TC02493

Appeal number: TC/2011/02215

VAT – claim for repayment of overpaid output tax – whether "discount" for traveller on price of holiday paid by Appellants as travel agent resulted in a deduction of the taxable amount of its transaction (provision of introductory services) with tour operator – no – whether breach of principles laid down in Elida Gibbs – no – Tour Operators' Margin Scheme TOMS considered

FIRST-TIER TRIBUNAL
TAX CHAMBER

TUI TRAVEL PLC and OTHERS **Appellants**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
HELEN MYERSCOUGH

Sitting in public at 45 Bedford Square London WC1 on 14 – 17 May 2012

Mr David Milne QC and Valentina Sloane instructed by Deloitte LLP for the Appellants

Mr Sarabjit Singh, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. TUI Travel plc and others ("the Appellants") appeal the decision of the Respondents ("HMRC) dated 5 August 2010, to refuse their claims dated 27 March 2009 and 25 June 2009 for repayment of output tax which the Appellants claim have been overpaid on commissions earned by UK travel agents within the Appellants corporate group. The Appellants also challenges the Respondents supplementary decision dated 14 April 2011 which sets out HMRC's additional grounds for refuting the claims.

2. The total output tax claimed in the notice of appeal by the Appellants to have been overpaid amounts to £156,678,000.

3. The claim dated 27 March 2009 by voluntary disclosure relates to output tax claimed to have been overpaid for the periods :

(i) 1 January 1980 to 4 December 1996 and 1 April 2006 to 30 September 2008 –

in respect of commissions on the sale of holidays outside the EU ("non-EU claim")

(ii) 1 April 1988 to 4 December 1996 and 1 April 2006 to 30 September 2008 –

in respect of commissions on the sale of holidays within the EU ("EU claim")

4. The claim made on 25 June 2009 by voluntary disclosure relates to output tax claimed to have been overpaid for the period :

1 January 1997 to 31 March 2006 – in respect of commissions on the sale of holidays within and outside the EU. This claim is the subject of a separate appeal on the question of limitation. If the Appellants succeed on the question of limitation, the Tribunal's decision in this appeal becomes relevant.

5. For ease of reference the Tribunal refers to the claims (both EU and non-EU claims) :

for the period before 4 December 1996 as the "Fleming claim"

for the period 1 January 1997 to 31 March 2006 as the "Scottish Equitable claim", and

for the period 1 April 2006 to 31 September 2008 as the "Current claim".

6. The Fleming claim relates to a claim made by Lunn Poly Limited VAT group which subsequently became members of the TUI Travel plc VAT group, covering the period 1 January 1980 to 4 December 1996. The Scottish Equitable claim relates to a claim by Lunn Poly, TUI Travel and First Choice and covers the period 1 January 1997 to 31 March 2006. The Current claim made by TUI Travel and First Choice covers the period 1 April 2006 to 30 September 2008.

7. The Fleming claim was submitted following the House of Lords decisions in *HMRC v Fleming (t/a Bodycraft) and HMRC v Condé Nast Publications ([2008]UKHL 2) 1 All ER 1061* which decided that the three year time limit for reclaiming overpaid input VAT as laid down by the VAT Regulations 1995 (SI1995/2518) Regulation 291A had to be disapplied in the case of all claims for the deduction of input tax that had been accounted for before the introduction of

the time limit. This was because the time limit was invalid under European Community Law since there had been no transitional period as required by the CJEC decision in *Marks & Spencer v C & E Commissioners (no 4) ECJ case C-62/00; [2002] STC 1036.*

8. The value of the respective claims as summarised by HMRC from information provided by the Appellants are :

Fleming claim	£62,737,000
Current claim	£10,349,000
Scottish Equitable claim	£83,016,000
	£156,102,000

The difference between the total value of £156,102,000 above and the sum referred to in paragraph 2 is not an issue before the Tribunal.

Background

9. The Appellants are a corporate group which specialise in leisure travel and include well known brands such as Thompson, First Choice and Lunn Poly. First Choice Corporate Group merged with TUI Travel plc/ TUI UK Limited on 3 September 2007 and First Choice Holidays plc has been a member of the Appellants' VAT group since 1 October 2007. (Lunn Poly having become members of the TUI Travel plc VAT group on 24 July 2003). The UK leisure travel business of the Appellants includes travel agents, tour operators and a charter airline, Thompson Airways Limited.

10. The basis of the arrangements in issue is that the tour operator assembles holidays by purchasing the component parts, which are then sold as package holidays to end customers through the Appellants' travel agency business. The Appellants offer customers a discount on the package holidays which is typically 5% of the brochure price. This discount is funded by the Appellants and the full brochure price of the package holiday is paid to the tour operator. The tour operator pays the Appellants commission, usually 10%, based on the full brochure price of the holiday. The Appellants account for output tax on the full amount of the commission it receives from the tour operator. The tour operator is the principal in the sale of the holiday to the final customer. The discounts are entirely at the discretion of the travel agent and tour operators are aware of the general practice of travel agents funding discounts out of their commission.

11. When a holiday is sold the tour operator issues a customer invoice which is sent to the Appellants. This is a multi-page document. The Appellants part shows the brochure price and the amount of commission by reference to the price. There is no reference to discount and it is not a VAT invoice. The customer's part states the full brochure price of the holiday and again there is no reference to any discount. There is also no reference to the Appellants' commission. The Appellants then send the tour operator's invoice to the customer, either with a separate statement showing the holiday cost as the brochure price, less the discount, or by having made a manual amendment to the invoice showing the brochure price, less the discount.

12. The Appellants claim that they are entitled to a repayment of output tax by deducting the value of the discount from the commission and accounting for the output tax on the reduced amount.

13. The arrangements as described above are materially the same as those considered by the VAT and Duties Tribunal in *First Choice Holidays plc v C & D Commissioners 1999 VAT Dec 16379* and by the ECJ in *C & D Commissioners v First Choice Holidays plc (case C-149/01) [2003] STC 934* which decided that the tour operator had to account for VAT on the full amount of its margin and could not make any adjustment for the discount offered by the travel agent to the customers. In other words, the total taxable amount paid by the customer included the additional amount that "a travel agent, acting as an intermediary, on behalf of a tour operator", had to "pay to the tour operator on top of the price paid by the traveller and which corresponds in amount to the discount given by the travel agent to the traveller on the price of the holiday stated in the tour operator's brochure".

14. The tour operator accounted for VAT via the Tour Operators' Margin Scheme for VAT accounting ("TOMS"). Under TOMS if a holiday is taken within the EU the tour operator accounts for VAT on its margin (rather than the full sales value) and cannot reclaim VAT on purchases or claim refunds of VAT incurred abroad. TOMS was introduced on 1 April 1988. All businesses that buy and sell travel, hotel, holiday and certain other services to travellers must use TOMS to account for VAT on the supplies. The scheme adopts the provisions of Article 26 of the EC Sixth Directive 77/388/EEC (now Article 306-310 of Directive 2006-112). The relevant domestic law is contained in VATA s 53 and in Schedule 8 Group 8 item 12. The Regulations and provisions relating to their implementation are contained in the VAT (Tour Operators) Order 1987 as amended and HMRC's Public Notice 709/5.

15. So far as relevant, the provisions of Article 26 are:

> "1. Member states shall apply value added tax to the operation of travel agents in accordance with the provisions of this Article, where the travel agents deal with customers in their own name and use supplies and services of other taxable persons in the provision of travel facilities. This article shall not apply to travel agents who are acting only as intermediaries and accounting for tax in accordance with Article 11 A (3) (c)
>
> 2. All transactions performed by the travel agent in respect of the journey shall be treated as a single service supplied by the travel agent to the traveller. It shall be taxable in the member state in which the travel agent has established his business … The taxable amount and the price exclusive of tax…. shall be the travel agents margin, that is to say, the difference between the total amount to be paid by the traveller, exclusive of the value added tax, and the actual cost to the travel agent of supplies and services provided by the taxable persons where these transactions are for the direct benefit of the traveller.
>
> 3. If transactions entrusted by the travel agent to other taxable persons are performed by such persons outside the community, the travel agent's service shall be treated as an exempted intermediary activity… Where these transactions are performed both inside and outside the Community, only that part of the travel agent's service relating to the transactions outside the Community may be exempted.
>
> 4. Tax charged to the travel agent by other taxable persons on the transactions described in paragraph 2, which are for the direct benefit of the traveller shall not be eligible for deduction or refund in any member state"

16. In the context of UK travel industry terminology the reference to "travel agent" in Article 26 is effectively a reference to the tour operator.

17. It will be seen that, excluded from the calculation of the tour operators margin, are the costs of and charges made for the supplies to or from the travel agent, that is, the introductory

services. These supplies are disqualified because they are not the subject matter of any supply "for the direct benefit of the traveller".

The Issues

18. The Appellants say that because they have accounted for VAT on the full value of the commission without adjusting for the discount offered to the final customer:

(i) VAT is accounted for on a higher amount than that paid by the final customer for the holiday, which amounts to a breach of the principle of fiscal neutrality;

(ii) the amount of the discount has been taxed twice; once in the hands of the tour operator and again in the hands of the travel agent;

(iii) the travel agent has been taxed on an amount exceeding the consideration actually received by it.

