[2015] UKUT 0122 (TCC)
Appeal number: FTC/26/2014

VAT – whether section 80 of the Value Added Tax Act 1994 prevents HMRC from entering into a binding compromise agreement for the repayment of money paid by way of VAT – whether any such agreement was ultra vires and so void – whether such an agreement was concluded on the facts

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and -

SOUTHERN CROSS EMPLOYMENT AGENCY LIMITED

Respondent

TRIBUNAL: MR JUSTICE NEWEY

Sitting in public in London on 3 and 4 February 2015

Miss Jessica Simor QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Mr Peter Mantle, instructed by Crowe Clark Whitehill LLP, for the Respondent

DECISION

Introduction

1. In 2010, HM Revenue and Customs ("HMRC") made a payment of nearly £1.4 million to the respondent, Southern Cross Employment Agency Limited ("Southern Cross"). In the previous year, Southern Cross had submitted a claim to recover VAT for which it had in the past accounted to HM Customs and Excise (to whom I shall also refer as "HMRC"). According to Southern Cross, the payment to it was made pursuant to a contractual agreement compromising the repayment claim. HMRC, however, maintain that they were barred from entering into any such agreement by section 80 of the Value Added Tax Act 1994 ("the VATA"), that such an agreement would in any case have been ultra vires and void and, finally, that no contractual agreement was concluded on the facts. According to HMRC, Southern Cross was not entitled to the money it was paid and assessments were properly raised to recover it.

2. In a decision dated 17 January 2014 ("the Decision"), the First-tier Tribunal ("the FTT") (Judge Berner and Mr Jenkins) ruled in favour of Southern Cross. HMRC, however, appeal against the Decision.

Factual history

3. Southern Cross is an employment agency specialising in the supply of dental nurses to dentists.

4. In 2001, Horwath Clark Whitehill wrote to HMRC on Southern Cross's behalf to say that they considered its supplies of dental nurses to be exempt from VAT. When HMRC replied a few weeks later, they agreed that the supplies were exempt for VAT purposes. In the light of that, Southern Cross sought repayment of VAT for which it had accounted to HMRC between 1998 and 2001. HMRC met the claims.

5. In 2009, after HMRC had accepted that the three-year limitation period for which there had previously been provision was unlawful, Horwath Clark Whitehill submitted on Southern Cross's behalf a further claim for the repayment of VAT, this time for the period from 1973 to 1997. The total amount sought was £861,162.65.

6. Mr Barry Knight, an officer of HMRC, responded to Southern Cross's claim in a letter of 2 December 2009, raising the defence of unjust enrichment for which section 80(3) of the VATA provides. He suggested that there was evidence indicating that, "prior to VAT free competition, the VAT would have been passed on and that [Southern Cross] would be unjustly enriched". Horwath Clark Whitehill, however, replied that they were "strongly of the opinion that [Southern Cross] would not be unjustly enriched by the payment

of this claim" and that, in any case, the age of the claim rendered the unjust enrichment defence inapplicable.

7. Mr Knight took issue with the points made by Horwath Clark Whitehill. In particular, he said in a letter of 8 January 2010:

> "It seems that there is doubt whether [Southern Cross] would benefit by being wholly or partly unjustly enriched if the repayment of the claim of 30 March 2009 was made in full. In view of this doubt …, perhaps you could demonstrate how your client suffered a loss as result of passing the VAT on for the period of this claim. I would be happy to meet to discuss this further."

8. On 29 January 2010, Mr Knight and his manager had a meeting with Horwath Clark Whitehill. A fortnight or so later, Mr Knight sent Horwath Clark Whitehill a letter in which he said:

> "The point here is that the main competitors, for most of the period of the claim, were accounting for VAT in the same manner as your client. Hence, to at least an extent, it cannot be said to have suffered a loss as a result of accounting for VAT on its services when its competitors were exempting their supplies. It appears that Temp Dent Dental Agency Ltd may have been the first competitor to have finally got the VAT treatment correct.
>
> It follows, as VAT was passed on and as competitors were also accounting for VAT, that [Southern Cross] would, at least to an extent, be unjustly enriched by the payment of the claim."

9. Replying on 9 March 2010, Horwath Clark Whitehill continued to "maintain that [Southern Cross] rather than being unjustly enriched was put in a position whereby its profits were squeezed". They explained:

> "on the balance of probabilities and with the additional evidence which has come to light, it seems reasonable to assume that [Southern Cross] … would have been in competition with other businesses which did not have the burden of VAT for the entirety of the claim period".

10. Mr Knight wrote again on 26 March 2010. He accepted that it seemed "reasonable to assume that [Southern Cross] would have been in competition with other businesses which did not have the burden of VAT for the entirety of the claim period", but said that there was also "clear evidence that it was … in competition with businesses which did have the burden of VAT". He continued:

> "On the basis of the preceding points I suggest, on a 'without prejudice' basis, that we come to a compromise position. Without

sufficient information and given the date of the period of the claim it is difficult to suggest quite what this would amount to. I would, however, propose that 50% of the claim is due."

11. On 1 April 2010, Horwath Clark Whitehill emailed Mr Knight to say:

> "In order for our client to make a decision in respect of the offer in your letter of 26 March can you please provide me with the total payment (VAT plus interest) that would be made to [Southern Cross], as if the claim was paid on the date of your response."

Mr Knight replied that "50% of the claim would amount to interest of about £495,931.79, which, together with the reduced VAT would amount to £926,537.79 at today's date".

12. In a letter of 14 April 2010, Horwath Clark Whitehill said that they remained "of the opinion that [Southern Cross] would not be unjustly enriched by full payment of the amount claimed", but that Southern Cross was "willing to negotiate" in order "to attempt to bring this to a conclusion speedily". The letter concluded:

> "If we treat the industry margin as being that obtained by [Southern Cross] for the period of the original claim … which was 26%, our client would be willing to restrict its original claim by this amount.
>
> In conclusion, [Southern Cross] would accept a proposal from HMRC to repay 74% of the VAT plus interest but does not accept that payment of the claim in full would result in [Southern Cross] being unjustly enriched."

