operators) Order 1987. It will be necessary to refer to the legislation, and to the terms of the Scheme, in some detail later in this judgment. It is sufficient, at this stage, to note that it has been common ground that the effect of the Scheme, read with the legislation, is that where a travel agent or tour operator is supplying accommodation services as agent for a principal (the hotel operator) value added tax is payable in the Member State where the accommodation is situated; but where the travel agent is supplying accommodation services as principal (or in his own name) and not as intermediary the tax is payable on his margin in the Member State in which he is established. The issue which has given rise to this appeal is whether, as the Commissioners contend, Medhotels was (during the periods to which the assessments relate) supplying accommodation services as principal (or in its own name) – in which case it was required to account for VAT in the United Kingdom under the Scheme – or, as Medhotels contends, was acting as agent for a disclosed principal (the hotel operator) – in which case the supplies of accommodation services fell to be treated as made in the jurisdiction in which the hotel was situated and so do not give rise to any liability to VAT in the United Kingdom.

3. Medhotels appealed to the First-Tier Tribunal (Tax Chamber) against the assessments to output tax which had been made by the Commissioners. That appeal came before the Tribunal (Miss J C Gort and Mr A McLoughlin) in November 2009. The decision of the First-Tier Tribunal, [2010] UKFTT 120 (TC), dismissing the appeal, was released on 15 March 2010. Medhotels appealed to the Upper Tribunal. That appeal came before Mr Justice Morgan in June 2011. For the reasons set out in his decision [2011] UKUT 308 (TCC), released on 29 July 2011, he allowed the appeal. It is from that decision that the Commissioners appeal to this Court.

The legislative framework

4. In respect of the earlier accounting periods the relevant Community legislation was set out in the Sixth Directive. From 1 January 2007 the Sixth Directive was replaced by Council Directive 2006/112/EC on the common system of value added tax ("the VAT Directive"). In relation to the issues raised in this appeal, the terms of the relevant Community, or European Union, legislation did not alter in any substantial respect.

5. Article 9(1) of the Sixth Directive ("Supply of Services") set out the general rule:

> "The place where a service is supplied shall be deemed to be the place where the supplier has established his business or has a fixed establishment from which the service is supplied or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides."

Article 9(2) of the Sixth Directive (Article 45 of the VAT Directive) qualifies that general rule in relation to the supply of services connected with immovable property:

> ". . . the place of the supply of services connected with immovable property, . . . , shall be the place where the property is situated."

In that context, it is necessary to have in mind that, although (generally) Article 13B(b) of the Sixth Directive requires that Member States shall exempt the leasing or letting of immovable property from value added tax, excluded from that requirement (and from exemption) is "the provision of hotel accommodation . . . in the hotel sector or in sectors with a similar function . . .": Article 13B(b)(1).

6. As the First-Tier Tribunal pointed out, at paragraphs 15 and 16 of its decision, application of Article 9(2) of the Sixth Directive would require the supply of hotel accommodation to be treated as made in the place where the hotel was situated; so that a United Kingdom travel agent or tour operator providing hotel accommodation in another Member State would be liable for value added tax in that other Member State and might, under the domestic provisions in that State, need to be registered with the tax authorities there. This would give rise to obvious practical difficulties for travel agents and tour operators selling accommodation in a number of Member States: in that they might have to account for value added tax to the tax authorities in each of those Member States. It was to alleviate those difficulties, and the burden to which they gave rise, that Article 26 of the Sixth Directive (Articles 306 to 310 of the VAT Directive) provided a special scheme for travel agents. The Article is in these terms (so far as material):

> "1. Member States shall apply value added tax on to the operation of travel agents in accordance with the provisions of this Article, where the travel agents deal with customers in their own name and use the supplies and services of other taxable persons in the provision of travel facilities. This Article shall not apply to travel agents who are acting only as intermediaries and accounting for tax in accordance with Article 11A(3)(c). In this Article travel agents include tour operators.
>
> 2. All transactions performed by the travel agent in respect of a journey shall be treated as a single service supplied by the travel agent to the traveller. It shall be taxable in the Member State in which the travel agent has established his business or has a fixed establishment from which the travel agent has provided the services. The taxable amount and the price exclusive of tax, within the meaning of Article 22(3)(b), in respect of this service shall be the travel agent's margin, that is to say the difference between the total amount to be paid by the traveller, exclusive of value added tax, and the actual cost to the travel agent of supplies and services provided by other taxable persons where those transactions are for the direct benefit of the traveller.
>
> . . .

> 4 Tax charged to the travel agent by the other taxable persons on the transactions described in paragraph 2 which are for the direct benefit of the traveller, shall not be eligible for deduction or refund in any Member State."

Article 11A(3)(c) of the Sixth Directive, to which reference is made in paragraph 1 of Article 26, provides that:

> "The taxable amount shall not include:
> . . .
> (c) the amounts received by a taxable person from his purchaser or customer as repayment for expenses paid out in the name and for the account of the latter and which are entered in his books in a suspense account. The taxable person must furnish proof of the actual amount of this expenditure and may not deduct any tax which may have been charged on these transactions."

7. Those provisions were given effect under United Kingdom domestic law by section 37A(1)-(2) of the Value Added Tax Act 1983 (subsequently re-enacted as section 53 of the Value Added Tax Act 1994) and the Value Added Tax (Tour Operators) Order 1987 (SI 1987/1806). Section 53 of the 1994 Act is in these terms (so far as material):

> "Tour Operators
>
> (1) The Treasury may by order modify the application of this Act in relation to supplies of goods or services by tour operators or in relation to such of those supplies as may be determined by or under the order.
>
> (2) Without prejudice to the generality of subsection (1) above, an order under this section may make provision –
> (a) for two or more supplies of goods or services by a tour operator to be treated as a single supply of services;
> (b) for the value of that supply to be ascertained, in such manner as may be determined by or under the order, by reference to the difference between sums paid or payable to and sums paid or payable by the tour operator;
>
> . . .
>
> (3) In this section 'tour operator' includes a travel agent acting as principal and any other person providing for the benefit of travellers services of any kind commonly provided by tour operators or travel agents.

8. The 1987 Order was made under what became section 53(1) of the 1994 Act. It applied to ". . . any supply of goods or services by a tour operator where the supply is for the benefit of travellers": Article 2. Article 3(1) defines a "designated travel service" to mean:

> ". . . a supply of goods or services –
> (a) acquired for the benefit of his business; and
> (b) supplied for the benefit of a traveller without material alteration or further processing;

> by a tour operator in a member State of the European Community in which he has established his business or has a fixed establishment."

Article 3(2) provides that the supply of one or more designated travel services, as part of a single transaction, shall be treated as a single supply of services. Article 5(2) provides that a designated travel service shall be treated for the purposes of the Act as supplied in the Member State in which the tour operator has established his business or, if the supply was made from a fixed establishment, in the Member State in which the fixed establishment is situated. Article 7 ("Value of a designated travel service") is in these terms:

> "Subject to Articles 8, 9 and 9A of this Order, the value of a designated travel service shall be determined by reference to the difference between sums paid or payable to and sums paid or payable by the tour operator in respect of that service, calculated in such manner as the Commissioners of Customs and Excise shall specify."

Articles 8, 9 and 9A are not material in the context of the present appeal.

9. The effect of those provisions may be summarised as follows:

(1) Save where the person supplying accommodation services is a "tour operator" supplying a "designated travel service" within the meanings given to those expressions by, respectively, section 53 of the Value Added Tax Act 1994 and Article 3 of the 1987 Order, the supply of accommodation services is treated as made in the place where the accommodation is situated.

