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Deluxe Property Holdings Ltd v SCL Construction Ltd: VAT repayment on trust

Introduction

“Trust none; for oaths are straws, men’s faiths are wafer-cakes”, Pistol warned in *Henry V*.¹ In *Deluxe Property Holdings Ltd v SCL Construction Ltd (Deluxe)*,² the High Court was tasked with declaring a trust, when oaths and faith had crumbled like the proverbial Shakespearean crackers. The question before the court was whether overpaid VAT, repaid by HMRC, was held on trust when reimbursement arrangements were not honoured.

Factual background

Deluxe was a property development company who engaged SCL to undertake construction work on a residential student accommodation block in Tooting.³ Both parties were under the misapprehension that the works would be subject to the standard rate of VAT. Therefore, SCL included VAT at 20 per cent on all of its invoices, amounting to some £450,000-odd, paid or accounted to HMRC as output tax.

Subsequently, Deluxe was advised that most of the works ought to have been zero-rated for VAT purposes. Following a discussion by the parties, a section 80 claim for reimbursement of the overpaid VAT⁴ was submitted to HMRC by SCL, including an undertaking signed by SCL’s director in the following terms:

“I, the undersigned, can identify the names and addresses of consumers whom I intend to reimburse. I will reimburse those persons in cash or by cheque all of the amount credited by HMRC under section 80(1) or 80(1A) of the VAT Act 1994 together with any associated

¹Pistol in *Henry V*, Act 2, Scene 3: London. Before a tavern.

²*Deluxe Property Holdings Ltd v SCL Construction Ltd (Deluxe)* [2020] EWHC 3354 (TCC); [2020] 12 WLUK 111.

³One assumes as construction of new dwellings for a relevant residential purpose under group 5 of Sch.8 to the Value Added Tax Act 1994 (VATA 1994), although this is not discussed in the judgment.

⁴VATA 1994 ss.80 and 80A.

interest, without any deduction, for whatever purpose, within ninety days of receiving the credit, and I understand that I cannot use the credit for any other purpose....”⁵

However, shortly after the claim was submitted, the business relationship soured leading to Deluxe terminating SCL’s employment under the contracts. Deluxe requested SCL assign the section 80 claim but this was not agreed. Solicitors for Deluxe contacted HMRC to ascertain the status of the reimbursement and were informed that the payment had been approved. Then, in a later exchange, the solicitors were informed by HMRC that SCL had written to withdraw the section 80 claim and would instead seek credit against future liabilities. It was unclear whether any money had been received by SCL.

Deluxe, therefore, issued proceedings seeking a declaration that SCL held the money from the section 80 claim on trust.

Procedural background

In early October 2020, Mrs Justice O’Farrell DBE granted Deluxe’s application for an interim injunction, in the form of requiring payment to Deluxe’s solicitors of any monies received by SCL from HMRC in respect of the VAT claim and for the provision of information concerning the status of the section 80 claim and any money received therefrom.⁶

Upon return to the court in late October,⁷ SCL argued that once it had withdrawn the section 80 claim, it was entitled to issue a credit note to Deluxe without paying over the sums received from HMRC. It also averred that there were sums due to SCL from a dispute concerning the construction works and the termination. Mrs Justice O’Farrell accepted that SCL had been less than candid in its conduct of the proceedings, and it was established only on the evening before the hearing that £435,000-odd had been claimed by SCL in its VAT return for the period ending 31 May 2020, withdrawing the section 80 claim. Applying the usual test in *American Cyanamid v Ethicon Ltd*,⁸ the court upheld and continued the injunction order.

The arguments

On 8 December 2020, the hearing of the Part 8 claim came before Mr Justice Pepperall in the Technology and Construction Court (QBD). The issue before the court was whether SCL held the VAT sum on trust for Deluxe, or as a debt only.⁹ The benefit of a proprietary claim is that there will be no right to a set-off—in trust law¹⁰ (as indeed was already the case under the wording of the undertaking)—as well as priority in insolvency.¹¹

⁵ This is the wording in s.10 of VAT Notice 700/45.

⁶ *Deluxe Property Holdings Ltd v SCL Construction Ltd* [2020] EWHC 2865 (TCC); [2020] 10 WLUK 80 at [34].

⁷ *Deluxe Property Holdings Ltd v SCL Construction Ltd* [2020] EWHC 3066 (TCC); [2020] 10 WLUK 250.

⁸ *American Cyanamid v Ethicon Ltd* [1975] A.C. 396; [1975] 2 W.L.R. 316.

⁹ *Deluxe* [2020] EWHC 3354 (TCC) at [2].

¹⁰ *Zemco Ltd v Jerrom-Pugh* [1993] B.C.C. 275 at 279B, mentioned in *Deluxe* [2020] EWHC 3354 (TCC) at [44].