13. In response, Mr Knight said in a letter dated 29 April 2010:

> "I can confirm that the Commissioners will accept that 74% of the claim of £861,212 will be repaid. The VAT repayment will amount to £637,296.90 and together with the appropriate interest (to be calculated next week). I will arrange for authorisation of this sum next week."

14. Southern Cross was subsequently, as promised, paid a total of £1,371,529.10. On 23 July 2010, however, HMRC notified Southern Cross that they had made assessments under sections 80(4A) and 78A of the VATA to recover the payment. Mr Knight explained:

> "Since authorising this claim I have been advised by colleagues in VAT policy that the claim should not have been paid. As part of a wider review, the Commissioners have received legal advice to confirm that supplies of staff are not care or medical care, and that the

published guidance at that time amounted to an informal concession ….

That the exemption of the supplies in question was a concession means that when your client charged VAT on their supplies between 1973 and 1995 they were right to do so ….”

15. HMRC had already, in the previous year, refused to make a repayment to a Ms Sally Moher, who had run a business that supplied temporary dental staff to dentists. HMRC explained that, although they had taken a different view of the law in the past, they now considered that the relevant supplies were standard-rated for VAT purposes.

16. In a decision released on 3 May 2011, the FTT dismissed an appeal from HMRC’s decision as regards Ms Moher. The FTT held that the relevant supplies were supplies of staff to dentists rather than supplies to dental patients and so were not exempt (see *Moher v R & C Comrs* [2011] UKFTT 286 (TC), [2011] SFTD 917). Ms Moher obtained permission to appeal, but her appeal was dismissed (see *Moher v HMRC* [2012] UKUT 260 (TCC), [2012] STC 1356). The Upper Tribunal said (at paragraph 14):

> “It is in our view beyond argument that [Ms Moher’s] supply was of staff to dentists, who (as the tribunal found) assumed all the responsibility for directing the nurses as to what they should do, and for determining the treatment to be offered to the patients and the manner of its delivery. That the staff (and, indeed, [Ms Moher] herself) had a medical qualification cannot affect the nature of the supply. The tribunal correctly concluded that [Ms Moher] could not benefit from the exemption, and that [HMRC] were right to refuse the repayment.”

Earlier in its decision, however, the Upper Tribunal had spoken of HMRC’s “own doubts, one might say confusion, about the correct VAT treatment of such supplies over a number of years” (see paragraph 6).

The legislative framework

17. The central provisions of the VATA for the purposes of this case are sections 78, 78A and 80 (all of which are in a group headed “Interest, repayment supplements etc payable by the Commissioners”) and section 85 (which is concerned with “Settling appeals by agreement”).

18. Given its importance to this case, it is worth setting out much of section 80 in full. During the relevant period, it provided as follows:

> “(1) Where a person—

(a) has accounted to the Commissioners for VAT for a prescribed accounting period (whenever ended), and

(b) in doing so, has brought into account as output tax an amount that was not output tax due,

the Commissioners shall be liable to credit the person with that amount.

(1A) Where the Commissioners—

(a) have assessed a person to VAT for a prescribed accounting period (whenever ended), and

(b) in doing so, have brought into account as output tax an amount that was not output tax due,

they shall be liable to credit the person with that amount.

…

(2) The Commissioners shall only be liable to credit or repay an amount under this section on a claim being made for the purpose.

(2A) Where—

(a) as a result of a claim under this section by virtue of subsection (1) or (1A) above an amount falls to be credited to a person, and

(b) after setting any sums against it under or by virtue of this Act, some or all of that amount remains to his credit,

the Commissioners shall be liable to pay (or repay) to him so much of that amount as so remains.

(3) It shall be a defence, in relation to a claim under this section by virtue of subsection (1) or (1A) above, that the crediting of an amount would unjustly enrich the claimant.

…

(4A) Where—

(a) an amount has been credited under subsection (1) or (1A) above to any person at any time on or after 26th May 2005, and

(b) the amount so credited exceeded the amount which the Commissioners were liable at that time to credit to that person,

the Commissioners may, to the best of their judgement, assess the excess credited to that person and notify it to him.

(4AA) An assessment under subsection (4A) shall not be made more than 2 years after the later of–

(a) the end of the prescribed accounting period in which the amount was credited to the person, and

(b) the time when evidence of facts sufficient in the opinion of the Commissioners to justify the making of the assessment comes to the knowledge of the Commissioners.

…

(7) Except as provided by this section, the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them."

19. Section 80(4AA) was inserted by the Finance Act 2008. The explanatory note for the Finance Bill 2008 stated that the subsection:

> "ensures that assessments can be made to recover amounts improperly paid or credited under section 80 regardless of whether the incorrect payment or credit was made under a mistake of law or a mistake of fact".

20. Sections 78 and 78A relate to interest. Among other things, section 78 provides for HMRC to pay interest where, due to an error on their part, a person has "accounted to them for an amount by way of output tax which was not output tax due from him and, as a result, they are liable under section 80(2A) to pay (or repay) an amount to him". In this context, "references to an amount which the Commissioners are liable in consequence of any matter to pay or repay to any person are references, where a claim for the payment or repayment has to be made, to only so much of that amount as is the subject of a claim that the Commissioners are required to satisfy or have satisfied". Section 78A allows for the recovery of money paid by way of interest under section 78 where the recipient was not in fact entitled to it under the section.

