[2019] UKUT 340 (TCC)

Appeal number: UT/2018/0090

VAT – whether supplies of loan administration services made by appellant to a bank are exempt - Article 135(1)(d) PVD - Items 1 and 8 Group 5 Schedule 9 VATA - whether loan accounts are current accounts - whether services are transactions concerning payments or transfers - whether services are debt collection - appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

TARGET GROUP LIMITED

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Mr Justice Zacaroli
Judge Greg Sinfield

Sitting in public in London on 1 - 3 July 2019

Roderick Cordara QC, instructed by PricewaterhouseCoopers LLP, with Christian Bell of that firm, for the Appellant

Hui Ling McCarthy QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This appeal concerns whether loan administration services supplied by the appellant ('Target') to a UK bank, Shawbrook Bank Limited ('Shawbrook') are standard rated supplies for VAT purposes or exempt under Article 135(1)(d) of Council Directive 2006/112/EC ('Principal VAT Directive' or 'PVD') as claimed by Target.

2. Target provides outsourced loan administration services to banks and building societies including Shawbrook. Shawbrook is a provider of a range of mortgages and loans. On 21 May 2015, Target wrote to the Respondents ('HMRC') to request a non-statutory clearance of the proposed VAT treatment of supplies it made to Shawbrook, following changes to their supply agreement. Target asserted that its supplies to Shawbrook constituted composite supplies of payment processing and were thus exempt.

3. On 31 July 2015, HMRC notified Target of their decision that the supplies to Shawbrook were composite supplies of the management of loan accounts and were therefore taxable. On 27 August, Target asked for the decision to be reviewed by an HMRC officer not previously involved in the case. On 25 September, HMRC responded to the questions raised in Target's letter of 27 August and maintained their view that Target's supplies to Shawbrook were composite taxable supplies of the management of loan accounts. Following a review, HMRC confirmed their decision in a letter dated 8 January 2016 and Target appealed to the First-tier Tribunal ('FTT').

4. In a decision released on 20 April 2018 with neutral citation [2018] UKFTT 0226 (TC), the FTT (Judge Sarah Falk) dismissed Target's appeal. The FTT held that the loan administration services supplied by Target to Shawbrook are standard rated for VAT purposes as debt collection.

5. Target now appeals against the FTT's decision with permission of the FTT on all but one of four grounds and with permission of this Tribunal in relation to the remaining ground. Save as otherwise indicated, paragraph references in square brackets in this decision are to paragraphs in the FTT's decision.

Factual background

6. There was no challenge to the findings of fact by the FTT. The FTT set out the facts at [29] to [57]. For the purposes of this decision, the facts can be summarised as follows.

7. The relevant contract pursuant to which Target provided its services to Shawbrook was the Amended and Restated Master Servicing Agreement ('ARMSA') entered into in 2014. Supporting schedules to the ARMSA set out the Definition of Services ('DoS').

8. The recitals to the ARMSA describe Target as being "a provider of loan origination and account operation services" which "performs activities including the functions of: payment processing and servicing and portfolio management services".

9. Clause 3 of the ARMSA deals with the appointment of Target by Shawbrook to provide the "Services" in accordance with the terms of the agreement. It grants Target authority to do everything that, acting reasonably, it deems necessary or desirable in respect of the provision of the Services (provided that, without prior written consent, it

does not exceed the scope of its authority). The "Services" provided by Target are described as the "operation of individual loan accounts, processing payments received from Borrowers and the administration of Loans". A loan account is separately defined as "an account operated by Target containing details relating to transactions occurring in respect of a Borrower's Loan including, inter alia, charges, payments, interest, arrears, and sundry fees".

10. Clause 4.5 of the ARMSA provides that Target will act as agent of Shawbrook for the purpose of providing the Services. Further, clause 23.2 of the ARMSA provides that, in carrying out the Services, Target has full authority to bind Shawbrook in accordance with the criteria and standards agreed with it, and that it shall conduct all correspondence on Shawbrook's letterhead and otherwise carry out all dealings and activities in Shawbrook's name and not in its own name. The FTT held, at [31], that Target acted as an undisclosed agent of Shawbrook.

