[2015] UKUT 0123 (TCC)
Appeal number: FTC/82/2013

VAT – sale of motor car on part-exchange terms – price of part-exchange car includes 'over-allowance' – value of supply of replacement car – periods prior to 1 August 1992 – s 10 VATA 1983 – application of 'open market value' – whether such value of replacement car should reflect a discount on a cash sale equivalent to the amount of the over-allowance – no – appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

N & M WALKINGSHAW LIMITED **Appellant**

- and -

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

TRIBUNAL: MR JUSTICE WARREN CP
JUDGE GREG SINFIELD

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 24 November 2014

Amanda Brown and Michael Brady of KPMG LLP for the Appellant

James Puzey, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. What is the value of a supply of a motor car ("**the replacement car**") by the Appellant, N & M Walkingshaw Ltd ("**the Company**") to its customer where the customer has proffered a car in part-exchange ("**the part-exchange car**") and the Company has paid a part-exchange price in excess of what is said to be the cash realisable value of the part-exchange car (referred to as an "**over-allowance**")? This was the essential question addressed by Judge Roger Berner and Mr Julian Stafford ("**the Tribunal**") sitting in the Tax Chamber on the Company's appeal against the decision of HMRC to refuse the Company's claim for VAT output tax said to have been overpaid.
2. The Company's case was that what needs to be ascertained is the open market value of the replacement car, which should be determined by reference to the consideration in money that would otherwise have been payable in a cash transaction. According to the Company, an equivalent cash transaction would have given rise to a discount on the price of the replacement car, and the best evidence of that discount is the amount of the over-allowance. The effect is to reduce the value of the supply of the replacement car by the amount of the over-allowance.
3. HMRC's position was that the value of the replacement car is what the Company and the customer agreed it was. Those parties were independent, unconnected parties, acting at arm's length. The negotiated and agreed price of the replacement car between unconnected parties is, HMRC say, the best evidence one can have of its open market value.
4. In their decision released on 29 April 2013 ("**the Decision**"), the Tribunal answered the question in favour of HMRC and dismissed the Company's appeal.

The Company appeals against that decision. Ms Amanda Brown and Mr Michael Brady appear for the Company. Mr James Puzey appears for HMRC. We thank them all for the clarity and focus of their written and oral submissions.

Illustrative example

5. In the Decision, the Tribunal set out an example. It has been referred to in the parties' arguments. We proposed to use the same example and refer to it as "**the Illustrative Example**". It can be found at Decision [5] which we now set out. The Appellant referred to is, of course, the Company.

> "5. It is, we think, helpful at the outset to set out an illustrative example of what might be described as a typical transaction in the relevant period. The cars and the prices referred to in this example are real cars and prices taken from a copy of Glass's Guide printed in 1979. The parties agreed that this example encapsulated for our purposes the facts on which the issue arises.
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> 1. On 1 April 1979, Mrs Smith enters the showroom of the Appellant.
> 2. She speaks to Mr Jones, a salesman employed by the Appellant, and says that she is interested in purchasing a brand new Morris Princess, Mark 2, 4-door saloon, "1800 HL", with an automatic gearbox ("the Princess").
> 3. The advertised "list price" of the Princess is £4,480.
> 4. Mrs Smith's existing vehicle is a 1977 Morris Marina 1700, 4 door saloon, "Super" (Automatic) ("the Marina").
> 5. Mr Jones carries out an appraisal of the Marina and notes that it has 20,451 miles on the clock and is in reasonably good condition for a vehicle of its age, with no significant faults or damage.
> 6. Mr Jones consults the March 1979 edition of Glass's Guide and 10 notes that the Glass's "Trade" guide price for a vehicle of this age, make and model is £1,970. Bearing in mind that the vehicle is in good condition for its age and the mileage is slightly lower than the 24,000 guideline for a vehicle of that age, Mr Jones initially values the Marina at approximately £2,000.
> 7. It is the Appellant's policy to obtain two quotes from the trade before they accept a vehicle in part-exchange. Mr Jones phones two traders and receives offers of £1,970 and £1,990 for the Marina.
> 8. Mr Jones informs Mrs Smith that he has been through the process described above and that his valuation of the Marina is £1,990, taking the higher of the two trade offers. There would therefore be an additional £2,490 to pay in order to purchase the Princess.
> 9. Mrs Smith believes that the Marina is worth nearer to £2,500 as she paid £2,945 for it from new in 1977, has kept it in good condition and has only driven around 10,000 miles per year. She is a returning customer, having bought the Marina from the Appellant, so expects to

be treated well by the company. In addition, she had only budgeted to spend £2,000 extra in cash on a new car.

10. Mr Jones consults the sales manager. In 1979 the dealer margin on Morris motor cars was 18% of the list price. The wholesale price of the Princess was therefore £3,674 (i.e. £4,480 x 82%). No incidental costs have been incurred in respect of the Princess. The available profit margin in cash terms is therefore £806 (i.e. £4,480 - £3,674).

11. It is the Appellant's policy that they should always try to retain at least half of the dealer margin. The sales manager indicates that there is therefore £403 available for negotiation with Mrs Smith.

12. Mr Jones makes Mrs Smith an improved offer of £2,150 for the Marina (i.e. £1,990 plus £160 of the profit margin given as overallowance).

13. Mrs Smith is holding out for more so, after further negotiation, Mr Jones agrees to give £2,300 for the Marina (i.e. £1,990 plus £310 of the Appellant's profit margin given as over-allowance) in order to complete the sale.

14. Mrs Jones pays to the Appellant the Marina plus £2,180 in cash for the Princess.

15. The Appellant's gross profit on the sale of the Princess is £496 (i.e. £4,480 - £310 - £3,674).

Note. The list price of the Princess is stated inclusive of VAT. The gross profit figure expressed in this example therefore includes the VAT for which the Appellant is accountable on the sale of the Princess."

The legislation

6. Although the relevant provisions of domestic and EU legislation are set out in Decision [11] to [20], we need to repeat some of them here. Like the Tribunal, we will refer only to the provisions of the Value Added Tax Act 1983 ("**VATA 1983**"). Section 10 provided at the relevant times as follows:

> "10(1) For the purposes of this Act the value of any supply of goods or services shall be determined as follows.
> (2) If the supply is for a consideration in money its value shall be taken to be such amount as, with the addition of the tax chargeable, is equal to the consideration.
> (3) If the supply is not for a consideration or is for a consideration not consisting or not wholly consisting of money, the value of the supply shall be taken to be its open market value.
> (4) Where a supply of any goods or services is not the only matter to which a consideration in money relates the supply shall be deemed to be for such part of the consideration as is properly attributable to it.
> (5) For the purposes of this Act the open market value of a supply of goods or services shall be taken to be the amount that would fall to be taken as its value under subsection (2) above if the supply were for such consideration in money

as would be payable by a person standing in no such relationship with any person as would affect that consideration.
(6) This section has effect subject to Schedule 4 to this Act."

7. From 1 August 1992, section 10(3) was amended to remove the reference to open market value in cases where the consideration was not wholly in money. The new provision was as follows:

> "The value of a supply for a consideration not consisting of money, or not wholly consisting of money, is taken to be such amount in money as, with the addition of the tax chargeable, is equivalent to the consideration."

8. It is this difference in wording which makes it possible for the Company to raise the argument which it does. The claims in the present case all relate to periods before the amendment. For periods after the amendment, the decision of the House of Lords in *Lex Services plc v Customs and Excise Commissioners* [2004] STC 73 ("***Lex Services***") precludes an argument along those lines. We will consider that case later in this decision.