21. Section 85 is concerned with the settlement of pending appeals. It states:

> "(1) Subject to the provisions of this section, where a person gives notice of appeal under section 83 and, before the appeal is determined by a tribunal, HMRC and the appellant come to an agreement (whether

in writing or otherwise) under the terms of which the decision under appeal is to be treated—

(a) as upheld without variation, or

(b) as varied in a particular manner, or

(c) as discharged or cancelled,

the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was come to, a tribunal had determined the appeal in accordance with the terms of the agreement.

(2) Subsection (1) above shall not apply where, within 30 days from the date when the agreement was come to, the appellant gives notice in writing to HMRC that he desires to repudiate or resile from the agreement…."

22. A final point is that responsibility for the "collection and management" of VAT is entrusted to HMRC: see paragraph 1 of schedule 11 to the VATA and section 5 of the Commissioners for Revenue and Customs Act 2005.

The Decision

23. The FTT identified three main issues (paragraph 3 of the Decision):

(a) Did Southern Cross and HMRC enter into a binding compromise agreement?

(b) If the parties did enter into a compromise agreement, was that agreement ultra vires because HMRC had no power to enter into such an agreement with Southern Cross?

(c) If there was a valid compromise agreement, was HMRC entitled under section 80(4A) and section 78A(1) of the VATA to make the assessments under appeal to recover the sums paid?

24. The FTT answered the first question in the affirmative and the second and third questions in the negative.

25. With regard to the first issue, the FTT concluded that "the payment made by HMRC to Southern Cross was made pursuant to a compromise agreement entered into by them" (paragraph 46 of the Decision). In paragraph 44 of the Decision, the FTT said:

> "In our view the agreement reached between HMRC and Southern Cross compromised the original claim of Southern Cross. It is evident

from the correspondence that Southern Cross did not accept, as a matter of law, that the amount due to it should be reduced on the basis of unjust enrichment, but that in spite of that position it was willing to accept a reduced amount. In our view Southern Cross agreed to give up 24% of its original claim in order to achieve a settlement; that was consideration for the agreement on the part of HMRC to pay that reduced amount. The agreement was in full and final settlement, and it was not necessary for there to have been express wording to that effect. There was, as a result, no scope for Southern Cross to make a further claim in the same respect, or to appeal to the tribunal in relation to the 24% of the original claim that was unpaid."

26. Turning to the second issue, the FTT decided that the compromise agreement it had held to have been made "was not outside the powers of HMRC or *ultra vires*" and "was therefore … a valid compromise agreement" (paragraph 68 of the Decision). Having referred to an argument advanced on behalf of HMRC to the effect that they "cannot settle a case (or make a payment in response to a voluntary disclosure) where HMRC has no liability to the taxpayer" (paragraph 64 of the Decision), the FTT explained:

> "65. … On the question of principle, it is clear that the discretion of HMRC in the exercise of their powers of management is a wide one, albeit bounded by their primary duty to collect taxes that are properly due. Concessions may be made that result in non-collection of tax lawfully due provided that they are made with a view to obtaining overall for the national exchequer the highest net practicable return. That has been shown to be the case, not only in relation to concessions, but more generally in the case of back duty agreements, again provided that HMRC do not agree to take a smaller sum for tax than is lawfully due on the information available to them. HMRC may, however, make a decision in the exercise of their management functions as to the extent of the information they can reasonably expect to get and then make an agreement on that basis as to the tax payable. Although HMRC have no power to refrain from collecting tax which is due, it does have the power to compromise where the actual tax recoverable has not been quantified.
>
> 66. In our judgment the agreement reached between HMRC and Southern Cross falls into this category. At the material time there was no clarity as to the correct VAT treatment of the supplies in question. HMRC may have had a view that Mr Knight was not aware of, but that view was evidently not universally shared. The agreement that was made was a genuine and realistic approximation of the actual amount due to Southern Cross, made after detailed discussion and negotiation, and in the absence of available information that showed that the amount was not due. Following *Moher*, Southern Cross accepts that it was not entitled as a matter of law to the repayment,

but that does not render unlawful an agreement made at a time when that position had not been determined.

> 67. We do not consider that an agreement that was made with a view to reaching a genuine and realistic approximation of the amount due, whether to HMRC or to the taxpayer, can be rendered unlawful if, in the event, it is later discovered that the deal was not a good one for HMRC. Were that to be the case, and leaving out of account special cases such as those where the taxpayer has withheld information from HMRC, it would render HMRC's power to compromise claims virtually worthless. There is, as the cases demonstrate, a clear public interest in HMRC being able to resolve the tax position of a taxpayer without resort to enforcement powers, provided that they do so within the boundaries of the management powers vested in them."

27. As for the third issue, the FTT took the view that, "having regard to the valid and enforceable compromise agreement between Southern Cross and HMRC under which the payment of both the principal amount and interest were made, HMRC had no power to assess to recover the amounts repaid under s 80(4A) or s 78A(1) VATA" (paragraph 90 of the Decision). The FTT did "not consider that the language of s 80 (or s 85) can permit HMRC to raise an assessment in respect of a matter compromised by common law agreement outside the scope of s 85, and where the liability (of the taxpayer or HMRC) is enforceable according to the terms of that agreement" (paragraph 89 of the Decision). The FTT thought that a distinction fell to be drawn, "not as between judicial determinations and everything else, but between cases where HMRC is liable, whether under the statute, by judicial determination, deemed judicial determination under s 85 or a valid and enforceable agreement, to repay an amount at the date of payment and cases, such [as] a voluntary payment of a claim, where they are not so liable, because the liability has not arisen as a matter of law" (paragraph 88 of the Decision). In the former class of case, where a liability had arisen "under the statute, by judicial determination, deemed judicial determination under s 85 or a valid and enforceable agreement", it is not (as the FTT saw things) possible to raise a further assessment.

The issues on this appeal

28. Miss Jessica Simor QC, who appeared for HMRC, addressed the issues identified by the FTT in reverse order. I shall follow her example. Approaching matters in that way, I shall consider the following questions in turn:

    (a) Did section 80 of the VATA bar HMRC from entering into a binding agreement with Southern Cross? ("Issue 3");

    (b) Would any compromise agreement have been ultra vires and so void? ("Issue 2");

(c) Was a compromise agreement formed on the facts? ("Issue 1").