11. Charges are dealt with principally in clause 8 of the ARMSA. The fee paid by Shawbrook is on a "per loan" basis. The amount payable per loan varies according to which of four portfolios of loans provided by Shawbrook it relates to and (except in the case of one portfolio) the number of loans outstanding in that portfolio. A higher figure is charged for each loan in arrears. The nature of the loans in each portfolio and the different amounts charged in respect of the different portfolios are not material to the VAT treatment of the supplies.

12. The DoS are relatively detailed documents which specify in detail how the Services are to be provided. The DoS also make clear what is out of scope, including marketing, requests to reissue cheques or instructions via Bacs Payment Schemes Limited, previously known as the Bankers' Automated Clearing Services, ('BACS') in respect of the original advance, and further advances.

13. The DoS prescribe a "change control" procedure for initiating any changes. The FTT was shown an example where Target requested a change to the procedure for dealing with refunds due to customers, which resulted in Target being empowered to refund up to £300 without referral to Shawbrook. The change request included a significant level of detail about the proposed changes to the processes.

14. The DoS provide in detail how particular processes in relation to the operation of the accounts should be handled. Separate procedures apply to accounts in arrears. Target can agree forbearance in accordance with a mandate agreed with Shawbrook and also agree repayment plans with customers under which they make a series of payments towards their arrears balance. Any decision to write off a loan, however, is for Shawbrook, as is any decision whether to instruct solicitors to take legal action. Only Shawbrook can agree to amend the terms of a loan.

15. Target provides a full business process outsourcing service which, in the case of Shawbrook, starts with the creation of a loan account, immediately after a loan is made, and includes the day-to-day operation of the account and dealings with the customer up to the point of final repayment. Target maintains and continuously updates (and later reports on) the financial relationship and position between Shawbrook and its borrowers. Target does not provide loan origination services to Shawbrook, such as assessing credit worthiness, valuing potential security or otherwise deciding whether to make a loan or processing the making of the advance.

16. Target's staff answer the phone as 'Shawbrook' and conduct correspondence on Shawbrook's letterhead. Target also uses its own specialised software (the "Centrac" system) to provide the services. In effect, Target provides the human and technical capability which Shawbrook does not need to resource. Without Target's service, Shawbrook would simply have granted credit but would lack the operational capability to calculate and recover repayments, apply fees and charges and deal with interactions with borrowers.

17. In providing its services to Shawbrook (and with an immaterial exception), Target operates under the "umbrella" of Shawbrook's regulatory approvals rather than its own.

18. The loan accounts maintained by Target are the sole record of the financial relationship between Shawbrook and its borrowers. They are effectively ledgers which evidence the level of indebtedness, capture repayments and record other financial information including fees and interest charged. Target credits and debits the loan accounts with all relevant amounts (payments, fees and interest etc).

19. Target operates bank accounts on behalf of Shawbrook. Target is responsible for matching payments to individual loan accounts and identifying missing payments. The vast majority of payments are made by direct debit. Target is responsible for generating the instructions for direct debit payments, in the form of a BACS file produced by Target's systems which contains electronic payment instructions to banks operating the borrowers' bank accounts, which BACS processes automatically. Target also accepts payments otherwise than by direct debit, eg by debit card payments and cheques.

20. As well as regular payments, Target processes irregular payments, for example where a borrower is in arrears and is seeking to pay amounts towards clearing the arrears, makes an overpayment or is paying off a loan early. Target reconciles and credits the payments to the loan accounts. Target has authority to transfer funds paid by borrowers into an incorrect account to the correct account. It uses both the BACS and CHAPS payment systems, which process instructions issued by Target (on behalf of Shawbrook), to move funds between Shawbrook's bank accounts where required, or to repay sums to the borrower where an overpayment has been made.

21. Target is also responsible for calculating the amounts of interest and principal repayments due, and for calculating and applying any fees. Where Shawbrook makes an additional advance to a borrower, Target follows the same processes as for a new loan with the new outstanding loan amount replacing the previous balance. Where a borrower wishes to repay a loan early, Target is responsible for providing an early settlement quote. It also handles the entire process for any loan repayment, including discharge of security (using Shawbrook's approved panel of solicitors) and closure of the account.

