VAT focus

Adecco: employment contract has primacy

Speed read

The Court of Appeal judgment in *Adecco UK Ltd v HMRC* once again confirms that 'contract has primacy'. However, was Lord Justice Newey correct in his assertion that *Reed Employment Ltd v HMRC* was incorrectly decided or has the landscape in relation to employment law changed? Indirect tax advisers are not always accustomed to determining the VAT liability of a supply by reference to non-VAT legislation. However, where those non-VAT provisions impact contractual and legal relationships, they may merit consideration.

Kevin Carletti
KPMG
Kevin Carletti is a director in the financial services and real estate VAT team at KPMG. With over 30 years' experience, both in-house and in practice, he advises a wide range of clients on structuring, liability and partial exemption related issues. Email: kevin.carletti@kpmg.co.uk; tel: 020 7311 2383.

Jill Bromwich
KPMG
Jill Bromwich is a manager in the financial services team at KPMG, advising clients in the asset finance, asset management and banking sector. Prior to joining KPMG, Jill was a solicitor at HMRC with a focus on MTIC fraud. Email: jill.bromwich@kpmg.co.uk; tel: 020 7311 2593.

The importance of contractual relationships, and how or whether they reflect the economic realities of a transaction, has been the subject of much discussion in the UK courts. Following the decisions of the Supreme Court in cases such as *WHA v HMRC* [2013] UKSC 24, *Secret Hotels2 Ltd v HMRC* [2014] UKSC 16 and *Airtours Holidays Transport Ltd v HMRC* [2016] UKSC 21, it is now a well-established VAT principle that, as a starting point, it should be assumed that the VAT analysis of a transaction should follow the contractual position. It is only necessary to deviate from this stance in circumstances where the contracts are sham or, by reference to the fact pattern, do not reflect economic and commercial reality. Taking this into account, the findings of the Court of Appeal in *Adecco UK Ltd v HMRC* [2018] EWCA Civ 1794 ('*Adecco*') are therefore unsurprising.

The appeal concerned the nature of the services being provided by Adecco to its clients. The Employment Agencies Act 1973 distinguishes between 'employment agencies', acting as an agent to place staff; and 'employment businesses', providing staff as principal.

Adecco maintained that the services it provided were akin to those of an employment agency and therefore limited to the introduction of temporary staff ('temps') to its clients. The temps, who despite the regulatory framework were not its employees, provided their services to the clients separately. As such, the only consideration Adecco was required to recognise in respect of its services was the retained commission element of the fee paid by the client. It argued that the balance of the monies it collected represented the employment costs of the temps, i.e. salary, PAYE, NIC, etc. which it merely disbursed. As such these amounts were not part of the consideration for the supply it made to its clients, and so not liable to VAT.

The legal relationship

A review of the contractual position revealed that there was a legal relationship between Adecco and the temps. Whether or not the temps were employed by Adecco, the contract was the same: the temps agreed to perform assignments; and Adecco agreed to pay them at an agreed rate.

Under the Conduct of Employment Agencies and Employment Business Regulations, SI 2003/3319 (see below), Adecco was obliged to pay the temps for their services, regardless of whether the end client paid Adecco. While under the terms of the contract between Adecco and the temps, the temps worked under the direct supervision and control of the end client, Adecco nonetheless had a legal relationship with the end client. As a consequence, any unauthorised absence of the temps could constitute a breach of Adecco's contract with the end client.

Based on the contractual position, the Court of Appeal decided that Adecco's supply was of a worker; and the value of that supply was the total amount that the client was contractually obliged to pay Adecco. Adecco only retained its margin (described as its commission or payment for the introductory service), and was obliged under a differed contract to pay the rest to the temps, less statutory deductions. However, this fact did not reduce the value of the supplies made by Adecco to its clients.

Reed Employment Ltd: an incorrect decision?

Perhaps the most surprising element of the judgment is Lord Justice Newey's comments in relation to the decision of the FTT in *Reed Employment Ltd v HMRC* [2011] UKFTT 200 ('*Reed*'). At para 51, Lord Justice Newey states:

> '…Reed, like Adecco, paid temps in discharge of obligations of its own, not as an agent for any client. It cannot therefore be said in any meaningful way that Reed paid a temp "on behalf of" the client, that Reed was "reimbursed" by a client or that such as payment was "not a cost component of Reed's own supply". Secondly, Reed, like Adecco, could perfectly well, in my view, supply more than the "introductory and ancillary services" found by the FTT without having had any pre-existing control over the temps. Thirdly, the "control of the client" to which the FTT referred to in paragraph 88 of its decision must have been derived from the arrangements between the client and Reed. Temps did not agree with clients that they would be subject to their control. It seems to me that Reed, like Adecco, will have been able to confer control on its clients by virtue of its contracts with temps.'

At para 52, Lord Justice Newey goes on to acknowledge that contractual provisions would not be identical in both cases, but he did not feel that was in itself enough to distinguish *Adecco* from *Reed*, before concluding that in his opinion *Reed* was wrongly decided.

This poses the question of whether Lord Justice Newey was correct in his observation that *Reed* was incorrectly decided or has the landscape in relation to employment law changed?

The regulatory framework

Under SI 2003/3319, in order to pay a non-employed temp, the employment agency must reconstitute itself as an employment business. By doing so, and in accordance

with reg 15 of the aforementioned regulations, the new employment business is thereby required to have a contract with the non-employed temp under which the employment business is liable to pay the temp, whether or not it receives its fee from the end client.

