

Private Client and Wealth Structuring

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Tax Tribunal Decision: Brunel Motor Co Ltd

Burgess Salmon warns that a draconian approach on administrative receivership of customers can have unintended tax consequences.

Clauses in commercial contracts setting out what happens in case of administrative receivership can have significant unintended consequences for VAT. Surprisingly, a clause that at first seems to confer a great commercial advantage can at the same time create expensive tax complications.

In the recent case of Brunel Motor Company Ltd, the Tax Tribunal was obliged to make a decision contrary to what it regarded as the common sense approach to the VAT treatment of certain supplies because of a particularly draconian termination provision in the relevant supply agreement.

The VAT litigation between Brunel Motor Co and HMRC began in with a decision by the VAT and Duties Tribunal in 2007, went as far as the Court of Appeal and ultimately turned on a question of fact because of the drafting of the relevant contract.

Brunel Motor Co was a main Ford dealership, trading as Brunel Ford. The dealership agreement provided that Ford would supply cars to Brunel Ford on a sale or return basis. The agreement also stated that if Brunel Ford went into receivership, the full purchase price and all outstanding amounts would immediately become payable. In addition, Ford could repossess the remaining cars. Ford's double right to both repossess the cars and to claim full payment of the purchase price was regarded as "overkill" by the court and it was this point on which the case ultimately turned.

In 2002 Brunel Motor Co was making losses and Ford terminated the dealer agreement. Ford put Brunel Motor Co into administrative receivership and repossessed the unsold cars. To allow the dealer to continue in business, Ford issued credit notes to Brunel Motor Co to release the debt owing on the repossessed cars, opened a new "dealer code", resupplied the cars under the new code and invoiced the company accordingly.

At that time, Ford agreed with HMRC that the VAT effect of this arrangement was that:

- (a) Ford could recover the VAT it had accounted for in respect of the original supplies;
- (b) the dealer lost its corresponding input tax deduction;
- (c) Ford accounted for VAT on the new supply; and
- (d) the dealer could claim an input tax deduction for the new supply in the period in which that supply was made.

This put Brunel Motor Co in difficulty because it had a greatly reduced VAT recovery in periods before the administrative receivership began, leading to significant liabilities in those periods. There was a large input tax deduction in the period commencing on the appointment of the administrative receivers. This affected the security of NatWest, a creditor of Brunel Motor Co, which sued Ford. Brunel Motor Co then wrote to HMRC claiming that the credit notes issued by Ford were invalid so that its original VAT position ought not to be disturbed. HMRC disagreed and refused to reverse its decision. Brunel Motor Co appealed to the Tribunal.

The case, through its various stages, determined that if Ford and Brunel Motor Co had agreed to rescind the original supply agreement, the credit notes would have been issued to recognise the legal right for both parties to reverse the supply. Accordingly, the VAT adjustments would correctly have taken place as asserted by HMRC. Alternatively, if Ford had unilaterally rescinded the agreement and repossessed the cars but left the whole price payable by virtue of the "overkill clause", the credit notes would not reverse the original supplies. Without that clause, it could be expected that the parties would have agreed adjust their respective VAT returns on the basis that the price payable for the cars would be reduced, if not eliminated, when they were repossessed.

The Tribunal held that the cancellation of the dealership agreement, repossession of the cars and issue of the credit note were all in fact unilateral acts by Ford. There was no

agreement by Brunel Motor Company to rescind the supply agreement. Consequently, the appeal was allowed and there was no adjustment to Brunel Motor Co's VAT liabilities for the periods before administrative receivership began.

Although this was a positive result for Brunel Motor Co, it was costly for Ford and did not follow the analysis that would have been expected in light of the commercial reality of the arrangements.

Before deciding to impose extreme measures on the administrative receivership of its customers, a supplier would be well advised to consider the potential VAT implications. In some cases, a theoretical advantage might be outweighed by the costs, risks, uncertainties and commercial distractions caused by protracted litigation. A more reasonable, measured approach could in the end be more beneficial to all concerned.

Burges Salmon advises a wide range of clients in negotiating supply contracts. As part of our service we can help businesses to maintain control when a supplier goes into receivership without facing the risk of unintended, adverse tax consequences.

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