22. Target also deals with missed payments and arrears. For any default, a letter is produced in Shawbrook's name providing formal notification to the borrower and advising them of the fee that will be applied. Target is provided with a certain level of authority by Shawbrook to negotiate how missed payments will be made up, with any longer term forbearance being referred to Shawbrook. Any changes to the terms of a loan, eg an extension to the loan period, are also a matter for Shawbrook. If an account remains in arrears, the decision whether to take legal action or write off a loan is solely a matter for Shawbrook. If Shawbrook decides to take legal action, Target will work with

a firm of solicitors on a Shawbrook approved panel, providing information, keeping records and continuing to handle contacts with the borrower.

23. Target also deals with any overpayments. Generally, borrowers can overpay a certain percentage of the balance, eg 10%, in any year without incurring an early repayment charge. Target amends the loan balance and term as appropriate and issues a letter confirming the overpayment. Alternatively, borrowers may be eligible for a refund if they overpay which Target will process. As mentioned above at [13], Target has authority to process refunds of less than £300 without reference to Shawbrook.

Legislation

24. Article 135(1)(d) of the Principal VAT Directive requires Member States to exempt the following transactions:

> "transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;"

25. This exemption was formerly contained in Article 13B(d)(3) of the Sixth VAT Directive (77/388/EEC), which was in the same terms but also included the words "and factoring" at the end.

26. This exemption is implemented in UK law, albeit using different language, by Group 5 of Schedule 9 to the Value Added Tax Act 1994 ("VATA"). Items 1 and 8 of Group 5 exempt the following:

> "1. The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money.
>
> …
>
> 8. The operation of any current, deposit, or savings account."

27. Article 135(1)(b) of the PVD exempts:

> "the granting and the negotiation of credit and the management of credit by the person granting it;"

28. The relevant corresponding domestic law provisions are Items 2 and 2A of Group 5 of Schedule 9 to VATA:

> "2. The making of any advance or the granting of any credit.
>
> 2A. The management of credit by the person granting it."

The FTT's decision

29. The FTT determined the appeal by considering the following five issues (see [74]):

(1) the approach that should be taken in classifying a single complex supply;

(2) whether what is supplied includes "transactions … concerning … payments, transfers, debts" (or the equivalent in Item 1 of Group 5 of Schedule 9 VATA);

(3) whether what is supplied includes the operation of current accounts;

(4) the scope of [what the FTT referred to as] the debt collection carve-out; and

(5) the appropriate description of the single supply in this case.

30. In the FTT, as before us, both parties agreed that the services provided by Target to Shawbrook comprise a single (composite or complex) supply for VAT purposes rather than multiple separate supplies. The parties disagreed, however, in their view of how the supply should be classified and whether it was exempt or standard rated. In relation to the first issue, the FTT concluded, at [81], that "the starting point is to identify the individual elements of a single complex supply" and that "whether that supply falls to be treated as exempt will generally (but not necessarily exclusively) be determined by reference to predominance, but this might either be a single predominant element or in some cases a combination of elements". Before us, neither party raised any objection to the FTT's description of the proper approach to the question of how to determine the nature of a single complex supply for VAT purposes and, for the purposes of this appeal, we are content to adopt it.

31. On the second question, the FTT held, at [82] – [87], that what Target supplies to Shawbrook includes elements that are "transactions … concerning … payments, transfers". The FTT decided, in [84], that "the operation of the loan accounts, and specifically the crediting and debiting of entries to those accounts, involves changes in the legal and financial situation between Shawbrook and the borrowers which fulfil the specific, essential functions of payments or transfers, going beyond a mere physical or technical supply".

32. As to the question of whether Target operated current accounts, the FTT decided at [88] – [93], that they did not because, in summary, the loan accounts in this case did not have the same functionality as a current account, eg payments could not be made to third parties, and the economic purpose of the account with Shawbrook was quite different, namely to lend a fixed amount to the borrower on specified terms. The FTT held (at [92(8)] that:

> "The loan account is no more than a ledger which records the current and historic position as between the lender and borrower in terms of the amounts paid and the amounts due or falling due."