Issue 3: Did section 80 of the VATA bar HMRC from entering into a binding agreement with Southern Cross?

29. It is HMRC's case that section 80 of the VATA operates to prevent them entering into any binding compromise agreement for the repayment of money paid by way of VAT unless section 85 of the Act is applicable. Section 80, Miss Simor argued, establishes a comprehensive regime for the repayment of VAT and the recoupment of such payments. HMRC cannot make a repayment otherwise than pursuant to section 80(1)-(2A), and section 80(4A) empowers them to reclaim any payment so made if and to the extent that it turns out not to have been due. The recipient of a repayment is protected by the limitation period for which section 80(4AA) provides. That apart, Parliament has chosen to adopt a regime under which HMRC are entitled to revisit any repayment they have made unless doing so would conflict with (a) a judicial determination, (b) an agreement settling an appeal pursuant to section 85 or (c) a legitimate expectation of the recipient of the repayment (as to which, see e.g. *Al Fayed v Advocate General for Scotland* [2004] STC 1703, at paragraph 119).

30. In support of her submissions, Miss Simor took me to several cases in which section 80 has been said to be comprehensive in its scope. Thus, in *Customs and Excise Commissioners v DFS Furniture Co plc* [2003] EWHC 857 (Ch), [2003] STC 739 (reversed on other grounds by the Court of Appeal: see [2004] EWCA Civ 243, [2004] STC 559), Morritt V-C said (at paragraph 25) that section 80(4A) "was evidently intended to be all embracing and to introduce a statutory mechanism for the recovery of sums repaid by the Commissioners in excess of the amount for which they were legally liable, for whatever reason". In *FJ Chalke Ltd v Revenue and Customs Commissioners* [2009] EWHC 952 (Ch), [2009] STC 2027, Henderson J concluded (at paragraph 255) that, "As a matter of English domestic law, the statutory scheme in VATA 1994 for the repayment of wrongly levied VAT and the payment of simple interest thereon is exhaustive and excludes any other remedy". Earlier in his judgment, Henderson J had said (at paragraph 68) that it was "crystal clear that the s 80 regime for the recovery of overpaid VAT was intended by Parliament to be both exclusive and exhaustive where the circumstances are such as to fall within the scope of the section". The wording of section 80(7), Henderson J said (at paragraph 67), "is clear and unambiguous" and "leaves no room for the co-existence of other remedies for the recovery of overpaid VAT from the Commissioners". In a subsequent case, *Investment Trust Companies v Revenue and Customs Commissioners* [2012] EWHC 458 (Ch), [2012] STC 1150 (reversed on other grounds by the Court of Appeal: see [2015] EWCA Civ 82), Henderson J noted (at paragraph 90) that it was "common ground that, for taxpayers who have themselves accounted to HMRC for output tax that was not due ('undue VAT'), s 80 provides a code

for the recovery of the undue VAT which is both exhaustive and excludes other remedies (such as a common law claim for restitution)".

31. On HMRC's case, section 80(7) of the VATA is of key importance. As already mentioned, this provision states that, except as provided by section 80, HMRC "shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them".

32. For his part, Mr Peter Mantle, who appeared for Southern Cross, argued that section 80(7) of the VATA is designed to prevent taxpayers from seeking to recover overpayments by common law claims for restitution or through their tax returns. It was not, he said, meant to prevent HMRC from settling claims made under section 80. The case law shows, he submitted, that HMRC cannot use section 80(4A) to recover a payment made in pursuance of a judicial determination or a settlement under section 85. There is, Mr Mantle suggested, similarly no objection to HMRC entering into a contract to settle a claim where no appeal is on foot.

33. The cases to which I was referred on judicial determinations and section 85 agreements were *R v Customs and Excise Commissioners, ex p Building Societies Ombudsman Co Ltd* [2000] STC 892 and *R (on the application of DFS Furniture Co plc) v Customs and Excise Commissioners* [2002] EWHC 807 (Admin), [2002] STC 760 (on appeal, [2002] EWCA Civ 1708, [2003] STC 1). One of the questions to which the *Building Societies Ombudsman* case gave rise was "whether the clawback provisions in s 80(4A) and (4B) can overrule a judicial decision which pre-dates the exercise of that power" (see paragraph 111). The Court of Appeal held that they could not. Rix LJ, who gave the leading judgment, observed (in paragraph 106):

> "Where ... the commissioners have paid a claim after 18 July 1996, they are given the power to recoup that part of the payment which exceeds their liability under the three-year cap. Where, however, the amount of the repayment liability has been determined judicially, it does not follow that the commissioners should be able to recoup administratively what they have been adjudged liable to pay, nor is there any logic in focusing on the time of payment as distinct from the time of the judicial decision."

In paragraph 119, Rix LJ said:

> "That provision [i.e. section 80(4B)(b) of the VATA] raises the question: What was the amount which the commissioners were liable to repay to [the Building Societies Ombudsman] as at the date of their payment, viz 23 January 1997? At that time there was a decision of the VAT tribunal giving effect to [the Building Societies Ombudsman's] claim for repayment of £1,306,212.60. How can it be said that that

decision did not establish the amount of the commissioners' liability at that time?"

34. In the *DFS* case, Moses J, at first instance, concluded that HMRC could not recoup a payment under section 80(4A) of the VATA because the money had been paid in accordance with the settlement of an appeal under section 85. Moses J said (at paragraph 61):

> "Section 80(4A) operates whenever there has been a voluntary payment in response to a claim under 80(2), but sub-s (4A) does not operate where a payment has been made in settlement of a dispute which has given rise to an appeal settled within the meaning of s 85. The distinction finds support at para 106 in [the *Building Societies Ombudsman* case].... It is true that there was no intervention of a judicial determination as in [the *Building Societies Ombudsman* case], but s 85 has the same effect as the intervention of a judicial determination."

