VAT focus

VAT for employment businesses: clarity at last?

Speed read

The VAT treatment of employment businesses that place temporary workers ('temps') is currently in a state of confusion. In April, the Court of Appeal is scheduled to hear the taxpayer's appeal in *Adecco UK Ltd v HMRC*. It is to be hoped that the court's decision will provide some much needed clarity in this area.

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Many employment businesses in the temporary employment sector are currently uncertain how to account for VAT. The fundamental issue is whether they are liable to account for output tax on: the full value of the payments received from their clients (e.g. 120), consisting of both the temps' remuneration (e.g. 100) and commission charged by the employment business (e.g. 20); or on their commission alone. The answer turns on the correct analysis of the supplies made by employment businesses to their clients. This is another multi-party situation in VAT, where advisers and the courts must determine 'who supplied what, to whom?'

The VAT treatment of employment businesses has come before the UK courts and tribunals a number of times. Prior to the Upper Tribunal (UT) decision in *Adecco UK Ltd v HMRC* [2017] UKUT 113, the two leading cases were *CCE v Reed Personnel Services* [1995] STC 588 ('*Reed Personnel*') and *Reed Employment Ltd v HMRC* [2011] SFTD 720 ('*Reed Employment*').

Reed Personnel did not directly concern the output tax liability of an employment business, but whether it was supplying nursing services that were exempt from VAT. The VAT tribunal, in a decision upheld by the High Court, held that 'the nursing services [were] supplied by the nurses and not by Reed'. Instead, Reed was providing standard-rated 'administrative services' and could therefore deduct its input tax in full.

Reed Employment was about the output tax treatment of an employment business. The First-tier Tribunal (FTT) held that the taxpayer made supplies of the service of introducing temps to its clients, plus other ancillary services (e.g. operating payroll for those clients). On that basis, the FTT held that Reed was only liable to account for output tax on the commission it received from its clients (i.e. the 20). Although the case went on to the Court of Appeal on other issues, the FTT's conclusion about the nature of Reed's supplies was not challenged by HMRC.

Many hoped, therefore, that the FTT decision in *Reed Employment* had clarified the VAT treatment of employment businesses. However, HMRC subsequently released *HMRC Brief 32/11*, which stated that it considered that the FTT decision was 'decided on its specific facts' and did not have 'any wider impact'.

Adecco raises the same issue as *Reed Employment*. In *Adecco*, the FTT held that the taxpayer was liable to account for VAT on the full amount that it received from clients (i.e. the 120). The UT upheld that result, albeit for different reasons. Much of the UT's analysis is clear and correct. In particular, following the decision of the Supreme Court in *Airtours Holidays Transport Ltd v HMRC* [2016] STC 1509, the UT held that:

1. the VAT analysis of multi-party situations involves a two-stage process of: analysing the contractual position; and determining whether 'the contractual analysis reflects the economic reality of the transaction';
2. the contractual position 'normally reflects the economic reality of the transactions', although it may not do so, e.g. where the transactions involve purely artificial arrangements; and
3. the analysis is highly fact-sensitive.

Unfortunately, the UT analysis also contains a fundamental error. In para 47, the UT held that the case should be analysed in the same way as *Reed Personnel*, stating that:

> 'The VAT tribunal held that Reed had supplied the nurses who in turn had supplied their services to the hospitals. On appeal, [the High Court], accepted that … the contractual documents indicated that Reed was supplying nurses, not nursing services. We take the same view in this case.'

However, despite expressly relying on the reasoning and conclusions in *Reed Personnel*, the UT arrived at a different result. In *Reed Personnel*, the VAT tribunal held that the taxpayer was supplying 'administrative services' with 'the consideration for these supplies being the commission it receives', such that Reed was liable to account for VAT on its *commission alone* (i.e. the 20); that decision was upheld by the High Court. The UT in *Adecco* provided no reasons for coming to an entirely different result, namely that the taxpayer was liable to account for VAT on the *full amount it received from its clients* (i.e. the 120). It follows that the decision of the UT is clearly wrong in law.

The UT's confusion may stem from its repeated reliance on the phrase 'supplying the temps'. Although the concept of a 'supply of staff' is known to VAT (e.g. Principal VAT Directive articles 59(f) and 132(1)(k)), it is an unhelpful label when attempting to determine the nature of the supplies made by employment businesses. It is clear that such businesses are making supplies of *services* (i.e. the temps are not goods!), but that fact is obscured by referring to 'supplies of temps'. More analytical clarity is achieved by specifically identifying the *actual services* supplied by employment businesses to their clients, e.g. are they supplying: the work done by the temps; a service of introducing temps to clients; and/or other services?

What next?

Employment businesses and their advisers should:

- study the forthcoming decision of the Court of Appeal in *Adecco*, in the hope that it will clarify the VAT treatment of employment businesses;
- remember that the correct VAT analysis of any particular business is fact-sensitive, and so may not be determined by the final result in *Adecco*; and
- carefully review the contractual terms on which the employment business is operating in light of the decision in *Adecco*. ■

For related reading visit www.taxjournal.com

- Cases: *Adecco UK and others v HMRC* (21.3.17)
- *Adecco* and supplies of workers: a temporary result? (Nick Skerrett, 28.1.16)