33. In relation to whether what Target did was debt collection and thus excluded from exemption, the FTT held at [103] that:

> "Once it is accepted, as it must be in the light of [Case C-175/09 *HMRC v AXA UK plc* [2010] 5 STC 2825 ('*AXA CJEU*') and *HMRC v AXA UK plc* [2012] STC 754 ('*AXA CA*')], that debt collection covers amounts as they fall due rather than simply amounts that are overdue, then it must follow that the payments or transfers processed by Target can be described as the collection of debts."

34. On the question of what is the appropriate description of the single supply in this case, the FTT held, in [110], that "the essence of what is being acquired, and the main objective [of Target's supplies], is the collection of debts as they fall due …" and the predominant nature of the services supplied by Target to Shawbrook is debt collection.

35. Although it was not necessary to do so, the FTT stated, at [113], that if it had been wrong to classify Target's supplies as debt collection then it would have concluded that the exemption applied because "the predominant nature of the supply falls within 'transactions ... concerning ... payments, transfers'".

36. At [114] - [116], the FTT dismissed HMRC's alternative argument that Target's supplies are taxable as supplies of the management of credit by a third party.

37. Having concluded that "the loan administration services supplied by Target to Shawbrook fall within the debt collection carve-out to Article 135(1)(d), and accordingly are not exempt", the FTT dismissed Target's appeal.

Grounds of Appeal

38. The FTT granted Target permission to appeal on three of its four grounds and the Upper Tribunal granted permission in relation to the remaining ground. Accordingly, Target's grounds of appeal are as follows:

> (1) Having (correctly) identified that Target's supplies changed the legal and financial relationship between the parties and so were capable in principle of being exempt transactions under Article 135(1)(d) PVD, the FTT erred at [94] – [108] in identifying the definition of debt collection.
>
> (2) Having (correctly) found at [30] that, under the contract with Shawbrook, Target provided "loan origination and account operation services", the FTT erred in concluding, in [110], that "the essence of what is being acquired, and the main objective, is the collection of debts as they fall due … the transactions Target performs are designed to obtain payment of pecuniary debts. That is what the lender is seeking to achieve…".
>
> (3) The FTT erred by incorrectly applying the relevant case law – *Customs and Excise Commissioners v FDR Ltd* [2000] STC 672 ("*FDR*"), *Customs and Excise Commissioners v Electronic Data Systems Ltd* [2003] STC 688 ("*EDS*"), and *AXA CA* to the facts of Target's case. The FTT incorrectly distinguished those cases from Target's case on superficial grounds.
>
> (4) Alternatively, and without prejudice to the above, the FTT erred in finding that the supplies did not constitute "transactions … concerning deposit and current accounts" within Article 135(1)(d) PVD.

39. In their response to the grounds of appeal, in addition to the arguments that they put forward in the FTT, HMRC also relied on the CJEU's judgment in Case C-5/17 *HMRC v DPAS Ltd* (Case C-5/17) [2018] STC 1615 ("*DPAS*"), which had not been released at the time of the FTT's decision, to contend that Target's supplies are not "transactions… concerning… payments, transfers" within Article 135(1)(d) of the PVD.

Discussion

40. We consider that the appropriate way to approach the issues in this appeal is, first to consider whether Target's services are exempt under Article 135(1)(d) PVD as either transactions concerning deposit and current accounts or transactions concerning payments, transfers and, if so, whether the services are debt collection and thus excluded from the exemption.

Preliminary points as to the construction of Article 135(1)(d)

41. The FTT set out the general approach to the interpretation of VAT exemptions at [11] – [12] and the parties did not dispute it. It was common ground that the exemptions contained in Article 135 are to be construed strictly but that is not to be equated with a restricted construction (see the passages from Case 348/87 *Stichting Uitvoering*

Financiële Acties v Staatssecretaris van Financiën 1989] ECR 1737and *Expert Witness Institute v Customs & Excise Commissioners* [2002] STC 42 CA ('*Expert Witness*') set out by the FTT at [11] and [12]). Further, the exceptions to exemptions (such as the exception relating to debt collection) are to be construed broadly (see *AXA CJEU* at [30] cited by the FTT at [19]).

