Case No: A3/2015/0964

Neutral Citation Number: [2016] EWCA Civ 663

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
Proudman J
TCC-JR/04/2013
[2015] UKUT 0048 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 5 July 2016

Before :

LORD JUSTICE PATTEN
LORD JUSTICE FLOYD
and
MR JUSTICE BAKER

- -

Between :

THE QUEEN ON THE APPLICATION OF ELS GROUP LIMITED	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

- -
- -

Hui Ling McCarthy (instructed by **Forbes Hall LLP**) for the **Appellant**
Nicola Shaw QC and Aparna Nathan (instructed by **General Counsel and Solicitor to HM Revenue and Customs**) for the **Respondents**

Hearing dates : 14 and 15 June 2016

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Judgment

Lord Justice Patten :

Introduction

1. This is an appeal from a decision of the Upper Tribunal (Tax and Chancery Chamber) (Proudman J) released on 2 February 2015 refusing the appellant, ELS Group Limited, permission to apply for judicial review of the decision of HMRC not to allow an ELS Group company (Education Lecturing Services ("ELS")) to take advantage of an extra-statutory concession relating to VAT on supplies of services by employment bureaux.

2. The concession is contained in Business Brief 10/04 ("BB10/04") and I shall refer to it by that name. It is reproduced in its entirety in the Appendix to this judgment and I shall come later to certain of its key provisions in more detail. But, by way of background, the following facts are material. ELS was incorporated in 1995 as a company limited by guarantee. Its business consisted of the supply of lecturers to colleges of further education in the UK. Employment bureaux can provide at least two kinds of service to their clients. Where the client is someone seeking to recruit personnel, they can contract with the client as principals to supply the services of workers who, although not usually employees as such, are sub-contracted to the bureau as staff available for hire and are paid by the bureau. The hirer client will be charged a fee for the services supplied which will cover both the bureau's wage costs and its profit charges. Alternatively the bureaux can act as agents by supplying to the intending hirer staff which the hirer will then engage and remunerate. In so doing they will act as the agent of the job seeking client and not as principal in placing the client with their would-be employer. The distinction between acting as principal and acting as agent is reflected in the Employment Agencies Act 1973 which defines those acting in the capacity of principal as "employment businesses" (s.13(3)) and those who act as agents as "employment agencies".

3. For VAT purposes where the bureau acts as principal in the supply of its own personnel to the client then VAT is charged on the whole sum payable to the bureau for the supply of services which will obviously include the cost of the salary payable to the personnel involved. Where the bureau acts only as an agent in finding employment or an employee for its client VAT is charged only on the commission payable to the bureau for the service it provides.

4. Since the early days of VAT, HMRC has operated an extra-statutory concession (known originally as the staff concession) which limited the amount of VAT which a business was required to charge and account for when it seconded its own staff to its clients' business. The history of the concession is described by Sales J in *R (on the application of Accenture Services Ltd) v Revenue and Customs Commissioners* [2009] STC 1503. In broad terms, the concession applied to limit VAT to the fees which the client was charged for the arrangement provided that the client paid the salaries of the staff supplied direct to the personnel involved and paid any tax and national insurance to the relevant authorities. The concession was necessary because the payment by the client of a salary due contractually between the bureau and its employees or sub-contractors would be treated as a payment to the bureau for the supply of its staff. The concession did not, however, apply to cases where the salary and tax continued to be paid by the supplier which then charged its client a sum to cover these amounts

plus any profit charge. In such cases, the client was required to pay VAT on the entire sum charged.

5. For present purposes, all that needs to be noted is that the concession in its original form was only available to the employment bureaux who used their own employees to fulfil the contract with the hirers and not to bureaux who were hiring out self-employed workers.

6. By the mid-1990s there was an increasing trend by employment bureaux to reduce the VAT chargeable on the cost of their supply of labour by taking on self-employed staff rather than employees and then supplying them to hirers on an agency basis so that VAT would be payable only on the commission charged by the bureau to their hirer clients who would directly contract with and remunerate the workers they engaged. This was a particularly attractive arrangement for hirers (e.g. banks and health care providers) who were unable to recover the VAT payable to the bureaux because the supplies which their businesses made were largely exempt.

7. This trend was significant for two reasons. In the first place, it put at a commercial disadvantage those bureaux who acted as principals and placed their own staff with their hirer clients. Secondly, it encouraged agency arrangements of the kind I have described in preference to bureaux acting as principals which was what the DTI regarded as best practice because it gave temporary workers better employment rights than they enjoyed under agency arrangements where the contracts between the hirer and the temporary workers were often never properly settled or regulated and were beyond the control of the bureaux supplying the staff.

8. To deal with this combination of factors, HMRC introduced in 1997 what was intended to be a temporary statutory concession under which bureaux that acted as principals could elect not to charge VAT on the salary costs of the workers placed with their hirer clients where the hirer paid the staff directly. This was known as the staff hire concession and was a refinement of the original staff concession referred to earlier. It was, however, still limited to cases where the bureau supplied its own employees rather than self-employed staff to the hirers. The concession was expected to be withdrawn once the government had introduced new legislation requiring bureaux to act as principals when supplying temporary staff.

9. Consultation about the form of this legislation lasted in fact until December 2003 when the DTI made the Conduct of Employment Agencies and Employment Business Regulations 2003 which took effect from 6 April 2004. At the same time HMRC announced that the staff hire concession would continue for 18 months after the commencement of the new regulations in order to allow HMRC to review the impact of the 2003 Regulations on the VAT treatment of employment agencies and businesses and the effect of withdrawing the concession. BB10/04 therefore preserved the original staff hire concession for the benefit of employment bureaux to whom it applied but also continued the ability of bureaux to act as agents for VAT purposes in their dealings with their hirer clients even though, as a result of the regulations, they were required to act as principals. Consequently bureaux who now as principals provided self-employed staff to their hirer clients could opt to be treated as agents for tax purposes and so limit the VAT payable for their services to the commission element of their charges.

