VAT Clauses

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There is a well-known principle in drafting sale or lease contracts that prices are quoted net of VAT, but the contract specifically reserves that the Seller or Lessor can add VAT if appropriate. The reason for this is the fact that any contract that fails to mention that VAT may be added purports to charge only the exact sum stated. This is reinforced by the fact that the VAT legislation treats 'consideration' for any goods or services as an amount inclusive of VAT. There are some exceptions to this, the most important being a change in the VAT liability created by a change in law, and a decision by the Seller to opt to tax the property after the contract has been 'made' but before the supply itself is made.

This is what we all thought until the Court of Appeal decision in *CLP Holding Company Limited*. Or, at least that decision gave rise to some speculation concerning the above position. The purpose of this update is to explain the reasons for that decision and to conclude that, for the most part, the traditional view remains appropriate.

This related to the sale of a property. The Seller had opted to tax the property years before the sale but did not realise that that meant he would have to add VAT to the sale price. He decided to sell the property for a figure to which he did not intend to add VAT. He negotiated with the Buyer on the basis of a figure, without ever mentioning VAT. The deal was not a smooth one, and it went off and on over a protracted period, but the price never altered. Finally, the Buyer was induced to make the payment of the negotiated sum to a member of the Seller's corporate group. At this stage there were no written contractual terms.

The contract was then drawn up which had special provisions which quoted the price without mentioning VAT. It was subject also to general provisions, with an override to the effect that the special provisions took precedence over the general provisions. As it happens, the general provisions included the usual clause whereby VAT may be added to the stated price.

The two parties signed up to this agreement. As it happens, the Seller returned the payment to the Buyer because it now needed that payment to be made to another party within its group, and the Buyer duly repaid the agreed sum to the other group member. Nobody noticed that VAT ought to be charged, and the Seller proceeded to complete the deal on the basis of the stated figure.

More than a year later HMRC paid a visit to the Seller, and assessed the tax. The Seller relied on the general clause allowing it to charge VAT to the Buyer. The Buyer did not want to pay, and litigation ensued.

The Court of Appeal found in favour of the Buyer. However, it did not resoundingly endorse the Buyer's main argument, which was that the special provision, which showed a price without VAT being added, flatly contradicted the general provisions, and that therefore such general provisions could not apply in most broadly similar cases. Construing the agreement in its entirety, the Court of Appeal seemed inclined to accept such a contract as giving rise to an ability, in and of itself, to add VAT, despite the imperfections of its drafting.

That might have appeared to have disposed of the issue in the time-honoured way, but the Court of Appeal decided that it could go beyond those points. It considered the wider picture, and viewed the contract in light of the surrounding circumstances. It considered the entire history of the case, and how the Seller had never intended to charge VAT and had never purported to do so. It considered the nature of the Buyer (unsophisticated) and it considered that the payment had been made to the Seller (or its group) prior to that agreement ever having been drawn up. It considered the delay in the VAT charge being made, and the fact that it was only made once HMRC had demanded tax from the Seller. One could describe this fact pattern as a messy one, and it certainly put the Seller in a dim light.

The upshot was that the Court of Appeal decided that the Seller was not in a position to demand the extra VAT because, despite the fact that the general provision had not necessarily been displaced by an ostensibly contradictory special provision, in all the circumstances, the behaviour of the Seller had caused the special provision to take primacy, and that it was unable to demand the extra sums to meet its VAT bill.

Whilst it is always preferable to have hard rules to follow, which can never be overridden by messy facts, nonetheless one can see how the Court of Appeal reached the conclusion that this was a case where the VAT should not be recovered from the Buyer. But it is a far cry to conclude that a general provision which reserves the right to charge VAT can be overridden by a special provision which fails to mention VAT at all. Had the Seller demanded the VAT at completion, or otherwise shown that it had acted reasonably, the Buyer would probably have failed in its argument.

But this also highlights another rule which can catch the unwary. If in this case the Seller had concluded a contract without the general provisions, and had not at that stage opted to tax, but then (prior to completion) opted, he would have had the ability, under s.89 of the VAT Act, to demand the VAT in any case. The Buyer could only have protected himself from that outcome by the contract specifically stating that VAT could not be added (or that the Seller could not opt). The difference, of course, is between a case where the Seller opts before entering into the contract (as in CLP), and where he only opts after entering into the contract.

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