9. As to EU legislation (which it was the purpose of VATA 1983 to implement), the relevant Articles were set out by the Tribunal in Decision [16] to [19]. It is convenient to have those Articles to hand so we set those paragraphs out here:

> "16. Article 8(a) of the Second Council Directive 67/288/EC sets out the fundamental principle for the basis of the assessment of VAT:
>
> > The basis of assessment shall be:
> >
> > (a) In the case of a supply of goods and the provision of services, everything which makes up the consideration for the supply of the goods or the provision of the services, including all expenses and taxes except the value added tax itself.
>
> 17. Paragraph 13 of Annex A to the Second Directive expands on Art 8(a), and in particular refers to the use of goods as consideration for a supply, in other words a barter transaction:
>
> > The expression 'consideration' means everything received in return for the supply of goods or the provision of services, including incidental expenses (packing, transport, insurance etc.) that is to say not only the

> cash amounts charged, but also, for example, the value of the goods received in exchange …

18. The Second Directive was superseded, on 17 May 1977, by the Sixth Council Directive 77/388/EC. Article 11 of the Sixth Directive is concerned with the taxable amount in respect of supplies of goods and services. Article 11A(1)(a) essentially replicates Art 8(a) of the Second Directive:

> The taxable amount shall be:
>
> (a) in respect of supplies of goods and services other than those referred to in (b), (c) and (d) below, 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 for such supplies including subsidies directly linked to the price of such supplies.

19. At the material time Art 11A provided in one instance for the taxable amount to be the open market value of the relevant supply. Article 11A(1)(d) applied the open market value to certain self-supplies of services, and for this purpose the "open market value" of services was defined to mean:

> … the amount which a customer at the marketing stage at which the supply takes place would have to pay to a supplier at arm's length within the territory of the country at the time of the supply under conditions of fair competition to obtain the services in question."

The Facts

10. The Illustrative Example, together with the additional matters referred to in this paragraph provides a sufficient scenario in which to determine the issues of law which arise. The additional matters are as follows:

a. Where the consideration tendered for a replacement car includes a part-exchange car, the customer makes a single net payment covering the purchase of the replacement car and the sale of the part-exchange car. (Decision [22(2)])

b. The whole negotiation is carried out between the customer and the dealer: this negotiation will include the issue of a discount from the list price. In some cases, dealers will agree with customers a price for a part-exchange car which may be in excess of its "true" trade value of the part-exchange car and at the same time give the customer a lower discount on the new car, known as an over allowance. (Decision [22(2)])

c. For used cars, detailed guidance on price is provided by a number of publications, the most authoritative of which is Glass's Guide, but this is not available to the public. (Decision [22(3)]) Glass's Guide, on Mr Walkingshaw's own evidence, was only a guide and the trade value indications "would not provide a fully accurate valuation because it was too generic" but it would provide a "ballpark" figure or a "starting point". (Decision [23]) Glass's Guide did not, as the Guide itself explains, give part-exchange values (in contrast with trade prices) "because of the many possible variations in transactions involving a trade-in vehicle". (Decision [24])

d. Broadly speaking, the discounts achieved by customers matched their expectations. The evidence suggests that in 1990 of those who expected no discount, 84% receive no discount; and at the other end of the scale of those who expected more than 10%, 83% received more than 10%. (Decision [22(4)])

e. Those figures excluded transactions which involved a part-exchange. One dealer survey showed that more than 80% of dealers gave away about the same value to customers of replacement cars in the form of an over allowance as they would have given in a discount had the replacement car been sold for cash. (Decision [22(5)])

f. Based on one consumer survey, consumers with no part-exchange believed they received a higher discount than consumers with a part-exchange did. However, consumers may not equate a discount with an over-allowance or they may not know how large an over-allowance they are receiving. (Decision [22(6)])

g. There were a number of different values that could be applicable to the same vehicle: auction or trade value, retail value, dealer asking price and private sale. Glass's Guide provides trade and retail values. The part-exchange value, including the over allowance, would according to Mr Walkingshaw's explanation, be between trade price and dealer asking price and would broadly equate to what the customer could achieve on a

private sale (Decision [26]). The Company adopted the lowest of these, the trade value, as the "open market value". This was because it reflected the Company's accounting practice. There were many factors that came into play for a dealer in setting a trade price that it would be prepared to pay including the size and state of the dealer's business, its present stock and whether the dealer had a buyer in mind. (Decision [25])

h. The over allowance given in any particular instance reflected an amount of the available profit margin that the salesman was prepared to give away in order to achieve the sale of the replacement car. It had the same overall financial effect as the giving of a discount. The Tribunal considered that, viewed in this way, "it [the over-allowance] could be regarded in economic terms as an amount of discount hidden within the over-allowance". (Decision [27])

i. Neither a discount nor an over-allowance would be offered unilaterally by the dealer. (Decision [28])

j. A spreadsheet of part-exchange cars sold by the Company contained 50 entries. It showed that 18 cars were sold on for a price greater than that which had been allowed (including the over-allowance), in each case on a retail sale. (Decision 30]).

Subjective value and open market value

11. Before turning to the Decision and the arguments, we wish to say something about the way in which non-monetary consideration is valued in the VAT system. The matter was addressed by Lord Walker in *Lex Services* in various paragraphs of his speech. At [7], he simply stated that this non-monetary consideration "is to be quantified by finding the appropriate monetary equivalent" and referred to the guidance from the Court of Justice that this must be done by reference to its "subjective value". In an appropriate case, this means the value overtly agreed and adopted by the parties to the transaction and attributed by them to the goods

and services in question. At [17], Lord Walker referred to the *Dutch Potato Case (Staatssecretaris van Financiën v Coöperative Aardappelenbewaarplaats GA* (Case 154/80) [1981] ECR 445) setting out this principle:

> ".. such consideration is a subjective value since the basis of assessment for the provision of services is the consideration actually received and not a value assessed according to objective criteria".

12. This reflects precisely what Chadwick LJ had said in the Court of Appeal:

> The 'subjective' value must be ascertained by reference to the consideration actually received for the goods or services actually supplied. The inquiry excludes any valuation which is independent of the actual transaction; that is to say, any valuation based on criteria which are not those adopted by the parties themselves."

13. Returning to Lord Walker, he went on, in [18] of his speech, to say this (in a passage cited by the Tribunal at Decision [58]):

> "The expression 'subjective value', to be understood in the sense described above, has been repeated in many later cases before the Court of Justice, including *Argos Distributors Ltd v Customs and Excise Comrs* (Case C-288/94) [1996] STC 1359, [1997] QB 499, para 16 and the other cases cited in that paragraph. Nevertheless the expression continues to cause some difficulty, partly because it naturally suggests a value which is chosen as a matter of individual discretion, and might therefore be expected to be more vague, labile and difficult to ascertain than one determined by objective criteria. But any such impression would be mistaken and would overlook one of the basic strengths of the VAT system. It is a system which is intended to be self-policing in the sense of operating automatically on the economic activities of registered taxpayers and final consumers, with the least possible need for VAT authorities to undertake independent investigation of the facts. In a straightforward case the 'subjective value' of non-monetary consideration means the value overtly agreed and adopted by the parties to the transaction in question, just as the price overtly agreed and adopted by the parties is (in most cases) conclusive as to the quantum of monetary consideration. So far from introducing an element of vagueness or obscurity, the concept of subjective value (correctly understood) achieves legal certainty and ease of administration of the VAT system (just as a subjective apportionment of the consideration for a package of taxable goods and exempt services may achieve those results: see *C R Smith Glaziers* (*Dunfermline*) *Ltd v Customs and Excise Comr*s [2003] UKHL 7, [2003] STC -19, [2003] 1 WLR 656, especially the speech of my noble and learned friend Lord Hoffmann (at para 21)."

