[2018] UKUT 0189 (TCC)

Appeal number: UT/2017/0090

VALUE ADDED TAX – Supply – Characterisation of supply – Discounts paid by brewers to a company in respect of its own and other publicans' purchases – Aggregation used to obtain higher discounts – Proportion retained by company not disclosed to publicans – whether properly characterised as a supply of a service by the company to the publicans – yes.

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

ON APPEAL FROM THE
FIRST-TIER TRIBUNAL (TAX CHAMBER)

REDWOOD BIRKHILL LIMITED

Appellant

v

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: LORD TYRE

Sitting in public at George House, 126 George Street, Edinburgh on 13 March 2018

Philip Simpson QC, instructed by Grant Thornton UK LLP, for the Appellant (Redwood Birkhill Limited)

Ross Anderson, Advocate, instructed by the Office of the Advocate General for Scotland, for the Respondents (HMRC)

Introduction

1. The appellant ("Redwood") carries on the business of owning and managing hotels and public houses. In the course of that business it negotiates discounts on the purchase price of beer and other products from two of its suppliers, namely Tennent Caledonian Limited and Heineken UK Limited (collectively "the Brewers"). It also – and it is this part of its business that gives rise to the present appeal – negotiates discounts with the Brewers on the price of beer and other drinks supplied to public houses owned or tenanted by other persons (collectively "the Publicans"). Redwood negotiates those discounts each year and pays the Publicans a proportion, but not all, of the sums it receives from the Brewers. The issue in this appeal is the appropriate analysis for VAT purposes of the trading relationship between Redwood and the Publicans; or, to put it another way, who supplies what to whom.

2. On 17 March 2017, the First-tier Tribunal (FtT) dismissed Redwood's appeal against a decision by HMRC that in the circumstances described above there were supplies by Redwood to the Publicans, the consideration for which consisted of the proportion retained by Redwood of the discounts earned by the Publicans.

The facts

3. The primary facts are not in dispute. They were set out by the FtT at paragraphs 5 to 27 of its decision. What follows is a somewhat abridged version.

4. It is common practice in the licensed trade for brewers to sell stock in barrels, and to require customers to commit to a minimum purchase level and incentivise purchases above that level by offering a retrospective discount per barrel where the minimum is exceeded. The amount of stock supplied is referred to as "barrelage". Each year Redwood negotiated discounts with the Brewers in relation to quantities of beer, lager, cider, wines, spirits and minerals. Redwood entered into agreements with the Publicans which entitled Redwood to use the Publicans' barrelage as well as its own in calculating the volumes of product purchased by Redwood for the purpose of assessing the discounts Redwood received from the Brewers. The agreements obliged the Publicans to sell the products of the Brewers rather than those of their competitors.

5. In most cases (Method 1) the discounts due to the Publicans were paid by the Brewers to Redwood. Redwood calculated the discount due to each public house and paid a proportion of the discounts received from the Brewers to the Publican concerned. Redwood retained a share of the Publican's discount for itself. The amount retained was not disclosed to the Publican. In a small number of cases (Method 2), Redwood agreed with the Brewers, for cash flow reasons, that part of the negotiated discount would be applied as a credit or reduction in price of the amount invoiced for stock by the Brewer to the relevant Publican. In such cases the balance of the discount was paid by the Brewer to and retained by Redwood. Again the amount paid to and retained by Redwood was not disclosed to the Publican concerned.

6. The benefit to the Publicans from this arrangement was that the discounts they received from Redwood were greater than the discounts that they would have obtained from the Brewers (or, it was suggested, from any other brewer) based upon the level of their own

individual orders and supplies. Redwood benefited in two ways: firstly, it obtained its share of the Publicans' discounts and, secondly, the discounts that it obtained from the Brewers on its own purchases were increased by virtue of their aggregation with the Publicans' purchases.

7. Discounts were payable quarterly in arrears and, whereas the Publicans were obviously aware of the discount they received from Redwood, they did not know the amount of discount received by Redwood from either of the Brewers. No written agreement existed specifying or confirming that the Publicans knew that Redwood was obtaining a higher discount than it was passing on to them, or how much it was, but Redwood's managing director stated in evidence, which the FtT appear to have accepted, that this understanding "was implicit or even an implied term in the agreements with the Publicans".

Contractual documentation

8. It was common ground that the arrangements between Redwood and the Publicans were not comprehensively set out in a single written contract. The documentation produced to the FtT included the following:

    - Trading agreements between the respective Breweries and Redwood, in terms of which the Breweries retained title to all goods supplied to the Publicans pending payment.