10. The concession was eventually withdrawn with effect from 1 April 2009 by which time distortion in competition originally created by agency arrangements was deemed no longer to exist.

11. As explained in detail by the Upper Tribunal in [5]-[28] of its decision, ELS originally structured its business in order to take advantage of the exemption from VAT for supplies of education by an eligible body which is contained in Item 1 of Group 6 to Schedule 9 of the Value Added Tax Act 1994 ("VATA"). It supplied lecturers to the colleges as principal and relied on another group company, Protocol National Limited ("PNL"), to provide it with operational services. As a result of the decision of the ECJ in *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00) [2002] STC 502, HMRC subsequently (in December 2005) challenged ELS's status as an "eligible body" providing education within the meaning of the Schedule 9 exemption on the basis that its distribution of profits via PNL had to be taken into account in determining whether ELS was non-profit making. But HMRC continued to accept that ELS was making educational supplies rather than supplies of staff because the lecturers it supplied remained employees of ELS and did not, in the view of HMRC, come under the direction or control of the colleges in which they taught. This ruling, if correct, meant that ELS would be placed under an immediate competitive disadvantage because, in making supplies of educational services otherwise than as an eligible body, it would have no exemption from VAT and, by acting as a principal in its dealings with the colleges, it would have to charge VAT on the entire amount of the charges it made for the supply of lecturers. The colleges which made largely exempt supplies, would be able to recover very little, if any, of the VAT as input tax. By contrast, many of its competitors who were able to establish that they were making supplies of staff rather than educational services could take advantage of BB10/04 and opt to charge VAT only in respect of the commission element of their fees.

12. To deal with these difficulties, ELS decided in 2006 to re-structure its business by establishing PNL as an employment bureau which would take over the supply of lecturers to the colleges. As part of these arrangements, PNL (although acting as a principal in accordance with the 2003 regulations) would be able to take advantage of BB10/04 so as to limit its VAT liability to the commission it charged. Negotiations took place with the colleges to persuade them to enter into new contracts with PNL with effect from 1 February 2006 but, for a variety of reasons which it is not necessary to explore, 89 of the colleges either declined or failed to change their supplier to PNL. I will need to return to some of the evidence in more detail later in this judgment but, in outline, PNL proposed to invoice the colleges in a way which separated the commission element of its charges from the wage costs and applied VAT only to the former. ELS, on the other hand, continued to invoice the 89 colleges that remained contracted to it for a single lump sum for its services with no VAT.

13. The form of the invoices rendered to the colleges by ELS accords with the VAT returns which ELS continued to make throughout the period with which we are concerned. In response to HMRC's rejection of its status as an "eligible body" for the purposes of the Item 1 exemption, ELS had taken advice on other possible exemptions that might be available to it. One of these was the Group 6 Item 5A exemption for the supply of educational services where the consideration payable is ultimately a charge to funds provided by the Learning and Skills Council for England. ELS therefore

continued to claim exemption for the services it supplied which, as I have said, HMRC accepted were educational services rather than supplies of staff.

14. PriceWaterhouseCoopers had written to HMRC on 30 January 2006 explaining the proposals to re-organise the business of the ELS Group and to transfer the contracts with the colleges to PNL. The intention, they said, was for ELS to terminate this part of its business and for PNL to contract with the colleges as principals in the supply of staff but to elect to be treated as an agent for VAT purposes in accordance with BB10/04. The letter contained a specimen proposed invoice from PNL to its college clients in which the commission and the staffing costs were separately itemised with VAT being charged only in respect of the commission. Later in January 2006 all the colleges were informed that the hourly rate charged for lecturers would be £21.76 for the academic year 2006/2007 which included VAT on the commission element of the charge. This hourly rate was charged to all the colleges including those that remained contracted to ELS although in their case, as mentioned above, they continued to pay the charge under invoices for exempt supplies of educational services.

15. Again, I will need to return to these billing arrangements in a little more detail later but the nature of the supplies made by ELS and PNL continued to be a matter of controversy between the companies and HMRC. Although it was accepted that ELS continued to make supplies of education under the terms of its contracts with the 89 colleges that it retained, HMRC told the Group in a letter of 10 July 2006 that it could see no difference between the supplies made by ELS and those made by PNL to the colleges it was now contracted with. It therefore refused PNL the relief claimed under BB10/04 and requested the company to submit any further information it wished to rely on to establish a difference between the supplies made by the two companies.

16. The dispute about the nature of the supplies continued throughout 2007 but was ultimately resolved by the decision of the CJEU in *Stichting Regionaal Opleidingen Centrum Noord-Kennemerland/West-FriELSand (Horizon College) v Staatssecretaris van Financiën* (Case C-434/05) [2008] STC 2145. In a letter dated 22 January 2008 but sent in March 2008 HMRC informed PNL that it accepted that the company was making supplies of staff and was entitled to take advantage of BB10/04. Mr Philip Harrison, the CEO of PNL, replied on 8 April and stated in his letter that there were no differences between the supplies made by PNL and those made by ELS. It followed, he said, that ELS should benefit from BB10/04 to the same extent as PNL.