14. Lord Walker referred to *Hartwell plc v Customs and Excise Commissioners* [2003] STC 396, which is relied on by the Company, and which was referred to

by the Tribunal. This was another car part-exchange case. The summary of the headnote found at Decision [55] is sufficient for present purposes:

> "In *Hartwell*, H plc sold both new and used cars. Frequently its customers wished H plc to accept an existing car in part-exchange for a replacement car. It was common practice in the motor trade for a dealer to offer a part-exchange price which was higher than market value in order to make a sale. H plc attributed market value to customers' existing cars. In many cases the balance of the purchase price, or part of it, was provided through a finance company. H plc issued two types of voucher when it sold a car, one of which was called 'purchase plus', which took the form of a purchase plus discount note which the customer received. In purchases involving finance the amount of the purchase plus note was accepted by H plc as part payment of the 10% deposit against the purchase price which finance companies usually required. Where no finance was involved, the note was credited against the purchase price together with the agreed value of the car which was taken in part-exchange."

15. The tribunal had held that the amount of the purchase plus voucher was value provided by the customer for the purchase of the replacement car, in particular because that was the only result consistent with the finance company's requirement for a 10% deposit which was to be, in part, satisfied by the amount of the voucher. Patten J allowed Hartwell's appeal, holding that the purchase plus allowance was negotiated and agreed as a reduction by Hartwell in the amount which the customer would have to pay for the replacement car. The tribunal had wrongly re-written the transaction and determined the "subjective value" otherwise than in accordance with the guidance of Court of Justice. His decision was upheld by the Court of Appeal. The consideration for the replacement car comprised a money payment, the purchase plus voucher and the part-exchange car. Patten J had been correct to decide that the value of the consideration which the dealer obtained for the supply of the voucher was nil. The parties to the transaction had made it clear that the value attributed to the part-exchange car was its "true" value which, to use the words of Chadwick LJ, is its "trade or market value". This appears to have been the price which Hartwell's sales manager

estimated to be the market value using Glass's Guide or CAP: see [4] of the tribunal's decision set out at [7] of the judgment. The purpose of the purchase plus voucher was to make it clear that there was no overvaluation of the part-exchange car. Accordingly, Patten J had been correct to treat the tribunal's approach as an inadmissible re-writing of the transaction.

16. In the foregoing paragraphs, we have considered the concept of "subjective value" and how it has been applied in the two cases, *Hartwell* and *Lex Services*, which we have addressed. There is a different concept to examine, namely "open market value". The phrase "open market value" appears in both Article 11A(1) of the Sixth Directive (see Decision [18] at paragraph 9 above) and in the unamended section 10(3) and (5) VATA 1983. It may or may not have the same meanings in both provisions.

17. The open market value, as defined, is not *a priori* to be assumed to be an objective value in the sense of the price which would be paid on a wholly hypothetical supply. Whether that is the meaning to be attributed to the phrase is a matter we consider later in this decision.

18. The Court of Justice has considered the concept of "open market value" in two decisions which we mention: *Direct Cosmetics Ltd and Laughtons Photographs Ltd v Customs and Excise Commissioners* (Cases 138/86 and 139/86) [1988] STC 540 ("***Direct Cosmetics***") and *Naturally Yours Cosmetics Ltd v Customs and Excise Commissioners* (Case 230/87) [1988] STC 879 ("***NYC***).

19. The first, *Direct Cosmetics*, is addressed by the Tribunal at Decision [38] to [41]. Their discussion repays reading. As the Tribunal explained, that case concerned a direction issued under paragraph 3 Schedule 4 VATA 1983 to each of the taxpayer companies. Paragraph 3 applied where the whole or part of the business

of a taxable person consisted of making supplies to persons who were not taxable persons (and thus not VAT registered) of goods to be sold by them, or others, by retail. In such a case, the Commissioners could serve a notice on the taxable person the effect of which was that supplies of such goods would be at "open market value on a sale by retail", the definition in section 10(5) applying to ascertain the meaning of "open market value". The question, essentially, was whether paragraph 3 was capable of having been adopted as a derogating measure, where the transactions were for commercial reasons and not to obtain a tax advantage.

20. Ms Brown places reliance on passages from the opinion of the Advocate-General. At paragraph 145, the Advocate-General noted that the UK legislature

> "must have borne in mind the concept of the 'open market value' of a service, defined in the second subparagraph of art 11(a)(1) when it determined the basis of assessment in the case of services supplied by a taxable person for the purposes of his undertaking within the meaning of art 6(3)."
>
> [The second paragraph of Article 11A(1) contained the definition of "open market value" for the purposes of Article 11A(1)(d) which itself referred to Article 6(3).]

21. Equally, we think, it must have had that concept in mind when it passed section 10(5) VATA 1983 into law. Indeed, as the Advocate-General noted at [148] of his opinion, the EU definition "is comparable" to the UK definition.

22. As to the EU definition, he pointed out that "open market value" was "clearly aimed at situations in which the service, as it is supplied 'for the purposes of [the taxable person's] undertaking', does not have a contractual price". In a case where the Member State had implemented Article 6(3), the only way to determine the basis of assessment was by means of the open market value as defined. Then, at [153], he observed that whatever the meaning of "open market value" in the UK legislation actually was (a matter which it was not for him to address), its use

would be compatible with the derogating measure (*ie* paragraph 3 Schedule 4 VATA 1983) and the principles laid down by the Sixth Directive:

> "… only in so far as it does not purport to impose tax on an amount exceeding the value added along the entire length of the distribution chain as far as the final consumer."

23. And so, in the context of the case before him, the Advocate-General said this at [154] to [156] of his opinion (quoted at Decision [39]):

> "154. That means, in my view, that, if such a measure is not to be seen as excessive or disproportionate, the choice of a taxable amount different from the consideration actually paid to the taxable person by the 'retailer' to whom the goods are supplied must not be based on anything other than the real price at which the goods are sold to the final consumer, or their open market value if, and only if, it is impossible or excessively difficult to ascertain that price.
>
> 155. In the latter case, however, it must be the 'open market' or 'current' value at which the goods reach the final consumer in transactions of the same kind.
>
> 156. That means transactions concluded in the same manner and involving goods of the same kind (for instance, cosmetic products which cannot be sold by other means and not products of 'standard quality' sold through the usual commercial channels)."

24. The Advocate-General, in these paragraphs, is not describing what the UK has actually done. What he is saying is that the price paid by the retailer can be displaced as the value assessable to tax on the supply to the retailer by the "real" price at the retail stage (or by the "open market value" as defined if but only if that real price is impossible or excessively difficult to ascertain). Thus, where there is, to take by way only of example, a regular and consistent business carried on by the taxable person from which that "real price" can be ascertained, that is the amount to be taken as the value of the supply to the retailer. If such a real value is impossible or excessively difficult to ascertain, the open market value can be adopted. This is reflected in [171] and [172] of the Advocate-General's opinion. In [171] he noted that, in the case of Laughtons Photographs Ltd, the company did not know in advance the price which the schools would charge to the pupils. But

in [172] he expressed the view that if the real value could be determined, then even so there would be no justification for taking the open market value as the taxable amount.

25. There is, it can be seen and as Ms Brown emphasises, a difference between the concepts of the "real" price and the "open market value" of the goods at the marketing stage of sale to the end consumer although, on the facts of a particular case, they may be of the same amount.