    - Two leases of premises entered into between Redwood on the one hand and a Publican on the other. Both contain trading conditions prohibiting the supply of beer or other drinks from any supplier other than one nominated by Redwood. One of the leases makes provision for payments by Redwood to the Publican of a certain sum for the first 268 barrels purchased in a given year and a higher sum for each barrel in excess of 268 in that year.

    - A discount agreement entered into between Redwood (under a previous name) on the one hand and a Publican on the other, in terms of which it was agreed *inter alia* as follows:

      "1. For each barrel of beer supplied by [a Brewer] sold from the Premises, the Landlord [ie Redwood] shall pay to the Tenant the sum of £x [specified] provided [the Brewer] pay the Landlord £x or more for each whole barrel of beer sold from the Premises.

      …

      3. For each barrel of beer or lager supplied in excess of an aggregate of 350 barrels, the Landlord shall pay to the Tenant the sum of £y [specified] provided that the supplier of such barrels pays the Landlord £y or more for each whole barrel of beer or lager sold from the Premises.

      …

      5. The sums payable to the Tenant will be payable quarterly in arrears…"

- Letters from Redwood's managing director to Publicans intimating increases in their discount levels.

9. The agreement between Redwood and the Publicans allowing Redwood to use the Publicans' barrelage in negotiating discounts with the Brewers does not appear to have been set out in writing. It will be noted that although the discount agreement quoted above does not expressly state that Redwood will be paid a higher amount than the discount given to the Publican, it can be inferred from the words "or more" that that might be the case.

The decision of the First-tier Tribunal

10. As the FtT noted at paragraph 88 of its decision, the issue was: who made what supply to whom? Redwood argued that under Method 1 there was a supply by the Publicans to Redwood consisting of the grant of a right to use their barrelage in ascertaining the volume purchases from the Brewers for the purpose of calculating the retrospective discount. The consideration for the supply was the money paid by Redwood to the Publicans. Under Method 2, there was a supply by Redwood to the Brewer concerned of exclusivity, the consideration for which was the payment by the Brewer to Redwood. HMRC contended that under both methods there was a supply by Redwood to the Publicans consisting of organising and facilitating the aggregation of purchases made by the individual Publicans (and by Redwood itself) in order to achieve increased discounts. The consideration for the supply was the amount, unknown to the Publicans, retained by Redwood.

11. The FtT preferred HMRC's analysis. The Tribunal's reasoning is set out at paragraphs 102 to 108 as follows:

> "102. The Tribunal considered that Redwood provided a service of organising and/or facilitating the aggregation of the purchases made by the individual publicans in order to achieve increased discounts for members of the Publicans group.
>
> 103. The Tribunal favour HMRC's submission that the Publicans do not take title to the goods supplied by the Brewers as the individual publicans do and so the payment received is not a discount on the purchase price but the consideration for the service provided by Redwood to the publicans and thus is taxable at the standard rate. That supply is arranging/obtaining the Publicans' discount and the consideration for this is the amount of the retained discount upon which VAT is due.
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> 104. The Tribunal consider this to be the economic reality and that the reason the retained discount is not disclosed to the Publicans is a matter of commercial judgement or practice which may not, nonetheless, be a tenable arrangement within the VAT regime.
>
> 105. The Tribunal considers that there is a supply, notwithstanding that there are no formal agreements between the Publicans and Redwood and, consequently, no legal obligation that Redwood *will* (emphasis added) use its purchasing power to achieve a discount. On the facts, the Publicans enter into these arrangements with Redwood for the reasons stated by HMRC.

106. The Discount Agreement presented to the Tribunal showed that there could be no benefit, but also no loss, to Redwood as the discounts are only paid if they are at least matched by the discounts from the Brewers to Redwood. In those circumstances clearly the consideration for the supply could reduce to the point of being non-existent.

107. The Tribunal considered that the agreement between Redwood and the Publicans was not a purely artificial arrangement and instead did correspond with the economic and commercial reality of the transactions and that the basis of this was to enhance the amount of discount obtained from the Brewers in return for which Redwood received the retained discount as a consideration.

108. The Tribunal consider that there has been a supply of services for consideration within the meaning of the VAT legislation and that there is a direct link between the service provided and the consideration received. The consideration is the retained discount, by Redwood, in consideration for its services for combining barrelage and negotiating discounts for the Publicans and is, therefore, subject to VAT."

12. Redwood now appeals against that decision.

Argument for Redwood

13. On behalf of Redwood it was submitted that the correct analysis was that in Method 1 there was a supply by the Publicans to Redwood of the right to use the Publicans' barrelage in ascertaining the volume purchased for the purpose of calculating retrospective discounts. In Method 2, there was no supply between Redwood and the Publicans. The fact that there was no payment by the Publicans to Redwood was an important starting point and created difficulties for the FtT's conclusion. There was nothing to suggest that the intention of the Brewers in relation to the sum retained by Redwood was to make a payment for the benefit of the Publicans. The Publicans did not know how much was retained, and hence did not know the consideration for the putative supply. It was not money that would have come to them if they had not entered into the discount agreement with Redwood, and it included something that was paid in respect of Redwood's own barrelage.

