HMRC - VATSC37400 - Practical Consequences

This section should be read in conjunction with the rest of VATSC36400.

The Law Society asked if Customs and Excise were happy that Press Notice 82/87 was correct, and they confirmed that they were satisfied with the general approach, and did not think it should be extended, for example, on the basis of the decisions in Neville Russell v Customs and Excise (1987 VAT TR 194) and Gleneagles Hotel plc v Customs and Excise (1986 VAT TR 196), to indicate that anything done in exchange for consideration is a supply.

Customs and Excise did not consider that a person had an intrinsic right to sue so that by not suing, a person was not necessarily giving up any right. Customs and Excise thought the position could be analysed by saying that a person was really exercising an option not to enforce an alleged wrong, rather than giving up any right. The acceptance of an offer not to sue is taken because the reason for wanting to sue in the first place is settled on receipt of payment.

Customs and Excise agreed that if VAT was never mentioned in negotiating a settlement, the plaintiff could suddenly find that the amount of cash he received in his settlement was reduced by VAT. There was a suggestion that this could be avoided by adding to the agreement for settlements the words “VAT will be added [to the agreed sum] if applicable”. However, it would obviously be preferable to issue clear guidance to avoid the necessity of requiring such terms automatically to be added to settlement wordings.

The Law Society asked if Customs and Excise agreed that liquidated damages paid under contracts were also outside the scope, and Customs and Excise confirmed this. Such cases would not involve litigation, but were within the spirit of the Press Notice. If a contract contained provisions for damages in respect of a breach, this would generally be within the Press Notice, but if a plaintiff was giving up a separate right, for example, the right to receive notice, this could be a taxable supply.

Customs and Excise agreed a “Joint Statement of Practice” (JSP) with the principal leasing association in order to avoid contractual arguments and any ambiguity over the correct VAT treatment of termination payments and rebates/refunds of rentals arising under equipment leases. The object of the JSP is to establish a common treatment which provides that:

all lease termination payments may be treated as being in respect of taxable supplies, ie of the right to terminate. Here the termination payment is usually calculated by references to the amount of rental payments outstanding under the primary lease period; and

where on expiry or termination of an equipment lease, the lessee receives from the lessor a rebate or refund of rentals, no adjustment for VAT previously charged need be made. However, credit notes should be endorsed “This is not a credit note for VAT purposes”.

Importantly, the JSP does not override any contractual arrangements in force. If the lessors wish to revert to the terms of their original agreements, they may do so. For example, lease termination payments may arise on default by a lessee which are by way of liquidated damages and therefore outside the scope of VAT.

Taxpayers who were not within the major leasing associations could rely on this agreement, but they would not necessarily be aware of it. It was confirmed that local VAT offices had knowledge of it.

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