26. As to the open market value, it is to be noted that this, according to the EU definition, is to be ascertained at the marketing stage at which the supply takes place. In that context, it is to be observed that the same goods can have different "open market values" depending on what marketing stage is relevant. For instance, the amount which a wholesaler pays a manufacturer for goods will be less than the amount which the retailer pays the wholesaler which in turn will be less than the end price paid by the consumer. Each stage will give rise to a different "open market value". In *Direct Cosmetics*, the focus was on the "open market value" ascertained at the final marketing stage of supply to the final customer.

27. Before leaving the Advocate-General's opinion, it is apparent from [156] that the open market value at the relevant stage is, in his view, to be ascertained by reference to comparable transactions. In particular the comparable transactions must be ones "concluded in the same manner" as the taxable transactions under consideration. Whether a sale of a replacement car in a transaction involving part-exchange is one which he would view as "concluded in the same manner" as a sale without any part-exchange and perhaps at a discount is a matter we will address later.

28. The Court of Justice dealt with the matter quite briefly. It took a rather different approach from the Advocate-General, although nothing which it said is inconsistent with his analysis. We need only refer to Judgment [53]:

> "…the open market value for the purposes of the system established by the derogating measure in question must be understood as meaning the value that is closest to the commercial value on a sale by retail, that is to say the actual price paid by the final consumer. That interpretation finds support by art 11(A)(1)(d) of the Sixth Directive, which refers to the open market value of the services supplied, and by art (11)(B)(1)(b), which refers to the open market value, in connection with the importation of goods, where no price is paid or where the price paid or to be paid is not the sole consideration for the imported goods. Accordingly, the concept of open market value is neither vague nor imprecise."

29. It will be remembered that the derogation in question (paragraph 3 Schedule 4 VATA 1983) referred to "the open market value on a sale by retail", for which purpose the definition of the open market value in section 10(5) VATA 1983 must be applied. In [53] of its judgment, what the Court of Justice was saying, among other things, was that the concept of open market value in the derogating measure and thus also the concept of open market value in section 10(5) VATA 1983 had to be interpreted against the background of its EU meaning. That meaning, by reference to the use of the concept in the two Articles referred to in [53] of the judgment, was to be found in the express definitions in Articles 11A(1) and B(1).

30. It is clear from [52] of the judgment, however, that the derogation permitted by Article 27 (which was the relevant EU provision authorising paragraph 3 Schedule 4) was permitted only so far as strictly necessary for preventing evasion or avoidance. It does not appear to us that the Court of Justice was intending to make a finding that the UK legislation was strictly necessary; that would be a matter for the national court. What it was doing in [53] of its judgment was to provide an answer to the suggestion that the concept of open market value adopted in the UK legislation was so vague as to be incapable of constituting a precise

base and was therefore capable of being applied in an arbitrary manner. It was, in effect, saying that the EU concept of open market value was to be applied in the interpretation of the UK legislation so as to reach a conformable result. It was, in essence, anticipating in a special case the more general approach to construction laid down in *Marleasing SA* Case C-106/89 ("***Marleasing***"). In the context of the two cases before it, the Court identified the open market value as "the value that is closest to the commercial value on a sale by retail, that is to say the actual price paid by the final consumer".

31. The second case, *NYC*, is addressed by the Tribunal at Decision [42] to [47]. Taking the summary of facts and decision from Decision [42] and [43]:

> "42. In [*NYC*], the taxpayer company made wholesale sales of beauty products to beauty consultants for resale by them at private parties. The parties were organised by others (hostesses). As a reward for organising a party, the beauty consultant would give the hostess a pot of cream as a "dating gift". The pot of cream was supplied by the taxpayer to the beauty consultant for a price below its normal wholesale price. The Commissioners, relying on s 10(3) VATA 1983 [that is to say in its unamended form], assessed VAT on the normal wholesale price. The case was referred to the ECJ for a preliminary ruling on what constituted the taxable amount in those circumstances.
>
> 43. The ECJ held that the taxable amount was the sum of the monetary consideration and the value of the service provided by the beauty consultant in procuring the hostess's services. The value of that service had to be regarded as being equal to the difference between the price actually paid for that product and its normal wholesale price."

32. We draw attention to [49] to [52] of the Opinion of the Advocate-General in order to put in context the important discussion at [53] to [59]. The Advocate-General noted:

    a. NYC and the beauty consultants, as contracting parties, reduced the wholesale price of the goods delivered (the pot of cream) in return for the provision of a service consisting in the organisation of a party; (see [49])

b. The fact that the price is reduced only if the party actually takes place, at which point the pot is given to the hostess of the party, shows that the parties (NYC and the beauty consultant)

> "subjectively assigned to the service provided a value corresponding to the price reduction. Since the portion of the price of the goods which was not paid initially must be paid subsequently, if the party is not in fact held, it is clear that, as regards that portion, the goods are paid for either by provision of the service or by a specific sum of money in lieu of that service." (see [50])

c. Accordingly, the Advocated-General considered it legitimate to apply tax to that value (see [51]). That value is the sum of the initial sum paid plus the price reduction. And so, (see [52]), where the transaction is an exchange, the value of what is supplied by one party represented, in the final analysis, the consideration for what is supplied by the other.

33. In the light of that analysis, the Advocate-General regarded the application of the concept of open market value to the case as misconceived: see [53] and [54] of his Opinion. That concept was to be contrasted with the aim of the valuation exercise which was "to determine the value actually assigned by the parties to the consideration so that tax can be assessed on it": see [55]. He noted that the calculation of that value, in that case, involved a reference to the wholesale price normally charged (see [56]). But, in the rather opaque language found in [57], he considered that HMRC were seeking to apply section 10(3) in a way which did not involve reliance on open market value in the strict sense for the purpose of evaluating the consideration, that is to say in the sense of "a fictitious concept dissociated from the terms of the transaction in question and from the synallagmatic relationship established between the two parties to the contract". Used in that sense, open market value would fall to be established using wholly objective criteria. But for reasons which we will come to, we do not consider that

section 10(3) VATA 1983 requires the transaction in which the supply takes place or the relationship thereby established between the parties to be ignored.

34. On the facts of that case, it was possible (see [58]) to discover what value the parties to the contract attributed to the service which formed part of the consideration. Importantly,

> "That value is calculated, indirectly, by reference to the normal wholesale prices of the product; there too, however, it is not a question of an abstract value but rather of a specific price, applied by the same contracting parties in 'normal' transactions, and moreover that price will be charged for the goods in question if the promised service is not provided."

35. At [60], the Advocate-General noted that in certain circumstances use of open market value will be the only effective way of calculating the value of consideration to prevent fiscal distortions or the avoidance of tax "which would necessarily occur if the part of the consideration not represented by the transfer of a given sum of money had to be disregarded" . He went on, at [61] to say that

> "….it would not be appropriate to accord different tax treatment to two contracts for the sale of a particular product under which payment is made partly in money and partly in the form of goods or services merely because, in one of the contracts, the parties fixed the value of the items supplied or the services provided in exchange and, in the other, did not do so. Only reference to … open market value can avoid the distortion which would derive from different treatment being accorded to transactions which were virtually identical from an economic point of view."

36. The Advocate-General was not saying here that the <u>amount</u> of the value of the supply would be identical in each case. In the first case, the "real" value of the supply could easily be ascertained. But in the second case, where the parties had not placed a value on the part-exchange goods, the real value could not be ascertained and it was appropriate to adopt the open market value rather than leave the value of those goods out of account altogether. Thus we agree with how the Tribunal understood what the Advocate-General was saying in the first part of [45] of the Decision:

> "In saying this, the Advocate-General was drawing the same line he had drawn in *Direct Cosmetics* between those cases where it is possible, or not excessively difficult, to identify the price at which goods are sold, and those where it is not. The use of "open market value" in the strict sense is confined to the latter. The Advocate-General emphasised that the concept of open market value, (or normal value in the Romance language versions of the texts), had its place, giving (at [61]) as an example a case where in two contracts for the sale of a particular product payment is made partly in money and partly in the form of goods or services."