(2) It follows that, in such a case, if the accommodation is situated outside the United Kingdom, the person supplying the accommodation services is not liable to account to the United Kingdom tax authorities for VAT on the supply of those services, notwithstanding that he has established his place of business in the United Kingdom. If the accommodation is situated within another Member State, then (*prima facie*, at least) he is liable to account to the tax authorities of that other Member State for value added tax on that supply.

(3) Where a person who is a "tour operator" within the meaning of section 53 of the Value Added Tax Act 1994 supplies a "designated travel service" within the meaning of Article 3 of the 1987 Order, the service is treated as supplied in the Member State in which that tour operator has established his business (or, if the supply is made from a fixed establishment, in the Member State in which the fixed establishment is situated); and the value of the supply is determined by reference to the margin earned by the tour operator in respect of that supply. So, in such a case, if the tour operator has established his business in the United Kingdom (or the supply is made from a fixed establishment in the United Kingdom), he is liable to account to the United Kingdom tax authorities for VAT (output tax) on the margin which he earns on accommodation services supplied in the course of supplying a designated travel service, notwithstanding that the accommodation is situated outside the United Kingdom.

(4) A person is not a "tour operator" within the meaning of section 53 of the 1994 Act if, in relation to the supply of the relevant travel services, he is acting as an intermediary and not as principal. In that context (reading section 53(3) of the 1994 Act with Article 26(1) of the Sixth Directive) a person acts as principal where he deals with customers in his own name and uses the supplies and services of other taxable persons in the provision of travel facilities; and does not act as principal where he acts only as an intermediary and accounts (or is

entitled to account) for tax in accordance with Article 11A(3)(c) of that Directive.

The findings of fact made by the First-Tier Tribunal

10. The First-Tier Tribunal set out the background at paragraphs 3 to 5 of its decision:

> "3. At all material times, the Appellant [Medhotels] was part of a group of travel related businesses which includes lastminute.com and Holiday Autos. The group was owned by lastminute.com Ltd (a wholly owned subsidiary of Sabre Holdings Corporation). On 2 February 2009, the trade and assets of the Appellant were sold to Hotels4U.com Ltd as part of a transfer of a going concern of the lastminute.com group. . . [On] 25 February 2009 the Appellant changed its name from Med Hotels Ltd to Secret Hotels2 Ltd. The grounds of appeal state that for VAT purposes the Appellant remains part of the lastminute.com group. It is irrelevant to the decision we have to make precisely what the group structure is.
>
> 4. At all material times the Appellant operated a website (www.medhotels.com) through which it marketed hotel accommodation. The website featured approximately 2,500 resort hotels, villas and apartments in a variety of destinations throughout the Mediterranean and the Caribbean.
>
> 5. Approximately 94% of all hotel sales were made to travel agents who supply the hotels on to the holidaymakers. The remaining 6% of sales were made to holidaymakers."

The Tribunal went on to explain, at paragraphs 6 and 7 of its decision:

> 6. The appeal is concerned with the nature of the supplies made by the Appellant between 12/04 and 06/07. It is the Appellant's case that for the majority of the period in question (from 12/04 to 31 May 2007), the Appellant's contractual arrangements established an agency business model, for which they rely on the Accommodation Agreements, the Terms and Conditions, Agreements with travel agents and the Booking Conditions. The Commissioners' case is that those documents should be looked at as well as all other contractual documents and the entirety of the Appellant's commercial arrangements.
>
> 7. It is not in dispute that for the remainder of the period of the assessment (1-30 June 2007) the Appellant operated as principal. Between 1 June 2007 and 21 July 2008 the Appellant changed its business model and accepted that in that period it was acting as principal. The reason given by the Appellant for this change was that there was commercial pressure upon it following the deaths of children on holiday from the United Kingdom in Corfu from carbon monoxide poisoning. The travel agents wanted to ensure that the Appellant was acting as principal in relation to the supplies of hotel accommodation and was therefore in a position to indemnify them against claims from any holidaymaker or his family for such incidents which might occur in the future. Some adjustments were made to the contractual arrangements covering this period, but on 21 July 2008 the Appellant reverted to what it claimed to be an agency model. . . ."

The Tribunal accepted the submission made on behalf of Medhotels that the post-July 2008 contractual arrangements were irrelevant to the issues before them – because they related to a period after the period of assessment – and did not take them into account in reaching its decision. The Tribunal observed, at paragraph 11 of its decision, that "during the material time [the period of assessment] the Appellant did not pay VAT either in the UK or in the Member States where the relevant accommodation was situated".

11. After setting out the relevant provisions in Community and domestic legislation and summarising their effect, the Tribunal turned to the evidence which had been adduced. The Tribunal explained, at paragraph 27 of its decision, that agreed bundles of documents had been provided; and that oral evidence had been given by Mr Alan McLintock, a Senior Tax Director with Sabre Management Services Ltd, a wholly owned subsidiary of Sabre Holdings Corporation. The documentary evidence included documents setting out the contractual arrangements.

12. The Tribunal described the contractual arrangements between Medhotels and the hotel operators, between Medhotels and the travel agents to which it sold accommodation, and between Medhotels and holidaymakers, under three heads:

(A) The Accommodation Agreements

> "These were drawn up by Global Hotels, an internal department of lastminute.com Ltd which was responsible for negotiating hotel room rate[s] and reviewing them twice a year. The Agreements show the pricing and availability of rooms, excluding inventory risk, and the allocation of units to the Appellant for specific periods at specific rates."

(B) The Terms and Conditions

> "These govern the relationship between the Appellant [Medhotels] and the hotel and were managed by Global Hotels. They cover all the supplies of hotel accommodation made by the Appellant over the period in question. Although the contracting party was Last Minute Network Ltd, this was not an issue in the case."

(C) The Agency Agreement

> "This governs the relationship between the Appellant and the travel agent. The agreements were broadly of two types: 'gross rate' contracts where the travel agent's commission was set out in the agreement with the Appellant and, from around the start of 2007, 'net rate' contracts in which the travel agent could decide its own commission above the price agreed with the Appellant."

(D) The Booking Conditions

> "The Booking Conditions, i.e. the terms on which a holidaymaker contracts with the Appellant, appear on the Appellant's website."

The Tribunal referred, also, to a template of a "Handling Agency Agreement"; which it described as an agreement between the Appellant and the relevant handling agent in a particular resort ("the Agent"). The stated purpose of those agreements was to define "the services which must be delivered by the Agent to support Medhotels in the provision of holidays and excursions to its Customers". In that context, "Customer" was defined as a customer of Medhotels.

13. The First-Tier Tribunal held (at paragraph 61 of its decision) that the principal document was that setting out the Terms and Conditions between Medhotels and the

hotel operator: that is to say, the document described under head (B). The Tribunal observed that:

> ". . . The majority of this contract imposes obligations upon the hotel in question, the only obligation, which appears in the preamble, undertaken by the Appellant is that it undertakes "to deal accurately with the request for accommodation bookings and relay all monies, which it receives from the principal's client(s) … which are due to the principal, but shall have no further commitment to the principal under this agreement." There is no other document imposing obligations on the Appellant as far as the hotel is concerned and indeed all the documents are drafted by the Appellant and we have seen no documents drafted by any of the hotels which impose any conditions upon the Appellant."