14. In assessing what, from an economic point of view, was being supplied, one was seeking to ascertain the economic and commercial reality of the transaction, taking all material circumstances into account including the contractual terms. If one compared a "normal" transaction in which a brewery supplied products to a publican with the transactions carried out here, it was clear that what happened was that the Publicans agreed to transfer their right to claim a discount to Redwood in exchange for the payments made to them (Method 1) or Redwood's agreement that the Brewers should grant a discount directly to a Publican (Method 2). Accordingly, the Publicans have made supplies to Redwood, and not the other way round. Both parties know how much was paid and therefore how much VAT was payable. The decision of the tribunal in *Landmark Cash & Carry Group Ltd v C&E Commissioners* LON/1979/883supported Redwood's analysis. The FtT had failed to explain why this did not accord with the economic and commercial reality. The sum

retained by Redwood would never have been due to the Publicans; nor was it linked to the value obtained by the Publicans.

15. In contrast, the analysis preferred by the FtT was unrealistic. No money actually passed from the Publicans to Redwood. The "consideration" for the supply would be an authority granted by the Publicans to retain money or to contract with the Brewer for a payment to be made. No invoice was issued for this, and it was impossible for the Publicans to claim credit for the input tax element because they did not know how much was paid or when it was due or paid to Redwood. The fact that the amount retained also affected Redwood's own discount introduced a further uncertainty: was part of this consideration for the supply to the Publicans? To argue that the commercial and economic reality had to reflect the VAT analysis was to approach the matter the wrong way round.

16. Alternatively, the correct analysis of both methods was that the effect of the discounts was simply to adjust the price paid by the Publicans to the Brewers, so that there was no separate supply involved: cf *Elida Gibbs v C&E Commissioners* [1996] ECR I-5339.

Argument for HMRC

17. On behalf of HMRC it was submitted that the analysis preferred by the FtT was the correct one, and should not be disturbed by an appellate tribunal. There was a lack of clarity in Redwood's analysis as to what "rights" were held by the Publicans that were capable of being supplied to Redwood. The better view was that barrelage was not a right but simply a measure of sales. The point of the arrangement was to obtain different and better discounts than the ones to which the Publicans would otherwise have been entitled: nothing was transferred by the Publicans to Redwood. Knowledge of the Publicans' usage gave Redwood confidence that, in negotiating discounts with the Brewers, the minimum barrelage would be used by the Publicans, that the Publicans would be able to pay for the goods supplied, and that the higher discount would in fact be earned, resulting in Redwood obtaining its cut. HMRC's analysis accorded with the commercial and economic reality. It was an unsatisfactory feature of Redwood's analysis that Methods 1 and 2 led to different characterisations of the supply when the purpose of the discount arrangement was the same under both methods. The *Landmark Cash & Carry Group Ltd* decision was clearly distinguishable. The fact that there was a separate supply of goods by the Brewers to the Publicans did not determine whether there was a supply of services by Redwood to the Publicans.

18. Although there had to be an identifiable consideration for a supply, it did not have to consist of a transfer of money by the recipient (in this case the Publicans) to the supplier (Redwood), provided that the consideration was capable of being expressed in money (*Elida Gibbs*, above). The fact that money was paid by the Brewers to Redwood was not determinative of the service supplied as between Redwood and the Publicans. The fact that there was no advance agreement as to the level of Redwood's retention did not prevent it from being consideration for a supply. The commercial substance of the agreement between Redwood and the Publicans was the enhancement of the discount obtainable by the Publicans. For its services, Redwood obtained its own benefits. The fact that the sums retained by Redwood was not a sum to which the Publicans were ever

entitled is not inconsistent with consideration: there were many contracts where consideration for professional and other services was deducted from funds held by the supplier of the service.

19. Nor did it matter that the recipient of a service did not know (but for the issuing of a VAT invoice) what the amount of the consideration might be. For example, in *Argos Distributors Ltd v C&E Commissioners* [1997] QB 499 (ECJ), a customer buying goods from Argos and tendering a voucher in payment would not necessarily know how much Argos would have received for the voucher. What mattered was the sum actually received: cf *National Car Parks Ltd v HMRC* [2017] STC 1859 (UT). In the present case there was no difficulty in calculating the consideration and therefore the VAT due. The fact that VAT invoices had not in fact been issued was immaterial.

Decision

20. The following propositions, none of which I understand to be controversial, can be extracted from the case law:

    (i) The VAT treatment of a transaction must accord with economic and commercial realities: *HMRC v Newey* [2013] STC 2432 (ECJ), paragraph 42.