17. As the Upper Tribunal observed in [21] of its decision, this was the first time that anyone had claimed that ELS was making supplies of staff rather than of educational services. HMRC replied to the ELS Group on 10 April 2008 explaining that they were as yet unable to make any decision about ELS's supplies until they had obtained further information but in the letter they said that they were:

> "prepared to accept that the concession in Business Brief 10/04 can be applied retrospectively [but] the terms of the concession will still need to be adhered to. The evidence for the choice of status for VAT purposes is the VAT invoice issued to the customer. We would therefore expect revised invoices to be issued to your customers to evidence this choice if necessary."

18. On 9 July 2009 HMRC wrote to ELS to inform the company that they had now decided that the supplies it was making to the colleges were supplies of staff rather than of educational services. The terms of their letter indicated that HMRC were still of the view that an election under BB10/04 to be taxed as an agent could be made with retrospective effect. But in a subsequent letter of 14 December 2009 written by HMRC's Policy Team ELS was informed that HMRC were not prepared to allow retrospective use of the concession because ELS had not at any time done anything to indicate to its customers that it was acting or intended to act as an agent. This change of position was confirmed in HMRC's decision letter of 21 November 2012 which is the subject matter of the application for judicial review in this case. Their position was and remains that the choice to be taxed as an agent requires to be made no later than the date of the relevant supply and cannot be made with retrospective effect. They also do not accept that ELS in fact made the choice to be taxed as agents at any time before or during the tax period March 2007 to March 2008 which is the subject of these proceedings. The earliest occasion was perhaps 8 April 2008 when Mr Harrison asked that the company should benefit from BB10/04 in the same way as PNL.

19. In the Upper Tribunal ELS sought permission to apply for judicial review of the 21 November decision on three grounds: (1) that HMRC was wrong about BB10/04 not being capable of being applied retrospectively; (2) that even if the choice to be taxed as an agent had to be made by the date of the relevant supply, that had in fact occurred in this case as part of the arrangements made in 2006-7 for the transfer of the ELS colleges to PNL; and (3) that if ELS had failed to make the necessary choice in time and was now too late to do so, that was the consequence of HMRC's conduct in treating the supplies made by ELS as educational under its direction of 23 December 2005 without which it would have changed its business model so as to take advantage of BB10/04 with immediate effect.

20. This third ground failed before the Upper Tribunal and is not pursued on this appeal. We are concerned only with the first two issues, both of which the Upper Tribunal decided in favour of HMRC.

Can the choice be exercised with retrospective effect?

21. The first issue is ultimately one of construction in respect of the terms of BB10/04. Extra-statutory concessions are not without controversy. The power to grant them is said to be contained in s.1(1) of the Taxes Management Act 1970 but doubts have frequently been expressed about the scope of the power it contains. In *R v Commissioners of Inland Revenue ex parte Wilkinson* [2003] EWCA Civ 814; [2003] 1 WLR. 2683 Lord Phillips of Worth Matravers MR queried whether the power extended to refraining from collecting taxes that were statutorily due by making available an extra-statutory allowance to all widowers. In the House of Lords Lord Hoffmann said:

> **"**[21] This discretion enables the commissioners to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of Parliamentary time. The

> commissioners publish extra-statutory concessions for the guidance of the public and Miss Rose drew attention to some which she said went beyond mere management of the efficient collection of the revenue. I express no view on whether she is right about this, but if she is, it means that the commissioners may have exceeded their powers under s 1 of TMA. It does not justify construing the power so widely as to enable the commissioners to concede, by extra-statutory concession, an allowance which Parliament could have granted but did not grant, and on grounds not of pragmatism in the collection of tax but of general equity between men and women."

22. There is no issue in this case about vires but the nature of what amounts to a dispensing power in relation to taxes imposed by legislation has an obvious relevance when one comes to consider how the courts should approach issues of construction in relation to the language of the concession. Extra-statutory concessions are enforceable by the taxpayer to the extent and on the basis of the legitimate expectation which they create as statements of practice by HMRC. In *R v Inland Revenue Commissioners ex p. MFK Underwriting Agents Ltd* [1990] 1 WLR 1545 Bingham LJ said:

> "The doctrine of legitimate expectation is rooted in fairness. But fairness is not a one-way street. It imports the notion of equitableness, of fair and open dealing, to which the authority is as much entitled as the citizen. The revenue's discretion, while it exists, is limited. Fairness requires that its exercise should be on a basis of full disclosure. Mr. Sumption accepted that it would not be reasonable for a representee to rely on an unclear or equivocal representation. Nor, I think, on facts such as the present, would it be fair to hold the revenue bound by anything less than a clear, unambiguous and unqualified representation."

23. Miss Shaw QC relies on this as supporting a principle of construction that any ambiguities in an extra-statutory concession should be resolved in favour of HMRC but this may be another way of saying that such concessions should be given a relatively narrow construction in recognition of the fact that they involve a derogation from statute and should not be given a more liberal scope than the words used can, on a fair reading, reasonably bear.

24. It seems to me that the most influential contextual element in the process of construction must be the statutory default position which in this case is the correct tax treatment under VATA of the supplies made to the colleges by ELS. It is common ground that, but for the concession, ELS was obliged to charge and account for VAT on the total value of the supplies it made. That charge was imposed by s.1(1) VATA and VAT became due at the time the supplies were made: see s.1(2). The nature of the supply made dictated not only the nature of the returns which ELS was required to make but also the form of the invoices supplied to the colleges. Regulations 13 and 14 of the Value Added Tax Regulations 1995 ("VAT Regulations") required ELS to provide the colleges with an invoice containing particulars of the services supplied and the amount of VAT chargeable. As mentioned earlier, ELS invoiced the colleges

for the entire amount of its charges without VAT on the basis that the supplies were exempt although, as subsequently determined, the exemption was not in fact available.

