



TC01503

Appeal number: LON/2007/0059

INPUT TAX – Supply for a consideration – Payment made by equipment dealer to finance leasing company – Payment was consideration for termination of existing finance leasing agreement relating to old equipment – Payment made as part of deal by which customer under existing finance leasing agreement agrees to enter into new leasing agreement of upgraded agreement – Whether VAT charged on payment is input tax of equipment dealer – Yes – VATA 1994 s.24(1)

FIRST-TIER TRIBUNAL

TAX

CANOTEC LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: SIR STEPHEN OLIVER QC
DR MICHAEL JAMES**

Sitting in public in Plymouth on 30 September 2011

Austin Kinsley, accountant, for the Appellant

Mathew Donmall, counsel, instructed by the general counsel for HMRC, for the Respondents

DECISION

1. The Appellant, Canotec Ltd, is a retail supplier of reprographic and office equipment. Canotec operates in a field of rapidly moving development in the technology of photocopying and document management systems. Many of its customers finance their needs for such equipment through finance leasing. The finance leasing providers require fixed year terms, say five years, and a fixed quarterly return in the form of hire payments from their customers. Hence the useful life of the equipment, which may have become obsolete well within the term of lease, will turn out to have been shorter than the five year term demanded by the finance leasing provider.

2. Many customers and potential customers of Canotec find themselves constrained by the terms of their existing finance leases of their obsolete or obsolescent equipment when addressing the need to introduce new equipment. It is against that background that the present issue arises. The dispute concerns the allowability of VAT charged to Canotec on four invoices. Canotec seeks to recover the amount of £11,549 (plus interest) charged on the four supplies. HMRC say that each of the four supplies has been made to another person, namely Canotec's customer; as such the VAT on the tax will not have been input tax for Canotec.

The four invoices

3. The invoices that are the subject of this appeal are as follows:

(a) An invoice dated 1 July 2005 from CF Asset Finance Ltd ("CF Asset") to Canotec relating to an agreement expressed to be for "Terminal Rental due on Early Settlement of above Agreement for client Winterthur ...", at £19,186.82 with VAT at £3,357.69.

(b) An invoice dated 10 November 2005 from CF Asset to Canotec relating to agreement No 202794 for "Terminal Rental due on Early Settlement of above Agreement ... for client": the client was Regency Mortgages and the amount involved was £17,258.45 with VAT at £3,020.23.

(c) An invoice dated 30 November 2005 from CF Asset to Canotec relating to an agreement ... for "Terminal Rental due on Early Settlement of above Agreement" for client. The amount involved was £22,998.94 with VAT of £4,899.81.

(d) An invoice dated 16 September 2004 from Anglo Financial Services to Ceuta Health Care, noting "Settlement re agreement": the amount involved was £1,556.25 plus VAT of £271.64.

4. As regards all four invoices there had been an existing lease agreement in respect of reprographic equipment between Canotec's customer (i.e. Winterthur,

Regency Mortgages and the other two companies). The existing lease agreement (“the existing lease”) had time to run, and could not be terminated by the customer without the payment of a sum of money (“the termination cost”). Under the arrangements explained later in this Decision Canotec agreed to pay the Termination Cost to the finance company which had granted the Existing Lease. Canotec was invoiced for the termination cost. Canotec paid the amounts specified in such invoices and subsequently claimed VAT paid as input tax.

Relevant legal principles

5. Input tax is defined by section 24(1) of the VAT Act 1994, which states:

“(1) Subject to the following provisions of this section, “input tax”, in relation to a taxable person, means the following tax, that is to say –

- (a) VAT on the supply to him of any goods or services;
- (b) and (c) ...

being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.”

The interested parties

6. There will typically be four or five interested parties in each deal of the sort that is in issue here.

7. First there is the customer whose demands are (a) for the new equipment on a fixed term finance lease and (b) for the rescheduling of its obligations under its unexpired existing lease of its old equipment. The means of rescheduling will be to add the value of the outstanding obligation under the existing lease to the cost of the new equipments, thereby producing a hire charge under the new lease that provides a payback to the leasing company of both amounts plus interest.

8. Second, there is the equipment provider, who supplies the new equipment to Canotec (normally) will invoice Canotec for the price of the equipment once the customer has committed himself to the deal with Canotec and the new finance leasing company.

9. Third there is the new finance leasing company. This provides the money to buy the equipment from the equipment provider and to pay off the customer’s outstanding obligations under its existing lease of the old equipment. The new finance leasing company will become proprietor of the new equipment following the supply to it from Canotec. In at least two of the transactions with which this appeal is concerned, the new finance leasing company has been the same company as the original leasing company that granted the existing lease (“the original leasing company”).

10. Then there will be the original leasing company. This company may be the same as the new finance leasing company. As will appear, Canotec has to commit itself to procure that the existing lease is discharged and that the original leasing company is paid off in full.

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11. Finally there is Canotec which makes the deal happen both as principal and in one respect as an agent.

Analysis of the deal

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12. We take as representative a deal by which a company (Regency Mortgages) was enabled to replace old equipment that had been leased to it under an existing lease from CF Asset with new equipment to be leased under a new finance lease from CF Asset. We heard evidence from Mr Ian Smith, sales director of Canotec.