The Tribunal identified, as the main obligations imposed upon the hotel, that it should (i) provide accommodation as described in its advertising material (clause 1.2 of the Terms and Conditions); (ii) honour accommodation bookings (clause 1.5); (iii) where it could not do so, provide alternative accommodation (*ibid*); (iv) pay Medhotels compensation for loss of profit, commission and client compensation if alternative accommodation was not acceptable to the holidaymaker (clause 1.7); (v) indemnify Medhotels in respect of losses, damages, liabilities and demands and compensation payments to clients resulting from a breach of the agreement by the hotel or from death, injury or illness for which Medhotels might have liability if caused by a wrongful or negligent omission by the hotel (clause 2.1); (vi) notify Medhotels of any complaint by a holidaymaker to the hotel, resolve such complaint, keep Medhotels informed and provide all assistance requested by Medhotels (clauses 2.2-2.4). The Tribunal noted that the Terms and Conditions provided that Medhotels was to receive the difference between the sum charged by the hotel to the client and the sum charged by the hotel to Medhotels (clause 2.5); and that the hotel was obliged to maintain insurance cover (clause 4) and to allow Medhotels' representatives to inspect the property at any reasonable time on request (clause 6). The Tribunal noted, also, that the Terms and Conditions "did not set terms as to how Medhotels was to market the accommodation".

14. The First-Tier Tribunal went on to observe (also at paragraph 61 of its decision) that:

> ". . . The Appellant provided the accommodation direct to holidaymakers booking through its website and subject to its own booking conditions and to other travel agents on the basis of agreement with those travel agents. Those holidaymakers who booked accommodation through other travel agents were still subject to the Appellant's booking conditions."

In those circumstances the Tribunal held that it was not appropriate to look at the document which set out the Terms and Conditions between Medhotels and the hotel (described under head (B)) in isolation from Medhotels' own Booking Conditions (described under head (D)).

15. The Tribunal noted that, on the first page of the Booking Conditions, it was stated that:

> "medhotels.com act as Booking Agents on behalf of all hotels, apartments and villas featured on this website and your contract will be made with those accommodation providers. . . ."

The Tribunal observed (at paragraph 62 of its decision) that the Booking Conditions sought to make clear, both in the statement just set out (which they described as "the preamble") and in the body of the document that the holidaymaker would have a contract with the hotel or other accommodation provider. It went on to say this (*ibid*):

> "After the preamble, in the first paragraph on the first page, it is stated:
>
> > 'Once the contract is made, the accommodation provider is responsible to you to provide you with what you have booked and you are responsible to pay for it, in each case subject to these Booking Conditions, and any other terms and conditions specific to the relevant accommodation.'
>
> However, this does not specifically state that the holidaymaker is responsible for paying the accommodation provider. The Booking Conditions subsequently state:
>
> > 'Please note: your booking may be cancelled, if you fail to make payment on time (*i.e. to the Appellant*) and you would then be liable to pay the accommodation provider the cancellation charges set out below.'
>
> This may be contrasted with the next statement:
>
> > 'Payment for incidental extras (e.g. mini bars, telephone charges, etc) has to be made directly to the accommodation provider, when you check out',
>
> which make a distinction between those payments which must be made direct to the accommodation provider and those which must be made to the Appellant."

And it observed that:

> "Whilst there was no obligation upon the Appellant to accommodate the changes to bookings, any such changes as were made would incur an administration charge of £15 payable to the Appellant itself, not to the hotel, in addition to potential charges by the hotel in question subject to the hotel's own terms and conditions. We have seen no such terms and conditions and there was no evidence of the Appellant being bound by any particular hotel's own terms and conditions. The agreement with the hotels did not provide for a charge to the Appellant in cases where administrative charges were received by the Appellant, nor was there a clause in the agreement with the hotels for the cancellation charges in the Appellant's Booking Conditions to be paid to the hotels. There was no evidence that they were in fact passed on to the hotel, despite the fact that the Appellant was entitled to charge the holidaymaker up to 100% of the price payable."

16. The First-Tier Tribunal noted (at paragraph 64 of its decision) that the Agency Agreement (the document described under head (C) and made between Medhotels and the various travel agents) obliged the travel agent to promote and use its reasonable endeavours to increase sales of accommodation etc. through all means. That, the Tribunal observed, was in contrast to Medhotels' relationship with the hotel; under which no such obligation was imposed on Medhotels. The Tribunal noted, also, that, on a sales invoice which had been issued to Medhotels, the price shown was that which the hotel expected to receive from Medhotels in respect of each customer's stay; and that that invoice included local VAT on that value only.

17. The Tribunal summarised Mr McLintock's evidence at paragraphs 38 to 43 of its decision; without stating, in terms, what parts of that evidence it accepted and what parts (if any) it did not accept. It is convenient to set out the relevant passages in that summary which, by inference from the Tribunal's reasons for its decision, the Tribunal must be taken to have accepted :

> "38. . . . when a holidaymaker (a term which we will use to avoid the ambiguity of the word 'customer') makes a booking using the Appellant's website, he/she . . . makes a payment to the Appellant. A deposit of 25% is made at the time of the booking unless it is less than five weeks prior to the travel date, in which case the full price is paid. Payment is made by credit card and the Appellant takes the balance of the payment five weeks before the travel date. This payment is made into the Appellant's bank account, not the hotel's account. Interest on direct sales is therefore earned by the Appellant. . . .
>
> 39. It was accepted by Mr McLintock that the holidaymaker would not know the rate which the hotel charged to the Appellant and neither did the hotel know what rate the holidaymaker was paying. It was not disputed that the bill from one hotel to a particular holidaymaker, Mrs Cotter, sent to the Appellant showed an IVA (VAT) rate of 5%. It was accepted that the Appellant ought on all occasions to have issued a VAT invoice for its commission (an amount unknown to the hotels in question) but this had not been done, . . . The Agency Agreement itself stipulated in its Agreement with the travel agent that a VAT invoice in respect of commission earned would be required before commission would be credited. . . . but in practice only twenty-seven travel agents out of many hundreds in fact issued a VAT invoice. It was accepted by Mr McLintock that where a hotel would make an error in the Appellant's favour, then the Appellant would not account to the hotel for the difference, but where a hotel made an error in its own favour, then the Appellant would look to the hotel to correct it. . . . The Appellant retained the 25% deposit it had received prior to the holidaymakers' arrival on such occasions when the holidaymaker did not in fact go on holiday in question, i.e. the holidaymaker forfeited that amount to the Appellant, not to the hotel. . . . However in circumstances where a travel agent was involved, the money would be passed back to the travel agent, although in practice the travel agent almost never charged for cancellations. Equally hotels would not generally charge for cancellations other than when a large party was involved. On such an occasion the hotel would contact the Appellant. In situations where the hotel did not charge, the Appellant would not do so. It was accepted that a holidaymaker would have contracted to pay cancellation charges and the Appellant therefore had a discretion to impose such a charge. The evidence shows that even where a hotel did not charge, the Appellant would retain the customer's deposit. . . .
>
> 40. Various letters of complaint written to the Appellant were produced which showed that it had corresponded with the complainants and offered payment without first clearing the matter with the hotel in question, although that hotel would then be charged by the Appellant for any monies paid to the complainant. . . . It was accepted that at a meeting on 25 January 2006 between HMRC and

> representatives of the Appellant it was said that the Appellant could agree compensation without prior approval from the hotel in question. It could also recover the compensation by way of deducting it from the payment it made to the hotel. In some cases the Appellant would issue a voucher but that voucher would be in respect of a future holiday with the Appellant and not with the hotel in question. . . . The fact that some customers complained to the Appellant and not to the hotel was explained by it being easier for the holidaymaker to contact the Appellant as it was in the United Kingdom. In another case there was evidence of a complaint which was rejected by a hotel but nonetheless the Appellant paid the complainant and then charged the hotel in question. . . .
>
> . . .
>
> 43. The Appellant had made pre-payments to certain hotels which, at the meeting referred to above with HMRC, were referred to as 'loans' which were made in order to get the hotel to sign up with the Appellant. . . . Mr McLintock accepted that there was a risk that the hotel in question might go insolvent, but it was deemed at the time to be an acceptable risk. The payments in question were made in return for higher commission rates."

