

It's all in the contract

SANTHIE GOUNDAR examines the recent High Court decision in *A1 Lofts Ltd v CRC*.

‘What usually comes first is the contract’, said Benjamin Disraeli, and never was a truer word spoken. The appeal of *A1 Lofts Ltd v CRC* [2009] EWHC 2694 (Ch) revolved entirely around one contract.

The question here is whether A1 Lofts Ltd, a loft conversion business that used individual contractors to perform the work for their customers, were supplying a complete package of a full loft conversion service for their customers, or were merely agents for the customer in their role as project manager.

HMRC contended that A1 Lofts supplied the complete package, and sought to recover output VAT on the full cost. A1 Lofts argued that it had a contract with customers as project manager, with the individual contractors (e.g. fitters, plumbers, electricians) making supplies to the customer.

The VAT tribunal decision was decided in HMRC’s favour. The High Court recently allowed the taxpayer’s appeal and sent the case back to the tribunal for reconsideration.

The appeal centred around the terms in the contract between contractor, customer and company. The eventual decision is likely to have repercussions for any business using individual contractors to provide a complete package service to customers.

The facts

A1 Lofts (formerly A1 Loft Conversions Ltd) would sign an agreement with a customer ‘appoint[ing] A1 Lofts Ltd as project management and agent’ for the ‘client’ in respect of the loft conversion, and according to the company’s terms of business.

The terms of business set out the responsibilities of A1 Lofts as project manager and defined the ‘contractors’ as ‘the architect, service providers, tradesmen and other persons engaged by the project manager on behalf of and as independent contractors to the client to fulfil in whole or in part the obligations herein’.

KEY POINTS

- A complete package of services is liable to VAT on the full amount.
- Supply of services is not determined by customer knowledge of contractual arrangements.
- Analysis of contracts between all parties.



There were no contracts between customers and contractors, and the contractors were often not known to the customers. The contractors’ agreement, which would be signed by the individual tradesmen, stated that A1 Lofts was the agent of the client.

The contractors, most of whom were not VAT-registered, had already agreed a total fee for their work with A1 Lofts, and addressed their invoices to the customer but sent them to A1 Lofts for payment. Contractors were allowed to negotiate directly with a customer if the customer required any extra work.

Money paid by a customer at each stage of the works went into a ‘client account’, and payments to contractors were made out of this client account. On completion, the customer paid the final balance and signed a completion notice stating the works ‘have been completed by A1 Loft Conversions’.

A1 Lofts recorded its accounting turnover as the amount transferred to its business bank account from the client account, less output VAT. Output VAT was the relevant fraction applied on the amount released from the client account.

Appeal decisions

The tribunal found that customers believed that their only contract for the full loft conversion works was with A1 Lofts, rather than with the individual tradesmen: they were not wholly clear that A1 Lofts was only acting as their agent, or ‘project manager’.

In addition, the tribunal decided that customers were not clear who to approach for legal redress should the need ever arise. The tribunal judges concluded:

‘We do not find that the contracts/agreements entered into by A1 Lofts create the type of agency relationship argued for ... We do not accept that the client’s perception in this matter is irrelevant. Were things to go wrong ... we have no doubt that the client would look to A1 Lofts for a remedy.’

The High Court appeal considered VATA 1994, s 1(2) and s 4(1) as relevant provisions, from which Mr Justice Lewison noted:

‘... it is important to identify the supplier, for it is his liability to account for VAT. Of course if he is not a taxable person (e.g. because his turnover is below the statutory limit) then there will be no VAT for him to account for. That is the economic crux of the present appeal, because some 60% of the contractors are not required to be registered for VAT. If they are making direct supplies to the client, then the client will not have to pay VAT on their supplies.’

The court also reviewed the various contracts between A1 Lofts, contractors and customers, and examined the approaches made in similar cases.

Both the tribunal and the High Court looked in detail at *Kieran Mullin Ltd v CCE* [2003] STC 274. The taxpayer in this case operated hairdressing salons where some stylists were employed by Kieran Mullin and some were self-employed. The self-employed stylists operated under ‘rent-a-chair’ contracts in the salons. While the tribunal held that the taxpayer was liable for VAT, Park J allowed the appeal, on the grounds that ‘different VAT consequences could flow from different contractual structures ... whether the customer knows the details of the structure or not’:

‘Who, for the purposes of s 1 of the 1994 Act, makes to the customer the supply of the service of hairdressing? Is it Kieran Mullin Ltd, acting by the stylist as its agent? Or is it the stylist, acting as principal? In my opinion the answer depends on the relationship between Kieran Mullin Ltd and the stylist. Further, the answer does not depend on what the customer knows about that relationship. Usually the customer will not know about it. This is a matter of common experience in all sorts of contexts, and is in no way special to hairdressing salons.’

He held that:

‘In my view, the starting point, and sometimes the finishing point as well, in answering a question of that nature is to analyse the contractual terms which operate between the parties.’

Judgment

After considering the implication of *Kieran Mullin* and other similar cases, Mr Justice Lewison summarised:

- Where two or more persons are supplying goods or services to a consumer, different VAT consequences may result from different contract structures, regardless of whether the consumer knows of any contractual arrangement.
- Analysing the contractual arrangements between all parties is the starting point in establishing the true relationship between them.

- The true rights and obligations of each of the parties need to be identified before deciding how they should be classified for VAT.

Mr Justice Lewison eventually concluded that the tribunal had ‘adopted an unstructured approach’. He therefore remitted it to the tribunal for reconsideration, saying:

‘They ought first to have construed the contract ... Once they had determined the legal rights and obligations of the various parties, they would then have been in a position to classify them for the purposes of VAT. The process of classification would have required them to determine two interlinked questions: to whom the contractors supplied their services, and what services A1 Lofts supplied to the client ... the construction of the contracts is likely to be the finishing point as well as the starting point.’

What to do next?

While we do not know whether the second tribunal will rule in favour of the taxpayer or HMRC, any business that operates by using individual contractors (especially those whose turnover is below the VAT registration threshold) to provide a complete package of services should watch the progress of this case with interest.

These are likely to include any labour-intensive businesses providing many components to their service, such as double-glazing companies, minicab companies, home extension builders, kitchen companies and hairdressing salons (as in *Kieran Mullin*).

Perhaps the best way to avoid an inquiry into who supplies what and to whom, lies in what has been detailed extensively above: the construction of the contract.

All contracts and, as the *A1 Lofts* tribunal decision showed, perhaps even the company literature and website too, should be clearly drafted regarding:

- the exact provision of services: that of project management/agent services, or the full package of services;
- who is contracted with whom: will customers be aware if they have a contract with the individual tradesmen rather than the company?
- who is liable if things go wrong: are customers aware whether they can or cannot seek remedy from the company?

In short, it starts with the contract. As Mr Justice Lewison concluded: ‘the starting point for determining the true relationship between [all parties] is an analysis of the contractual arrangement between them’.

Disraeli himself would certainly agree. ■

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