Transactions concerning deposit and current accounts

42. As Target did not contend that the loan accounts were deposit accounts, the first issue is whether the borrowers' loan accounts with Shawbrook are current accounts. Only if the answer to that question is yes is it necessary to consider whether Target's supplies are transactions concerning current accounts or, in the terms of item 8 of Group 5 of Schedule 9 to VATA, the operation of current accounts.

43. At [89], the FTT noted Target's case that the borrowers' accounts with Shawbrook are clearly current accounts, because (1) they were a running account between the bank and its customer; (2) there was automatic set-off; and (3) absent special agreement, there is a need for either party to make a demand before seeking recover. The FTT accepted, in [92(3)] that the loan accounts might be running accounts but held, correctly in our view, that was not enough to bring them within the term "current accounts". To say that something is a "running account" is saying no more than it is an account in which debits and credits are recorded to reflect the mutual debt position at any point in time. That is not an exhaustive or conclusive definition of a current account. We agree with the FTT that whether an account is a current account is determined by the functions or features of the account.

44. Both parties cited authorities to the FTT describing the nature of a current account in different contexts. At [90] the FTT quoted from the lengthy description of the nature of a current account by Andrew Smith J in *Office of Fair Trading v Abbey National plc and others* [2008] EWHC 875 (Comm) ('*OFT case*') which was relied on by HMRC. In our view, the term "current account" in Article 135(1)(b) of the PVD must be given an EU law meaning so cases on the meaning of the term in English law are of limited assistance. In interpreting "current account" in Article 135(1)(b), we must take account of the context in which it appears which is conjoined with "deposit account" (and "savings account" in the VATA).

45. The FTT set out the reasons for concluding that the loan accounts were not current accounts at [92]. These were, in summary:

(1) The term "current account" is not legally defined but takes its meaning from the commercial world. In that world, the accounts would be regarded as loan accounts rather than current accounts.

(2) Functionality is critical. The key functions of a current account include the ability not only to pay in and draw out funds by one or more methods, but also, and importantly, to pay third parties by drawing on funds or credit available. A further important element of functionality was the free ability of the customer to vary the amount owed to it up and down.

(3) The loan accounts in this case did not have that functionality. Even assuming that they are running accounts and that set-off operates in a similar way to a current account, there is no ability to pay third parties, no general ability to draw out funds

or go into credit (save only in the case of a mistaken overpayment), and no ability for the customer to pay into the account at will.

(4) Target's approach would render the reference to deposit accounts otiose, because deposit accounts clearly satisfied the three criteria relied on by Target.

(5) The words "current" and "deposit" accounts in Article 135(1)(d) need to be interpreted in their context, but on a strict and fair (not broad) basis.

(6) Lenders have another route to exemption in the case of accounts such as those in this case, namely Article 135(1)(b) of the PVD and Items 2 and 2A of Group 5 of Schedule 9, albeit that these apply only to the person granting the credit and would not encompass outsourcing.

(7) The economic purpose of a current account and the economic purpose of the loan account with Shawbrook are quite different. The purpose of a current account is to allow a customer to pay in varying amounts and to draw out amounts, including by payment to third parties, whereas the purpose of the loan account is to lend a fixed amount to the borrower on specified terms as to repayment.

46. In our judgment, the FTT came to the right conclusion on this issue, essentially for the reasons given by it, as summarised above. We agree that the essential characteristic of both deposit and current accounts is that the customer is able to deposit and withdraw funds in varying amounts. Current accounts have the additional feature, not found in deposit accounts, that the account holder can pay amounts from the account to third parties by way of cheque or transfer. In the case of the loan accounts with Shawbrook, the customer can only pay money into the account in amounts that are specified or allowed by the loan agreement and can never withdraw the monies thus paid in. A borrower could ask Shawbrook to increase the amount of the loan but that is not the withdrawal of monies paid in: it is a new advance or loan as is an overdraft. There is no possibility of any amounts being paid from the loan account to a third party.