The reasons which led the First-Tier Tribunal to dismiss the appeal from the assessments

18. The First-Tier Tribunal concluded that Medhotels was a "tour operator" within the meaning of section 53 of the Value Added Tax Act 1994; in that it "was not simply supplying agency services to the hotels, but was itself supplying the holiday." It followed that Medhotels was required to account to the United Kingdom tax authorities for VAT in respect of its supply of a "designated travel service" within the meaning of Article 3(1) of the Value Added Tax (Tour Operators) Order 1987; and that it was correctly assessed on that basis. The reasons which led the Tribunal to that conclusion are set out at paragraphs 59 to 68 of their decision. Those reasons may, I think, fairly be summarised as follows:

    (1) The correct approach, when determining the nature of a supply for VAT purposes, was to be found in observations of Mr Justice Laws in *Customs and Excise Commissioners v Reed Personnel Services* [1995] STC 588, 591*f-h*, 595*a-e* as explained by Mr Justice Lewison in *A1 Lofts Ltd v Revenue and Customs Commissioners* [2009] EWHC 2694 (Ch), [40]; [2010] STC 214, 228*f-j*. It was necessary to look not only at all the various contractual documents but also at the behaviour of Medhotels: paragraphs 59 and 60.
    (2) There were aspects of the Terms and Conditions (described under head (B)) which it was unusual to find in an agency contract. Although that document referred to Medhotels as "the agent" and to the hotel as "the principal", that was not of itself determinative of the roles of the parties: paragraph 61.
    (3) That, on a proper analysis of the Booking Conditions (described under head (D)), ". . . there is no contract between the hotel and the holidaymaker, and there is no possibility that the hotel could have gone to the holidaymaker and demanded the price of a room": paragraph 62.
    (4) Medhotels could not rely on the Booking Conditions for its claim that it is an agent: paragraph 63. The Tribunal pointed out that the Booking Conditions contained a provision in these terms:

> "If in the unlikely event that we are informed by the accommodation owner that they are unable to provide the accommodation which you have booked, we will try to provide you with similar accommodation of equal standard. If we are unable to do this or you prefer not to accept our alternative, you may cancel free of charge."

They observed that that was an unusual undertaking by an agent. They referred to Mr McLintock's evidence: that it was an undertaking made in order to create good customer relations, the reality being that the Appellant would then look to the hotel to reimburse it for any consequent expenditure. But they took the view that, on the basis of that provision in the Booking Conditions, a holidaymaker could look to Medhotels – rather than to the hotel he had anticipated staying at - to provide accommodation. They went on to point out that the provision just set out was followed by a provision in these terms:

> "Because we are acting only as a booking agent we have no liability for any of the accommodation arrangements and in particular no liability for any illness, personal injury, death or loss of any kind, unless caused by our negligence. Any claim for damages for injury, illness or death arising from your stay in the accommodation must be brought against the owner of the accommodation and will be under the jurisdiction of the law of the country in which the accommodation is based"

and that, given their view that the holiday maker would have no contract with the hotel, the two provisions were contradictory. As they put it: "an onus in the one being on the Appellant to provide alternative accommodation in certain circumstances, but in the other the Appellant states that the liability for injury is that of the accommodation provider".

(5) The absence from the Terms and Conditions of any obligation on Medhotels to promote and use its reasonable endeavours to increase sales of accommodation – in contrast to the obligation imposed on travel agents in the Agency Agreement (described under head (C)) was inconsistent with the role of an agent: paragraph 64.

(6) The fact that Medhotels retained handling agents at the location where the accommodation was situated – in circumstances where there was no condition in the contracts between the hotels and the Appellant which required or allowed Medhotels to provide in-resort services – was a further indication that Medhotels saw itself as providing hotel accommodation as principal: (*ibid*).

(7) The fact that Medhotels set its own commission; and did not disclose the amount of that commission to the hotel was "strongly indicative" of the fact that it was acting as a principal. The Tribunal pointed out that, under the arrangements in the contractual documents, the responsibility to provide accommodation was owed by the hotel to Medhotels and not to the holidaymaker. The holidaymaker contracted with Medhotels. It explained that, although in a case not involving VAT the fact that the hotel (as principal) did not know the amount of the commission charged by its agent might be of no consequence, in a case where VAT would be payable on the supply of accommodation by the hotel (as it would be if the accommodation was situated in a Member State) it was necessary for the hotel to know the amount of the agent's commission. In a case where VAT would be payable on the supply of accommodation by the hotel (but sold through an agent), the hotel could not properly account to the tax authorities of the Member State in which the

accommodation was situated unless it knew the price charged by the agent to the holidaymaker: paragraph 66 of the decision. As the Tribunal explained (*ibid*):

> "In the present case the Appellant did not invoice the hotel with its commission or even inform it of what it was, which assumes that the hotel will not be accounting for VAT based on the full price paid for by the holidaymaker. The hotel only accounted for local VAT on the net amount payable by the Appellant to it. The VAT due on the amount retained by the Appellant should have been payable by the Appellant in the UK, and it was not. If the Appellant were simply supplying agency services to the hotel it should have charged VAT to the hotel on its commission unless it had issued an invoice indicating that the hotel was liable to pay the VAT on the Appellant's services under the reverse charge procedure, which did not ever happen. Similarly there is no evidence that the hotels were accounting for VAT on the full price paid by the holidaymaker."

In the Tribunal's view, the fact that Medhotels did not invoice the hotel for its commission – and did not inform the hotel of the amount of that commission – supported the conclusion that both were treating the supply of accommodation by the hotel as a supply of accommodation to Medhotels; and that neither were treating the supply of accommodation by the hotel as a supply to the holiday maker (with Medhotels supplying intermediary services to the hotel).

(8) Further matters indicative of Medhotels acting as a principal, rather than as an agent, in the supply of accommodation included the treatment of deposits and the payment of compensation. As the Tribunal observed (at paragraph 66 of its decision):

> "The Appellant would deposit a payment from holidaymakers into its own account so that any accrued interest or bank charges arising belonged to it and it did not account for these to the hotel. It therefore carried the benefit/risk of currency fluctuations between payment by the holidaymakers and payment to the hotels. Additionally the Appellant made compensation payments to the holidaymakers and then charged these on to the hotels, despite there being no basis in the agreement with the hotel for its so doing. Furthermore the compensation on occasion took the form of discounts/vouchers in respect of future bookings with the Appellant, not the hotel. The Appellant did not maintain a suspense account in respect of the compensation payments it allegedly made on behalf of the hotels. We find these matters more indicative of the Appellant acting as a principal than an agent."

(9) While accepting that an agent was under no obligation to retain monies received on behalf of his principal in a separate account, it was clear that the agent would hold such monies subject to a duty to transfer or account for them to its principal. In the present case Medhotels did not account to the hotel for monies received from the holidaymaker. Further, as Mr McLintock accepted, where Medhotels had been overpaid by the hotel in respect of a particular booking, it would retain that money; but where the hotel had underpaid Medhotels, Medhotels would immediately invoice the hotel for the difference. Those matters pointed to Medhotels acting as a principal and not as an agent for VAT purposes: paragraph 67 of the Tribunal's judgment.