The Appellants say that to remedy matters there should be an adjustment to its output tax.

19. In *First Choice* the tour operator argued that the taxable amount of its supply was the discounted amount paid by the customer. The ECJ disagreed as referred to in paragraph 13 above. In the present appeal the Appellants argue that the travel agent is entitled to deduct the value of the discount from the commission it receives from the tour operator and account for output tax only on the reduced amount.

20. HMRC reject the Appellants' claims in full. In its rejection letter dated 5 August 2010 HMRC dealt with the claims by reference to nine separate decisions as follows :

Decision 1 – Fleming claim: non-EU holidays pre-1 April 1988 were either outside the scope of VAT, subject to VAT at the zero rate or exempt from VAT.

Decision 2 – Fleming claim: non-EU holidays from 1 April 1988 to 30 September 1996 were zero rated under TOMS.

Decision 3 – Fleming claim: EU holidays from 1 April 1988 to 30 September 1996. Although HMRC did not reject the claim in full, it disputed the methodology used to calculate the claim. HMRC said that the Appellants' methodology did not take into account the percentage of VAT actually accounted for by the tour operator.

Decisions 4, 5 and 6 - Scottish Equitable claim: from 1 October 1996 to 31 March 2006. The Appellants' EU and non EU claims are time barred, and should the claims not be time barred the non-EU holidays were zero rated under TOMS and the Appellants' methodology did not take into account the percentage of VAT actually accounted for by the tour operator on the EU holidays.

Decision 7 – Current claim: non-EU holidays 1 April 2006 to 30 December 2008. Non-EU holidays were zero rated under TOMS.

Decision 8 – Current claim: EU holidays 1 April 2006 to 30 December 2008. Again, although HMRC did not reject the claim in full, it disputed the methodology used to calculate the claim for the same reasons as those stated in Decision 3.

Decision 9 - HMRC said that should the Appellants' claim be successful in whole or in part, the amount payable to the Appellants should be set off by the amount that HMRC repaid to

First Choice Holidays plc (a member of the Appellants' VAT group) following the VAT and Duties Tribunal decision in the Appellants' favour that was subsequently overturned by the ECJ. At the time the decision was overturned HMRC were out of time to raise the assessments to recover the amount paid.

21. In its supplementary decision letter of 14 April 2011, HMRC put forward an additional reason for refusing the Appellants' claims. HMRC said that as the travel agent does not supply the holiday to the end customer and only supplies third party consideration to the tour operator, the Appellants are not part of the supply chain of transactions which ends with the final customer. HMRC argued that consequently the output tax on the Appellants commission related to an entirely separate supply, that of agency services provided by the travel agent to the tour operator, for which the commission paid by the tour operator is the consideration. HMRC therefore say that the commission received by the Appellants is not "reduced" by the Appellants funding the "discount", but instead is used by way of contribution towards the consideration paid by the customer to the tour operator and however the Appellants may wish to utilise the monies received from commissions this cannot affect the value of the supply of agency services to the tour operator. HMRC therefore said that they no longer accepted the Appellants' EU claim in principle. HMRC say that this is their primary argument and that a decision on this issue must be determined before any consideration is given to the reasons given for rejection of the Appellants' claim in its decision letter of 5 August 2010.

22. The Appellants have separately appealed (TC/2009/13503) HMRC's rejection of its Scottish Equitable claims. The question of whether the claim is time barred is therefore not an issue for determination by this Tribunal. That appeal is currently stayed and not consolidated with this appeal.

23. HMRC have proposed that the set-off issue should be stood over pending the outcome of further proceedings in *Birmingham Hippodrome Theatre Trust Limited v Commissioners for HMRC* ("*Birmingham Hippodrome*") in which the same issue has been raised by HMRC. The Appellant has agreed with that proposal and therefore the set-off issue is stayed pending the outcome of *Birmingham Hippodrome*.

24. Accordingly, the issues for determination by the Tribunal can be summarised thus :

(i) whether the Appellants have overpaid VAT by accounting for VAT on the full value of the commission received from the tour operator without making any adjustment for the discount offered to the final consumer of a holiday enjoyed in the EU;

(ii) whether the Appellants' EU claim is correctly quantified or whether it should as HMRC allege be reduced to take account of TOMS;

(iii) whether the same principles can be applied to the non-EU claim, that is whether TUI has overpaid VAT by accounting for VAT on the full value of the commission received from the tour operator without making any adjustment for the discount given to the final consumer.

25. The Appellants' grounds of appeal are that :

(i) (a) It is entitled to make an output tax adjustment to reflect the value of the discount given to the customer because otherwise VAT would be collected on an amount exceeding the amount paid by the final customer. The Appellants say that this is contrary to the principles of fiscal neutrality encapsulated in the ECJ's decision *Elida Gibbs (Case C-317/94)* that

"the tax authorities may not in any circumstances charge an amount exceeding the tax paid by the final consumer" (paragraph 24)

(b) The Appellants' introductory services are not a separate chain of supply and when the tour operator accounts for VAT on the total amount paid by the customer for the holiday this includes the discount element given by the travel agent to the customer (as established in *First Choice*). Therefore as the discount given by the travel agent represents part of the consideration received by the tour operator for the supply of the holiday to the customer it cannot also represent part of the taxable amount in the hands of the travel agent, otherwise the amount of discount would be taxed twice. The Appellants refer to *Elida Gibbs* (paragraph 29) where the ECJ confirmed that discounts given (in that case by a manufacturer to a consumer) should reduce the taxable amount and hence the amount of VAT paid by the manufacturer;

(c) If the claim is not accepted the Appellants would be taxed on an amount exceeding the consideration they received;

(ii) HMRC are incorrect when they say that only a proportion of the consideration paid by the final customer contains UK VAT. The Appellants argue that this is on the basis that all of the tour operator supplies are within the VAT net, regardless of the fact that the tour operator uses TOMS to account for VAT. The Appellants submit that TOMS is merely a simplification tool which allows a tour operator to account for output tax on its margin.

Evidence

26. The evidence consisted of a joint bundle of documents including pleadings, correspondence between the parties, relevant legislation, case law authorities and a copy of the Tour Operators' Margin Scheme. Witness statements were provided by Ms Helen Deegan (Commercial and Trading Director for distribution of TUI UK Limited, a subsidiary of TUI Travel plc), Mr Ian Strachan (Director of Finance of TUI UK) and Mr John Wimbleton (a member of TUI Travel plc Group Management Board) on behalf of the Appellants. HMRC submitted a witness statement from Mr Keith Metcalfe, the allocated Officer in respect of TUI Travel plc, who made the decisions under appeal. Neither party objected to the other parties witness statements.

Analysis of the principles laid down in Elida Gibbs

The Appellants' first ground of appeal as referred to above is based on the principles laid down in *Elida Gibbs.*

27. The facts of Elida Gibbs are that the company was a manufacturer of toiletries, which it sold at a specific, VAT exclusive price to wholesalers or retailers who then made onward sales to final consumers. To promote retail sales of its products, Elida Gibbs operated two schemes, a "money-off coupon" scheme and a "cash-back coupon" scheme. In essence, those schemes entailed Elida Gibbs giving a discount to the final consumer, with Elida Gibbs paying the discount either directly to the consumer (in the case of the cash-back coupon scheme) or to the retailer from whom the consumer purchased the product (in the case of the money-off coupon scheme). Neither the wholesaler nor the retailer knew, at the time of purchasing the goods from Elida Gibbs, whether they would be the subject of a promotional scheme.

28. Elida Gibbs had historically accounted for VAT on the full amount paid to it by the retailer. It sought repayment of VAT from Customs & Excise on the basis that its reimbursement of the coupons constituted a retroactive discount which fixed its VAT liability

on its prior sales of the products to wholesalers or retailers. It therefore argued that the taxable base for calculation of the money due from it should be reduced accordingly. Customs & Excise refused, stating that the money-off coupons represented "third-party" consideration which was to be included in the taxable amounts. In addition, in relation to the cash back scheme under which Elida Gibbs made payment directly to the customer, HMRC considered that the retailer played no part in the transaction and as such, there was no direct link between the supply of goods by the manufacturer to the retailer or wholesaler and the reimbursement from the manufacturer to the consumer.

29. The ECJ held that Elida Gibbs was entitled to repayment from Customs & Excise. In addressing this question, it set out the following three "basic principles" of the VAT system and how it operates :

> "The basic principle of the VAT system is that it is intended to tax only the final consumer. Consequently, the taxable amount serving as a basis for the VAT to be collected by the tax authorities cannot exceed the consideration actually paid by the final consumer which is the basis for calculating the VAT ultimately borne by him." (paragraph 19)
> "It is not the taxable persons themselves who bear the burden of VAT. In order to guarantee the complete neutrality of the machinery as far as taxable persons are concerned, the Sixth Directive provides for a system of deductions designed to ensure that the taxable person is not improperly charged VAT." (paragraphs 22 and 23)
> "It follows that, having regard in each case to the machinery of the VAT system, its operation and the role of intermediaries, the tax authorities may not in any circumstances charge an amount of tax exceeding the tax paid by the final consumer." (paragraph 24)

30. In the light of those considerations, the ECJ held that :

> "the taxable amount attributable to the manufacturer as a taxable person must be the amount corresponding to the price at which he sold the goods to the wholesalers or retailers, less the value of the coupons." (paragraph 29)

31. In arriving at its decision the ECJ referred to Article 11 of the Sixth Directive, (77/388EEC) which defines "the taxable amount" and said that its interpretation of the definition in Article in 11A(1)(a) was borne out by the provisions of Article 11C(1).