It is also relevant to note that Moses J said (at paragraph 66):

> "I should record that [counsel for DFS] says none of this matters. It is sufficient that there was an agreement to settle at common law. Whatever my doubts about that submission I have no need to reach any conclusion. Very different considerations may apply if DFS cannot rely upon s 85 and in particular it falls for consideration elsewhere as to whether s 85 ousts or merely augments the common law rule."

35. An appeal by HMRC against Moses J's decision was successful, but on the basis that, contrary to the judge's view, the parties had not "come to an agreement" within section 85 of the VATA. The Court of Appeal did not need to comment on that section's relationship with section 80.

36. The last authority that I should mention in the context of the issue now under consideration is *IRC v Nuttall* [1990] STC 194. That case concerned the ability of the Inland Revenue to enter into back duty agreements. At first instance, it had been held that any such power had been overruled or abolished by section 54 of the Taxes Management Act 1970 ("the TMA"), which is in very similar terms to section 85 of the VATA but deals with appeals relating to direct taxes rather than VAT. The judge had taken the view that, since section 54(2) of the TMA gave the taxpayer the right to resile from a section 54 agreement for 30 days, any pre-existing power to make a contract of composition in which no such power of resiling was reserved must have been abolished (see the judgment of Ralph Gibson LJ, at 203). The Court of Appeal did not agree. Ralph Gibson LJ said (at 203):

> "The provisions of s 54 did not, in my judgment, abolish the power of the commissioners to make enforceable back-duty agreements. There is no such necessary implication to be derived from the express words

> of s 54. Further, if Parliament had intended to abolish what was already in 1949 a long established practice of the commissioners, and, as I have no doubt, a useful and important part of their procedure, I have no doubt that clear express words would have been used to give effect to such an intention."

Another member of the Court, Bingham LJ, expressed the view (at 204) that it would be "extraordinary, and also regrettable, if the Revenue could not achieve by agreement that which it could undoubtedly achieve by coercion". Bingham LJ went on to say (at 205):

> "The power to make agreements with taxpayers for the payment of back duty, even in the absence of assessment and appeal, is in my view a power necessary for carrying into execution the legislation relating to Revenue within the meaning of s 1 of [the Inland Revenue Regulation Act 1890]. It is, of course, a power to be exercised with circumspection and due regard to the Revenue's statutory duty to collect the public revenue. But if in an appropriate case the Revenue reasonably considers that the public interest in collecting taxes will be better served by informal compromise with the taxpayer than by exercising the full rigour of its coercive powers, such compromise seems to me to fall well within the wide managerial discretion of the body to whose care and management the collection of tax is committed. Such informal compromise deprives the taxpayer of the locus poenitentiae provided by s 54(2), and the right to re-open assessments under s 33, but it protects him against exercise of the Revenue's more draconian enforcement powers (eg under ss 61 and 65) and often, as here, against further liability for penalties and default interest. I have no hesitation in holding such an agreement, properly made, to be binding."

37. In the end, I have concluded that section 80 of the VATA does not bar HMRC from entering into a binding agreement to settle a claim under section 80(1) where there is no pending appeal. My reasons include these:

(a) It is apparent from Moses J's judgment in the *DFS* case that section 85 of the VATA allows HMRC to enter into a binding settlement agreement in the context of an appeal. It is hard to see why Parliament would have wished HMRC to have such an ability only where an appeal has been instituted. On the face of it, Parliament might have been expected to have thought it undesirable that parties should have to resort to litigation to achieve a binding agreement;

(b) As mentioned above (paragraph 34), Moses J observed in the *DFS* case that "it falls for consideration elsewhere as to whether s 85 ousts or merely augments the common law rule". The issue raised before Moses J was, however, whether an agreement to settle could be concluded at common law where an appeal was underway and, hence,

section 85 could apply. Moses J was not dealing with a case (such as the present one) in which no appeal has ever been launched;

(c) *IRC v Nuttall* shows that HMRC can enter into binding agreements relating to direct taxes otherwise than under section 54 of the TMA, which corresponds to section 85 of the VATA. Much as Bingham LJ thought that it would be "extraordinary, and also regrettable," if HMRC lacked such a power, it strikes me as preferable that HMRC should be able, if they so choose, to dispose of claims under section 80 of the VATA on a final basis regardless of whether an appeal has been brought;

(d) On HMRC's case, a person to whom HMRC made a payment pursuant to section 80(1)-(2A) of the VATA could be exposed to the possibility of a recoupment assessment under section 80(4A) for an extended period. As a minimum, HMRC could make an assessment until two years after the end of the accounting period in which the relevant amount was credited to the recipient (see section 80(4AA)(a)). If "evidence of facts sufficient in the opinion of the Commissioners to justify the making of an assessment" did not come to the knowledge of HMRC until after the end of that accounting period, the limitation period would be extended indefinitely;

(e) The cases cited in paragraph 30 above indicate that section 80(7) of the VATA was intended to leave "no room for the co-existence of other remedies for the recovery of overpaid VAT from the Commissioners". It does not follow that it was any part of Parliament's intention to prevent HMRC from settling claims made under section 80; and

(f) It is evident from the *Building Societies Ombudsman* and *DFS* cases that HMRC can be precluded from assessing under section 80(4A) of the VATA by judicial determinations and section 85 agreements even though section 80 does not expressly cater for either possibility. The decisions can be reconciled with the terms of section 80 on the basis that such determinations and agreements serve to "establish the amount of the commissioners' liability" for the purposes of section 80(1) and (4A) (to use words of Rix LJ in the *Building Societies Ombudsman* case). The better view, as it seems to me, is that, where no appeal is pending, HMRC's liabilities can similarly be fixed for the purposes of section 80(1) and (4A) by means of a contractual agreement outside section 85.