But we do not agree with what followed:

> "The value of the supply could not differ between those two cases merely on the basis that in one the parties fixed the value of the goods or services provided, and in the other they did not. The use of open market value could avoid the distortion that would derive from different treatment being accorded to transactions that are virtually identical from the economic point of view."

It was the treatment of each case which had to be the same, that is to say a treatment which brought into account the value of the part-exchange goods. The Advocate-General was not saying that open market value had to be adopted even in the first case.

37. In [68] to [71] (set out in Decision [46]), the Advocate-General had more to say about open market value, reiterating the approach he had taken in *Direct Cosmetics*. We do not need to repeat those paragraphs, noting only [70] where he emphasised, quoting *Direct Cosmetics*, that "the open market value for the purposes of the system established by the derogating measure in question must be understood as meaning the value that is closest to the commercial value on a sale by retail, that is to say the actual price paid by the final customer". He considered (see [71]) that, on the facts of *NYC*,

> "…an approximation of that kind is possible in so far as a value can be accurately (although indirectly) attributed, within the relationship between the parties, to the service provided as consideration for the goods supplied, without its even being necessary, contrary to what might be suggested by the terms of the domestic provision (and particularly by the normal translation thereof into the various Romance languages) pursuant to which the

commissioners took their decision, to refer to the concept of normal value or open market value."

38. By "an approximation of that kind", he meant, we think, the value that is closest to the commercial value. And so it was possible to reach an attribution of value to the supply by Naturally Yours Cosmetics Ltd to the beauty consultant without the need to invoke open market value at all.

39. As to the UK provision, he declined, as he had declined in *Direct Cosmetics* and as is customary, to interpret it. The compatibility of section 10(3) with EU law was not in issue.

40. The Court of Justice dealt with the matter in a short judgment. At [16], referring to the *Dutch Potato* case, it stated first, that the consideration must be capable of being expressed in monetary terms and, secondly, that it is a subjective value, since the basis of assessment is the consideration actually received and not a value estimated according to objective criteria. Then, at [17], it put the matter this way:

> "…the parties to the contract have reduced the wholesale price of the pot of cream by a specific amount in exchange for the supply of a service by the beauty consultant which consists in procuring hostesses to arrange sales parties by offering them the pots of cream as gifts. In those circumstances, it is possible to ascertain the monetary value which the two parties to the contract attributed to that service; that value must be considered to be the difference between the price actually paid and the normal wholesale price."

41. The Court said nothing to illuminate the concept of open market value.

42. On the facts of *Direct Cosmetics*, the goods supplied by Direct Cosmetics Ltd were supplied to the end customer at the company's catalogue price, with the unregistered agent earning his remuneration by the 20% discount given to him by the company if he paid within 14 days. There was, therefore, a clearly established retail price for transactions of the nature involved, namely the catalogue price at which the goods were actually sold. The goods supplied by Laughtons Photographs Ltd to the schools concerned were sold on by the schools to the

parents of children. The company did not know the price at which the school made such sales. We do not know, and the Court of Justice did not know, whether different schools had different charging rates for similar products or, indeed, whether the same package within a school was available to all parents at the same price. Nonetheless, the Court felt able to identify the open market value in the way which it did.

43. As the Advocate-General said at [155] and [156] of his opinion, the open market value is the value at which the goods reach the final consumer in transactions of the same kind, meaning transactions concluded in the same manner and involving goods of the same kind. We consider that, consistently with this approach, it is appropriate to take account of the particular market in which the supply actually takes place. Thus suppose that Direct Cosmetics Ltd had, for commercial reasons, adopted different catalogues for different outlets (hospitals, factories and offices) with different prices for the same product; suppose that the catalogue price for product A was £X in a hospital but £Y in an office. Or suppose that Laughtons Photographs Ltd supplied similar packages (obviously not identical because the pictures would be of different children) to School 1 and School 2 for £Z in each case but suppose that, to the knowledge of the company, School 1 applied a mark-up of 10% on sales to parents and School 2 applied a mark-up of 15%. The sales of the product and the sales of the similar photographic packages at different prices are all sales in the retail market between persons at arm's length and are all at a commercial value; there is no unique or correct retail commercial sale price.

44. What, then, is the open market value (in accordance with EU law) of the various supplies? In our view, it is appropriate to answer that question by applying the approach of the Court in the context of each market. It is not appropriate to ask

the question entirely divorced from the market in which the transaction takes place and thus treat open market value as the fictitious concept to which the Advocate-General referred. Thus the open market value of product A in relation to a supply made in a hospital would be £X but in relation to a supply make in an office would be £Y. Similarly, the open market value of the supply of the photographic package to School 1 would be £1.1xZ but to School 2 would be £1.15xZ. In each case, there is a uniform price in the relevant market (*ie* the outlet in the case of the cosmetics or the School in the case of the photographs) and in each case that price is the value which is closest to the commercial value on a sale by retail of the product or package in that market. The price which a customer in that market "would have to pay to a supplier at arm's length within the territory of the country at the time of the supply under conditions of fair competition to obtain the services in question" is precisely the commercial price which has to be paid in the market in question. The subjective value as between the end consumer and his or her supplier and the open market value in retail sale are the same but this is not simply a coincidence: rather, it is because the subjective value on the facts precisely reflects the concept of open market value in that market.

45. In contrast, if there is no readily available information about the price paid at the retail marketing stage (for instance, if the supplier does not know and cannot ascertain the onward sales policy of its customer), the open market value will have to be ascertained in some other way. It is true that the Advocate-General at [172] of his opinion in *Direct Cosmetics* appears to consider that it might, even in such a situation, be possible to ascertain the "real" value of the supply; nonetheless, he does acknowledge that where this cannot be done, open market value must be adopted. Where the supplier does not know (and cannot discover) in advance

what the actual price paid by the final consumer will be, it will nonetheless have to charge VAT to its customer and will therefore need to adopt a yardstick for the value that is closest to the commercial value on a sale by retail. It might have to adopt, in the absence of any alternative, the price at which it would itself supply a similar package direct to an end consumer. This will be a matter of evidence.

46. Similarly, if the end sale price depended on what the agent was able to negotiate with the end customer (for instance in the case of cosmetics, in the hospitals, factories and offices), it might be necessary to carry out some sort of sampling to ascertain an average or median price or to adopt some other yardstick.

47. Consideration of cases of the type considered in the preceding two paragraphs does not, in our view, detract from the approach which ought to be applied where there is a unique end price which relates to the goods actually supplied at the earlier stage and does not cause us to reject the conclusion reached in paragraph 44 above. An interpretation of open market value which allowed for the adoption of the fictitious concept described by the Advocate-General could result in supplies giving rise to a taxable amount in excess of the taxable amount on the "real" price and thus result in tax on an amount exceeding the value added along the entire length of the distribution chain. If "open market value" can be read in a way which prevents that result, it should be read in that way. We consider that it can be and that, indeed, this is precisely what the judgment of the Court of Justice in *Direct Cosmetics* requires.