Article 11A(1) provides that :

> "(a) the taxable amount shall be, in respect of supplies of goods and services …. everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party for such supplies including subsidies directly linked to the price of such supplies"

Article 11C(1) provides that:

> "in the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount is to be reduced accordingly under conditions to be determined by the Member States."

Article 11A(1)(a) now appears in materially identical form in Article 73 of Directive 2006/112/EC (The Principle VAT Directive) and states.

> "In respect of the supply of goods or services, …the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.'

32. The ECJ said that the consideration is the "subjective" value, i.e. the value actually received in each specific case. The ECJ pointed out that Elida Gibbs receives, on completion of the transaction, the sale price of the goods to the retailer/wholesaler minus the value of the coupons. In those circumstances:

> "It would not therefore be in conformity with the Directive, for the taxable amount used to calculate the VAT chargeable to the manufacturer, as a taxable person, to exceed the sum finally received by him. Were that the case, the principle of neutrality of VAT vis-à-vis taxable persons, of whom the manufacturer is one, would not be complied with." (paragraph 28).

33. As the ECJ observed (at paragraph 31) although Article 11C(1) refers to the normal case of direct contractual relations between two parties which is modified subsequently, it is nonetheless an expression of the principle that the position of taxable persons must be neutral. The ECJ held that in order to observe the principle of neutrality :

> "account should be taken, when calculating the taxable amount for VAT, of situations where a taxable person who, having no contractual relationship with the final consumer but being the first link in a chain of transactions which ends with the final consumer, grants the consumer a reduction through retailers or by direct repayment of the value of the coupons. Otherwise, the taxable authorities would receive by way of VAT a sum greater than that actually paid by the final consumer, at the expense of the taxable person."

34. The ECJ said that its interpretation was not invalidated by the objections of the German and UK governments that deduction from the taxable amount of reductions granted directly, or of refunds made directly, to the consumer by the initial supplier after delivery to a wholesaler or retailer would render the VAT machinery unworkable because it would require each wholesaler or retailer in the chain retroactively to adjust their price and to issue amended invoices. The ECJ stated that there was no need to readjust the taxable amount for the transactions between the intermediate links in the distribution chain. (paragraphs 32 and 33)

35. We were referred to *EC Commission v Federal Republic of Germany, (case C-427/ 98) [2003] STC 301*. In that case, under German law, amounts refunded by a manufacturer to a final customer (of the type considered by the ECJ in *Elida Gibbs*), were not treated as deductible from the consideration. Following the ECJ decision in *Elida Gibbs* the EC Commission brought an action against Germany seeking a declaration that it had failed to fulfil its obligations under Article 11 of the Sixth Directive. The ECJ granted a declaration accordingly, holding that by not adopting the measures necessary to allow adjustment of the taxable amount of the taxable person who has effected reimbursement, where money-off coupons are reimbursed, Germany had failed to fulfil its obligations under Article 11.

36. The ECJ reiterated and affirmed the principles it had set out in *Elida Gibbs.* It addressed and rejected each of the objections raised by the German and UK governments including the objection that the manufacturer was doing no more than providing "third party" consideration in the context of a transaction between the retailer and the final consumer, which could not affect the taxable amount in the separate transaction between the manufacturer and the retailer. Germany likened the position of the manufacturer to the final consumer's "dear old grandmother" advancing part of the price, while the UK compared the situation to the manufacturer standing outside the shop, handing banknotes to people who had bought his goods. In paragraph 45 and 46 the ECJ dismissed those points saying :

> "In that regard, it is sufficient to state, first, that although the manufacturer may in fact be regarded as a third party as regards the transaction between the retailer who receives

> reimbursement of the value of the voucher and the final consumer, that reimbursement entails a corresponding reduction in the amount finally received as consideration for the supply by him and that consideration constitutes, pursuant to the principle of VAT neutrality, the basis for calculating the tax for which he is liable (see, in that connection, *Elida Gibbs*, paragraph 28). As regards, secondly, the supply by the retailer who receives the reimbursement, it is important to note that the fact that a portion of the consideration received for that supply was not actually paid by the final consumer himself but was made available on behalf of the final consumer by a third party not connected with that transaction is immaterial for the purposes of determining that retailer's taxable amount"

The Appellants' case

The submissions of Mr Milne for the Appellants are that:

37. If a customer pays a discounted price for the package holiday and the discount is funded by the Appellants, HMRC have still received exactly the same amount as it would have done in a normal non TOMS supply of goods or services and therefore the principles set out in *Elida Gibbs* are offended because HMRC have received VAT from the tour operator based on the full price of the holiday (see *First Choice*) and not the discounted price. Mr Milne says that by applying the legal principles established in *Elida Gibbs* and *EC Commission v Germany*, the EU claim is straightforward. He says that because the travel agent is the first step in a supply chain, which leads to the sale of a holiday to the final customer, the discount it grants to the final customer entails a corresponding reduction in the taxable amount of its transaction with the tour operator. If no reduction were made, the resulting tax treatment would be in breach of all three legal principles established in *Elida Gibbs* (see paragraph 30 above). He submits that alternatively, and in any event as a matter of law, there is no requirement for the person funding the discount to be the first link in the chain of transactions in order for the principles of *Elida Gibbs* to apply.

38. The Appellants either implicitly or explicitly had authority to discount the tour operator's product. Tour operators are aware in general that the Appellants discount holidays and neither discouraged nor prohibited the Appellants from carrying out the discounting. Mr Milne argues that accordingly, the discount given is part of the consideration for the supply of the holiday, which must therefore operate as a reduction in the consideration for the supply of introductory services between the travel agent and the tour operator.

39. The tour operator in practical terms receives the net amount after the deduction of the introductory services. The consideration in the hands of the Appellants is the "subjective value" which cannot exceed the amount actually received by the Appellants and not an amount estimated according to "objective criteria". Therefore the taxable amount in the hands of the Appellants is the commission net of the discount given by the Appellants.

40. In the case of *EC Commission v Germany* the ECJ found that the discount funded by the manufacturer must be included within the taxable amount on which the retailer accounts for VAT, and therefore it cannot also be included in the amount which forms the basis for calculating the VAT liability of the manufacturer, since the discount has entailed a corresponding reduction in the amount finally received by it as consideration. That is necessary to avoid double taxation of the amount of the discount (as referred to in paragraph 52) :

> "… there is no contradiction between, on the one hand, inclusion of the value of the money off coupon in the consideration paid by the final consumer to the retailer and, on the other hand, the reduction in the manufacturer's taxable amount. On the contrary, inclusion of the amount stated on the voucher in the retailers taxable amount entails a corresponding reduction of the

> manufacturers taxable amount in order to ensure that the amount represented by the voucher is subject to VAT only once, namely at the stage of the supply made by the retailer" (paragraph 52 *EC Commission v Germany*)

41. Expanding on the point he makes in paragraph 37 above, Mr Milne says the ECJ made it plain that it does not matter who in the chain of supply makes the discount available to the final customer so long as the VAT collected by the tax authorities does not exceed the amount finally paid by the final customer (see paragraphs 45 and 46 of *EC Commission v Germany* where by analogy the Court said that where the manufacturer may be regarded as a third party as regards the customer and the retailer it does not matter that the retailer in that scenario accounts for the undiscounted price of the goods).

42. With regard to the Appellants' EU claim Mr Milne submits that the principles established in *Elida Gibbs* were on very similar facts to the present case confirmed and applied by the decision of the German Federal Fiscal Court ("GFFC") of 12 January 2006, [V R 3/04]. In that case the GFFC upheld a decision of the Lower Court of FG Brandenburg to allow the appeal by a travel agent against assessments by the German Inland Revenue Office ("IRO") ("the *Brandenburg* case") where the travel agent sold holidays to final consumers from tour operators on which it granted discretionary discounts. The cost of those discounts was borne by the travel agent. There was no agreement between the travel agent and the tour operator as to the discount, although the tour operators were aware of the general practice of discounting. The travel agent was entitled to receive a commission of 10% from the tour operators for its brokerage services. The travel agent accounted for VAT on the basis of turnover figures which were reduced by an amount corresponding to the discounts that it funded. The IRO said the travel agent was not entitled to do this and raised an assessment based on the full amount of commission due to the travel agent (i.e. the 10%), with no reduction corresponding to the discounts. In the travel agent's appeal against those assessments, the Lower Court allowed the travel agent's claim. The IRO's appeal to the GFFC failed.