25. The actual supply of services therefore has real consequences in terms of the tax liabilities it creates as at the date of supply both in terms of the tax charged and accounted or accountable for by the supplier and in respect of the right of its customers to re-claim the VAT as input tax. Miss McCarthy for ELS rightly emphasised in her submissions that the tax provisions I have referred to do not create an immutable state of affairs. There is power in VAT Regulation 34 for the taxpayer to correct an overstatement or understatement in his return that does not exceed £2,000 in amount and in VAT Regulation 35 to correct any "errors" in the return in excess of that amount. Similarly HMRC has power under s.73 VATA to make an assessment of the VAT due in cases where the returns of the taxpayer are incomplete or incorrect provided they exercise the power not more than 3 years after the end of the relevant accounting period: see s.77(1) VATA. It is, however, clear from these provisions that in any case where the value of the supplies exceeds £2,000 the taxpayer can only amend his return where the under or overstatement of tax in the return was an error. Miss McCarthy therefore accepts that had ELS invoiced the colleges not in respect of what they claimed were exempt supplies but in respect of taxable supplies of staff which it had supplied as principal and had therefore charged and accounted for VAT on the full amount of its fees, it would not have been possible for it subsequently to change its mind about the basis on which it wished to be taxed for those past accounting periods and seek to take advantage of the BB10/04 concession in respect of them. Its failure to make the necessary choice at the time of the supplies would not be categorised as an error within the meaning of VAT Regulation 35 and no amendment of the returns would be possible. But what she says makes a difference in this case is that ELS never made a choice between being treated as a principal and being treated as an agent for the purposes of BB10/04. It purported to make exempt supplies of educational services so that the issue never arose. The claim to be making exempt supplies was an error and can and has been subsequently corrected under the statutory machinery. To construe the concession as including the ability to make the necessary choice with retrospective effect does not therefore conflict with the operation of the statutory machinery for the recovery of VAT in this case. Having ruled that the supplies of services were taxable, HMRC could raise an assessment for the VAT due and ELS could then exercise its right to be taxed as an agent under BB10/04 in respect of those accounting periods.

26. As with any exercise in construction one needs to start with the actual words used. Like any written document, no one part should be read in isolation and the meaning of any particular paragraph has to be ascertained by reading the words in the context of the document as a whole having regard to its purpose and function. I set out earlier in this judgment the circumstances in which the concession came to be made and these are summarised in the opening paragraphs of BB10/04. The concession was published in advance of the coming into effect of the 2003 Regulations and was designed to allow employment bureaux to "continue to choose whether to act as an agent or as a principal for VAT purposes" even though the effect of the Regulations would be that they acted as principals under the contracts with their hirer clients.

27. In that sense it could be said that the language of the concession is necessarily prospective and Miss Shaw emphasised in her submissions the use of the present tense throughout the document. The critical paragraphs of BB10/04 for the purposes of this appeal are those set out below:

> "VAT will be due only on the commission element of the charge made by employment bureaux that choose to act as agents for VAT purposes. In such cases, work-seekers who are themselves registered for VAT will have to charge VAT to the hirer on the total value of their services. Invoices issued by employment bureaux acting as agents should therefore show the salary element of the charge to the hirer separately from any commission charged.
>
> In summary, until Customs have completed their review, the VAT position of employment bureaux will be as follows:
>
> - The staff hire concession is available only to employment bureaux that hire out their own employees. It allows them to exclude the salary and associated costs from the VAT charge.
>
> - All other employment bureaux that hire out self-employed work-seekers cannot use the staff hire concession. But they can choose whether to act as agents or principals for VAT purposes.
>
> - Employment bureaux that choose to act as agents for VAT purposes account for VAT only on the commission or margin element of their charges to the hirer.
>
> - Employment bureaux that choose to act as principals for VAT purposes account for VAT on the total charges made to the hirer.
>
> - Customs will accept that the VAT invoices issued by the employment bureaux will be acceptable as evidence of the choice made as to the status of the bureaux for VAT purposes.
>
> - Until the Customs review is completed, all new employment bureaux can also take advantage, as appropriate, of any of the above arrangements."

28. The first sentence of the passage quoted indicates that the choice to act as agents needs to be made before the VAT becomes due and will dictate the tax consequences which follow from the making of the supply. It is more difficult to understand the thinking behind the second sentence because even if the bureau as principal elects to be treated for VAT purposes as making supplies as an agent, that will not alter the contractual arrangements between the relevant parties. The workers will have no

contractual relationship with the colleges and will provide no taxable services to them. Consequently the college will be under no corresponding liability to pay VAT to them even if the workers are in fact registered for VAT. But in this case none of the lecturers appears to have been registered for VAT and, even if they were, HMRC does not suggest that the payment of VAT by the colleges to the lecturers was a further condition which required to be satisfied in order for the concession to apply.

29. The only possible significance therefore of the second sentence is its use of the future tense to describe the consequences of the bureau's election to be treated as an agent. Similarly the final sentence of that paragraph indicates that the invoices issued by the bureau post-election should separate out the salary element from the commission in order to identify the amount of commission on which VAT will be payable under the concession. Consistently with the VAT Regulations referred to earlier, this would appear to indicate that any choice to be treated as an agent would have to precede the date of the relevant supply.

30. The same observation can be made about the bullet points which follow. Bureaux that choose to act as agents for VAT purposes will account for VAT only on the commission element of their charges and HMRC will treat VAT invoices issued as evidence of the choice made about the tax treatment of the supplies. Again the summary seems to contemplate that the election will be made prior to the making of the supply.