Commission v Ireland

48. We have been referred, as was the Tribunal, to *Commission v Ireland* Case C-17/84 [1985] ECR 2375. This case concerned the validity of an aspect of the Irish system in relation to part-exchange transactions. The Irish provision in question

provided that, in computing the amount on which VAT was chargeable in respect of goods sold, a deduction could be made for the value of second-hand goods accepted in part-exchange. The Commission challenged the Irish provisions. It maintained that the value of the second-hand goods accepted in exchange formed part of the consideration for the new goods and therefore formed part of the taxable amount. It maintained that the Irish provision could not be regarded as a special system which Member States were entitled to retain under Article 32 of the Sixth Directive until the introduction of a harmonised system. It argued that Article 32 referred to special systems for second-hand goods and certainly did not permit a derogation from the rule relating to the taxable amount of new goods.

49. At [9] of the Judgment, the Court recorded Ireland's concession that the Irish system gave rise to a loss of revenue to the Exchequer, as compared with other systems proposed by the Commission, when the second-hand good were resold at a price lower than the trade-in price. However, according to Ireland, that was to be equated with a discount originally given by the taxable person and authorised by Article 11(3)(b) of the Sixth Directive. The Court analysed, at [10] to [18], the difficulties encountered in relation to the sale or part-exchange of second-hand goods, describing the Commission's two proposals and explaining how the residual element was taken account of under the Irish system. At [18], the Court stated that it was immaterial that the compensation directly benefited the purchaser of the new goods whereas the Commission's two proposed schemes directly benefited the non-taxable purchaser of the second-hand goods on re-sale. Worked examples provided to the Court showed that

> "… the prices agreed between the parties to the two transactions involving such goods tend to be adjusted according to the systems applied so as to lead generally to the same result both for the three parties to the transactions and for the Exchequer..."

although there was a timing difference. But all three systems examined "re-established neutrality of competition between direct sale from one consumer to another and transactions through commercial channels".

50. The Court concluded at [19] that

> "…. the object and effect of the Irish system is to offset the residual part of the VAT already borne by the second-hand goods traded in, so that on resale those goods may be subject to the general system of VAT. It follows that the Irish system is in principle covered, both as regards is object and its effects, by Article 32 of the Sixth Directive and that it does not infringe Article 11 of the directive."

51. The fact that the Irish system results in a loss of revenue where the resale price is lower than the trade-in price was not a decisive factor. Thus (see [21]):

> "By providing that supplies effected by a taxable person are subject to tax and that the tax paid by him at an earlier stage may be deducted, the general rules set out in the directives also reduce the revenue paid to the Exchequer when new goods are sold at a loss. The Irish provisions concerning the trade-in of second-hand goods therefore do not infringe the general rules contained in the Community directives in that respect either."

52. What the Court was recognising here was that allowing the full deduction on the taxable value of the new goods (*ie* the replacement car) would result in effect in a reduction in the VAT equal to the residual VAT in the second-hand goods (*ie* the car being traded-in). If the second-hand car were subsequently sold at a loss, this would represent over-compensation. But in that respect, the position was no different from a sale of new goods by a trader at a loss applying the general rules set out in the directives. This contrasts with the margin scheme eventually introduced under which no allowance is obtained for residual VAT when a second-hand car is sold by the dealer at a loss. The Tribunal dealt with this paragraph of the judgment at Decision [53]:

> "The reasoning of the Court in this regard is concentrated on the equation of the Irish system of allowing a full deduction on the taxable value of the replacement car, which over-compensated for the VAT inherent in the price of the second-hand vehicle if that vehicle was sold at a loss, with the general rules for deduction of input tax attributable to the acquisition of goods then resold at a loss. We see nothing in that reasoning to support Ms Brown's submission that the Court had equated a loss on the sale of the second-hand vehicle to a discount on the price of the replacement car. Indeed, it is apparent from what the Court said at para 18 that economic equivalence was something that would be provided through price adjustments made by the parties, adjusted according to the system adopted. If, therefore, a price was to be discounted, that would be by virtue of the agreement of the parties."

53. The Company's Grounds of Appeal criticise that paragraph. Those Grounds suggest that Decision [53] was interpreting *Ireland* as a decision that the adjustment effected under the Irish system was akin to imputed or deemed input tax. It is said that this ignores the fact that the Commission's challenge to that scheme represented a derogation from the general valuation provisions: the judgment (see [7] and [9]) makes clear that the Irish government was asserting that there was no derogation as the adjustments to the taxable amount of the replacement car was that it represented a legitimate adjustment because of the inseparability of the part-exchange and the replacement cars. Ms Brown submits on the basis of that consideration that the Court recognised that an over-allowance is to be equated with a discount from the price of (and therefore the taxable amount in relation to) the replacement car.

54. In her oral submissions, Mr Brown explained how *Ireland* would have applied to the Illustrative Example and used the explanation to support her contention that the over-allowance is to be equated with a discount. We do not find reference to the Illustrative Example helpful. In a scenario where the *Irish* system is assumed to apply, the figures might look very different. As the Court pointed out in [18]

(in a passage relied on by the Tribunal themselves), prices agreed tend to be adjusted according to the system applied.

55. We reject Ms Brown's submission that the Court recognised that an over-allowance is to be equated with a discount. We agree with Decision [53]. The Tribunal correctly appreciated that the Court was focusing on a rather broader question than an over-allowance. It was concerned with any case where the re-sale price might be less than the acquisition consideration, something that could occur as much in the case of new goods as in the case of second-hand goods. As Mr Puzey put it, the Court was focusing on the question whether the Irish system of disregarding the value of second-hand goods taken in part-exchange wrongly exempted from VAT that part of the consideration obtained by the taxable person who is wishing to resell for the supply of new goods. The Court held that the object and effect of the Irish system was to take account of that part of the VAT already borne by second-hand goods which are traded in so that when resold they may be subject to the general system of VAT. We do not consider that *Ireland* assists in the resolution of the current dispute.

Construction of the UK legislation

56. In construing section 10(5) VAT A1983 we must take account of what the Court of Justice said in *Direct Cosmetics*, bearing in mind what we have already said at paragraph 47 above. Further, the *Marleasing* principle must be applied. The legislation is to be construed, so far as possible, so as to effect a valid implementation of the terms of a Directive which it is intended to implement. If a conforming construction is not possible, then a Member State cannot rely on the direct effect of the Directive. In contrast, an individual is able to assert the direct

effect. But he does not have to do so: he can rely on the national legislation if that would put him in a better position than enforcement of his rights under EU law.

57. There are limits, as Ms Brown points out, on the application of that principle. She has referred us to *Wilkinson v Fitzgerald* [2012] EWHC Civ 116 paragraphs 47 to 50, and generally to the decision of the Court of Justice in *Marshall v Southampton and South West Hampshire AHA* [1986] 2 All ER 584 and *Hans Markus Kofoed v Skatteministriet* C321/05 [2007] ECR I-5818. We accept that there is a clear line between, as she puts it, a situation of conforming interpretation and a situation where there has been ineffective implementation which cannot be remedied without legislative change. She submits that the present case is the wrong side of the line so that section 10(5) is to be given its ordinary meaning construed as a UK statute. It is not possible, as a matter of interpretation, to read that provision in a way which is compliant with the Sixth Directive. She submits that the UK legislation was patently deficient and that the Tribunal has effectively permitted HMRC to rely on the direct effect of Article 11A. We bear these submissions in mind when addressing the issue of construction.

58. Ms Brown's case depends on equating the open market value with the amount of an equivalent cash transaction. In essence, the cash price for the replacement car would be a discounted price which would represent its open market value. The amount of the discount would, in any particular case, broadly reflect the amount of the over-allowance given to the customer in the relevant transaction. Under both EU law and UK law, the appropriate comparator, as a matter of the meaning of the legislation, is the cash transaction. Although the definitions of open market value in the Sixth Directive and in section 10(5) are not identical, the language

used is, she says, strikingly similar. Thus, under the Sixth Directive, Article 11A(1) provided that open market value was the amount which a customer would have to **pay** (indicating, as she says, a monetary equivalent) to a supplier **at arm's length**; and under sections 10(2) and (5), the open market value of a supply was its value under subsection (2) if the supply were for a consideration in **money** which would be **payable** by a person standing in no such relationship with any person as would affect that consideration.