43. In its judgment, the GFFC referred to the principles set out in *Elida Gibbs* and *EC Commission v Germany* and applied them to the case of the travel agent as follows:

> "The European Court of Justice ruled on these principles in cases where the product manufacturer has issued credit notes and the manufacturer, in the event of a final sale, reimburses same to the end consumer – where applicable via the last retailer. Nonetheless, for such cases the European Court of Justice expressed a generally valid principle for the VAT system, which can always be applied to the rendering of goods and services at different preliminary stages, including any intermediary services: if a contractor involved in the rendering of services grants the end consumer a direct price discount, this reduces the calculation basis for the sale generated by it [the contractor] . In this case, the claimant is a travel agency and as such is to be regarded, with its intermediary services, as the first contractor in the chain of services, which are ultimately rendered as a unit to the end consumer (travel customer)". (paragraph II)

Mr Milne says that the above confirms that it is not necessary for the travel agent to be the first link in the chain of supply. He submits that *EC Commission v Germany* states that even if the discount is regarded as third party consideration the travel agent providing the discount is nonetheless entitled to adjust his output tax. He says that is consistent with the standard accounting practice of travel agents who report revenue net of agent funded discounts. It is irrelevant that the travel agent is a disclosed agent rather than a principal in the chain of supply.

44. The GFFC in *Brandenberg* undertook a worked example of the transaction between the parties, to show that the tax authorities received the VAT contained in the amount spent by the end consumer, and thus the principle of fiscal neutrality was observed.

45. Mr. Milne also referred to two other German cases where the GFFC similarly confirmed the application of the *Elida Gibbs* principles where discounts had been granted by brokers or intermediaries.

(i) In its judgment of 13 July 2006, V R 46/05 on an appeal from the Lower Court of Schleswig-Holstein ("the *Schleswig-Holstein* case"), the GFFC considered the situation of a company ("the broker") who referred customers to telephone companies, with whom customers concluded a contract for the operation of a mobile phone. When a contract was concluded, the broker received commission from the telephone company in question. To induce customers to conclude a contract, the claimant paid the customer he had referred, a reward of 20DM for each month of the contract term in which the contract was complied with by the customer. The broker accounted for VAT on the full amount of commission received and then applied to the tax office to amend them, to take account of the payments made to the final consumers. The tax office rejected his application and the broker's claim before the Lower Court failed. His appeal to the GFFC succeeded. The GFFC reaffirmed that brokerage services can be part of the relevant service chain and explained that nothing in the *First Choice* decision contradicted that, since *First Choice* only related to the service relationship of the tour operator (the analogy in that case being the telephone company) and the end customer.

(ii) In another GFFC judgment of 13 March 2008, [V R 70/06] on an appeal from the Cologne Tax Court ("the *Cologne* case"), which concerned a purchasing association, the same interpretation was confirmed. Again, the GFFC applied the principles in *Elida Gibbs* and *EC Commission v Germany* to a chain of transactions which included brokerage services.

46. Mr Milne argues that these judgments accord with and confirm the Appellants' accounting analysis and application of the principle of fiscal neutrality to the facts of the present case. He submits that while they are not binding on this Tribunal, they nonetheless provide highly persuasive authority on the correct application of the principles in *Elida Gibbs* and *EC Commission v Germany*, to the circumstances of a broker at the start of a transaction chain and that a travel agent acting as a disclosed agent is entitled to reduce its output VAT liability when it funds a discount to the price of a holiday.

<u>HMRC's case</u>

For HMRC Mr Singh submits that:

47. The Appellants are not in the position of the company in *Elida Gibbs*. The Appellants are not the first link or even one of the links in the chain of transactions that ends with the customer, and in any event is paying third party consideration to the customer. In Elida Gibbs the company offered discount to consumers on its own products, whereas the Appellants acted as an agent and sold the product, that is, the package holiday of another party, namely the tour operator. The tour operator was the principal and the customer who purchased the package holiday was the tour operator's customer. Contrary to Mr Milne's submissions the Appellants had no authority from the tour operator to "discount" the tour operator's product. In fact the

tour operator's product was not discounted. Unlike the company in Elida Gibbs the tour operator received the full brochure price for its product.

48. The starting point for the consideration of the Appellants' claim is Article 11 of the Sixth Directive and that the "taxable amount" in the hands of the tour operator include the consideration the tour operator receives not only from its customer who is the person purchasing the package holiday but also from a third party (as confirmed in *First Choice*). However that does not mean that the funds provided by the Appellants which make up the discount do not belong to the supply by the Appellants of its introductory services to the tour operator. That is a separate chain of supply from which the Appellants fund the discount. Indeed, if the discount was not in that separate chain of supply and was regarded as having been netted off from the cost of the holiday at source from the tour operator the ECJ could not have come to the conclusions which it did in *First Choice.*

49. In *Elida Gibbs* the company was the manufacturer of the products and whilst it had no contractual relationship with the final customer, it was the first link in a chain of transactions which ended with the final consumer obtaining a discount. The Appellants cannot rely on this aspect of the ECJ's decision because the travel agent was not as Mr Milne argues "the first step" in the relevant chain of transactions. The Appellants received commission from a tour operator for introducing customers. The Appellants offered discounts to customers in order to increase sales of package holidays and therefore increase the commission received from tour operators. The discount the Appellants offered to the customer properly belonged to the chain of transactions involving the supply of introductory services to the tour operator, not the chain of transactions involving the supply of the package holiday by the tour operator to the customer, particularly as the supplier of the package holiday, i.e. the tour operator, received the fully discounted price for that product.

50. Mr. Singh referred us to the ECJ's observations on Article 26(2) of the Sixth Directive in *First Choice*, which included a consideration of TOMS. The ECJ clearly stated that the :

> "….consideration which has been or is to be obtained by the supplier from the … customer or a third party"

under Article 11A(1)(a) was the same economic element as the :

> "total amount to be paid by the traveller"

under Article 26(2), and that this element "corresponds to the price paid to the supplier of the services"

The ECJ stated that the words:

> "to be paid by the traveller"

used in Article 26(2)

> "cannot be interpreted literally as meaning that they exclude from the taxable amount for VAT part of the consideration obtained from a third party within the meaning of art 11A(1)(a)." (para 28).

51. Mr. Singh therefore argues that just as it is not possible to interpret the words :

> "to be paid by the traveller"

in Article 26(2) of the Sixth Directive literally so as to exclude from the taxable amount third party consideration under Article 11A(1)(a), as confirmed by the ECJ in *First Choice*, equally it is not possible to take the words :

> "the taxable amount…cannot exceed the consideration actually paid by the final consumer"

literally so as to exclude from the taxable amount, any third party consideration. (as stated in *Elida Gibbs* at para 19) Consequently the holiday price was not "discounted" in strict contractual terms at all. The Appellants' contribution towards the brochure price was effectively a gift to the customer. The "discount" on the package holiday offered to the customer was not offered by the tour operator but by the travel agent. The agent arranges a sale at a discount and bears the cost of that discount. The tour operator may well have been aware at a general level that discounts were offered by travel agents, or even encouraged the practice, but the decision to offer a discount rested with the travel agent alone, as did the amount of any discount. The mechanics of how the travel agent funded the discount are of no significance. Therefore, the fact that the travel agent may have funded the discount "*out of the amount of commission the travel agent would otherwise receive from the tour operator*" is irrelevant, as the travel agent was able to fund the discount in whatever manner it wished to.

52. Mr Singh says that there is no reciprocal or direct link between the payment made by the Appellants and the supply made by the tour operator. The travel agent was not the customer. It was not in a contractual relationship with the tour operator and so the payment it made was not consideration "moving from the promisee" in contractual terms. The Appellants' involvement in the arrangements did not include the supply to the customer

53. We were referred to the observations of the ECJ in *First Choice*:

> "29. The consideration referred to in art 11A(1)(a) is the subjective value, that is to say, the value actually received in each specific case (see *Argos Distributors Ltd v Customs and Excise Comrs* (Case C-288/94) [1996] STC 1359, [1997] QB 499, para 16, and *Elida Gibbs Ltd v Customs and Excise Comrs* (Case C-317/94) [1996] STC 1387, [1997] QB 499, para 27).
>
> 30. The taxable amount for a service is everything which makes up the consideration for the service, and there must therefore be a direct link between the service and the consideration received (see, inter alia, *Naturally Yours Cosmetics Ltd v Customs and Excise Comrs* (Case 230/87) [1988] STC 879, para 11).
>
> 31. That link must therefore also be present where part of the consideration is obtained from a third party.
>
> 32. In circumstances such as those described by the national court, the additional amount paid by the travel agent to the tour operator constitutes a condition of the supply by the tour operator of his services, and the commission due to the travel agent is calculated on the full price of the holiday stated in the brochure.
>
> 33. There is therefore a direct link between that additional amount paid by a third party and the supply of the services provided to the traveller. It follows that it is included in the consideration for that supply received by the tour operator and so in the "total amount to be paid by the traveller" within the meaning of art 26(2) of the Sixth Directive…"

54. Mr Singh submits that the Appellants' claim that the travel agent is "the first step in a supply chain which leads to the sale of a holiday to the final consumer" is not correct, but that in any event the relevant question under *Elida Gibbs* is not whether the travel agent is the first "step" in a supply chain "which leads to the sale of a holiday to the final consumer", but

whether the travel agent grants the final consumer a discount by being "the first link in a chain of transactions which ends with the final consumer" obtaining that discount (paragraph 31of Elida Gibbs). The travel agent is not in that position. The Appellants are not in the chain of transactions relating to the supply of the holiday to the final customer. There is no reason why a "discount" offered in the supply of the holiday should reduce the VAT on the agency services provided by the travel agent to the tour operator.