19. The First-Tier Tribunal's own summary of the reasons leading to its conclusion is, I think, to be found at paragraph 68 of its decision:

> "In our judgment the principal document for our consideration is the contract between the Appellant and the hotel. Despite the clear statement in that document to the effect that the Appellant is the agent and the hotel is the principal, we do not find the document as a whole consistent with that declaration when taken together with the way it is implemented by the Appellant, considering the further factors which we have set out above. The Appellant's failure to account to the hotel (its alleged principal) for all the funds received by it, which if it were truly an agent it would be obliged to do . . . and its failure either to account for VAT or put the hotel in a position to pay the relevant VAT on those sums, render its actions those of a principal in the supply of accommodation not an agent particularly when viewed in the whole context of its actions. We do not accept Mr Milne's submission [on behalf of Medhotels] that in this case the failure to account may be regarded as no more than a breach of the Appellant's fiduciary duty. It is the Appellant who dictates to the accommodation providers the terms of the relationship, the accommodation providers impose no terms on the Appellant, and no hotel could go to any holidaymaker to demand payment for the accommodation provided. In all the above circumstances we find that the Appellant was not simply supplying agency services to the hotels, but was itself supplying the holiday."

The decision of the Upper Tribunal

20. As I have said, the Upper Tribunal (Mr Justice Morgan) allowed Medhotels' appeal from the decision of the First-Tier Tribunal.

21. At paragraph 9 of its decision, the Upper Tribunal identified what Mr Justice Morgan described as "the real issue" before him: "in relation to the supplies of hotel accommodation, who is the supplier?" At paragraph 10 he explained that, although the First-Tier Tribunal had taken the view that, in relation to the question before them, the most significant document was the contract between Medhotels and the hotel (described by the First-Tier Tribunal under head (B)), he took the view that "because the question to be answered relates to the identity of the person making the supply to the holiday maker, it is more relevant to see what contract the holidaymaker entered into for the supply of hotel accommodation and in that way seek to identify the person who had contracted with the holiday maker to supply the hotel accommodation".

22. The Upper Tribunal went on, at paragraph 11 of its decision, to identify two sources for the relevant terms as to the contract or contracts made with a holidaymaker:

> "The first source is Med's website which is accessed by the holidaymaker, or by a travel agent dealing with the holidaymaker. . . . The second source is the set of booking conditions."

It referred, thereafter, to the terms which appeared on the website (other than the booking conditions) as "the website terms"; and to the booking conditions, separately, as "the Booking Conditions". At paragraphs 13 to 18 Mr Justice Morgan described various provisions of the website terms; at paragraphs 19 to 27 he set out provisions of the Booking Conditions (described by the First-Tier Tribunal under head (D)). At paragraph 28 he explained that, on successful completion of a booking via Medhotels' website, the holidaymaker would receive an e-mail confirmation of the booking; and that, in due course, the holidaymaker would receive from Medhotels a voucher for presentation to the hotel which had been booked to establish the holidaymaker's

entitlement to the hotel accommodation. At paragraphs 29 to 35 he described, in some detail, the provisions in the agreement between Medhotels and travel agents (the Agency Agreement, described by the First-Tier Tribunal under head (C)).

23. At paragraphs 38 to 40 of the decision, the Upper Tribunal set out provisions of the agreement between Medhotels and the hotel operators (the Terms and Conditions, described by the First-Tier Tribunal under head (B)). At paragraphs 41 to 45 it described provisions in the agreement between Medhotels and its handling agents (the Handling Agency Agreement). Mr Justice Morgan then turned to the provisions of the Sixth Directive, the VAT Directive, the Value Added Tax Act 1994 and the Value Added Tax (Tour Operators) Order 1987. He summarised what, in his view, was the effect of those legislative provisions at paragraphs 60 and 61 of the decision:

> "If the hotel accommodation is supplied by the hotel operator, and not by Med, to the holidaymaker, then Med is not liable to account for VAT on that supply. In such a case, Med will have supplied agency services to the hotel operator and will be liable to account for VAT on that supply or to arrange for that VAT to be paid by its principal, the hotel operator. The parties are agreed that such liability will be in the Member State where the relevant hotel is situated and not in the UK.
>
> If the hotel accommodation is supplied by Med to the holidaymaker, then Med is liable to account for VAT on that supply to the Commissioners in accordance with TOMS [the Tour Operators Margin Scheme]."

24. The Upper Tribunal then summarised the decision of the First-Tier Tribunal (at paragraphs 62 to 74) and the respective submissions of Medhotels (at paragraphs 75 to 81) and the Commissioners (at paragraphs 82 to 85) on the appeal which was before it. At paragraphs 86 to 114 Mr Justice Morgan addressed "the relevant legal principles". He began, at paragraph 86, with this observation:

> "The issue in the present case is as to the identity of the supplier of holiday accommodation to holidaymakers. In order to determine that issue, it is necessary to apply basic principles as to the construction of written agreements, some further principles as to the law of agency and to consider whether there are any special principles which apply by reason of the fact that the issue arises in a VAT context."

25. Adopting that approach, Mr Justice Morgan set out, first (at paragraphs 87 to 93), a summary of "some basic principles which govern the way in which a court (or a tribunal) construes a written agreement". At paragraph 90 of his decision he said this:

> "In some cases, the parties purport to state the legal effect of their agreement. They may, for example, state that the agreement is a licence in relation to land and not a tenancy. They may do this even where there is no question of the agreement being a sham. They may act in this way through a misunderstanding of what is involved in the legal concept to which they refer or for other reasons. Notwithstanding this, the court will examine the substance of the agreement to determine its legal effect: see, for example, *Street v Mountford* [1985] AC 809. This will often produce the result that the court finds that the parties have correctly described the legal effect of the agreement but in other cases the court will determine that the

> description used by the parties is incorrect and is overridden by the substance of what they have otherwise agreed."

He went on, at paragraph 91, to observe:

> "In the present case, the FTT stated that it would not only look at the written contractual documents but also at 'the behaviour' of Med. This raises an important question as to the purposes for which the FTT, and the Upper Tribunal on this appeal, is entitled to look at behaviour in this case where the contractual arrangements between the parties are the subject of detailed written agreements."

He answered that question at paragraph 93:

> "Subject to the above matters [set out at paragraph 92, and not material in the present context], it remains the law that the court may not have regard to the subsequent conduct of the parties to a written agreement as a suggested aid to the interpretation of that agreement: *Schuler AG v Wickham Machine Tools Sales Ltd* [1974] AC 235. . . ."

26. The Upper Tribunal then addressed "some further principles as to the law of agency". Mr Justice Morgan pointed out, at paragraph 94, that it was open to the parties to an agency relationship to agree terms which would not otherwise apply to such a relationship. He said this:

> "Thus the fiduciary obligations of the agent may be modified by express agreement. In particular, an agency agreement may contain express terms which provide for matters which would otherwise not be appropriate as involving an impermissible conflict of interest. These express terms which are at variance with what would otherwise be the obligations of parties to a relationship of agency do not necessarily mean that the relationship has ceased to be one of agency. There may, however, come a point where the parties have created a contractual relationship which is so far removed from that of agency, that it is not appropriate to analyse the case as one of principal and agent."