59. We do not disagree with her. Further, in our view we should, applying the *Marleasing* principle, interpret the definition in section 10(5) conformably with the meaning given for the purposes of EU law insofar as it is possible to do so. We point out, in this context, that section 10(5) contained a definition which was used not only for the purposes of section 10(3) but also for the purposes of other provisions, in particular paragraph 3 Schedule 4. It was in the context of those provisions (what the Court of Justice referred to as "the open market value, which has been adopted as the taxable basis under the system established by the derogating measure") that the Court of Justice said what it did in [53] of its judgment in *Direct Cosmetics*. It is in that context that the definition has to be interpreted, and in accordance with the approach which we have considered in paragraph 47 above *ie* so as to prevent a taxable amount in excess of the value added along the entire length of the distribution chain.

60. Paragraph 3 Schedule 4 must, if possible, be read conformably with Article 27 and with what the Court of Justice said in [53] of its judgment in *Direct Cosmetics*. Paragraph 3 refers to the "open market value on a sale by retail", thus incorporating the definition in section 10(5). Accordingly, we are of the view

that, if possible, section 10(5) should also be interpreted in a way which permits "the open market value on a sale by retail" in paragraph 4 to capture "the value that is closest to the commercial value on a sale by retail" which, on the facts of that case, was the actual price paid by the final consumer". This can be done only if "the consideration in money" referred to in section 10(5) equates to the commercial value on a sale by retail. We see no difficulty at all in interpreting section 10(5) in that way. Indeed, we think that there is really no difference between the EU and UK definitions once the relevant marketing stage has been identified. Thus, in applying the definition in section 10(5) to paragraph 3 Schedule 4, the relevant marketing stage is the retail sale since that paragraph refers expressly to "the open market value on a sale by retail".

61. As we have already pointed out, the same goods can have a different open market value for the purposes of EU law depending on different markets. The Sixth Directive recognises this, providing expressly for the open market value to be assessed at the marketing stage at which the supply takes place. We consider that section 10(5) VATA 1983 should be construed conformably with that. The section defines open market value in relation to a supply and provides that the value of that supply is to be taken to be the amount which falls to be taken as its amount if the supply were, in effect, at arms' length. It is appropriate, we consider, to assess that amount by reference to the market in which that supply takes place. There will thus be different open market values for the same goods at the wholesale and retail stages. Further, as our discussion of the example of product A discussed at paragraphs 43 and 44 above demonstrates, there can be different open market values in relation to the same product sold at the same marketing stage (retail) in different retail outlets.

62. Just as the open market value on a sale by retail is the value which is the closest to the commercial value on a sale by retail, we think that the open market value in relation to any other transaction (*eg* a wholesale transaction) is the value which is closest to the commercial value on a sale in the market relevant to that transaction. In other words, it is necessary to identify the relevant market and the kind of transaction concerned when it comes to identifying the open market value as defined by section 10(5). We arrive at that result as a matter of construction of the UK legislation without reference to the Sixth Directive. But if that is wrong, that must be the result applying the *Marleasing* principle. In our view, there is no material difference between the EU meaning of open market value and its meaning in sections 10(3) and (5) VATA 1983.

63. In the light of what the Advocate-General said in [154] and [155] of his opinion in *Direct Cosmetics*, the question arises whether account has to be taken of the transaction in which the supply actually took place or whether a wholly cash transaction is to be assumed. The Tribunal dealt with this at [71] *ff* of the Decision in addressing Ms Brown's case (which she maintains before us) to the effect that section 10(5) requires a wholly cash transaction to be assumed.

64. The Tribunal rejected Ms Brown's argument. They considered that the reference in section 10(5) to a consideration in money did no more than reflect the terms of section 10(2). Those words could not operate to deem the transaction to be something different from the actual transaction of part-exchange. They rejected Ms Brown's submission that what section 10(5) was looking to identify was the value in money of the replacement car if there had been no part-exchange; and they also rejected her submission that the reference to consideration in money

required the part-exchange car to be valued at its cash realisable value (and thus on the Company's argument, is "true value" by which was meant its trade price). And so they concluded that the value of the replacement car should not be determined by reference to an equivalent cash transaction but by reference to the actual transaction expressed in terms of a monetary value. As they put it:

> "The reference in section 10(5) to a consideration in money provided no scope for re-analysing the transaction as though it had been a cash sale, with no part-exchange, and then on that basis applying a discount said to be applicable if the transaction had been wholly for cash."

65. Ms Brown addressed the meaning of the phrase "a person standing in no such relationship with any person as would affect that consideration". She took the Tribunal to a number of provisions in the legislation where there was a requirement to apply open market value. In each case, there was a relationship which fell to be ignored in determining that value. She argued that the types of relationship which fell to be ignored covered a wide compass and that section 10(5) therefore had to be construed broadly. In support of her argument that section 10(5) was focused on a purely cash transaction, she contended that the relationship between the customer and the dealer in the context of a part-exchange was a relationship which would affect the consideration in money.

66. The Tribunal rejected that submission, saying this in [78] and [79] of the Decision:

> "78. The only assumption that needs to be made is that the parties do not have a relationship that of itself affects the consideration for the supply. The purpose is not to eliminate the circumstances in which the open market value falls to be ascertained. Where those circumstances do amount to a relationship that would affect the consideration, then that relationship will be ignored. But where it does not, then the only requirement is to assume that the parties to the transaction will have no such relationship. We agree with Mr Puzey, and reject Ms Brown's submission in this respect, that to construe "relationship" so as to include anything which affects the commercial bargain struck between

the parties would be to go far beyond the meaning that term can properly bear in this context.

79. It is only if it is the very relationship that affects the price that it will fall to be disregarded. Otherwise the transaction itself must be respected. We do not consider that the fact that a customer wishes to provide part of the consideration for a replacement car by means of a part-exchange can amount to a relationship that itself affects the price of the replacement car. It is not the relationship that affects the consideration, but the application by the dealer of an over-allowance in preference to a discount. That was the commercial pricing choice made by the Appellant. It was a choice open to him in an open market transaction of part-exchange. In our view s 10(5) does not operate to alter the effects of that choice."

67. Leaving aside the final sentence of [79], we agree with those paragraphs. We have set them out in full because we do not think we can provide a better explanation of the provision. We only add that in all of the cases to which Ms Brown referred where the legislation effectively requires a relationship to be ignored, the relationship exists immediately before the transaction is entered into. In none of those cases does the transaction itself give rise to the relationship. In contrast, there is no pre-existing relationship between the dealer and the customer which might affect the consideration in money which the customer would pay for the car in the context of the part-exchange transaction which is about to take place. Accordingly, we do not accept Ms Brown's argument that the "relationship" wording lends supports to the view that section 10(5) is concerned with a solely cash transaction.

68. We also agree with the final sentence of [79] but need to say more about why we do so. Given our rejection of the "fictitious concept dissociated from the terms of the transaction in question and from the synallagmatic relationship established between the two parties to the contract" as the concept by which to assess open market value, and given our conclusion that open market value is to be assessed in the context of the actual transaction in question, the question comes down to this:

What is the consideration in money which would be payable by a customer for the replacement car in the context of a part-exchange of the part-exchange car?

