Case Name: Ventgrove Ltd v Kuehne & Nagel Ltd

Case Ref No: CA100-21

Date of Hearing: Wednesday 20 July 2022

Division: Extra Division

Agents for the pursuers and reclaimers: Burness Paul LLP

Agents for the defenders and respondents: Brodies LLP

Agents for the interveners: Office of the Advocate General

Case Description

In this reclaiming motion (appeal) the pursuers challenge a decision of the commercial judge following debate dated 22 December 2021. The pursuers had sought declarator that the break option contained in a commercial lease was invalidly exercised as VAT was not paid on the sum due to the pursuers to exercise it. The commercial judge determined VAT was not due on the sum and refused to grant declarator. The pursuers reclaim that decision, while the defenders cross appeal in respect of hypothetical reasoning given by the commercial judge had he been satisfied that VAT was due.

Since December 2016 the pursuers leased commercial premises to the defenders. The date of entry was 3 January 2017 and the commercial lease was to endure for a period of ten years. A break option was inserted into the commercial lease at clause 3.1. It entitled the defenders to terminate the lease one day prior to the fifth anniversary of

the date of entry, provided that, by 3 April 2021, it had (i) served noticed on the pursuers to this effect and (ii) made payment to the pursuers of £112,500 together with any VAT properly due thereon. The draft lease was never executed but both parties regard themselves as being bound by its terms.

On 23 February 2021 the defenders gave notice to the pursuers that it wished to exercise the break option in clause 3.1 and made payment by BACS transfer of £112,500. Discussions ensued, the nature of which are disputed, regarding continuation of the lease on new terms. In any event the pursuers wrote to the defenders on 4 June 2021 advising that the break option was not validly exercised because £135,000 (being £112,500 plus VAT at 20%) was not paid. That being so the lease would endure until 3 January 2027. The defenders contended that no VAT was due on the payment.

Before the commercial judge the dispute centred on interpretation of the phrase "VAT properly due thereon" and the relevant HMRC guidance. (The HMRC guidance allegedly applicable at the time, issued in January 2021, suspended prior revised guidance intended to give effect to decisions of the Court of Justice of the European Union (CJEU) in *MEO Serviços de Comunicações e Multimédia SA* v *Autoridade Tributária e Aduaneira* (Case C-295/17) EU:C:2018:942 and *Vodafone Portugal — Comunicações Pessoais SA* v *Autoridade Tributária e Aduaneira* [2020] S.T.C. 1975,

being that early termination payments would now be subject to VAT). The commercial judge determined that the break option was validly exercised. HMRC's traditional approach was to treat break option payments as outside the scope of VAT and the CJEU decisions did not change this; they were distinguishable on their facts. The pursuers were not prejudiced because they could indemnify themselves against any retrospective VAT liability pursuant to clause 4.4.1 of the lease. However, had VAT been properly due on the break option payment (which was interpreted as meaning VAT properly due to HMRC), no separate demand would have been necessary.

The pursuers contend that the commercial judge erred on two grounds. First, he elevated HMRC's January 2021 guidance above the law. The CJEU cases were not distinguishable. A wider point was being made regarding the economic reality of early termination payments. Second, *esto* HMRC's guidance was relevant, it had been misunderstood as it left it to businesses whether to charge VAT. The defenders argue the CJEU cases were properly distinguished and, in any event, the HMRC guidance created a legitimate expectation that the break option payment was exempt from VAT.

The defenders cross appeal on the basis that the commercial judge erred in concluding no separate demand was required under clause 3.1 before VAT would be properly due. Unless a demand is made, the defenders have no way of knowing

whether it is due. The pursuers submit that a demand is contained in clause 3.1 by virtue of the phrase "together with any VAT properly due thereon".

OAG have intervened on behalf of HMRC. It argues that the commercial judge's decision is unsupportable. Neither January 2021 update nor the CJEU cases apply to the leasing of immoveable property. The correct approach is to be found in *Lubbock Fine & Co v Customs and Excise Commissioners* [1994] Q.B. 571 and VATLP02400 (which follows *Lubbock Fine*). The pursuers exercised an option to tax in respect of the rental of the premises with effect from 15 July 2013. That being so VAT was also due on the break option payment.