In particular, as the Upper Tribunal pointed out at paragraphs 96 to 98 of its decision, it was conceptually possible for an agent to be remunerated by way of a "mark up". Mr Justice Morgan said this, at paragraph 96:

> "It is possible in an agency relationship for the principal and the agent to agree that the agent can contract on behalf of the principal with a third party on terms that (1) the third party will pay the agent £X plus a mark up and (2) the agent will remit £X to the principal. Of course there is an entirely different set of legal relationships involving three parties which can lead to one party receiving a mark up. I refer to the relationships created by a sale and a sub-sale, for example where A sells goods to B for £X and then B sub-sells the same goods to C for £X plus a mark up. In any particular case, it may be relevant to determine whether the parties have contracted for an agency relationship or the relationship of sale and sub-sale. If there is no written agreement between the parties, then the court will have to look

> carefully at the course of dealing to see which relationship exists. Conversely, if the matter is governed by a written document, then the legal answer is to be arrived at by construing the written document applying conventional principles as to the interpretation of written documents."

27. The Upper Tribunal then turned to consider whether "the identity of the supplier of hotel accommodation under the contractual documents was necessarily the same as the identity of the supplier for the purposes of VAT". Mr Justice Morgan referred to the two cases on which the First-Tier Tribunal had relied in reaching its conclusion that it should look not only at the contractual documents: *Reed Personnel Services Ltd* and *A1 Lofts Ltd* . He added to the passages cited by the First-Tier Tribunal a further passage from the judgment in *A1 Lofts Ltd*, [2009] EWHC 2694 (Ch), [47]; [2010] STC 214, 231b-232a, in which Mr Justice Lewison had said this (omitting the references to authority):

> "I would summarise my conclusions as follows:
>
> (i) Where two or more persons (call them A and B) are involved in the supply of goods or services to an ultimate consumer (call him C) different contractual structures may entail different VAT consequences;
>
> (ii) Those consequences will follow whether C knows about the contractual arrangements between A and B or not;
>
> (iii) The starting point for determining the true relationship between A, B and C is an analysis of the contractual arrangements between them;
>
> (iv) Where the contractual arrangements are contained wholly in written agreements, this will be a question of construction of the agreements. But a contract may be partly written and partly oral, in which case what the parties said and did may throw light on the extent of their contractual obligations;
>
> (v) The apparent contractual arrangements will not represent the true relationship between A, B and C if the contractual arrangements are a sham; or if the parties have failed to operate the contractual arrangements; or if the evidence is wholly inconsistent with the apparent contract;
>
> (vi) The identification of the true rights and obligations of the parties will be the same, whether the question arises in the context of VAT or in the context of an action for breach of contract; and is the same whether the question arises in a domestic or a European context;
>
> (vii) Having identified the true rights and obligations of the parties, it will then be necessary to decide how those rights and obligations should be classified for the purposes of VAT;
>
> (viii) Sometimes this will be concluded by the terms of the contract themselves; but it may not be. If it is not then the classification of the parties' rights and obligations for the purposes of VAT may involve the application of particular deeming provisions of the VATA; or deciding whether the nature of the supply falls within a particular description; whether there is one contract or

> more than one; or in some cases deciding whether on the true construction of a single contract there is one supply or more than one;
>
> (ix) Depending on the true relationship between A, B and C the conclusion might be that A makes a supply to B, who makes an overall supply to C; or A and B may make separate and concurrent supplies to C."

The Upper Tribunal concluded, at paragraph 106 of its decision, that Mr Justice Lewison's explanation, in *A1 Lofts*, of the earlier decision in *Reed Personnel Services*, together with Mr Justice Lewison's summary of the legal principles (just set out), supported an approach in the present case whereby the question as to the identity of the supplier of holiday accommodation was to be answered by considering the contracts entered into between the relevant parties and determining their effect as a matter of contract. Mr Justice Morgan observed that:

> "Once the supplier under the contract is identified in that way, that party will be the supplier for the purpose of the VAT provisions. In the present case, it would appear to be unnecessary to engage in any further classification or assessment of the relevant supply."

And he went on, at paragraph 107 of the decision, to say this:

> "In any event, I do not think that anything said in *Reed Personnel Services Ltd* could justify the course taken by the FTT in this case. What the FTT appears to have done in this case was to consider the terms of the written agreements, then to consider some evidence as to how they were implemented in some cases and then to hold that the written agreements were not consistent with the way that they were implemented and, finally, to conclude that the terms of the written agreements could not be relied upon as setting out the governing terms of the relevant arrangements."

At paragraph 114, after setting out and rejecting the submission that to identify the supplier of hotel accommodation for contractual purposes did not necessarily identify the supplier for VAT purposes, the Upper Tribunal concluded that it should analyse the contracts entered into by the relevant parties in this case; that, for that purpose, it should construe the written agreements in accordance with the established principles as to construction of such agreements; and that, when it had identified the identity of the supplier under those contracts, that person would be the supplier of the hotel accommodation for the purpose of the provisions relating to VAT.

28. It was on that basis that the Upper Tribunal addressed what it described, at paragraph 115 of the decision, as "the critical question":

> ". . . in the transactions with which this case is concerned, who supplies the hotel accommodation to the holidaymakers? Is it the hotel operators (through the agency of Med) or is it Med?"

Mr Justice Morgan pointed out, at paragraph 116, that there was no doubt that the holidaymakers entered into contracts with someone for the supply of hotel accommodation; and observed that, for the purpose of answering the question which he had posed, it was natural to start with those contracts and to ask: with whom do the

holidaymakers make those contracts? As I have said, he had identified two relevant contracts made by the holidaymakers: one a contract between the holidaymaker and Medhotels relating to the use by the holidaymaker of the Medhotels website, the other providing for a supply of hotel accommodation to the holidaymaker. He went on, at paragraphs 117 and 118, to say this:

> ". . . As the holidaymaker enters into these two contracts at around the same time, the terms of these two contracts can be referred to as part of the relevant background when construing either contract.
>
> There does not appear to be any other relevant background which is admissible as an aid to construing the contracts with the holidaymaker. In particular, the terms of the agreement between the hotel operators and Med are not admissible for this purpose because those terms would not be available to the holidaymaker. Further any course of dealing between the hotel operators and Med prior to the relevant holidaymaker contract would similarly not be available and not admissible. . . . In this way, the true construction of the contracts with the holidaymakers turn upon the wording of the contracts themselves without the addition of any other material and they are not to be construed by reference to 'the behaviour' of Med as the FTT suggested."

29. Adopting that approach, the Upper Tribunal concluded, at paragraph 119 of its decision, that the express terms of the contract to provide hotel accommodation to the holidaymaker and the contract as to the use of Medhotels website made it clear that: (1) the holiday maker was not contracting with Medhotels for Medhotels to provide hotel accommodation; and (2) the holidaymaker was contracting with "the accommodation provider", who was not Medhotels, for the provision of hotel accommodation. Mr Justice Morgan observed (*ibid*) that he could not see how the contract made by the holidaymaker was open to any other reasonable interpretation; and he reaffirmed that view, at paragraph 122, stating that:

> "Taking the express terms as a whole, I find that they clearly and unambiguously state that the contract for the provision of hotel accommodation is to be between the hotel operator and the holidaymaker. It is not suggested that these express terms are a sham and they therefore have full legal effect in accordance with the construction at which I have arrived."