47. Mr Cordara submitted that the ability to pay third parties was not significant. He contended that the exemption applied to deposit as well as current accounts which, as one could not commonly pay third parties from a deposit account, showed that, as a matter of policy, the ability to make payments from the account was not a distinguishing feature. We disagree. It is clear that there is a distinction between current accounts and deposit accounts and other accounts. If it was not intended to distinguish deposit and current accounts from each other and other types of account then the PVD would simply have referred to bank accounts. It cannot be inferred merely from the inclusion of deposit accounts that a feature of current accounts that is *not* present in deposit accounts is to be ignored when considering whether an account falls within that description.

48. In our view, consistent with the need to construe exemptions strictly (see *Expert Witness*), the specific reference in Article 135(1)(b) of the PVD to deposit and current accounts shows that accounts which are neither deposit nor current accounts do not fall within the exemption.

49. Mr Cordara further submitted that the fact that balances on the borrowers' loan accounts normally show a negative, ie the outstanding loan, was not relevant as many current accounts would be overdrawn at some point as part of a pre-planned borrowing or an overdraft, whether authorised or unauthorised. He suggested that if the FTT and HMRC were right then two bank accounts achieving the same effect, namely to allow

borrowing, would be treated differently for VAT purposes depending on whether the account was a current account with overdraft facility (exempt) or a loan account such as the one in this case (standard rated). In our view, there is no danger of such an inconsistency of VAT treatment. We agree with the FTT at [92(7)] that the loan account is part of the supply of the grant of credit, ie the loan, which is exempt under Article 135(1)(b) of the PVD. Accordingly, any supply by Shawbrook of the operation of the loan account would be an exempt supply of the management of credit by the person granting it. The reason why the management of the loan accounts by Target is not an exempt supply is that Article 135(1)(b) of the PVD specifically restricts the exemption to the management of credit by the person granting it.

50. In light of the conclusion reached above, it is not necessary to consider whether Target's supplies are transactions concerning such current accounts.

Transactions concerning payments, transfers…

51. Target contended that the services it supplied to Shawbrook were "transactions … concerning … payment, transfers …" within Article 135(1)(d) of the PVD on one or other of two grounds, namely

(1) by reason of its involvement in procuring, via instructions to BACS, payments from borrowers' bank accounts to Shawbrook's bank accounts; and

(2) by reason of its inputting entries into the borrowers' loan accounts with Shawbrook ie a ledger maintained by Target to record details such as charges, payments, interest, arrears, and sundry fees in relation to each borrower's loan.

52. At the heart of Target's submissions is the proposition that, by giving instructions to BACS to transfer funds from a borrower's bank account to Shawbrook's bank account in circumstances where all steps following the instruction by Target occur automatically and inevitably, Target is "effecting" the transfer of funds. As Mr Cordara for Target put it, Target "reaches in" to the borrower's account and takes the money in order to deposit it with Shawbrook. In support of this proposition, he relied in particular on four cases, namely: Case C-2/95 *Sparekassernes Datacenter (SDC) v Skatteministeriet* [1997] ECR I-3017 ('*SDC*'), *Customs & Excise Commissioners v FDR Ltd* [2000] STC 672 ('*FDR*') and *HMRC v Electronic Data Systems Ltd* [2003] STC 688 ('*EDS*') and *AXA CJEU*. However, we must also consider *DPAS*, a decision which was published after the decision of the FTT in this case, as it sheds light on how the use of BACS, which is an essential feature of the arrangements between Target and Shawbrook and its customers, is regarded for VAT purposes.

SDC

53. SDC was a Danish association of savings banks which provided its members, who were connected to its data handing network, with data-handling services, comprising the execution of transfers, the provision of advice on and trade in securities, and the management of deposits, purchase contracts and loans. The Danish court referred to the ECJ the question whether the data-handling services provided by SDC to banks constituted "transactions, including negotiation, concerning … payments, transfers, debts" within Article 13B(d)(3) of the Sixth VAT Directive (the predecessor provision to Article 135(1)(d) of the PVD) and a number of subsidiary questions. The ECJ set out the principles to be applied, leaving it to the national court to determine whether the services provided by SDC fell within them. In summary, the ECJ held that, for the services

provided by a data-handling centre to be regarded as exempt, they must "form a distinct whole, fulfilling in effect the specific, essential functions of a service described in [Article 13B(d)(3)]". The ECJ also held that, for a "transaction concerning transfers", the services provided must therefore have the effect of transferring funds and entail changes in the legal and financial situation.