31. Miss McCarthy criticises this reading of the concession on the basis that it gives primacy to a rule that the tax position of the supplier and the supplies which he makes is always crystallised at the date of supply. As she points out, this is not inevitably the case as the present appeal illustrates. Errors in the characterisation of the nature of the supply can be subsequently corrected either by the taxpayer or by HMRC through the machinery of VATA and the VAT Regulations. The eventual acceptance by HMRC that ELS was making supplies of staff and not supplies of educational services has led to ELS being assessed to VAT on the supplies in respect of the previous 3 years. The existence of some overriding principle that the tax position is somehow crystallised for all purposes at the date of supply is also, she says, inconsistent with a number of cases where the courts have construed provisions in the VAT legislation as having retrospective effect. Perhaps the best example of this is the decision of Mann J in *Marlow Gardner & Cooke Ltd (Directors' Pension Scheme) v Revenue & Customs* [2006] STC 2014 which concerned the making of an election under paragraph 3 of Schedule 10 VATA to bring property into taxation. For the option to take effect there has to be both an election and written notification of the election to HMRC. The taxpayer made the election before the completion of the purchase of the property but notification was given afterwards. The question was whether the notification was capable of operating retrospectively so as to make the sale of the property taxable.

32. Mann J held that, on the proper construction of Schedule 10, notification could be given with retrospective effect after the election had been made and after the completion of the sale:

> 22. This point is put in a number of different ways. Mr Mc Nicholas says that the character of the sale (in VAT terms) is fixed as at the date of the sale, and cannot be changed by subsequent events. Since, as at the date of the sale, there was no

notification, the process of trying to take the land out of the VAT exemption was not complete. The character of the transaction was therefore fixed as at the date of the sale and cannot be changed subsequently. Another way of looking at the matter is to say that (contrary to the finding of the Tribunal in paragraph 12 of its decision) Net Support was not the (or a) taxable person at the date of the notification, so the notification failed. He also said that the Tribunal erred in finding that there could be any retrospective effect in the process of election and notification, where that would involve what Mr Mc Nicholas referred to as rewriting the tax status of a supply of land after the event.

…

25. The UK legislation clearly supposes a two stage process. There is first an election, and secondly a notification within 30 days. Under schedule 10 paragraph 3(1) an election "shall have effect" from the beginning of the day on which it is made (or any later date specified in the election). Under paragraph 2(1) it then governs any grant made "at a time when the election has effect". These provisions are quite clear. A grant made after an election has had effect falls within the VAT regime. Paragraph 3(6) provides a qualification – an election can only have effect once notification is given. It is quite clear from that paragraph that notification can be given after the election. Paragraph 3(6)(ii) allows for a period of 30 days to give the notification. If one reads the provisions together, they operate so as to effect a form of retrospection. If one has an election on day 1, a chargeable output on day 3 and the incurring of a chargeable input on day 5, and stops the clock at that point, the election to take the property out of the exemption has not yet had any effect for fiscal purposes. However, if notification occurs on day 8 then the effect of the notification is to complete the effect of the election, with effect from the beginning of day 1. Accordingly, at that point, the events of days 3 and 5 become events which are subject to the VAT regime.

26. No particular problem arises if the supply on day 3 is one which does not involve disposing of the land – for example a charge to rent. I am not sure that the appellant would necessarily dispute that. However, Mr Mc Nicholas certainly claims that there is nothing in the legislation which permits retrospectivity to operate so as to allow an ex-landowner to "rewrite" the tax status of the supply if, by that supply, the land was parted with at a date prior to a notification (thus making the taxpayer an ex-landowner at the date of the notification). I do not accept this submission. The mechanism provided by the UK legislation is clear enough. It inevitably builds in an element of retrospection (if that is the right word). There is no

> reason why that element should be different, depending on the nature of the taxable supply on day 3. Mr Mc Nicholas would emphasis the words "to the extent that any grant made in relation to it at a time when the election has effect" in paragraph 2(1), and would say that at the time the supply is made on day 3 (in my example) the election does indeed have no effect and that state of play persists. That submission ignores the totality of the legislation. It is true that as at day 3 the election has not taken effect, but when one gets to test the situation after day 8 (at a point of time when notification has been made) one can see that the notification has occurred which allows the election to take effect, and paragraph 3(1) provides that the date from which the election has effect is (in my example) the date of the election itself. So at that point in time the supply on day 3 becomes a taxable supply. Nothing in that wording requires a different conclusion depending on whether the supply has the effect that the landowner parts with all interest in the land or not."

33. It is true that Mann J's construction of the option provisions in Schedule 10 VATA is at odds with some kind of immutable rule that everything crystallises at the date of supply. But that was not the submission for HMRC in *Marlow Gardner* nor is it Miss Shaw's submission in this case. There is no doubt that the effect of s. 1 VATA is to impose VAT on supplies of services when they are made and to set in train the obligation of the taxpayer to invoice his customers and to account for the tax. But the operation of those provisions can be qualified by other parts of VATA and in every case where the issue is whether an option given to the taxpayer can be exercised with retrospective effect after the date of supply it is simply a question of construction whether the legislation or, in this case, the extra-statutory concession should be interpreted as having that effect. In *Marlow Gardner*, as the judge said, the relevant statutory provisions could be seen to effect a form of retrospection and were interpreted accordingly.