69. Just as there is no unique or correct retail commercial sale price (see paragraph 43 above), so too there is no unique or correct consideration in money which would be payable by a customer in the context of a part-exchange. Even if the part-exchange car did have a unique and correct value which the parties used for the purpose of the transaction, the actual cash consideration payable in addition would reflect the parties' negotiating positions as well, of course, as other factors relating to the market. However, the part-exchange car does not, of course, have a unique or correct value. As explained in paragraph 10g above, different values can be attributed to the part-exchange car including auction or trade value, retail value, dealer asking price and private sale price. The price which a customer and the dealer are prepared to agree for the replacement car will depend on what price is agreed for the part-exchange car. If the customer and dealer agree a price of £X for the part-exchange car and a balancing cash amount of £Y, the cash amount attributed to the replacement car is £(X+Y). In the context of the question identified at the end of the immediately preceding paragraph above the amount which the customer would pay in money for the replacement car, in the context of a part-exchange transaction where the value attributed to the part-exchange car in £X, is £(X+Y). Accordingly, the open market value is £(X+Y).

70. Ms Brown says that this result is simply to apply a subjective value when what is required is the open market value. However, once one moves away from a purely objective assessment of value (*ie* the fictitious concept described by the Advocate-General) there is no reason why the open market value and the subjective value should not be the same, not simply as a matter of valuation but as a result of the

correct approach. The application of the subjective value precisely achieves what the definition of open market value and the EU case law requires, namely, the value nearest to the commercial value on a sale by retail in the context of the part-exchange transaction concerned.

71. We can see the argument, although we have rejected it, that a wholly objective approach should be taken to section 10(5). But if that were so, there would be significant difficulties in ascertaining the open market value. To illustrate that, let us return to the example at paragraphs 43 and 44 above. What is the open market value of product A? There is no reason to take £X rather than £Y or £Z since, on this wide, objective, interpretation of open market value, one must survey the whole market in which the consumer might acquire the product. We do not propose to suggest answers to the correct way in which to establish the open market value which is to be applied uniformly across factories, hospitals and offices; we comment only that whatever methodology is adopted, it will move away from the obvious and simple solution which a more flexible interpretation of section 10(5) allows.

72. In the context of a part-exchange transaction, a wholly objective approach would take no account of the value of the second-hand car at all. The wholly objective approach requires one only to ascertain the cash consideration which would be payable in an arms' length transaction. But just as the value of the part-exchange car does not feature, so too, it seems to us, the open market value of the replacement car would have to reflect some objectively ascertained discount. If the dealer sells identical cars for cash, they each have the same open market value. But if the dealer sells the cars at different prices because the different customers

had different negotiation skills, the actual discount achieved cannot, in both cases, be the correct discount to apply in ascertaining open market value.

73. In the context of a part-exchange, the over-allowance, like an actual discount on a cash sale, varies from sale to sale. Thus the over-allowance in any particular case may not reflect, on the objective approach, an appropriate deduction from the cash price agreed in arriving at market value. The over-allowance cannot, in any particular actual transaction, lead to the objective open market value any more than the discount on any particular cash sale leads to that value. The Company itself does not appear to argue for a unique value of this sort. Rather, its case is that value of the supply of the replacement car is the agreed price for the replacement car less the over-allowance which is said to be a hidden discount. It accordingly looks to the actual transaction in question and identifies the open market value by reference to the agreed cash price less the over-allowance.

74. In taking that approach, the Company, it seems to us, is acknowledging that the terms of the actual transaction are relevant to establishing the open market value and to that extent the strict approach is tempered by a subjective element.

75. Matters, however, go further than that. The Company's approach is to assess the over-allowance by reference to the trade price. In doing so, the Company is again moving even further away from a strictly objective approach to market value. It is one thing to treat an over-allowance as a discount and to treat the notional discount as an appropriate deduction from the cash price in arriving at open market value. It is quite another thing to determine the amount of that over-allowance/notional discount by the unilateral selection of trade value as the starting point for its determination. The Company is, in our view, adopting a

subjective approach to the ascertainment of the open market value which is inconsistent with the objective approach. It does not even give a reliable guide to the appropriate notional discount which might apply when assessing the open market value by reference to a fictitious cash transaction. We agree with the Tribunal (themselves agreeing with Mr Puzey), at Decision [86], that the Company's process "is no less subjective than a negotiated agreement between buyer and seller, and that arguably it is more so because it is entirely one-sided, taking account only of the Appellant's view, and is thus further removed from an open market valuation".

76. Rather than attempt to apply the open market value in a cash transaction in the context of a part-exchange, we consider that the legislation requires the open market value as defined to be ascertained in the context of the actual part-exchange transaction concerned. Once it is appreciated that section 10(5) falls to be construed in accordance with the Sixth Directive and the case law of the Court of Justice, it can be seen that the notion that an English lawyer might ordinarily hold about the meaning of open market value is inapposite. Applying the words of the definition to the actual transaction, the amount in money which a person would pay for the replacement car is, it seems to us, the price which was actually agreed with the dealer by the actual customer. Under the actual contract, the second-hand car is sold for an agreed price and the replacement car is also sold for an agreed price. In the Illustrative Example, Mrs Smith negotiated £2,300 as the price of the Marina which she considered was worth £2,500; the Princess was sold at its list price of £4,480. In the context of a part-exchange transaction where the part-exchange car is sold for an agreed sum, the money consideration which the customer is prepared to pay for the replacement car and the consideration which

the dealer is prepared to pay for the part-exchange care reflect each other. The money consideration payable by the customer is the same money consideration as would be payable by any arms' length purchaser in the context of a part-exchange transaction which attributed the agreed price to the second-hand car.

77. We accordingly agree with what the Tribunal said at [84] of the Decision:

> "There is no scope, in our view, for arguing that the value of the replacement car is anything other than the price agreed by the parties. We do not accept the argument of Ms Brown, based on *NYC*, that the discounted price applicable to a cash sale can be taken as the benchmark for valuing the part-exchange car. Not only is the discount, on the facts, not universally applicable, the part-exchange car itself has an agreed price, and is not in the nature of services as in *NYC*, to which there was no monetary value ascribed."

78. Ms Brown also relied on the opinion of Lord Millett in *Lex Services* where he said this (in a passage quoted more fully by the Tribunal at [65] of the Decision):

> "4……..I have found it difficult to accept that a sum of money which is not available to the seller of a second hand vehicle except by way of an allowance against the price of a new vehicle is an unequivocal attribution of value to the second hand vehicle. In so far as the sum exceeds that which would be paid for the second hand vehicle free from any obligation apply it towards the purchase of the new, it seems to me to have all the characteristics of a hidden discount.
>
> 5. But the question is one of fact, and your Lordships take a different view. In those circumstances, though with some misgiving, I too would dismiss the appeal."

79. Like the Tribunal (see Decision [85]) we do not consider that this alters the conclusions which we have reached. The Tribunal have found as a fact that the over-allowance was part of the agreed price for the part-exchange car and that the price for the replacement car was agreed without any discount. There is no scope, as the Tribunal said, for treating the value of the replacement car as having been discounted. Further, once it is accepted that the open market value must be assessed in the context of the actual transaction concerned, the question is what amount in money a person at arms' length would pay for the replacement car in

the context of a part-exchange transaction which had attributed an agreed price to the part-exchange car. The consideration depends on the amount of that agreed price and it is immaterial whether or not it includes an over-allowance.

Decision

80. For the reasons given above, we dismiss the Company's appeal from the decision of the Tribunal.

Mr Justice Warren **Greg Sinfield**

Chamber President **Upper Tribunal Judge**

Release Date: 18 March 2015