38. In short, it appears to me that Issue 3 falls to be determined in favour of Southern Cross.

Issue 2: Would any compromise agreement have been ultra vires and so void?

HMRC's case

39. It is HMRC's case that, even if not barred by section 80 of the VATA from entering into a binding agreement, they could not properly have done so. Any such agreement would, it is claimed, have been ultra vires and so void.

40. HMRC have, Miss Simor submitted, no power to waive tax that is due or to pay money where they have no liability to do so. Here, it can be seen from the *Moher* case that Southern Cross had not "brought into account as output tax an amount that was not due" and, accordingly, that HMRC were never "liable to credit" Southern Cross with such an amount. Any agreement to make a payment to Southern Cross will thus have been based on an error of law and so unreasonable and unlawful. The subjective beliefs of Mr Knight, the HMRC officer who dealt with Southern Cross, are immaterial. An objective test is to be applied.

HMRC's role

41. *Vestey v IRC (Nos 1 and 2)* [1980] AC 1148, one of the cases to which I was taken in this context, shows that it is incumbent on HMRC to apply the law as it stands. Lord Wilberforce said (at 1173):

> "When Parliament imposes a tax, it is the duty of the commissioners to assess and levy it upon and from those who are liable by law. Of course they may, indeed should, act with administrative commonsense. To expend a large amount of taxpayer's money in collecting, or attempting to collect, small sums would be an exercise in futility: and no one is going to complain if they bring humanity to bear in hard cases. I accept also that they cannot, in the absence of clear power, tax any given income more than once. But all of this falls far short of saying that so long as they do not exceed a maximum they can decide that beneficiary A is to bear so much tax and no more, or that beneficiary B is to bear no tax."

42. It is also clear, however, that HMRC have a managerial discretion. In *IRC v National Federation of Self-Employed and Small Businesses Ltd* [1981] STC 260, Lord Diplock said (at 269):

> "[T]he Board are charged by statute with the care, management and collection on behalf of the Crown of income tax, corporation tax and capital gains tax. In the exercise of these functions the Board have a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge the highest net return that is practicable having regard to the staff available to them and the cost of collection. The Board and the inspectors and collectors who act under their directions are under a statutory duty of confidentiality with respect to information about individual taxpayers'

affairs that has been obtained in the course of their duties in making assessments and collecting the taxes; and this imposes a limitation on their managerial discretion. I do not doubt, however, and I do not understand any of your Lordships to doubt, that if it were established that the Board were proposing to exercise or to refrain from exercising their powers not for reasons of 'good management' but for some extraneous or ulterior reason that action or inaction of the Board would be ultra vires and would be a proper matter for judicial review if it were brought to the attention of the court by an applicant with 'a sufficient interest' in having the Board compelled to observe the law."

43. There was also reference to HMRC's managerial discretion in *IRC v Nuttall*, where, as I have mentioned, it was held that HMRC could enter into back duty agreements. Citing the *National Federation* case, Ralph Gibson LJ said (at 203):

> "The commissioners, of course, have no power to agree to take a smaller sum for tax than is lawfully due on the information before the commissioners. They can, however, make a decision in their management functions as to the extent of the information which they can reasonably expect to get and then make an agreement on that basis as to the tax payable."

Parker LJ said (at 202):

> "But it appears to me that if the Revenue are to have the necessary powers, as they are under s 1 of the [Inland Revenue Regulation Act 1890], it is an incidental power to enable them to enter into an agreement to compromise an overall situation consisting partly in outstanding tax, partly in a potential liability to culpable interest and partly in potential liability to pay penalties if by that means they consider they can best recover and manage the tax which is committed to their care."

In a passage I have already quoted, Bingham LJ said:

> "[I]f in an appropriate case the Revenue reasonably considers that the public interest in collecting taxes will be better served by informal compromise with the taxpayer than by exercising the full rigour of its coercive powers, such compromise seems to me to fall well within the wide managerial discretion of the body to whose care and management the collection of tax is committed."

44. The Court of Appeal summarised the effect of the authorities in these terms in *R (Wilkinson) v IRC* [2003] EWCA Civ 814, [2003] STC 1113:

"[45] It seems to us that the effect of these authorities is plain. One of the primary tasks of the commissioners is to recover those taxes which Parliament has decreed shall be paid. Section 1 of the [TMA] permits the commissioners to set about this task pragmatically and to have regard to principles of good management. Concessions can be made where those will facilitate the overall task of tax collection. We draw attention, however, to Lord Diplock's statement that the commissioners' managerial discretion is as to the best manner of obtaining for the national exchequer the highest net return that is practicable.

[46] No doubt, when interpreting tax legislation, it is open to the commissioners to be as purposive as the most pro-active judge in attempting to ensure that effect is given to the intention of Parliament and that anomalies and injustices are avoided. But in the light of the authorities that we have cited above and of fundamental constitutional principle we do not see how s 1 of the 1970 Act can authorise the commissioners to announce that they will deliberately refrain from collecting taxes that Parliament has unequivocally decreed shall be paid, not because this will facilitate the overall task of collecting taxes, but because the commissioners take the view that it is objectionable that the taxpayer should have to pay the taxes in question."

On appeal, Lord Hoffmann observed (at paragraph 21) that HMRC's managerial 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", but "[i]t 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."

Ultra vires contracts

45. It is common ground that any agreement between Southern Cross and HMRC will be void if the agreement was outside the powers of (or "ultra vires") HMRC.

46. In this connection, Miss Simor took me to paragraph 5-018 of Lewis, "Judicial Remedies in Public Law", from which it can be seen that a contract may be invalid either because "the public body had no power to enter into the contract in the narrow sense that it had no power at all to make contracts of that type" or because the decision to enter into the particular contract was "ultra vires because that decision was based on improper motives or was taken without regard to relevant considerations".