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13. In July 2005 Canotec notified CF Asset of a proposed deal relating to a new copier to replace existing equipment on lease from CF Asset. On 10 August 2005 the customer signed a "proposal sheet". CF Asset was to be the owner of equipment known as "IR 5000" and Regency Mortgages was to be the hirer. Rent was to be £2,536 (which included VAT) payable quarterly over five years and the first payment was to be made on acceptance by CF Asset. The proposal sheet records how the rent is calculated. It identifies two amounts, i.e. £16,314 being the price of the new equipment and £17,258 being the "amount needed to settle current agreement" (i.e. the termination cost): the aggregate of those two figures is £33,573. The stated "cost of rentals paid over the term" is entered as £45,327.

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14. The proposal sheet notes that the existing (old) equipment has been leased to Regency Mortgages from CF Asset with a reference number of 202794 and it states:

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"If you wish the proposed Agreement to include the amount needed to settle your liability under an existing agreement then you should insert details of the Finance Company and agreement number ... below. By entering those details you acknowledge that the Supplier acts as your agent for the purpose of receiving those settlement monies from us and paying the Finance Company."

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The "supplier" is Canotec.

15. At that stage the proposal sheet is signed by Regency Mortgages and in due course forwarded to CF Asset by Canotec. Mr Scott explained that the amount of £17,258 required to settle the old contract 202794 was already known to Canotec because CF Asset was lessor in relation to both contracts. In situations where the "old" finance leasing company was different from the "new" one, Canotec would normally have to make an estimate of the termination cost the existing agreement.

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16. By 23 August 2005 property in the equipment had passed from Canotec to CF Asset. We infer that the equipment had been duly installed by Canotec at Regency

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Mortgages' premises and the formalities relating to the old equipment (such as the exercise of any option to purchase it from CF Asset) had been concluded. Canotec invoiced CF Asset Finance for £33,573 plus VAT (£39,448) for "the product" on 25 August.

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17. On 10 November 2005 CF Asset Finance issued an invoice to Canotec relating to the "Early Settlement" of the Agreement 202794 (the existing agreement) for £17,258 plus £3,020 of VAT, endorsed with the words "payment received".

10 18. As we interpret the arrangements and the agreements summarised above we see that Canotec committed itself to the customer to procure release from the old agreement on 23 August 2005. At that moment (a) the hiring of the new equipment commenced and the customer became obligated to pay the rescheduled hire fees and (b) Canotec assumed the liability to pay the terminal amount due on surrender of the
15 old agreement. Though nominally the customer remained hirer under the old agreement (2027894) Canotec was contracted to both the customer and to CF Asset (the finance company under the new finance lease) to discharge the termination cost under the existing agreement; the agency status given to Canotec by the Lease
20 Proposal of 10 August 2005 (quoted above) enabled Canotec to effect the surrender of the old agreement using £17,258 of the £33,573 covered by the invoice of 23 August 2005.

19. There is no significant difference between the Regency Mortgages agreement and the other three with which this appeal is concerned. We will use the details of the
25 Regency Mortgages agreement to illustrate our conclusion.

Conclusion

20. The question is whether the tax on the release by CF Asset of the outstanding
30 rental obligations under the existing agreement (202794) covered by the invoice of 10 November 2005 was VAT on the supply to Canotec of a service used for the purposes of Canotec's business. If so, the VAT will be "input tax" within the meaning of that term in section 24(1).

35 21. HMRC say that it is not: the entire cost of terminating the old agreement was consideration for the release of the customer (Regency Mortgages) from the existing obligations under the existing agreement (202794). The value of that benefit to the customer was therefore (to use the phrase found in the *Loyalty Management UK Ltd*
40 Case C-53/09) exactly proportional to the price paid for it. Because there was no residual price for any service to Canotec there was no residual or separate supply to Canotec. The argument for Canotec is that the consideration given by Canotec for the release of the obligation under the existing agreement (202794) was to enable Canotec, in the course of its business, to make the supply of the new equipment.

45 22. In our opinion Canotec's undertaking to procure the release of the hirer's obligation to pay the outstanding hire fees under the existing agreement was an inseverable part of, in the circumstances of the Regency Mortgages arrangements, a

tripartite deal. Canotec's supply of the equipment to the finance leasing company (FC Asset) and the terms of lease to the customer (set out in the Lease Proposal signed by the customer on 10 August 2005) are dependent on the customer ceasing to be liable for rent under the existing agreement. As from the moment of commencement of the equipment lease, which triggers the obligation of the FC Asset, to pay for the equipment (£17,314) and to provide £17,358 to cover the cost of "settling" the existing agreement, Canotec takes on the obligation to settle it by paying the termination cost. Canotec's undertaking (backed by its appointment as agent to procure the release) effectively displaces the liability of Regency Mortgages under the existing agreement. That was part of the deal struck between Canotec, Regency Mortgages and FT Asset; the deal had taken that form in order to accommodate the needs of Regency Mortgages to be released from the existing agreement by rescheduling its outstanding rental liability under the existing agreement into an increased rental under the new agreement.

23. So understood, Canotec's undertaking to pursue the release of the customer's obligations under the existing lease was in no real sense an inducement. It was what the transaction demanded. Thus on 10 November 2005 Canotec was discharging its own liability, being a liability assumed in the course of its business of making taxable supplies of equipment. In return for the payment of £17,358 Canotec obtained the release of its own obligation and that obligation had been assumed for the purpose of its own business.

24. For those reasons, which are applicable to all four invoices, we think that the appeal should be allowed and the assessment made to recover the amount of £11,549.37 plus interest should be dismissed.

25. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE
RELEASE DATE: 12 October 2011

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