34. In the present case, there is nothing in the language of the concession to indicate that the necessary choice is capable of being made with retrospective effect after the date of the relevant supply. The language of the concession referred to earlier contemplates that the choice will be made prior to or at the date of supply so as to dictate the way the services are invoiced for and therefore their tax treatment. ELS's case is that to allow the choice to be made retrospectively would not conflict with the operation of the machinery of VATA and the VAT Regulations at least in this case because, as part of the assessment of ELS to tax on the supply of staff, it could then elect to be treated as an agent. But in my view, that is not enough for at least two reasons.

35. The first is that extra-statutory concessions such as BB10/04 operate in effect as a decision by HMRC not to collect tax that becomes statutorily due under VATA in respect of the supplies that were in fact made. That militates strongly in my view against giving the concessions any greater scope than a fair and normal reading of the language of the concession dictates. If the election to be taxed as an agent was to be capable of being operated retrospectively then it would in my opinion require clear

words in order for it to be given that effect. Here the language used is entirely prospective.

36. The second reason is that the correct interpretation of BB10/04 has to be one which accommodates the ordinary circumstances in which the employment bureau will come to exercise the right to be treated as an agent. Although in the present case ELS had not invoiced the colleges for VAT on the supply of the lecturers because it continued to maintain that the services it supplied were educational in nature and exempt, in the cases contemplated by the concession the bureau will be making taxable supplies of staff and its choice (or not) to be taxed as an agent will be irreversible for the reasons already explained once the supplies are made. The concession was drafted in terms to deal with cases of this kind and, as Miss McCarthy accepts, there is simply no statutory machinery in the VAT Regulations which would permit a subsequent choice to be taxed as an agent to be given retrospective effect in relation to earlier supplies. To construe the concession in that way would therefore create an obvious inconsistency with VAT Regulation 35 and is a powerful reason why the concession should be assumed and interpreted not to have that effect. The fact that the necessarily prospective nature of the election will prevent taxpayers like ELS who have attempted but ultimately failed to obtain exemption from VAT for their past supplies from claiming the benefit of the concession for those past tax periods is to my mind neither here nor there. It cannot dictate an interpretation of the concession which is inconsistent with the statutory machinery within which it was intended to operate. I would therefore dismiss the first ground of appeal.

Was the choice made in time?

37. The second ground of appeal is advanced as an alternative to ground 1. It is essentially a factual issue as to whether ELS did make the choice to be treated as an agent under BB10/04 prior to or by the date of the supplies made during the March 2007 to March 2008 period. This requires the court to determine what has to occur in order for the necessary choice to be made and whether HMRC was entitled to conclude as they did that ELS had not established that the choice was made before the letter of 8 April 2008. It is worth emphasising that these questions are not ones for us to determine for ourselves *de novo* any more than they were for the Upper Tribunal. Judicial review can only be granted if the decision of HMRC is open to challenge on rationality grounds.

38. In their decision letter of 21 November 2012 HMRC expressed the view that ELS's position in the correspondence between 23 January 1995 and 8 April 2008 was inconsistent with the company having made a choice to be taxed as an agent on its supplies of staff. It had continued throughout this period to account to HMRC on the basis that it was making exempt supplies of education and had invoiced the 89 colleges on that basis. In relation to the evidence relied on by ELS as showing that it made the choice to be treated as an agent in its communications with the colleges in 2006-7 about the change of supplier to PNL and the increase in fees, the decision letter states:

> "Furthermore, we do not consider the alternative evidence contained in and appended to the various witness statements you have provided to change matters. In particular, we consider that:

- the discussions concerning the imposition of VAT on the commission charge took place in the context, and on the assumption, of PNL making the supply. It was only those colleges that signed up with PNL that were invoiced for the fees plus VAT. The colleges that remained with ELS were not so invoiced; they were invoiced for a single, VAT exempt amount. It is not, therefore, correct to say that ELS increased its fees to take account of VAT when it did not actually ever charge VAT.

- The correspondence, spreadsheets and pro forma documents relied upon by you are not evidence of ELS exercising the requisite choice. The items relied upon demonstrate a systematic failure to differentiate between the supplies made by ELS and the supplies made by PNL. PNL appears to have acted on the (false) assumption that the intention for it to take over all ELS' contracts was realised when, in fact, it was not. That would explain why the documents and correspondence refer to PNL alone and make no reference to ELS and would also explain why letters to ELS' college were sent out under PNL's letterhead. You assert that the correspondence and documents should have referred to ELS and not PNL. However, it is at least possible that the error was more fundamental, namely that the correspondence and documentation should not have been sent to ELS' colleges at all.

- The fact remains that all of the colleges were invited to enter into new contractual arrangements with PNL, the consequence of which was that they would receive a supply of staff and pay VAT on the commission element of the consideration. Not all of the colleges accepted the invitation and those that did not were not treat as if they had. The colleges that remained with ELS were not invoiced in the same way as the PNL colleges – they continued to be invoiced on the previous VAT exempt basis – and there is no evidence that those invoices were ever queried by the colleges. In those circumstances we do not accept your assertion that the colleges understood ELS to be acting as agent in the supply of staff.

- As for the contention that you maintained accounting records and made provision for the VAT that would have been payable on the basis that ELS was acting as agent in the supply of staff, we do not consider this to be unequivocal evidence of ELS having made the

> requisite choice; it is simply evidence of ELS having made a contingency."