47. There is an echo here of the much-cited judgment of Lord Greene MR in *Associated Provincial Pictures Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223. Lord Greene said (at 229):

> "Lawyers familiar with the phraseology commonly used in relation to exercise of statutory discretions often use the word 'unreasonable' in a rather comprehensive sense. It has frequently been used and is frequently used as a general description of the things that must not be done. For instance, a person entrusted with a discretion must, so to speak, direct himself properly in law. He must call his own attention to the matters which he is bound to consider. He must exclude from his consideration matters which are irrelevant to what he has to consider. If he does not obey those rules, he may truly be said, and often is said, to be acting 'unreasonably'. Similarly, there may be something so absurd that no sensible person could ever dream that it lay within the powers of the authority. Warrington LJ in *Short v Poole Corporation* gave the example of the red-haired teacher, dismissed because she had red hair. That is unreasonable in one sense. In another sense it is taking into consideration extraneous matters. It is so unreasonable that it might almost be described as being done in bad faith; and, in fact, all these things run into one another."

48. In *Council of Civil Service Unions v Minister for the Civil Service* [1985] AC 374 (at 410-411), Lord Diplock termed "*Wednesbury* unreasonableness" "irrationality". It applies, he said, to "a decision which is so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it".

49. An argument that a contract made by a public body was void as ultra vires failed in *Gibb v Maidstone & Tunbridge Wells NHS Trust* [2010] EWCA Civ 768, [2010] IRLR 786. In that case, an NHS Trust sought "to escape the coils of a contractual obligation it [had] entered into by suggesting that it could not rationally have signed up to it" (paragraph 5): according to the Trust, its undertakings in a compromise agreement "were 'irrationally generous' to the [claimant] and therefore beyond its power" (paragraph 4). The Court of Appeal was not, however, persuaded that there was anything irrational about the severance package for which the compromise agreement provided. In the course of his judgment, Laws LJ observed (at paragraph 7) that the Trust had "a very steep hill to climb" for reasons given by Simon Brown LJ in *Newbold v Leicestershire CC* [1999] ICR 1182. In the *Newbold* case, Simon Brown LJ had said (at 1191):

> "[O]ne may safely assume that no court is going to be astute to allow public authorities to escape too easily from their commercial commitments.

> That should particularly be the case where, as here, legitimate expectations have been aroused in the other party (who clearly entered the contract in good faith), where the relationship between the parties is essentially of a private law character, where it is the authority itself which is seeking to assert and pray in aid its own lack of vires, and where that lack of vires is suggested to result not from the true construction of its statutory powers but rather from its own *Wednesbury* irrationality. The burden upon the authority in such a case must be a heavy one indeed. It does not seem to me that the council came within measurable distance of discharging it here."

The present case

50. In the present case, there is, I think, no reason at all to believe that HMRC acted for an improper purpose (or, in the words of Lord Diplock in the *National Federation* case, "some extraneous or ulterior reason") in their dealings with Southern Cross. Miss Simor did not suggest that Mr Knight (or anyone else at HMRC) had any wish for Southern Cross to receive money to which it was not entitled, and there is in any case no evidence to that effect. The correspondence I have quoted in paragraphs 5-13 above indicates that Mr Knight was seeking to limit the amount paid to Southern Cross, not to pay it too much. There is no question of Mr Knight having had any intention of agreeing to give Southern Cross any more than appeared to him to be lawfully due to it on the information available to him.

51. Nor, in my view, can it be maintained that HMRC acted irrationally. They had in the past accepted that Southern Cross's supplies were exempt from VAT, and it has not to my mind been established that it was irrational for Mr Knight (or whoever else was responsible for HMRC's decision-making) to continue to proceed on that basis in 2009-2010. The *Moher* case had not yet been decided (by the FTT, let alone the Upper Tribunal), and there is no evidence that Mr Knight (or any other relevant decision-maker) was even aware of the change of heart that others within HMRC seem to have had as to the appropriate treatment for VAT purposes of supplies of dental nurses. As the FTT observed, "[a]t the material time there was no clarity as to the correct VAT treatment of the supplies in question".

52. The key question, as it seems to me, must be whether it is fatal to the validity of any compromise agreement that the decision-maker(s) did not appreciate that Southern Cross's supplies were in fact taxable. It has now been held, definitively, that supplies such as those provided by Southern Cross are not exempt from VAT. Is it to be inferred that HMRC did not realise this when they agreed to pay Southern Cross and, in consequence, that they made an error of law invalidating any agreement?

53. Miss Simor's submissions on this aspect of the case would, if correct, have far-reaching implications. According to Miss Simor, HMRC cannot "settle a

case (or make a payment in response to a voluntary disclosure) where they have no liability to the taxpayer". Any agreement between HMRC and a taxpayer could thus, it seems, be reopened if it involved HMRC paying more than proved to be due, regardless of whether the agreement was a reasonable one when it was made. As the FTT pointed out, that would severely impair HMRC's ability to compromise claims.

54. Other public bodies could also, presumably, escape compromise agreements that had subsequently proved to be disadvantageous. A hospital, for example, that had settled a clinical negligence claim would appear to be able to go behind the agreement if, say, a Court decision several years later showed that a particular head of loss had not in fact been recoverable. It would not, seemingly, be incumbent on a public body to satisfy the requirements that have to be met by other litigants wishing to impeach a compromise agreement for mistake of law (as to which, see e.g. *Brennan v Bolt Burdon* [2004] EWCA Civ 1017, [2005] QB 303).

55. For his part, Mr Mantle took issue with the proposition that a compromise agreement can be invalidated by *any* error of law on the part of HMRC. According to Mr Mantle, such an agreement is not open to challenge on ultra vires grounds unless either irrational or entered into for an improper purpose.