This change took effect from April 2004, and was therefore in force at the time *Reed* was decided. As such, it is of little consequence in distinguishing the decisions in question and indeed lends support to Lord Justice Newey's assertion that *Reed* was incorrectly decided.

However, the Agency Workers Regulations, SI 2010/93 ('the regulations'), which came into effect from 1 October 2011, are more pertinent to *Adecco*. These afford temps, following the completion of 12 weeks in the same engagement, the same basic terms and conditions of employment as if they had been employed directly by the end client. The agency is then responsible for taking steps to ensure that temps are afforded equality in respect of key elements of pay, duration of work time, rest breaks and annual leave.

Under the regulations, temporary work agencies are defined as businesses which supply agency workers on a temporary basis to end clients. The regulations acknowledge that the temporary worker will work under the supervision and direction of the end client, but will only have a contract with the agency.

Characteristics of temporary workers

In guidance issued by the Department for Business Innovation and Skills (see bit.ly/2vCLyaf), the characteristics of a temporary worker are listed as:

- The temporary worker works for a variety of end clients on different assignments but is paid by the agency, which deducts tax and NICs.
- The temporary worker has a contract with the agency but works under the direction and supervision of the end client.
- Timesheets are given to the agency, which pays the temporary worker for the hours worked.

In relation to the decision in *Adecco,* it is important to note that the regulations do not apply to self-employed agency staff, who are directly engaged by the end client, thereby distinguishing between non-employed temps and contract workers. In fact, from the FTT onwards HMRC never appears to have disputed that in respect of directly engaged workers, introduced by Adecco, the supply made by Adecco was of introduction; and, accordingly, that the consideration for its supply was confined to its fee for doing so.

Employment businesses: the employer of temps

The regulations acknowledge that it is normal for temps to:

- not have a contract direct with the end client; and
- still work under the direction and supervision of that client

The regulations therefore effectively close down the arguments advanced by Adecco in support of its appeal. Additionally, whilst Adecco may not in practice have dealt with issues such as annual leave, and termination and suspension rights, it was required by the regulations to obtain and provide that information to the temporary workers.

Effectively, the new regulatory provisions regard the employment business as the employer of temps, whether or not an employment contract exists.

There certainly seems to be an indication at paras 88-90 of *Reed* that the FTT took the view that the economic reality of the arrangements were such that Reed was not capable of supplying staff, since the temps were not employed by Reed. However, in the interim period between the hearings of *Reed* and *Adecco*, the regulatory framework has addressed this issue, clearly defining the legal relationship between Adecco and the temporary workers as one of employment.

HMRC's VAT Guidance 700/34: *Companies that supply staff and staff bureaux*, published on 6 June 2012, seems to reflect the change in the landscape. The guidance quite clearly brings both individuals who are 'contractually employed' and those who 'are otherwise engaged' by employment businesses (often on contracts for service as opposed to of service) within the definition of 'supplies of staff'. The guidance is also very clear that VAT must be charged on the full amount of consideration received for the supply of staff, including NICs, PAYE and other similar items.

Why no reference to *ADV Allround Vermittlungs AG*?

One slight curiosity in the *Adecco* case is that, having closely analysed the decisions of the FTT and UT, the Court of Appeal did not find it relevant to reference the CJEU decision in *ADV Allround Vermittlungs AG* (in liquidation) (Case C-218/10) ('*ADV Allround*'). The issue concerned the place of supply of self-employed lorry drivers to haulage contractors, and whether self-employed persons not in the employ of the trader providing the services, fell within the scope of the definition of the 'supply of staff' for the purposes of the Sixth VAT Directive art 9(2)(e).

Similar to the contractual position in *Adecco*, the drivers charged ADV for their work; and in turn ADV charged the haulage contractors for the supply of drivers. The CJEU concluded that the 'supply of staff' does not necessarily describe a service whereby a taxable person makes available his own staff to another person, but the main characteristic of such service may well lie in the fact that that another person is supplied with staff or manpower – regardless of the nature of the contractual relationship between the provider of that service and the person supplied.

The lack of reference to this case perhaps suggests that, having reached the conclusion that 'contract has primacy', the UK courts decided it did not add anything. However, a reading of the *ADV Allround* decision certainly does nothing to contradict the conclusion the UK courts have reached in *Adecco*.

What lessons can be taken away from *Adecco*?

The first lesson to be drawn from *Adecco* is that prima facie contractual positions have primacy in determining the VAT analysis of a transaction where there is nothing to suggest that the contract does not reflect economic and operational reality. In addition, whilst we as indirect tax advisors are not always accustomed to determining the VAT liability of a supply by reference to non-VAT legislation, where those non-VAT provisions impact contractual and legal relationships, they may merit consideration.

A successful appeal to the Supreme Court, if leave were granted, seems unlikely, given the comments of the Court of Appeal. It is clear therefore that going forward, businesses will incur VAT on the whole of the sums paid for the provision of staff by an employment business. Whilst this is not an issue for fully taxable businesses, it is for those which are partly exempt. There are options to such parties, e.g. joint employment contracts, the use of self-employed contractors or the direct employment of temporary workers. However, whilst it is possible to structure such arrangements to allow for VAT savings, other factors may make this unattractive. ■

For related reading visit www.taxjournal.com

- Cases: *Adecco UK (and others) v HMRC* (8.9.18)
- *Reed Employment Ltd* and economic reality (David Jamieson & Linda Adelson, 23.6.11)