39. What constitutes the making of a choice for the purposes of BB10/04 is not spelt out in the concession in terms of specific steps (such as written notification) which require to be taken in order for the choice to become effective. But it seems to me that for a choice to be exercised in relation to the VAT treatment of taxable supplies there must be some overt step taken in relation to those supplies which makes it clear that the taxpayer is implementing a decision to opt for a particular tax treatment. This would most obviously take the form of a notification to HMRC of the taxpayer's wish to take advantage of the concession and be taxed accordingly. Alternatively it could be evidence in the form of the invoices issued to the taxpayer's customers which, in order to comply with the VAT Regulations, would have to state what supplies were being made and the amount of VAT payable in respect of them. BB10/04 makes it clear that HMRC will accept invoices as evidence of the choice having been made.

40. Given that the choice has to be made either before or at the time of the supplies, it is difficult to see how, in conformity with the relevant statutory provisions, the making of the choice will not be indicated by the way in which the taxpayer invoices its customers and accounts for the VAT. If the bureau invoices its customers and charges VAT on the full amount of its fees it will be apparent that it has opted to be taxed as principal. If the VAT is charged only on the commission element of the fees then this will be obvious evidence that the bureau has opted to be taxed as an agent. ***This is not to say that the form of the invoices will always be conclusive.*** But where the bureau, as in this case, purports to make no supplies of staff but only exempt supplies of education to which the concession has no application then it is not in my view operating within the scope and terms of the concession and, ***in the absence of other evidence***, it is difficult to see how it can be treated as making an election which has no relevance to the supplies it is purporting to make.

41. The invoices rendered to the colleges by ELS in the March 2007-March 2008 period were for a single lump sum with no VAT and indicated on their face that the supplies were exempt. These were not therefore invoices for the supply of staff as agent nor were they accounted for as such. ELS seeks to overcome this difficulty by relying on various internal documents and communications between themselves and the colleges as evidence of the company having made a choice to be treated as an agent for the purposes of BB10/04 before the time of supply in the relevant period. It is said that it made the choice to be treated as an agent in the alternative to its claim to be making exempt supplies so that it was protected in the event that its claim for exemption turned out to be wrong. HMRC and the Upper Tribunal took the view that the assertion of an alternative choice was unsupported by the evidence and that ELS never made more than an accounting contingency for BB10/04 to be applied retrospectively were its claim for an exemption from VAT to fail.

42. The evidence relied upon by ELS was presented to the Upper Tribunal and to us in five parts and it is convenient to deal with it in that way.

(1) *The restructuring of the business*

43. Following HMRC's decision of 23 December 2005 to reject the claim for exemption based on ELS being an eligible body the business was re-structured as described

earlier with a view to the contracts with the colleges being transferred to PNL. Mr Harrison of ELS explained in his witness statement that the economic effect of losing the exemption was considerable and prompted the decision to re-structure matters so that PNL would take over the business of ELS and then claim the benefit of BB10/04. The use of ELS no longer had any tax advantages and the transfer to PNL was regarded as what he called a fresh start. This was explained to HMRC in a letter from PWC of 30 January 2006. That letter was, however, written in terms on behalf of PNL and the only reference to ELS is the statement that, as part of the re-structuring, ELS was to cease to carry on making supplies to the colleges after 1 February 2006. The rest of the letter details how PNL would conduct its business so as to be able to take advantage of BB10/04 and was obviously written on the assumption that all of the contracts with the colleges would be transferred over to PNL. There is nothing in this material to indicate that ELS wished to be treated as an agent in respect of future supplies. The intention at that time was that that part of its business should cease.

(2) *January 2006 price increases*

44. In January 2006 a decision was made to increase the prices charged for lecturers by the amount of VAT on the margin for the next academic year 2006/2007. The effect of adding VAT on to the margin increased what was described as the college rate to £21.76. Mr Harrison's evidence was that the increase in the hourly rate was necessary in order to incorporate the charge to VAT on the commission which PNL would charge under the BB10/04 regime. The Group intended to absorb the charge itself for the remainder of the 2004/2005 academic year and to bring the new charge into effect from September 2006. Meetings subsequently took place with the colleges to explain the reasons for the change. It is, however, clear that in January 2006 when the price increases were first proposed the Group's expectation was that PNL and not ELS would be conducting the business when the changes came into effect. There is nothing to indicate that at this stage the price increase was thought to be relevant to what ELS's tax position would be in the next academic year.

(3) *February-March 2006*

45. During this period emails and letters were sent to the colleges advising them of the proposed increase in rates for the next academic year. The information sent included schedules of charges which contained a breakdown of the college rate of £27.76 and its increase by the addition of VAT to the commission element of the charge. Mr Harrison said in his evidence that various meetings took place with the colleges at which senior personnel from PNL explained the details and consequences of the change of supplier. He said that when PNL communicated with the colleges it did so on behalf of itself and ELS and that the colleges did not distinguish between the two. Miss McCarthy criticises the Upper Tribunal because in [41] of its decision it expressed doubts as to whether the colleges can have properly understood that ELS was acting as agent or that VAT was to be payable on the commission element of any ELS fee. She says that the VAT treatment of a supplier cannot depend on its customer's understanding of the VAT position.

46. I am inclined to agree with that submission but I do not see how it assists ELS in this case. If one limits the focus to what was said and done by ELS it is clear that the intention in early 2006 was to transfer all of the contracts to PNL and for PNL to act as an agent within the terms of BB10/04. The new contracts were sent to the colleges

with an explanation to that effect to ensure what was described as a "seamless transition of the business from Protocol Professional [ELS] to Protocol National Limited". In the meantime, ELS continued to bill the colleges which remained in contract with it for exempt supplies of educational services for which no charge to VAT was made.

