

## The decision of the Supreme Court in the Med Hotels case: what it means for events agencies

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### Introduction

A number of years ago, Lord Justice Sedley commented that:

*“beyond the everyday world....lies the world of VAT, a kind of fiscal theme park in which factual and legal realities are suspended or inverted”.*<sup>i</sup>

Anyone following the Med Hotels case over the past few years will have seen the wisdom of these words. It has indeed been a real rollercoaster ride – first the decision went strongly in HMRC’s favour (the First Tier Tribunal), then it veered totally the other way (the Upper Tribunal), then it swerved back towards HMRC (the Court of Appeal) and now finally, decisively, it has gone off the rails completely (from an HMRC perspective) and ended in Med’s favour at the Supreme Court.

The case concerned the circumstances in which a person should be treated as an agent for VAT purposes. Many events agencies find it advantageous to arrange services as agent. Amongst other consequences, agency status means that the Tour Operators’ Margin Scheme (“TOMS”) cannot apply. Agencies often prefer to remain outside of TOMS as TOMS means the loss of input VAT paid on event costs, thus making the event more expensive for the client. Therefore, any case on agency for VAT purposes is important but this decision is particularly influential as it was decided by the highest court in the country and considered agency specifically in the context of travel services. Med’s victory will be a real help to many.

### The Court’s approach

The Court was asked to consider whether Med had arranged hotel accommodation as agent of the hotel or whether it had purchased the accommodation from the hotel in order to re-sell it. This required a detailed analysis of the contracts agreed between Med and the hotels, of Med's booking conditions and of various operational procedures.

#### (i) The hotel contract

The Court concluded that the intention of the hotel contract was clear: Med was appointed as the hotel's agent for the purpose of marketing the accommodation and customers would book rooms directly with the hotel via the agency of Med.

HMRC had argued that four aspects of the contract suggested that it did not in reality create an agency relationship. The four points were:

- 1 Med fixed its own commission. Med’s commission was the difference between the price paid by the customer (set by Med) and the price Med had agreed to pay to the hotel;
- 2 Some of the financial provisions were inconsistent with agency. For example, the hotel was obliged to compensate Med if it did not provide the accommodation booked;
- 3 The agreement contained provisions which suggested that Med’s interest was wider than that of an agent. For example, there were covenants by the hotel to honour bookings, insure the hotel, keep it clean and allow Med’s representative to inspect it; and
- 4 The agreement was “one-sided”: it imposed many obligations on the hotel but very few on Med and did not oblige Med to promote the hotel’s business.

The Court was unimpressed with all the above: they did not mean that the contracts should not be viewed as creating an agency. More specifically, an agent is allowed to fix its own commission; indeed, it is not unusual for agents to do so. Secondly, the Court did not see the financial provisions as inconsistent with agency. Thirdly, that the hotel agreed with Med to do things of benefit to guests could be explained by Med's desire to maintain customer goodwill. Lastly, the nature of the contract in general and more specifically its "one-sided" nature could be attributed to the size of Med's business and that it had greater bargaining power than the hotels.

**(ii) The booking conditions**

These were also considered by the Court to support agency. Again, however, HMRC had pointed to various factors which they argued contradicted the claimed agency status. These were, firstly, Med's charging of an admin fee when a customer made a change to a booking, secondly that Med charged a fee in the event of cancellation which did not appear to be passed on to the hotel and thirdly that Med agreed to try to find alternative accommodation if the hotel was unable to provide the service booked.

The Court did not think these factors undermined agency. The admin fee was thought to be "irrelevant". The cancellation fee, however, was more important and here the Court thought that the sums involved should have been paid to the hotel but that failure to do so represented either a breach of the agency agreement or an accepted variation of the agreement. Either reflected the bargaining power of Med and did not alter the nature of the relationships between the parties. Lastly, Med's undertaking to try to find alternative accommodation existed to protect Med's goodwill.

**(iii) Operational procedures**

Earlier hearings identified various operating procedures which helped to demonstrate that Med was not an agent. The Supreme Court did not agree that these factors negated the agency created by the contracts. The more notable points here (in addition to the contractual points discussed above) are:

- Med did not invoice hotels for the commission it earned and did not notify hotels of the selling price which it had set, thereby making it impossible for the hotels to comply with their obligation to pay VAT on the full price – these points were accepted by the Court and they were said to be "some sort of indication" that the arrangements were not as the contracts suggested. Nevertheless, the Court concluded that the fact that Med had not accounted for VAT in accordance with the agency rules was "not a very strong point";
- Hotels issued invoices to Med for the net rate payable – the Court accepted that it would have been correct for the hotels to invoice for the full gross amount showing a deduction for Med's commission. However, the invoices issued were financially consistent with the contracts as the hotel was only looking for payment of the net amount. Furthermore, invoices cannot change the nature of the arrangements as established by the contracts;
- Med treated deposits and other amounts received from customers as its own – to the extent the amounts in question were cancellation fees, the point is dealt with above but the Court did not say anything specifically about Med's treatment of deposits; and
- Med reserved some rooms and paid the net rate in advance – Med's desire to secure rooms in this way was thought to be sensible practice and not inconsistent with agency. The need

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to pay in advance was to be expected. The Court did recognise that Med was at risk of losing its advance payments but this did not undermine agency.

It followed that Med traded as agent of the hotel and that TOMS VAT was not payable. This was inconsistent with the economic reality of Med's position.

### **Conclusion**

There can be no further appeal and this, therefore, is the end of the road for this dispute. HMRC's reaction to the decision will now be key. It is understood that they are currently reviewing the wider impact of their defeat and that a policy announcement will be made in due course. An update will be circulated once HMRC's position is clear. The implications, though, are far reaching. The effect extends way beyond the narrow confines of the bed bank sector. Many in the events sector account for VAT as agents and HMRC's ability to challenge such an approach has been seriously weakened.

HMRC have challenged a number of events agencies arguing that their arrangements do not create agency and that TOMS applies. The goal posts have just moved and HMRC's arguments in individual cases may not be sustainable in the light of this decision.

The decision demonstrates the importance of the contracts. Med won largely because it had good contracts. In any situation, where there are no written contracts, or they are unclear, operational practices are bound to take a larger role in determining the VAT position. Clearly, it is prudent to have contractual documentation which supports the desired position.

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<sup>i</sup> 'Royal and Sun Alliance Insurance Group Plc vs HM Revenue & Customs'