55. The reason that the travel agent offers discounts is because, as stated in correspondence between HMRC and the Appellants :

> "The discount offered to the final consumer is an incentive for the consumer. The travel agent will benefit as they will be able to sell more holidays on the tour operator's behalf and receive greater commission income" (Appellants' letter to HMRC of 27 March 2009)

56. The discount accordingly belongs to a different chain of transactions, involving the supply of agency services, i.e. the introduction of the customer, by the travel agent to the tour operator. The discount acts as an incentive/inducement for the customer to agree to be introduced by the travel agent to the tour operator. The consideration for this supply is the commission paid by the tour operator to the travel agent, which is not discounted. The travel agent declares output tax on the full amount of the commission and the tour operator recovers input tax on the full amount.

57. Mr Singh said it is possible to analyse the different supplies in accordance with the "separate economic transactions" argument advanced in *Total UK Ltd v Revenue & Customs Comrs* [2007] EWCA Civ 987, [2008] STC 19, based on *Kuwait Petroleum (GB) Ltd v Customs and Excise Comrs* (Case C-48/97) [1999] STC 488.

58. In *Total* the company sold motor fuel through a number of service stations. It operated a promotional scheme, under which it gave "face value" gift vouchers to regular customers, entitling them to goods worth £5 at a major retailer. (It had purchased these vouchers from the retailer at a discount). It claimed a repayment of output tax, on the basis that the cost of providing these vouchers was a retrospective discount, within Article 11C(1). Customs rejected the claim and the Tribunal dismissed the appeal. The decision was upheld by the Court of Appeal, Richards LJ, holding that the transfer of the voucher by the company to the customer redeeming his points did not reduce the consideration obtained by the company in respect of its supplies of fuel. He observed that:

> "the customer who receives a voucher does not thereby receive a discount on the price of the qualifying purchases of fuel, but get something extra for the price he paid for the fuel. He paid the full price for the fuel, but sufficient purchases of fuel entitled him to a voucher that he could use for the acquisition of additional goods…'' Richards LJ also said "the supply of fuel and the transfer of a voucher cannot be said to be a single economic transaction. They are, or form part of separate transactions. There is plainly a link between the supply of fuel and the transfer of a voucher but for VAT purposes it does not seem to me to be a direct link capable of causing the transfer of the voucher to be treated as the grant of a discount on the price of the fuel …" (Paragraphs 66 and 67)

59. In *Kuwait,* the Appellant company distributed vouchers to customers who purchased a certain amount of fuel. When customers had collected a given number of vouchers they could be exchanged for goods. The Commissioners issued a ruling that the company was liable to account for output tax on the cost of the goods it supplied in this way. The company appealed and the case was referred to the ECJ for a ruling on the interpretation of (inter-alia) Article 11 A3(b). The ECJ held that there was no "price discount" allowed to the customer. The goods

were gifts and the amounts paid by the customers were entirely attributable to the purchases of fuel and could not be treated as consideration for the goods.

60. Mr Singh therefore argues that in the present situation, the discount the travel agent gives forms part of or properly belongs to the chain of transactions involving the supply of introductory services by the travel agent to the tour operator, and not to the chain of transactions involving the supply of the holiday by the tour operator to the customer. There may be a link between the two, but that is not relevant to the correct analysis

61. We were also referred to *Jag Communications (Plymouth) Ltd v Revenue and Customs Commissioners* (2007) VAT Decision 2002 where the Appellant company sold mobile phones. It received commission from service providers in addition to the consideration which it received from the purchasers. Under a promotional scheme, it offered customers a cashback payment exceeding the price of the phone, if they remained with the relevant service provider for a specified length of time. It treated these cash-back payments as deductible from the consideration which it received. Customs issued an assessment on the basis that the company was not entitled to deduct the cash-back payments in accounting for VAT. The VAT and Duties Tribunal upheld the assessment and dismissed the company's appeal, observing that treating the cash-back as a reduction in the price of the phone would have resulted in a "negative consideration". The Tribunal held that the "promise of the cash-back" was a generalised inducement to enter into the two contracts (to buy the phone from the Appellant and to contract for phone services). It was not a reduction in the price of either of them. Accordingly, the company was not entitled to reduce the amount of its outputs on account of the cash back.

62. The Tribunal in *Jag* referred to *Elida Gibbs*, *EC Commission v Germany* (Case C-427/98) [2003] STC 301 and *Total UK* (in the High Court) and stated that:

> "We regard these cases as authority for the proposition that in a chain of transactions where there is a payment made between parties not in a direct contractual relationship, the same adjustment to the payer's outputs must be made as if it were a reduction in price made between two parties to a contract. It is important that the reason for this apparent extension of the terms of art 11C(1) is the fundamental principle of that if such adjustment is not made the total tax collected at each stage in the chain exceeds the tax on the consideration paid by the final consumer. Such a principle can be tested only if there is a self-contained chain of transactions" (para 14)

63. Therefore, Mr Singh argues, the Tribunal was stating that for *Elida Gibbs* to apply, there must be a "self-contained chain of transactions", i.e. a chain of transactions relating to the supply of the same goods or services. This is essential because it is necessary to add the input and output tax of all the parties and see if this is the same as the tax on the consideration paid by the final consumer. In the Appellants' case, there is no "self-contained chain of transactions which includes the discount". The tour operator is supplying something (the package holiday) different to the travel agent (who supplies introductory services). The travel agent used the commission to fund the discount given to the customer.

64. With regard to the German decisions Mr Singh submits that :

(i) the decisions carry as much weight in an English tribunal as English decisions would carry in a German tribunal. None. Moreover, he says the German decisions should not be regarded as persuasive, for a number of reasons. They will have been influenced by German domestic law, for example on the law of agency. The Tribunal has no evidence about German domestic law and so cannot consider the German decisions in any kind of proper context, which makes them unsafe to rely upon. Mr Singh referred us to a translation of s 164(2) of the German Civil Code which suggests that unless an agent

makes it clear that he is acting only as an agent, he may be treated as acting as a principal even if this is not his intention. There may therefore be other nuances of German domestic law that have influenced the German decisions, which the Tribunal will not know about.

(ii) even putting the above point aside, the German decisions are flawed for other reasons. Little reliance can be placed on the *Brandenburg* case because there was no consideration of the ECJ's judgment in *Kuwait Petroleum*, and the decision was also prior to the decisions in *Total UK* and *Jag Communications*, which the GFFC would not have considered in any event. Unlike proceedings before the Tribunal, the GFFC did not have the benefit of any oral submissions.

(iii) the other German decisions relied upon by the Appellants do not advance matters. The decision of the GFFC dated 13 July 2006 ("the *Schleswig-Holstein* case") simply confirmed the approach in the *Brandenburg* case. It also concerned a different kind of supply, involving commission payments from mobile phone companies. This kind of supply has been considered by the English Tribunal, in *Jag Communications*, and that case has far more persuasive value than the *Schleswig-Holstein* case. The decision of the GFFC dated 13 March 2008 ("the *Cologne* case") adds nothing, as it merely applies the approach in the *Brandenburg* case to a different kind of supply.

Quantification and methodology

65. Mr Singh argues that the *Brandenburg* case does not assist the Appellants on the issue of quantification. He says that it was never suggested in *Brandenburg* that tour operators in Germany did anything other than account for VAT at the standard rate on the full value of their EU supplies to customers, and the GFFC was satisfied that the amount of VAT received by the tax authorities in Germany was the same as the VAT contained in the amount ultimately spent by the customer. By contrast, the Appellants are seeking to recover from the tax authorities in the UK proportionately far more VAT than that contained in the amount spent by the tour operator's customers.

66. HMRC argue that if the Appellants' claims are valid and the discount granted by the Appellants to the customer entails a corresponding reduction in the taxable amount of its transaction with the tour operator, then the Appellants can only recover output VAT on the amount of the discount in the same proportion as the discount bears to the full price of the package holiday supplied by the tour operator.

67. Mr. Singh submits that in substance and reality, very little UK VAT at the standard rate is actually accounted for by UK tour operators in respect of overseas package holidays. Prior to the introduction of TOMS on 1 April 1988, both EU and non-EU packages were apportioned between zero rated (54%), outside the scope (45%) and exempt (1%) supplies, and so no UK VAT at the standard rate was accounted thereon by the tour operator. Since 1 April 1988, there is still no UK VAT at the standard rate on non-EU packages, as they are subject to VAT at the zero rate. In respect of EU packages UK VAT at the standard rate is only accounted for on the tour operator's margin. However that margin constitutes only a proportion of the price charged by the tour operator to the customer at the retail stage. Therefore HMRC argue that only a proportion of the amount discounted by the Appellants contains VAT which can be adjusted.

68. It is therefore argued by HMRC that firstly, where the package is outside the EU, there can be no valid *Elida Gibbs* claim because the tour operator will have accounted for VAT at the zero rate on its margin. Secondly there can be no valid *Elida Gibbs* claim when a package has

been treated as wholly zero rated (e.g. flight only sales), or a mix of exempt and zero rated supplies, and thirdly where TOMS applies an *Elida Gibbs* adjustment must reflect the percentage of VAT actually accounted for by the tour operator to HMRC.