30. At paragraph 116 of his decision the Upper Tribunal had observed that, if it were to hold that the holidaymakers made their contracts with Medhotels acting as principal, then that would seem to be the end of inquiry; but that, if it were to hold that Medhotels purported to act as agent in relation to the contracts with the holidaymakers, then it would be necessary to ask whether Medhotels had the authority of the hotel operators to enter into those contracts as agent so as to bring into existence a contract between the hotel operators and the holidaymakers. Mr Justice Morgan addressed that further question - did Medhotels have authority to make contracts on behalf of the hotel operators to provide hotel accommodation to the holidaymakers – at paragraphs 124 to 130. He did so, as he said at paragraph 124, on the basis that the question turned on the terms of the agreement between Medhotels and the hotel operators (the Terms and Conditions). He concluded, at paragraph 126, that that agreement "clearly confers actual express authority on Med to enter into

contracts on behalf of the hotel operator to provide hotel accommodation to holidaymakers".

31. In reaching that conclusion the Upper Tribunal rejected the approach adopted by the First-Tier Tribunal. Mr Justice Morgan said this, at paragraphs 127 to 130:

> "The FTT referred to a number of matters in relation to the agreement between Med and hotel operators. It referred to the very limited obligations undertaken by Med. It referred to Med's commission being taken in the form of a mark up on the price received by the hotel. It referred to the way in which some of the hotels invoiced Med and the way in which VAT was accounted for. It referred to the fact that Med placed the monies received from holidaymakers in its own bank account, retained the interest and ran a currency risk before paying sums over to the hotel operators. Finally it referred to occasions when Med compensated holidaymakers.
>
> In my judgment, none of the matters which were stressed by the FTT, whether taken individually or collectively, allows me to ignore the clear provisions in the agreements between Med and the hotel operators to provide hotel accommodation to holidaymakers. The limited obligations undertaken by Med are not inconsistent with this grant of authority. Nor is the fact that Med's commission is taken in the form of a mark up on the price received by the hotel. Med's conduct in placing the monies received from holidaymakers in its own bank account, retaining the interest and running a currency risk is not contrary to the agreements with the hotel operators. As to the way in which some of the hotels invoiced Med, all that that shows is that the terms of the agreement were not correctly operated in some cases. In the absence of an allegation that the written agreements were shams or were superseded by later agreements on different terms, I do not see that I am able to disregard the effect of the written agreements. Further, the findings of the FTT appear to be limited to some cases and cannot therefore be applied to every case. As to the way in which VAT was accounted for, it is clear that VAT was not correctly accounted for in any case. Med did not account for VAT in accordance with its contentions as to the legal position but, of course, neither did it account for VAT in accordance with the Commissioners' contentions as to the legal position. Finally, the occasions when Med compensated holidaymakers can be explained, as Mr McLintock did explain, on the basis of Med protecting its own economic interest in the arrangements.
>
> The FTT relied on other matters which were also stressed by the Commissioners on this appeal. These included the arrangements under which Med made advance payments to hotel operators and the fact that Med engaged travel representatives in some resorts. I do not find that those arrangements were incompatible with the terms of the written agreements between Med and the hotel operators nor do they throw any doubt on the express grant of authority to Med enabling it, as agent for the hotel operators, to enter into contracts with holidaymakers.
>
> Accordingly I conclude that none of the matters relied upon by the FTT, nor any of the other circumstances of the case referred to in the course of argument, allow me to ignore the express grant of authority

> to Med. It is not alleged that the express terms of the agreements to which I have referred are a sham."

And he re-emphasised his view that the First-Tier Tribunal had been wrong to reach the conclusion that they did at paragraph 133 of his decision:

> "I have reached the opposite conclusion to that reached by the FTT. It seems to me that the FTT was persuaded by the Commissioners to approach the question in an impermissible way. The FTT seems to have lost sight of the point that it was common ground that the written agreements were not shams and their legal effect was to be arrived at by a process of construction of their express terms. The FTT does not seem to have applied conventional principles as to the construction of written agreements. It appears to have read far too much into the decision in *Reed Personnel Services* and to have ignored (although it cited the decision) the very helpful statements of principle in *A1 Lofts*. It had regard to what it called 'behaviour' in a way which would have been more appropriate if there had been no written contracts and the FTT had to infer the contractual terms from a course of dealing. Further, it seems to have extrapolated from events which occurred in some cases so that all of the contracts in all of the cases were governed by those events. Finally, it seems to have regarded anything which could be argued to be inconsistent with an agency relationship as far more weighty that the many matters which pointed unambiguously towards an agency relationship."

The issues for decision on this appeal

32. The principal issue for decision on this appeal, as it seems to me, is whether the Upper Tribunal was correct in its view that the First-Tier Tribunal had erred in law in its approach to the question which was before it. That is to say, whether the First-Tier Tribunal was wrong to hold (at paragraphs 59 and 60 of its decision) that the correct approach, when determining the nature of a supply for VAT purposes, was to look not only at all the various contractual documents but also at "the behaviour of Medhotels".

33. If the Upper Tribunal was not correct to hold that the First-Tier Tribunal had erred in law in its approach, then the other issue for decision on this appeal is whether the First-Tier Tribunal was entitled to reach the conclusion which it did for the reasons which it gave.

34. If, and only if, the Upper Tribunal was correct to hold that the First-Tier Tribunal erred in law in its approach it will be necessary to address a third issue: whether, on the basis of the approach adopted by the Upper Tribunal, it was entitled to reach the conclusion that it did for the reasons which it gave.

The principal issue: did the First-Tier Tribunal err in law in its approach

35. It is, I think, important to keep in mind that the question which was before the First-Tier Tribunal for decision was whether the Commissioners had been correct to assess Medhotels for VAT on the basis that the case fell within the Tour Operators Margin Scheme established by the Value Added Tax (Tour Operators) Order 1987. It was necessary, therefore, for the Tribunal to decide whether Medhotels was a "tour operator" for the purposes of the 1987 Order. If Medhotels were not a "tour

operator", then the 1987 Order had no application: see Article 2. If Medhotels were not a "tour operator", it could not be assessed under the Scheme.

36. If Medhotels were a "tour operator" then the Order applied to any supply of goods or services by Medhotels where the supply was for the benefit of travellers: again, see Article 2. It was not in issue that Medhotels did supply services; and it was not in issue that those services (whatever their nature) were for the benefit of travellers. The Tribunal did not need to decide those issues; and it did not do so.

37. It was not enough that Medhotels was a "tour operator" for the purposes of the 1987 Order. It was necessary for the Tribunal to decide whether the services supplied by Medhotels and in respect of which it was assessed to VAT were "a designated travel service" within the meaning of Article 3(1) of the Order. It was only if the services supplied by Medhotels were "a designated travel service" that (where supplied in connection with hotel accommodation outside the United Kingdom) they fell to be treated as supplied in the United Kingdom pursuant to Article 5(2). And it was only if the services supplied by Medhotels were "a designated travel service" that the value of that service fell to be determined by reference to "the margin" - that is to say, by reference to the difference between sums paid or payable to and sums paid or payable by Medhotels in respect of that service - pursuant to Article 7.

38. The 1987 Order contains no definition of a "tour operator". But the meaning of that expression is to be determined by reference, first, to section 53 of the Value Added Tax Act 1994 (formerly section 37A of the 1983 Act) read with Article 26(1) of the Sixth Directive (now Article 306 of the VAT Directive); and, second, the definition of "designated travel service" in Article 3(1) of the 1987 Order.

39. As I have explained, earlier in this judgement, section 53(3) of the 1994 Act defines "tour operator" to include "a travel agent acting as principal and any other person providing for the benefit of travellers services of any kind commonly provided by tour operators or travel agents". Plainly, the definition is not intended to be exhaustive. In particular, it does not limit the meaning of the defined term to "a travel agent acting as principal"; a "tour operator" as defined includes "any other person providing for the benefit of travellers services of any kind commonly provided by tour operators of travel agents".