¹¹ This was a factor in this case although not an issue before the court, see *Deluxe* [2020] EWHC 3354 (TCC) at [22].

Deluxe argued that the money was held on trust by way of a *Quistclose* trust.¹² Such a trust can be created when money is paid to another to be used exclusively for a particular purpose.¹³ In the alternative, Deluxe argued that it was held by way of a constructive trust as it would be “unconscionable for the owner of property to assert his own beneficial interest in the property and deny the beneficial interest of another”.¹⁴

SCL was not represented or in attendance at the hearing.

The judgment

By this point in the proceedings, it was clear that SCL had withdrawn its section 80 claim having received the refund by way of a negative VAT figure in its VAT return for the sums in dispute. SCL’s tax advisors had suggested this course of action due to the COVID-19 crisis, “in order to relieve pressure on the HMRC VAT corrections team and to allow traders to rectify their VAT position in a shorter timeframe”.¹⁵

The court recounted the unjust enrichment defence to VAT repayments available to HMRC and supported by section 80A of the Value Added Tax Act 1994 which sets out the need for “reimbursement arrangements” with undertakings. Read with regulations 43C and 43G of the VAT Regulations 1995, this ensures the persons (customers) who have borne the cost of the VAT are reimbursed “without any deduction by way of fee or charge or otherwise” and only by way of cash or cheque.

Mr Justice Pepperall found that, regardless of the abandoned section 80 claim:

“HMRC only allowed the overpayment to be claimed back through the return in circumstances where SCL had already given a signed reimbursement undertaking...^[16]

Accordingly, the mechanics of precisely how HMRC allowed the claim to be processed did not change the character of the claimed refund. This was a refund of tax mistakenly charged to Deluxe that was supported by a reimbursement undertaking.”¹⁷

Furthermore, SCL had signed an undertaking that it could “not use the credit for any other purpose”. Therefore, the court was satisfied that the credit was to be exclusively used for the stated purpose without set-off; giving rise to a *Quistclose* trust.

However, for the purposes of the *Quistclose* analysis (but not the constructive trust claim), the VAT refund would actually be held on trust *for HMRC*—the party that paid the money for a particular purpose.¹⁸ Therefore, the next question was whether Deluxe was able to enforce the trust for its benefit as a third party (intended payee).

¹² Named after the case of *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567; [1968] 3 W.L.R. 1097.

¹³ i.e. where the obligation to use it for the stated purpose has the effect that money is not intended to be at the free disposal of the recipient but to be used only in accordance with a stated purpose, see: Lynton Tucker, Nicholas Le Poidevin, QC and James Brightwell, *Lewin on Trusts*, 20th edn (Sweet & Maxwell, 2020), p.9-053.

¹⁴ *Deluxe* [2020] EWHC 3354 (TCC), fn.2, at [40], citing the decision of the Federal Court of Australia in *KAP Motors Property Ltd v Commissioners of Taxation (KAP Motors)* [2008] F.C.A. 159.

¹⁵ *Deluxe* [2020] EWHC 3354 (TCC) at [16].

¹⁶ Otherwise, such a significant VAT correction would not be permitted by way of a VAT return pursuant to the Value Added Tax Regulations 1995 regs.34(7) and 35.

¹⁷ *Deluxe* [2020] EWHC 3354 (TCC) at [29]–[30]

¹⁸ *Deluxe* [2020] EWHC 3354 (TCC) at [32].

The court referred to the case of *Re Margareta Ltd (In Liquidation) (Re Margareta)*,¹⁹ an insolvency case where two parties to a property transaction entrusted money amounting to the potential VAT on the sale of the property to an accountant who was tasked with resolving the VAT liability with HMRC. The disputed VAT was misappropriated from the accountant's client account and the seller was wound up for failure to pay the VAT. In that case, HMRC argued that they were due the money in the liquidation because the sum was paid for the purpose of paying HMRC—a *Quistclose* trust—even though the beneficiary would traditionally be the party advancing the money.²⁰ The court explained that the intended payee may obtain a beneficial interest:

“where the existence of the trust arrangements is communicated to the intended payee and the latter gains a beneficial interest in the money either because of the creation of an estoppel or because communication perfects an assignment of the donor's equitable interest to him.”²¹

Mr Justice Pepperall agreed with the judge in *Re Margareta*,²² holding that the undertaking in Deluxe's favour had been communicated to Deluxe on more than one occasion.²³ This perfected the assignment of HMRC's interest to Deluxe.

However, as a result of a drafting error, the undertaking failed to include one accounting period which did form part of the section 80 claim. That element of the refund, therefore, was not caught by the *Quistclose* trust, and the court had to consider whether a constructive trust had arisen.