69. Mr. Singh illustrates his point by saying that, in respect of an EU package consisting only of travel (e.g. flights from and to destinations within or outside the UK) VAT will have been borne at the zero rate; so where no VAT is chargeable on a supply to a traveller the travel agent cannot adjust its output tax. Equally where only a proportion of the amount charged to the traveller contains a UK VAT element, any payment made on behalf of the traveller by the travel agent will only have contained UK VAT in the same proportion, so that for example if the cost of a tour package is £1200 and the amount of the tour operators margin, including VAT at 17.5% is £200 then an *Elida Gibbs* claim, if the travel agents contribution is £50, would be £200 x 14.89% (the effective VAT rate) x 50/1200 = £1.24. For the sake of simplicity Mr Singh's example assumes that the whole of the margin is inclusive of standard rate VAT, whereas this is not always the case.

70. It is therefore argued that the Appellants' accounting analysis is flawed in that firstly it does not recognise that any *Elida Gibbs* adjustment must relate proportionately to the discount from the selling price to the customer and secondly presumes the whole of the discount is a discount on the margin rather than a discount from the selling price to the customer. So, for example, if the non-discounted VAT inclusive price of a tour operators package was £1000, but this included only £5 of output tax, i.e. 1/200 of the price, and the amount of the discount was £50, the travel agent could not recover any more than 1/200 of the £50 (£.0.25) as output tax as that would have been the only proportion of the £50 that was due as output tax. He says that it would be a logical absurdity to expect HMRC to repay more tax than they have collected on the £50.

71. Mr Singh says that this principle was made abundantly clear by the ECJ in *EC Commission v Germany*. Advocate General Jacobs said - insofar as is material:

> "83. If, in the normal intra-Community situation, A may be allowed to adjust his output tax downwards on making a promotional payment to or on behalf of D, that is because the price paid by D is inclusive of VAT, so that any reduction in it may also be deemed to include a proportion of VAT. Where on the other hand an item is exported from the Community free of VAT in accordance with arts 15 and 17(3)(b) of the Sixth Directive, no Community VAT is included in any price charged at that or any subsequent stage in the chain. Thus any payment made by A to a subsequent recipient outside the Community cannot be deemed to include any amount of VAT which could give rise to a reduction in A's output tax.
> 84. It should not be prohibitively difficult to ensure that A cannot deduct what would be a fictitious amount of VAT from his output tax in such cases…
> 86. The German government also claims that the same problem would arise in the case of exempt transactions within the Community—if, say, the supply by C to D were an exempt transaction, whereas the supply by A to B had been a taxable transaction.
> 87. In such cases, C will not have been able to deduct any input tax but the price of the final transaction is none the less deemed not to include any VAT. The answer is however the same: since D's purchase price does not include VAT, any reduction or partial repayment of that price cannot include any VAT either and A cannot adjust his output tax."

The ECJ went on to state as follows:

> "64. In particular, as regards normal intra-Community transactions the reason why the manufacturer using sales promotion schemes such as those at issue in the main proceedings is authorised subsequently to reduce his taxable amount is that the price paid by the final consumer includes VAT, and accordingly any reduction in that price likewise includes a VAT element. Conversely, where, owing to an exemption, the value stated on the money-off coupon is not chargeable to tax in the member state from which the goods are despatched, no price invoiced at that stage of the distribution chain, or at a later stage, includes VAT, which means that a

reduction or a partial reduction of that price cannot in turn include a VAT element capable of giving rise to a reduction of the tax paid by the manufacturer."

72. Mr Milne in reply to Mr. Singh's submissions argues that the application of TOMS makes no difference in principle or practice to the application of the relevant legal principles set out in *Elida Gibbs* and *EC Commission v Germany* and that TOMS is nothing more than a VAT accounting simplification method. In support of his argument Mr. Milne referred us to a number of worked examples to show that a retailer buying and selling standard rated goods and a tour operator selling a holiday using TOMS (for simplicity both using the same cost price and sale price), although using different accounting methods, would each earn the same margin and account for the same amount of VAT. Mr. Milne argues that TOMS merely puts tour operators in the same VAT position as other businesses without triggering multiple overseas VAT registrations and therefore submits that HMRC's arguments, that the Appellants account for VAT only on a proportion of its income is "wrong at law". He says the *First Choice* ECJ judgment provides that a tour operator must account for UK VAT on the entirety of the third party consideration that it receives in the form of an agent-funded discount and therefore HMRC cannot successfully argue that such discount is only partly or proportionately subject to UK VAT.

73. Mr. Milne also submits that the existence of zero rated supplies and/or supplies at a reduced rate in the supply chain again does not affect the Appellants' analysis either in principle as to liability or in practice as to methodology. He points out that in many situations the supply chain will involve transactions that attract reduced rates and zero rates of VAT. For example, a number of EU member states apply a reduced rate of VAT to the sale of hotel accommodation and international air transport is typically subject to a reduced rate of VAT. He says that the existence of zero rated or reduced rate products in the supply chain do not alter the VAT analysis: the value of the supply made by the hotelier to the tour operator has not been discounted, as the hotelier has set a price which is paid by the tour operator and similarly the price of the flight is not discounted because the airline sets the ticket price which is again paid by the tour operator. Therefore, no discounting of the reduced or zero rated supplies occur. It is therefore submitted that there is no reason why the existence of reduced rate or zero rated transactions in the supply chain should disturb the application of the *Elida Gibbs* principles.

74. With regard to the non-EU claim Mr Milne argues that it is irrelevant that holidays enjoyed outside the EU were not subject to VAT whether because they were outside the scope and exempt or zero rated. He says that it remains the case that the supply by the travel agent to the tour operator was taxable and that is the relevant taxable supply and in respect of which the taxable amount is reduced due to the agent funded discount. As the ECJ made clear in *Elida Gibbs* the travel agent cannot be taxed on an amount which exceeds the sum finally received by him. Mr Milne says this is so, irrespective of the tax liability of the separate transaction between the tour operator and the holidaymaker. In this respect he referred to the decision of a German law court, the Düsseldorf tax court (DTC), in a judgement of 23 March 2011 (the *Dusseldorf* case). That judgement was on appeal by the IRO to the GFFC, but has now been referred to the ECJ. However, Mr. Milne says that as it stands, the DTC's judgement is firmly supportive of the non-EU claim which decided that an agent funded price discount had a "consideration reducing effect. …on the plaintiffs mediation (introductory) transactions".

75. In summary, Mr. Milne argues that with regard to the EU claim the methodology used by the Appellants is correct and with regard to packages outside the EU the Appellants have overpaid VAT by accounting for VAT on the full value of the commission received from the tour operator without making any adjustment for the discount offered to the customer.

Accordingly the travel agent has been taxed on an amount which exceeds the sum finally received by it

76. Mr Singh's response is that Mr Milne's worked examples do not address the relevant point, being that to recover VAT at the standard rate on the discount incorrectly assumes that the tour operator accounts for VAT on the full supply of the holiday to the customer and at the full standard rate. He reiterated that for a travel agent, the method used to calculate the VAT adjustment has to be considered in the light of the operation of TOMS rather than treated as a simple reduction in taxable commission. He argues that to calculate any VAT refund due, it is necessary to take into account the size of the UK VAT element of the supply being made and that the overall VAT payable by the travel agent can only be reduced in proportion to the total tax of the supply in relation to the total value of the supply. To do otherwise would result in a significant overstatement of any refund due. Attributing the discounts solely to the UK taxable element of the supply to the customer distorts the correct value of any repayment due.

77. For the purpose of calculating any repayment of overpaid output tax, Mr Singh argues that the discount can only be treated as including a VAT element if the amount of the underlying supply includes a VAT element and that as a matter of arithmetical fact only a small proportion of the tour operators income is subject to VAT at the standard rate. Mr. Singh went on to illustrate his point by reference to the Appellants' own trading figures and TOMS declarations. Based on an analysis of the Appellants' TOMS declarations for 2005 the Appellants' full turnover/revenue was £2,211,486,000. The overall margin (turnover minus costs) was £310,285,917 (14% of turnover); the standard rated margin was £73,624,925 (24% of the overall margin, based on the proportion of the standard rated costs to total costs) and the output tax due was £10,965,414 (0.5% of the turnover). This meant that every one pound in turnover contributed output tax of just £0.005; the discount declared by the Appellants in 2005 was £11,719,000. The correct output tax on this amount would have been £11,719,000 x 0.005 = £58,595.

78. Mr Singh argues that applying the Appellants' calculation methodology the whole of the £11,719,000 would be treated as containing VAT at the standard rate. On the basis of the standard VAT rate of 17.5% the Appellants' approach would lead to the recovery of £1,745,382 on the £11,719,000 (£11,719,000 x 7/47), which would be a massive over recovery, approximately 30 times greater than it ought to be. It would lead to the Respondents paying over very substantial amounts of money as "output tax" that, simply did not exist as "output tax" in the system, i.e. "a fictitious amount of VAT" as referred to in *EC Commission v Germany* (at paragraph 65).

79. Mr Singh emphasised his point by saying that because the Appellants seek to reduce the travel agent's output tax liability on the basis of the alleged amount of discount in the tour operator's supply to the customer, they will need to calculate the output tax due on the tour operator's supply, in order to know by how much the travel agent's output tax liability can be reduced. In order to calculate the output tax due on the tour operator's supply, it would be necessary to take into account the various supplies made by the tour operator to the customer and the rate of VAT, if any, on each of those supplies (see paras 14 and 16 of *Jag Communications*, above). To unpick the supplies in this way would undermine the very purpose of TOMS, which is to promote simplicity in the accounting of VAT. He therefore submits that Mr Milne's arguments are logically unsustainable.