FDR

54. The judgment in *SDC* was considered by the Court of Appeal in *FDR*. FDR supplied credit card services to banks, being issuers (banks who issued credit cards to cardholders), acquirers (banks who paid merchants, normally retailers, who accepted cards) or banks acting in both capacities. FDR maintained merchant and cardholder accounts, posting credit and debit entries on each, effecting payments to merchants and reconciling accounts between issuers and acquirers under a netting-off procedure. One of the questions for the Court of Appeal was whether FDR itself effected transfers, in the sense set out by the ECJ in *SDC*, which constituted transactions concerning transfers or payments within Article 13B(d)(3) of the Sixth Directive. The Court of Appeal concluded that FDR made transfers by means of the netting-off process and by means of BACS (for example where the cardholder's ordinary bank account is debited with the amount which represents his payment of his monthly bill, and the Issuer's bank is credited accordingly).

55. In *FDR*, Laws LJ, giving the only judgment, referred to two earlier UK cases, *Momm v Barclays Bank International Ltd* [1977] QB 790 and *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] QB 728 ("*Libyan Arab Foreign Bank*"), which considered account transfers as a means of payment and concluded at [37] that:

> "… a transfer of money means no more nor less than the entry of a credit in the payee's account and the entry of a corresponding debit in the payor's account."

56. At [42], Laws LJ said:

> "On this aspect of the case, it is in my judgment of the first importance to recognise that BACS for its own part exercises no judgment or discretion whatever. Once the relevant tape is prepared (and that is admittedly done by FDR) and delivered to BACS, the process is, as I have said, automatic. Moreover the inevitable outcome is a redistribution of the rights and obligations of payor and payee − a change in the legal and financial situation − the very circumstances which in my judgment constitutes a transfer of funds for the purposes of Art.13B(d)(3). As far as I can see that result would only not be arrived at if the BACS hardware or software were to break down, or if (assuming this were possible) FDR were to countermand its instructions during the BACS payment cycle. In those circumstances BACS is in my judgment merely the agency by which FDR effects transfers, in the four situations I have identified. Any other conclusion would be contrary to the good sense of the general law: Qui facit per alium facit per se. And I cannot in this see the least affront to the reasoning in *SDC*: quite the contrary: it is a conclusion which conforms to the letter and spirit of Art.13B(d) as it was explained in that case."

57. Accordingly, the Court of Appeal held that FDR made exempt supplies of the transfer of funds for the purposes of Article 13B(d)(3) of the Sixth Directive.

EDS

58. The *SDC* case was further considered by the Court of Appeal in *EDS.* EDS supplied administrative services to a bank. The services related to loans granted by the bank to its customers. EDS was the contact point between the bank and actual or potential customers. EDS received and processed applications for loans and validated them using the bank's credit-rating system. When a loan had been validated, EDS produced a loan agreement, signed on behalf of the bank, and forwarded it to the borrower together with a direct debit mandate and other documents. EDS verified the documentation received from the borrower and, once verified, released funds to the borrower. The maximum and minimum amount of the loan and the interest rate payable were fixed by the bank. Once the loan had been made, EDS collected payments from the borrower using the direct debit system. EDS operated two accounts with the bank, as the bank's trustee and the funds in those accounts were the bank's funds. HM Customs and Excise rejected EDS's claim that its services were exempt within Article 13B(d)(3). The VAT and Duties Tribunal allowed the appeal and the Court of Appeal agreed with their conclusion.