40. Section 53(3) of the 1994 Act must be read with Article 26(1) of the Sixth Directive, to which section 53 gives effect in domestic law. Article 26(1) requires Member States to apply value added tax to the operations of travel agents in accordance with a margin scheme "where the travel agents deal with customers in their own name and use the supplies and services of other taxable persons in the provision of travel facilities". The Article provides, in terms, that it shall not apply "to travel agents who are acting only as intermediaries and accounting for tax in accordance with Article 11A(3)(c)". For the purposes of Article 26(1), "travel agents include tour operators."

41. Article 11A(1) identifies the "taxable amount": generally, the taxable amount includes "everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party . . .". Article 11A(3)(c) provides that the taxable amount shall not include "the amounts received by a taxable person from his purchaser or customer as repayment for expenses paid out in the name and for the account of the latter and which are recorded in his books in a suspense account".

42. I have explained, also, that a "designated travel service", as defined by Article 3(1) of the 1987 Order, is "a supply of goods or services – (a) acquired for the purposes of his

business; and (b) supplied for the benefit of a traveller without material alteration or further processing; by a tour operator . . .". It is clear, I think, that a travel agent who acts only as an intermediary will not be making a supply of a designated travel service – because, as an intermediary, he will not be supplying services for the benefit of a traveller which he has acquired for the purposes of his business. On the other hand, a travel agent who deals with customers in his own name and uses the supplies and services of other taxable persons in the provision of travel facilities is likely to be making a supply of a designated travel service. *Prima facie*, at least, he will be a tour operator for the purposes of the 1987 Order.

43. It seems to me, therefore, first, that the questions which it was necessary for the Tribunal to decide in order to determine whether the Commissioners had been correct to assess Medhotels for VAT on the basis that it fell within the Tour Operators Margin Scheme – that is to say (1) whether Medhotels was a tour operator for the purposes of the 1987 Order and (2) whether Medhotels was supplying a designated travel service – were so closely linked as to be inter-dependent; and, second, that those questions were essentially questions of fact.

44. In my view they are questions which fall squarely within the observations of Mr Justice Laws in *Reed Personnel Services* on which the First-Tier Tribunal had relied. Mr Justice Laws had said this, at [1995] STC 588, 591*f-h:*

> "I certainly accept that where any issue turns wholly upon the construction of a document having legal consequences, the exercise of construction is one of law for the judge. But for the proper resolution of a case of this kind, there are I think two qualifications. The first is that the concept of making a supply for the purposes of VAT is not identical with the performance of an obligation for the purposes of the law of contract, even where the obligation consists in the provision of goods or services. The second is that, in consequence, the true construction of a contractual document may not always answer the question – what was the *nature* of the VAT supply in the case? Insofar as the answer to that question is not concluded by the legal process of construing the document, there remains a question of fact . . ."

And, he had gone on, to reject the premise on which, in that case, the argument advanced on behalf of the Commissioners for Customs and Excise was founded: that "since the contracts were not qualified by oral agreement, or custom and usage, they must inevitably conclude the issue as to Reed's supplies" (*ibid* 594*j*). Mr Justice Laws said this (*ibid*, 595*a-e*):

> "But in my judgment the premise is false. First, as I have already said, the concept of 'supply' for the purposes of VAT is not identical with that of contractual obligation. Secondly, in consequence, it is perfectly possible that although the parties in any given situation may conclude their contractual arrangement in writing so as to define all their mutual rights and obligations arising in private law, their agreement may nevertheless leave open the question, what is the nature of the supplies made by A to B for the purposes of A's assessment of VAT. … Where and to what extent the tax falls to be exacted depends, as with every tax, on the application of the taxing statute to the particular facts. Within those facts, the terms of contract entered into by the taxpayer may or may not determine the right tax result. They do not necessarily do so. They will not do so where the

> contract, though it tells all the parties everything that they must or must not do, does not *categorise* any individual parties' obligations in a way which inevitably leads to the conclusion that he makes certain defined supplies to another. In principle, the nature of a VAT supply is to be ascertained from the whole facts of the case. It may be a consequence, but it is not a function, of the contracts entered into by the relevant parties."

45. It seems to me that the First-Tier Tribunal was correct to take the view that – in order to address the questions which it needed to determine - whether Medhotels was a tour operator for the purposes of the 1987 Order and whether Medhotels was supplying a designated travel service – it did need to have regard to "the whole facts of the case". It was, I think, the need to look at the whole facts of the case that the First-Tier Tribunal had in mind when it said that it would look "not only at all the various contractual documents but also at the behaviour of the Appellant".

46. It follows that I would hold that the Upper Tribunal was wrong in its view that the First-Tier Tribunal had erred in law in its approach to the question which was before it.

The second issue: was the First-Tier Tribunal entitled to reach the conclusion which it did

47. The First-Tier Tribunal found that, at all material times, Medhotels operated a website (www.medhotels.com) through which it marketed hotel accommodation. As the Upper Tribunal pointed out, holidaymakers contracted with Medhotels for the use of its website. Holidaymakers and travel agents used Medhotels' services to purchase hotel accommodation. Medhotels retained handling agents at the location where the accommodation was situated. In considering whether Medhotels was making a supply of services which fell within the Tour Operators Margin Scheme, it is important to have in mind that the supply of one or more designated travel services, as part of a single transaction, is to be treated as a single supply of services: Article 3(2) of the 1987 Order. In determining whether Medhotels was acting only as an intermediary, it is necessary, in my view, to look at the whole "package"; and not to concentrate on particular elements – in particular, the supply of accommodation - to the exclusion of others.

48. Having regard to the whole "package" it seems to me that the First-Tier Tribunal was plainly entitled to reach the conclusion that it did. The following features – amongst those identified by the First-Tier Tribunal – are, in my view, of particular weight:

    (1) Medhotels dealt with holidaymakers in its own name in respect of the use of its website and in the services of its local handling agents.
    (2) Medhotels dealt with holidaymakers in its own name (and not as intermediary) in those cases where the hotel operator was unable to provide accommodation as booked and the holidaymaker rejected the alternative accommodation offered.
    (3) Medhotels dealt with matters of complaint and compensation in its own name and without reference to the hotel operator.
    (4) Medhotels used the services of other taxable persons (the hotel operators) in the provision of the travel facilities marketed through its website.
    (5) In relation to value added tax, Medhotels dealt with hotel operators in other Member States in a manner inconsistent with the relationship of principal and agent. In particular, Medhotels did not provide the hotel operators with

invoices in respect of its commission (nor even notify the hotel operators of the amount of that commission); so making it impossible for the hotel operators to comply with their obligations to account to the tax authorities of that member State in accordance with the Sixth Directive.

(6) Medhotels treated deposits and other monies which it received from holidaymakers and their agents as its own monies. It did not account to the hotel operators for those monies. It did not enter those monies in a suspense account so as to take advantage of Article 11A(3)(c); and so cannot rely on the exclusion from the scope of Article 26 of the Sixth Directive which is contained in the second sentence of that Article.

The First-Tier Tribunal concluded that, taking account of those matters, Medhotels was not simply supplying agency services to the hotels, but was itself supplying the holiday. As I have said, I think it was entitled to reach that conclusion.

Conclusion

49. In those circumstances the issue whether, on the basis of the approach adopted by the Upper Tribunal, it was entitled to reach the conclusion that it did for the reasons which it gave does not arise; and it is unnecessary to address it.

50. I would allow this appeal and restore the decision of the First-Tier Tribunal.

Lord Justice McFarlane:

51. I agree.

Lord Justice Ward:

52. I also agree.