80. Mr Singh says that the *Dusseldorf* case cannot be relied upon and carries less weight than the *Brandenburg* case because it was a decision of a regional court and in any event did not address the separate economic supply argument.

81. Mr. Singh referred us to a similar scenario which arose in the case of *Vandoorne NV v Belgische Staat* (Case C-489/09). That case concerned a scheme, like TOMS, that was aimed at simplifying the procedure for charging VAT and removing certain opportunities for avoidance or evasion. The taxpayer was a Belgian wholesaler of tobacco products, who supplied its customers (mainly retail customers) under a special VAT arrangement where VAT had been accounted for on the retail selling price by the first supplier in the chain of supply, i.e. the manufacturer or importer. The VAT was passed on to the wholesaler, who in turn passed it on to the retailer. Neither the taxpayer nor its customers could recover any input tax in respect of the tobacco products, but they did not have to account for output tax to the Revenue authority. The taxpayer sought to rely on Article 11C(1) of the Sixth Directive. In particular, the taxpayer relied on the bad debt relief provision that applied in the "normal" VAT regime, which was aimed at relieving a supplier from the burden of output tax when it did not receive payment for its supplies of goods or services.

82. The ECJ found that the taxpayer could not do this. To allow it to do so would be "*as likely to complicate significantly the charging of VAT as it is to encourage avoidance and evasion, whereas the simplification of the charging of VAT and the prevention of such avoidance and evasion are precisely the objectives pursued by that scheme*" (para 43). Mr Singh submits that exactly the same result would follow if the Appellants were able to rely on Article 11C(1) in the context of a scheme such as TOMS.

83. The ECJ stated in *Vandoorne* that :

> "even though, in certain circumstances…the manufacturer or importer may, in the context of a scheme such as that at issue in the main proceedings, be obliged to pay an amount of VAT which is higher than that which would have resulted from the application of the ordinary harmonised system for levying VAT, the mere possibility that such events may take place is not sufficient, however, to justify the conclusion that that scheme might affect, to a non-negligible extent, the amount of tax due at the final consumption stage…Indeed, a simplification measure implies, by definition, a more general approach than that of the rule which it replaces and thus will not necessarily reflect the exact situation of each taxable person" (para 31).

The ECJ concluded that the inapplicability of Article 11C(1) is :

> "a consequence inherent in a scheme…the purpose and effect of which are… to simplify the procedure for charging VAT…" (para 45).

84. Mr. Singh submits that the same conclusions should follow when applying TOMS as were arrived at in *Vandoorne*. It is a consequence of TOMS that normal rules concerning the application of Article 11C(1) cannot apply. This is a "*consequence inherent*" in the scheme that may lead to a result that "*will not necessarily reflect the exact situation of each taxable person*", but this is outweighed by the advantages such a simplification measure brings. Accordingly, even if the Appellants have an otherwise valid claim, they cannot rely on Article 11C(1) for the reasons made clear by the ECJ in *Vandoorne*.

Conclusions

85. The Appellants are not in the chain of supply of transactions relating to the supply of the holiday to the customer. The agent does not buy in the holiday from the tour operator and then resell it to the customer. The Appellants do not enter into contractual relations with the customer with regard to the supply of the holiday. The contract is between the tour operator as principal and the customer. The Appellants operate as a broker and cannot, as referred to in the

Brandenberg case, be regarded "with its intermediary services as the first contractor in the chain of services which are ultimately rendered as a unit to the end customer ..". The Appellants did not, as in *Brandenberg*, grant the customer a price discount. It was not within the power of the Appellants to do this. Mr. Milne relied on the distinction referred to in *Total* between the customer who gets more goods for the same price and the customer who gets the same goods for a lesser price. He argues that here the customer "gets the holiday at a lesser price." But that cannot be correct. The consideration paid by the Appellants towards the cost of the holiday is mis-characterised when referred to as a discount. In reality there was no discount on the contractual cost of the holiday supplied by the tour operator. The Appellants contributed third-party consideration towards the price of the holiday from its own resources.

86. The Appellants say that they are being taxed on monies that they have not received. That is not a correct analysis of the facts. The Appellants may not have retained the monies that made up the contribution towards the cost of the holiday, but they certainly received them. The consideration paid by the Appellants was third party consideration and in effect a gift to the customer. Therefore the consideration in contractual terms was funded by the customer, utilising the contribution paid by the Appellants. Privity of contract only existed between the customer and the tour operator with regard to the supply of the holiday. The consideration for the holiday was at law paid in full by the customer. If this is not a correct interpretation of the arrangements and instead holidays were discounted at source directly with the tour operator, the ECJ could not have come to the conclusion that it did in *First Choice*, when deciding that when the tour operator accounts for VAT on the total amount paid for the holiday, this includes the contribution paid by the travel agent to the customer.

87. For the principles of *Elida Gibbs* to apply there has to be "a self-contained chain of transactions", that is, a chain of transactions relating to the supply of the same goods or services. This is essential because the net input and output tax of all the parties in the chain must be the same as the tax on the consideration paid by the final customer (*Jag* paragraph 16). The Appellants are in a separate chain of supply. They supply introductory services.

88. The contribution towards the cost of the holiday paid by the Appellants does not therefore lead to a reduction in the value of its supply of introductory services to the tour operator. The very reason the Appellants are able to fund the contribution is because they have been paid the full amount of the commission, irrespective of whether or not as a matter of expedience or standard accounting practice they report revenue to HMRC net of the contribution/discounts they have funded. The contractual documentation between the parties determines the VAT treatment of the arrangements, firstly, between the tour operator and the customer, and secondly between the tour operator and the agent. The tour operator was the disclosed principle. The supplies provided by the Appellants were those of an agent to the principal. It did not did not act in its own name or undertake any significant commercial risk in terms of the supply of the holiday to the customer. As stated in *Total* an objective analysis is called for, "without regard to the parties' subjective intentions or motivation". The contribution was an inducement to the customer to enter into the contract with the tour operator, and not a reduction in the price either of the holiday or the separate supply by the Appellants to the tour operator. There was accordingly no double taxation of the discount element.

89. In the context of a self-contained chain of transactions, the amount received by the manufacturer, tour operator or other link in the chain of supply is the subjective value and the VAT collected by HMRC must not exceed VAT paid by the final customer. However, as stated above, the subjective amount received by the Appellants with regard to its taxable supply to the tour operator was the full amount of the commission paid, and the tax received by HMRC in

respect of the supply by the tour operator to the customer did not exceed the amount paid by the customer. There was therefore total fiscal neutrality in the two chains of supply.

90. In summary therefore, with regard to the Appellants' grounds of appeal :

(i) VAT has not been collected on an amount exceeding that paid by the customer. There has been no breach of the principles of fiscal neutrality.

(ii) the Appellants supply of introductory services are separate from the supply of the package holiday and therefore VAT on the two chains of supply has not been paid twice. The consideration the Appellants receive as commission is separately taxable from the consideration which the tour operator receives from the customer.

(iii) the Appellants have not been taxed on an amount exceeding the consideration it has received.

Accordingly the Appellants are not entitled to reduce the amount of their output tax on account of the contributions made to the customer's holiday.

91. The submissions of the Appellants relating to quantification and calculation of any overpaid output tax do not therefore need to be considered. However there has been much detailed submission by both parties on the points and the issues in our view require clarification.

92. As HMRC say, the flaw in the Appellants' arguments is that the Appellants have arrived at their calculations on the incorrect premise that the tour operator has accounted for and HMRC has received VAT at the full standard rate on the sale of the holiday to the customer. The tour operator was using the tour operators' margin scheme. Any package holiday supplied by a tour operator consisting for example only of travel, that is flights from and to destinations within or outside the UK, will have always borne VAT at the zero rate. Furthermore, UK VAT at the standard rate will have been accounted for only on the tour operator's margin in respect of EU packages. It will not have been accounted for on the whole margin. In respect of the non EU claim for the period prior to 1988, holidays were, pursuant to an agreement between HMRC and the travel industry, either subject to VAT at the zero rate, or outside the scope of VAT, or exempt from VAT. After 1988 non EU holidays have been zero rated under TOMS.

93. Whilst it is correct to say that the tour operators' use of TOMS has no bearing on the amount of VAT borne by the final consumer, that is correct only if referring to UK VAT and that is the flaw in the Appellants' methodology. The tour operator does not account for output VAT to HMRC on the full value of the supply of the package holiday to the customer. In pro rata terms the Appellants seek repayment of output tax that has never been collected by HMRC from the tour operator. When a customer pays for a holiday the total price includes both UK and non UK VAT. The non UK VAT is included in the component costs bought in by the tour operator. Under TOMS the UK tax authorities have only received VAT on the tour operators' margin. The consideration paid by the travel agent represents only a proportion (approximately one-twentieth of the total cost of the holiday) and therefore HMRC have received only a pro rata proportion of the VAT. To allow the Appellants an adjustment in full at the standard rate on the contribution which the Appellants say has led to a reduction in its supply to the tour operator would result in the Appellants receiving a fictitious amount of VAT.