A constructive trust arises by operation of law to vindicate a claimant's title to specific property in circumstances where it would be inequitable to permit the defendant to assert his own beneficial ownership.²⁴ Quoting Patten LJ in *De Bruyne v De Bruyne (De Bruyne)*

“...equity will regard it as against conscience for the owner of the property to deny the terms upon which he received it”²⁵.

The court referred to the Australian case of *KAP Motors Property Ltd v Commissioners of Taxation (KAP Motors)*²⁶ where, in circumstances concerning overpaid Goods and Services Tax, a trader had refused to give a reimbursement undertaking and therefore the Commissioners had refused its refund. The Federal Court of Australia concluded that the refusal to give an undertaking was not a defence to the trader's claim for a refund and, in doing so, discussed the potential for the trader to become a constructive trustee of the amount received by the paying customer or of any money refunded by the Commissioners.²⁷

Deluxe's case was deemed stronger than that in *KAP Motors*²⁸ as a reimbursement undertaking was given, but in any event the court found that it would be unconscionable for SCL to retain

¹⁹ *Re Margareta Ltd (In Liquidation) (Re Margareta)* [2005] EWHC 582 (Ch); [2005] S.T.C. 610.

²⁰ *Re Margareta* [2005] EWHC 582 (Ch) at [23].

²¹ *Re Margareta* [2005] EWHC 582 (Ch) at [24(b)].

²² *Re Margareta* [2005] EWHC 582 (Ch).

²³ *Deluxe* [2020] EWHC 3354 (TCC) at [37].

²⁴ See: *Halsbury's Laws of England, Trusts and Powers*, 5th edn (LexisNexis, 2019), Vol.98 at section 1(3)(i)(a), para.114.

²⁵ *De Bruyne v De Bruyne (De Bruyne)* [2010] EWCA Civ 519 at [51].

²⁶ *KAP Motors* [2008] F.C.A. 159.

²⁷ *KAP Motors* [2008] F.C.A. 159 at [42].

²⁸ *KAP Motors* [2008] F.C.A. 159.

the benefit of the refund which was intended for the customer who had borne the burden of the wrongly paid tax.²⁹ This trust attached to the repayment irrespective of the accounting periods included in (or indeed omitted from) the undertaking.

Therefore, declaratory relief was granted on the basis that SCL held the credit or repayment on trust for Deluxe and set-off was not permitted.

Discussion

This case provides some clarification on the treatment of VAT repaid under section 80 and 80A, especially repayments with reimbursement arrangements and *Quistclose* trusts.

In relation to constructive trusts, the concept has been discussed tangentially in previous cases and now directly in *Deluxe*³⁰ but the applicability of a constructive trust is by no means clear.

The Supreme Court in *Investment Trust Companies (In Liquidation) v HMRC (ITC)*³¹ explained that the customer(s) on whom the incidence of undue VAT fell does not have any direct right to restitution against HMRC, bypassing the remitting party. Restitution can only be sought against that party: the two transfers cannot be collapsed into a single transfer of value.³² In the judgment, Lord Reed referenced two cases from other jurisdictions which concerned fiduciary obligations from repaid tax. The case of *123 East Fifty-Fourth Street v United States*³³ concerned taxes paid by a bar in New York which had been misclassified as a cabaret. Judge Learned Hand provided a dissenting opinion which stated that a tax, distinctly charged to patrons as a separate item which, before remitting to the tax authority, was found not to be due would be held in a constructive trust for the patrons

“...the plaintiff could not have successfully resisted the guest’s demand that it be turned back to them, the very purpose for which they had paid it having then become incapable of execution”.³⁴

Similarly, he opined, if the money was repaid, it would be held on trust for the guests.

ITC also discussed *Commissioner of State Revenue (Victoria) v Royal Insurance Australia Ltd (Royal Insurance)*³⁵ from the High Court of Australia. This case concerned overpaid stamp duty charged on insurance premiums. Having considered the opinion of Judge Learned Hand, above, Mason CJ agreed that

“...the owner held the moneys for the benefit of the patrons who paid the moneys. The same result would ensue if the owner recovered payments from the revenue authority made as and for tax which was not payable.”³⁶

ITC did not consider these authorities in great detail as the facts were different, but the court did stipulate that American and Australian law has a broader approach to constructive trusts than

²⁹ *Deluxe* [2020] EWHC 3354 (TCC) at [42].

³⁰ *Deluxe* [2020] EWHC 3354 (TCC).

³¹ *Investment Trust Companies (In Liquidation) v HMRC (ITC)* [2017] UKSC 29; [2017] S.T.C. 985.

³² *ITC* [2017] UKSC 29 at [72].

³³ *123 East Fifty-Fourth Street v United States* 157 F. 2d 68 2d Cir. (1946).