(4) *April-July 2006*

47. ELS relies on the fact that during this period details of the new hourly rates were sent to all colleges including the 89 with whom ELS remained contracted. On 10 July it was faced with the additional difficulty that HMRC was unwilling to accept that PNL was making supplies of staff so as to obtain the advantage of BB10/04. VAT returns were therefore prepared on the basis that the Group 6 Item 5A exemption was available to both companies, although the issue of the nature of the supplies made by PNL was, as I explained earlier, eventually resolved in PNL's favour. But through the relevant periods ELS continued to invoice its clients on the basis that it was supplying exempt services. It is therefore difficult to treat the April-July 2006 period as one in which ELS by its actions evinced an intention to be taxed as an agent if that intention cannot be spelled out of its communications with the colleges in the earlier January-April 2006 period.

(5) *Invoices and accounting records*

48. ELS accepts that its invoices for the relevant periods did not show VAT separately but relies on the fact that VAT on its commission was included as part of the college rate of £21.76. It also relies on the fact that provision for this VAT liability was made in its own VAT ledger. Miss McCarthy says that the Upper Tribunal was wrong to accept that HMRC could treat the accounting evidence as no more than evidence of ELS having made a contingency for BB10/04 to be applied in the event that its arguments for exemption came to be rejected. But the issue for the Upper Tribunal was whether this was a conclusion that was reasonably open to HMRC on the evidence and for that purpose the dealings by ELS with HMRC and its college clients need to be reviewed as a whole.

49. The real difficulty for ELS in relation to its argument that it actually made a choice to be treated as an agent during 2006 and 2007 is that none of this featured either in its invoices or VAT returns or more generally in its dealings with HMRC. I accept that BB10/04 does not in terms contain some form of notification provision. But, as indicated earlier, one would expect a decision to be treated as an agent to be communicated in some way to HMRC particularly if the election was being made to preserve ELS's position in the event that its claim for exemption eventually failed. Miss Shaw accepted that ELS could have made claims in the alternative. I am not convinced about that. I have some difficulty in understanding how a taxpayer can make some kind of provisional election for a particular kind of tax treatment whilst accounting to HMRC for VAT on a completely different basis. As stated earlier, the concession is meant to be operated in relation to the supplies which the taxpayer actually makes. But even if she is right ELS would, I think, have needed expressly to reserve its position in the face of invoices and tax returns claiming exemption for its supplies and containing no charge to VAT.

50. It is true, of course, that VAT on the margin did form part of the college rate of £21.76 but in relation to the colleges which remained customers of ELS, it was not charged as VAT. The colleges paid a flat rate of £21.76 for the services provided and could not reclaim the input tax involved. When Mr Harrison and other representatives of ELS meet with HMRC in September 2007 in connection with the dispute about the nature of the supplies being made by ELS and PNL it was made clear to HMRC that the direction and control of the lecturers remained vested in ELS which was consistent only with the company continuing to act as principal.

51. If one takes all these factors into consideration then the Upper Tribunal was right in my view to hold that it was reasonably open to HMRC to conclude as they did in their 21 November 2012 decision letter that ELS had not made a choice to be treated as providing supplies of staff as an agent at any time before the letter of 8 April 2008 and that the inclusion of a VAT element in the £21.76 college rate was at best a contingency in the event that the claim for exemption failed.

52. I would therefore dismiss the appeal.

Lord Justice Floyd :

53. I agree.

Mr Justice Baker :

54. I also agree.

VAT – Hire of self-employed staff by employment bureaux – further guidance

This Business Brief article provides guidance on the treatment of employment bureaux acting as agents or principals for VAT purposes when hiring out self-employed staff.

Business Brief 02/04 confirmed that the staff hire concession, which applies to employment bureaux that employ their own staff, will continue for 18 months after the relevant DTI regulations (the Conduct of Employment Agencies and Employment Businesses Regulations 2003) take effect in July 2004, after which Customs will review the continuing need for the concession.

Customs have now also confirmed there will be no change in existing arrangements for other employment bureaux. When the relevant DTI regulations come into effect, bureaux which act as agents for VAT purposes and hire out self-employed work-seekers who are themselves acting as principals may decide to change their business structure in a way that may mean they are acting as principals for VAT purposes when they place work-seekers; ie they will either become employers of the work-seekers, or they will contract directly with the work-seeker and provide services to the hirer in the capacity of principal.

Until Customs have completed their review, employment bureaux can continue to **choose** whether to act as an agent or as a principal for VAT purposes, even though the new DTI regulations may mean that they are in reality acting as principals. This choice is also available to

employment bureaux which had previously acted as principals when they contracted with self-employed staff to provide services to hirers.

VAT will be due only on the commission element of the charge made by employment bureaux that choose to act as agents for VAT purposes. In such cases, work-seekers who are themselves registered for VAT will have to charge VAT to the hirer on the total value of their services. Invoices issued by employment bureaux acting as agents should therefore show the salary element of the charge to the hirer separately from any commission charged.

In summary, until Customs have completed their review, the VAT position of employment bureaux will be as follows:

- The staff hire concession is available only to employment bureaux that hire out their own employees. It allows them to exclude the salary and associated costs from the VAT charge.
- All other employment bureaux that hire out self-employed work-seekers cannot use the staff hire concession. But they can choose whether to act as agents or principals for VAT purposes.
- Employment bureaux that choose to act as agents for VAT purposes account for VAT only on the commission or margin element of their charges to the hirer.
- Employment bureaux that choose to act as principals for VAT purposes account for VAT on the total charges made to the hirer.
- Customs will accept that the VAT invoices issued by the employment bureaux will be acceptable as evidence of the choice made as to the status of the bureaux for VAT purposes.
- Until the Customs review is completed, all new employment bureaux can also take advantage, as appropriate, of any of the above arrangements.