    (ii) Given that the contractual position normally reflects the economic and commercial reality of the transactions, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' have to be identified: *Newey*, paragraph 43.

    (iii) Where the question at issue involves more than one contractual arrangement between different parties, when assessing the issue of who supplies what services to whom for VAT purposes, regard must be had to all the circumstances in which the transaction or combination of transactions takes place: *HMRC v Loyalty Management UK Ltd* [2013] STC 784 (UKSC), Lord Reed at paragraph 38.

    (iv) The term "consideration" does not have a narrow domestic law meaning but refers to what is actually received in return for the provision of services: *Staatssecretaris Van Financiën v Cooperatiëve Aardappelenbewaarplaats GA* [1981] 3 CMLR 337 (ECJ), paragraph 13.

    (v) Consideration must be capable of being expressed as a monetary value, but it is irrelevant that the recipient of a supply does not know what that monetary value is: *Argos Distributors* (above), paragraph 21.

21. Applying those propositions to the circumstances of the present case, I consider that the FtT was correct to analyse the transaction for VAT purposes as a supply of services by Redwood to the Publicans. For my part, I would characterise that supply as being of a service consisting of negotiating and administering an arrangement with the Brewers whereby the purchases made by the Publicans were aggregated, along with those of Redwood itself, with the effect of achieving greater discounts from the Brewers than the Publicans would otherwise have obtained. That, in my view, accords with the commercial and economic realities. It is consistent with such contractual arrangements as were committed to writing, and is in no way artificial. As was pointed out by counsel for

HMRC, the arrangement could be enforced by legal action by the Publicans if Redwood failed to pay over the amounts of discount due. Importantly, it is also consistent with the respective contractual relationships between Redwood and the Brewers and between the Brewers and the Publicans for supplies of goods.

22. No difficulty arises in ascertaining the consideration for these supplies of services: it consists of the amounts actually received, ie the amounts retained by Redwood out of the discounts received from the Brewers in relation to particular Publicans. Those amounts are readily ascertainable. The fact that the Publicans have not hitherto been aware of the amounts (if any) retained by Redwood is, in my view, neither here nor there so far as the VAT analysis is concerned. It may be commercially unattractive for Redwood to have to disclose to Publicans the amount retained, but, at least as regards Publicans who are VAT-registered and make taxable supplies, disclosure may have to be made.

23. Nor, in my opinion, is it of any relevance to the characterisation of the supply as between Redwood and the Publicans that Redwood obtains a separate benefit consisting of an increased discount on the goods which it itself purchases from the Brewers. So far as the commercial relationship between Redwood and the Publicans is concerned, that is an extraneous matter which does not impact either on the analysis of the nature of the supply to the Publicans or the ascertainment of the consideration received by Redwood for that supply.

24. The alternative analysis contended for by Redwood has, in my view, considerable difficulties. The fact that Methods 1 and 2 have to be differently characterised is an unpromising start. The commercial and economic purpose of the agreement between Redwood and the Publicans is exactly the same in both cases; the only difference is that for unconnected commercial reasons it is preferable in the case of some of the Publicans for discounts to be paid by way of credit or price reduction rather than as a monetary payment. That should not lead to a difference in treatment for VAT purposes.

25. I am not persuaded that there is, as a matter of commercial and economic reality, any "right" supplied for a consideration by the Publicans to Redwood. In response to the criticism that there was a lack of clarity as to Redwood's preferred analysis, senior counsel's final position was that the service supplied by the Publicans consisted of the grant of permission to include within Redwood's discount calculations amounts referable to the goods purchased by the Publicans. The consideration for this supply was said to be the money Redwood agreed to pay to the Publicans (Method 1) or the extra discount received by the Publicans directly from the Brewers (Method 2). The difficulty with this analysis, as I see it, is that the sums received by the Publicans under either of the two methods are, as a matter of commercial and economic reality, the discounts due to them from the Brewers in respect of the amounts of beer and other goods supplied to and sold by them. The same sums cannot also have constituted consideration for a service supplied by Redwood. The necessary direct link between, on the one hand, the putative service consisting of a grant of permission to Redwood and, on the other hand, an amount received in return for such a grant is therefore absent.

26. I have not derived assistance from the *Landmark Cash & Carry Group Ltd* decision, whose facts were very different from those of the present case. In contrast to *Landmark*, I am not persuaded that there was here any "something" done by the Publicans in exchange

for payment by Redwood. The characterisation advanced by Redwood is, in my view, artificial and contrary to commercial and economic reality.

Disposal

27. For these reasons, which are largely the same as those given by the FtT, I refuse the appeal.

LORD TYRE

Release Date: 11 June 2018