Application for a direction by the Tribunal that the appeal be referred to the ECJ

94. Following the hearing of this appeal the Appellants applied for a direction of the Tribunal that the appeal be referred to the ECJ for a preliminary ruling, pursuant to Article 267 of the Treaty of the Functioning of the European Union. The grounds of the application are that The Federal Finance Court of Germany had announced on 27 June 2012 that the *Düsseldorf* case had been referred to the ECJ for a ruling on the application of the principles of *Elida Gibbs*, as to whether there should be a reduction of output tax in respect of "the allowance of discount by travel agents who operate as intermediaries.."

95. The questions referred to the ECJ are set out below :

1. Is there according to the principles of the ECJ verdict of [Elida Gibbs], also a reduction of the basis of taxation within the scope of a distribution chain if an intermediary (here: the travel agent) refunds to the recipient (here: the travel customers) a part of the price of the transaction brokered by him (here: the service of the tour operator to the travel customers)?

2. If the answer to the first question is in the affirmative: are the principles in Elida Gibbs also then to be applied if only the transaction brokered by the tour operator, but not the travel agents intermediary service, is subject to the special provision according to Article 26 of Directive 77/388/EEC?

3. If the answer to the second question is also in the affirmative: is a member state which has correctly implemented Article 11 C sub-paragraph 1 of Directive 77/388/EEC then entitled, in the case of tax exemption of the brokered service, only to deny a reduction in the basis of taxation if it has created additional conditions for the denial of the reduction by the exercise of the power of authority contained in this provision?

96. A brief summary of the facts of this case as described in the reference is as follows :

1. The plaintiff travel agent performed "intermediary services", some of which were partially tax-exempt and some partially liable for taxation.

2. To the extent that the plaintiff brokered services liable to tax, these were travel services which tour operators performed for travel customers, and which were subject to the Special Provision according to Article 26 of Directive 77/388 EEC. The Special Provisions of Article 26 did not apply as the plaintiff was only active as an intermediary and the Special Provision contained in Article 26 does not apply to intermediary services.

3. The plaintiff received commissions from the tour operators for the taxable intermediary services, and allowed a discount to travel customers which correspondingly diminished her commissions. After she had initially paid tax in full on the commissions she applied to the Fiscal Authority for a change to her tax assessments for years 2002 to 2005 as the discounts given to customers had, (in accordance with §17 of the Value Added Tax Act (UStG) 1999/2005) led to a reduction of the intermediary services performed for the tour operators.

4. The Fiscal Authority only acceded to a change in the assessments insofar as the services performed by the tour operators were liable to tax under the Special Provision in accordance with Article 26. So far as the services of the tour operators, in accordance with Article 26, were tax-exempt the Fiscal Authority refused a change to the plaintiff's tax assessments. The German Fiscal Court allowed the plaintiff's appeal.

97. The reference set out the principles in *Elida Gibbs* and the conclusions that had been reached by the German Fiscal Court ("FG") and said :

> ".. the Court assumed that the principles in .. Elida Gibbs are to be observed if an intermediary allows a discount for a service brokered by him", (as distinct for example from a manufacturer allowing a discount on goods manufactured by it) and "as a result the Treasury receives the tax which is contained in the amount expended by the end user ..".

98. The referral then goes on to describe the reason for the first question in the reference and the doubts over the FG's correct interpretation and application of the *Elida Gibbs* principles in the context of intermediary services:

> ".. these doubts arise from the fact that intermediary services are not part of a "distribution chain" in which "similar goods" are supplied repeatedly, and under the same taxable conditions. The competent Court is proceeding on the assumption that the repeated supply of goods also equates to the repeated performance of a service".

The reference is clearly making the point that where there are separate chains of different supplies it is doubtful that the principles of *Elida Gibbs* can be applied.

99. The reference goes on to describe the complications that could arise in the context of the Special Provision in Article 26 in that the tour operator only pays output tax on its margin and the intermediary could only accurately ascertain its tax assessment basis by knowing the basis of the tour operator's calculation and not from its own records. The reference says that the assumption that tour operators would allow a multitude of brokers to look at their calculations for each tour is unrealistic, which justifies the conclusion that where there are two separate chains of supply, the intermediary services and the brokered transaction, (the holiday) the principles of *Elida Gibbs* are not applicable.

100. The reference also makes the point that Article 26(4) says that tax charged to the tour operator by the travel agent cannot be deducted as input tax by the tour operator because the services are not "for the direct benefit of the traveller..".

101. The reference raises the point that, in accordance with *EC Commission v Germany*, member states do not apply the principles of *Elida Gibbs* to tax exempt services and that the difficulty is establishing to what extent the brokered services are tax exempt.

102. The plaintiff's claim was made under § 17 of the Value Added Tax Act (UstG) 1999/2005 on the basis that the discounts had led to a reduction in the intermediary services. The German Fiscal Authority had only refused the plaintiff's claim for an adjustment of her output tax in respect of her brokered tax exempt transactions. This appears to suggest that under German law in certain circumstances the travel agent is regarded as being one of the links in the chain of supply relating to the holiday and as acting in their own name as principals, otherwise the travel agents could have been regarded as operating as brokering only intermediaries and accounting for tax in accordance with Article 11A sub-paragraph 3C.

103. The Tribunal was not provided with any detailed information with regard to German domestic law and in particular agency law, and therefore it is not possible to come to any definite conclusions as to whether the facts of the *Dusseldorf* case were effectively on all fours with the facts of the present appeal. However HMRC provided a translation of s 164 of the German Civil Code which says :

"Effect of a declaration made by the agent

(1) A declaration of intent which a person makes within the scope of his own power of agents in the name of a principal shall take effect directly in favour of and against the principal. It is irrelevant whether the declaration is made explicitly in the name of the principal, or whether it may be gathered from the circumstances that it is to be made in his name.

(2) If the intent to act on behalf of another is not evident, the lack of intent on the part of the agent to act on his own behalf shall not be taken into consideration.

(3) The provisions of subsection (1) shall apply with the necessary modifications if a declaration of intent to be made to another is made to his agent."

104. Section 164(2) therefore appears to suggest that unless an agent makes it clear that he is acting only as an agent he may be treated as a principal even if this is not his intention. It may therefore be that the plaintiff in the *Dusseldorf* case was dealing in her "own name" within the meaning of Article 26(1). This appears to be confirmed by the language used by the Court in its decision when it said ".. in this case the claimant is a travel agent and *as such is to be regarded with its intermediary services* as the first contractor in the chain of services which are *ultimately rendered as a unit* to the end customer ..". (paragraph II) On the facts of the case this is not a conclusion which this Tribunal would come to.

105. Insofar as it is material, Article 267 of the TFEU provides as follows :

"The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning :

(a) the interpretation of the Treaties;
(b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;

Where such a question is raised before any court or tribunal of a Member State, the court or tribunal may, **if it considers that a decision on the question is necessary to enable it to give judgment,** request the Court to give a ruling thereon .." [emphasis added]

106. In *Dr Reddy's Laboratories (UK) Ltd v Warner-Lambert Co LLC* [2012] EWHC 1791 (Pat), Roth J stated that :

"6 The principles which apply to the making of a reference to the ECJ for a preliminary ruling were not seriously in dispute between the parties. They may be summarised as follows :

(1) A national court may only make a reference for a preliminary ruling if a decision on the question is necessary to enable it to give judgment in the case pending before it: Art 267 TFEU.

(2) In those circumstances, a court of first instance has a discretion whether or not to make a reference. In that regard, its position is to be contrasted with that of a court from whose judgment there is no appeal: ibid.

(7) Accordingly, if a reference is to be made at a preliminary stage, the court must have confidence that the factual situation can be sufficiently defined and that all the relevant legal issues have crystallised such that the questions on which a ruling of the ECJ is necessary can be framed with precision."

107. The fact that a reference has been made in a German case on different facts and where the issues are not identical does not make it "necessary" for the Tribunal to make a reference "to enable it to give judgment" in the present appeal.

108. Plainly the reference in *Dusseldorf* was made because the German Fiscal Authority was dissatisfied with the decision of the FG. The reference includes the same points that have been

argued in this case, but possibly in an entirely different context if the plaintiff in *Dusseldorf* was acting as a link in the chain of supply of travel services to the customer. In any event, on the facts of this appeal, the relevant issues are sufficiently clear and there is no need for a reference to the ECJ. In the German cases there does not appear to have been any detailed consideration given to the argument that there were two separate chains of supply and in any event they are not binding on this Tribunal.

109. There is in our view no doubt as to the correct application of EU law on the *Elida Gibbs* point, and therefore a reference is not necessary to enable the Tribunal to give judgment. Further, a decision from this Tribunal on the merits of the appeal clarifies and defines both the factual and legal issues involved, enabling any future reference to the CJEU, for example on appeal, to be made with a greater degree of precision. The Tribunal's findings as to the various issues which have been raised would assist the CJEU in the event of a reference being made in the future.

110. The Tribunal's decision is that the Appellants are not entitled to reduce their outputs as a consequence of providing third party consideration for the package holiday out of commission received, and HMRC's decisions to refuse the Appellants' claims are correct.

111. For the above reasons we dismiss the appeal.

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.

MICHAEL S CONNELL
TRIBUNAL JUDGE

RELEASE DATE: 26 November 2012