56. That submission is by no means without attraction, but I do not think I need arrive at any conclusion on it to decide the present appeal. I can dispose of Issue 2 on more limited grounds.

57. In the first place, I do not consider that HMRC can disavow any agreement with Southern Cross simply on the basis that the decision-maker(s) did not know what has since been determined: that supplies of dental nurses to dentists are standard-rated for VAT purposes. The fact that such supplies have *now* been held not to be exempt need not mean that the decision-maker(s) misdirected themselves in law or failed to have regard to relevant considerations when they agreed to pay Southern Cross. *At the time*, there was, as the FTT said, no clarity as to the VAT position and it could not be known with certainty that supplies of dental nurses were not exempt. HMRC cannot, therefore, be criticised for failing to treat the *Moher* decision as a foregone conclusion and, correspondingly, cannot claim that any agreement with Southern Cross is vitiated by such failure.

58. Supposing the true position to be that HMRC's decision-makers were aware that Southern Cross's supplies *might not* be exempt, they cannot, as it seems to me, be taken to have made an error of law. Their understanding of the position will have matched the reality. As, moreover, Lord Hope of Craighead explained in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 (at 410):

> "A state of doubt is different from that of mistake. A person who pays when in doubt takes the risk that he may be wrong - and that is so whether the issue is one of fact or one of law."

59. Finally, there was, on the evidence, no scope for a finding that HMRC's decision-maker(s) did not have in mind the possibility that Southern Cross's supplies were not exempt. Neither Mr Knight nor anyone else from HMRC gave evidence. It is, in the circumstances, impossible to say whether the decision-maker(s) were, or were not, conscious that there was doubt as to the correct VAT treatment of Southern Cross's supplies.

60. In all the circumstances, it seems to me that Issue 2, like Issue 3, must be determined in favour of Southern Cross.

Issue 1: Was a compromise agreement formed on the facts?

61. Thus far, I have concluded that section 80 of the VATA did not bar HMRC from entering into a binding agreement with Southern Cross and that such an agreement would not have been ultra vires. The remaining question is whether, on the facts, a contractual agreement was entered into.

62. Miss Simor argued that the FTT ought to have decided that no contract had been formed. In her oral submissions, she pressed essentially two points. First, she argued that there was no evidence of any intention to create legal relations outside the VATA regime. What was going on, Miss Simor submitted, was merely the determination of the amount to be credited to Southern Cross under section 80 of the VATA. Secondly, Miss Simor suggested that the supposed contract lacked consideration.

63. Taking the latter point first, it is of course trite law that, for a promise to be enforceable, "consideration must move from the promise". The FTT considered this requirement to be met in the present case. In the FTT's view, "Southern Cross agreed to give up 24% of its original claim in order to achieve a settlement; that was consideration for the agreement on the part of HMRC to pay that reduced amount" (paragraph 44 of the Decision).

64. To my mind, the FTT was amply justified in concluding that Southern Cross gave consideration. As Mr Mantle pointed out, agreement to give up a doubtful claim is capable of constituting good consideration. Bowen LJ gave this explanation in *Miles v New Zealand Alford Estate Co* (1885) 32 Ch D 266 (at 291):

> "It seems to me that if an intending litigant *bonâ fide* forbears a right to litigate a question of law or fact which it is not vexatious or frivolous to litigate, he does give up something of value. It is a mistake to suppose it is not an advantage, which a suitor is capable of appreciating, to be able to litigate his claim, even if he turns out to be

> wrong. It seems to me it is equally a mistake to suppose that it is not sometimes a disadvantage to a man to have to defend an action even if in the end he succeeds in his defence; and I think therefore that the reality of the claim which is given up must be measured, not by the state of the law as it is ultimately discovered to be, but by the state of the knowledge of the person who at the time has to judge and make the concession. Otherwise you would have to try the whole cause to know if the man had a right to compromise it, and with regard to questions of law it is obvious you could never safely compromise a question of law at all."

65. Miss Simor argued that HMRC had not requested Southern Cross to forbear from litigating to recover the balance of its claim and that it had been free to make a fresh claim. In reality, however, Southern Cross was giving up 24% of its claim for ever. Apart from anything else, any attempt to recover the 24% would have been time-barred. I accept Mr Mantle's submission that HMRC obtained complete protection against further claims for all relevant periods.

66. Turning to Miss Simor's other point, the FTT said this (in paragraph 42 of the Decision):

> "[W]e do not consider that the correspondence can support a conclusion that this was simply a case of HMRC seeking to ascertain the amount properly due. It is plain that such particularity would have eluded both HMRC and Southern Cross. There was no clear evidence of the effect of the competition on the issue of unjust enrichment. Mr Knight's proposal that the claim be paid as to 50% can only be regarded as an unscientific attempt to reach a compromise, and the counter-proposal of Southern Cross as an offer to settle at an amount based on a proxy for evidence that was not available to calculate a correct amount."

67. Once again, it seems to me that the FTT was fully entitled to take this view. I agree with Mr Mantle that the pattern of correspondence between Horwath Clark Whitehill and HMRC, and specific wording used in it, tend to point towards a process of negotiation and, in the end, an intention to conclude a contractual agreement. For example, Mr Knight suggested on 26 March 2010 that the parties reach a "compromise position" on a "without prejudice" basis; Horwath Clark Whitehill referred in their reply to the "offer" Mr Knight had made and then, on 14 April, to being "willing to negotiate"; and Mr Knight said on 29 April that HMRC would "accept" that 74% of the claim would be paid. Viewed objectively, such matters seem to me indicate contractual negotiation rather than HMRC doing no more than ascertain the extent of their liability under section 80 of the VATA. The individuals involved may or may not have seen things that way, but that is unimportant. Matters are to be assessed on an objective basis.

68. Southern Cross succeeds, therefore, on Issue 1.

Overall conclusion

69. I shall dismiss the appeal.

Mr Justice Newey

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