³⁴ *123 East Fifty-Fourth Street v United States* 157 F. 2d 68 2d Cir. (1946).

³⁵ *Commissioner of State Revenue (Victoria) v Royal Insurance Australia Ltd (Royal Insurance)* [1994] HCA 61.

³⁶ *Royal Insurance* [1994] HCA 61 at [49].

English law. In particular, the English and Welsh courts do not generally recognise the remedial constructive trust, by which a trust is imposed as a matter of discretion. Here, a trust will only be recognised if the claimant can establish some pre-existing title or proprietary claim, of a kind recognised in law; and that will often be difficult to establish if money has become mixed.

In relation to mistaken payments between parties *before* conveying the tax to HMRC, the remitting business might not keep the VAT received separate thereby treating it as part of their general assets. Therefore, the remedy between the parties will likely remain personal (under unjust enrichment) and contractual, rather than proprietary. However, if the tax is remitted then repaid and the sum is identifiable, equity will intervene to prohibit a windfall, to ensure the party who bore the burden is reimbursed.

This was applied without much conceptual or legal difficulty in *Deluxe*³⁷ with one clearly identifiable beneficiary. However, it will be interesting to see how these principles can be applied in cases involving repayments from HMRC: 1) to a taxpayer with a wide customer base; and 2) without any discussion or agreement between the parties as to repayment obligations. Will customers benefit from a cause of action in unjust enrichment and, now, constructive trust also?

The question of the formation of a constructive trust will be less obvious when there are large numbers of customers (potentially both B2B and B2C) with mixing of funds or VAT passed on further down a chain. Crucially in trusts law, both the class of beneficiaries and the sums must be ascertainable and certain. As summarised by Briggs J:

“A trust of part of a fungible mass without the appropriation of any specific part of it for the beneficiary does not fail for uncertainty of subject-matter, provided that *the mass itself is sufficiently identified* and provided also that *the beneficiary’s proportionate share of it is not itself uncertain*.”³⁸

Thus, the trust will be void if the “definition of beneficiaries is so hopelessly wide as not to form anything like a class”.³⁹ Furthermore, *Lewin on Trusts* explains that even where the class is conceptually certain, a trust will fail if it would be administratively unworkable or too vague to allow enforcement.⁴⁰

In relation to the lack of existing agreements on reimbursement, the case is also uncertain. In *Deluxe*,⁴¹ the court considered the case of *De Bruyne*⁴² where the Court of Appeal explained that constructive trusts imposed by equity concentrate on “the circumstances in which the transferee came to acquire the property in order to provide the justification for the imposition of a trust”. Patten LJ clarified it was not necessary to demonstrate fraud as equity

“...can extend to unconscionable or inequitable conduct in the form of a denial or refusal to carry out the agreement to hold the property for the benefit of the third party which was

³⁷ *Deluxe* [2020] EWHC 3354 (TCC).

³⁸ *Re Lehman Brothers International (Europe) (In Administration)* [2010] EWHC 2914 (Ch) at [225], emphasis added.

³⁹ Referring to express trusts, Tucker, Le Poidevin and Brightwell, *Lewin on Trusts* (2020), para.5-051, referring to *McPhail v Doulton (No.1)* [1971] A.C. 424 HL at 457, per Lord Wilberforce.

⁴⁰ Tucker, Le Poidevin and Brightwell, *Lewin on Trusts* (2020), para.5-045.

⁴¹ *Deluxe* [2020] EWHC 3354 (TCC).

⁴² *De Bruyne* [2010] EWCA Civ 519 at [51].

the only basis upon which the property was transferred. This is sufficient in itself to create the fiduciary obligation and to require the imposition of a constructive trust.”

In circumstances where a repayment is received before customers have sought a refund, the requisite lack of refusal to carry out an extant agreement might hinder the imposition of a constructive trust. However, when looking at the circumstances in which the taxpayer receives the repayment, one cannot ignore the very nature of the VAT system, with the importance of economic neutrality, creating an obligation for VAT to be passed down the chain to the final consumer. As such, it may be argued that it would be inequitable to receive a windfall even in the absence of prior agreement (or denial thereof).

The writer is unsure whether these arguments might provide comfort to businesses who receive a repayment from HMRC when the latter does not mandate reimbursement arrangements or where there is a large pool of potential claimant customers. In the circumstances where a constructive trust *is* established, the business as trustee may be open to claims relating to a breach of the trust were they to use the money for other purposes. Following *Deluxe*, this possibility will need to be considered when making claims for refunds from HMRC or from taxpayers who receive refunds, and professional advice should be sought. However, where reimbursement arrangements are agreed, parties can have faith that the undertaking will be honoured “in cash most justly paid”.⁴³

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⁴³ Pistol in *Henry V*, Act 2, Scene 1: London. A Street.

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