59. At [135] of *EDS*, Jonathan Parker LJ summarised the guidance to be taken from *SDC*, as it applied to EDS, as follows:

> "An exclusively textual interpretation of the expression 'transactions … concerning' is not appropriate: recourse must be had to the context in which the expression appears (para. 22).
>
> The word 'transaction[s]' in art. 13(B)(d)(3) refers to the nature of the services provided, rather than to the party who supplies or (as the case may be) receives such services (para. 32).
>
> The relevant services in a case like the instant case are the services provided by EDS to its customer the bank, for which the bank provides consideration: the services which EDS provides to customers of the bank are 'significant only as descriptors and as parts of the services provided by [EDS] to [the bank]' (para. 45–47).
>
> The identity of the provider of the service or of the recipient does not affect the application of art. 13(B)(d)(3), save in cases where the services are such as, by their nature, are provided to customers of financial institutions (para. 48).
>
> A 'transaction …. concerning … transfers', within the meaning of art. 13(B)(d)(3), is 'a transaction consisting of the execution of an order for the transfer of a sum of money from one bank account to another', where the transfer results in 'a change in the legal and financial situation' of the relevant parties: the functional aspects of the transfer are decisive in this respect, irrespective of 'cause' (para. 53).
>
> It is nothing to the point, for present purposes, that the services provided by EDS will inevitably appear to the end customer to have been provided by the bank (para. 58).
>
> '[T]he mere fact that a constituent element is essential for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt' (para. 65).
>
> In the instant case: (1) the contractual links between the bank and its customers do not affect the question whether the services supplied by EDS to the bank are exempt under art. 13(B)(d)(3) (para. 55); (2) to fall

> within that exemption, the services provided by EDS 'must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of' an exempt transaction (para. 66); (3) they must 'entail changes to the legal and financial situation' (para. 66); and (4) EDS's supply must amount to more than a supply which is 'restricted to technical aspects' (para. 66.)"

60. Applying that guidance, Jonathan Parker LJ held that EDS's supplies were exempt transactions concerning payments, transfers on the basis of his conclusions set out at [136]:

> "1. That the expression 'loan arrangement and execution services' is an apt general description of the package of services supplied by EDS under the 1999 agreement.
>
> 2. That, within that package, the 'core supply' (to use one of the expressions referred to earlier) is that of administrative services in connection with ('concerning') the making of loans. That is the specific essential function of the supply.
>
> 3. The package of services is properly to be regarded as forming a 'distinct whole', and it would be thoroughly artificial to attempt to split it into separate elements, whether on economic or on any other grounds.
>
> 4. The performance of the package of services crucially and inevitably involves the making of payments and transfers of funds: such transactions are not merely essential but absolutely central to the 'core supply'.
>
> 5. The functional aspects of the movements of money effected by EDS in performing services under the 1999 agreement result in changes in the legal and financial situation of the relevant parties."

AXA CJEU

61. In *AXA CJEU*, Denplan Limited ('Denplan') operated a range of services for dentists, the main one being the operation of payment plans between dentists and their patients. On receipt of a direct debit mandate from the patient, Denplan lodged details of the mandate with the patient's bank. Each month, it created for each patient an electronic file containing details of the patient's bank account number and the amount which Denplan was to collect from that account, which it transmitted to BACS, for onward transmission by BACS to the processing centre of the relevant bank. Provided that the patient had not cancelled the direct debit and provided the patient's account remained open and in credit, the bank would debit the patient's account and notify BACS accordingly. BACS then posted a corresponding credit to Denplan's bank for the credit of Denplan's account. After approximately ten days, Denplan accounted to the dentist for the payment it had received, less certain agreed deductions.

62. In the CJEU, the first issue (and the only one relevant to this appeal) was whether the payment handling services would be exempt on the assumption that they constituted a separate supply. The CJEU concluded, at [28], as follows:

> "Denplan is, in return for remuneration, responsible for the recovery of those debts and provides a service of managing those debts for the account of those entitled to them. Therefore, as a matter of principle, that service constitutes a transaction concerning payments which is

> exempt under Article 13B(d)(3) of the Sixth Directive unless it is 'debt collection or factoring', a service which that provision, by its final words, expressly excludes from the list of exemptions".

63. At [32], the CJEU concluded that the service supplied by Denplan to dentists was 'debt collection and factoring' in Article 13B(d)(3) and was thus not exempt.

64. As we have noted above, *AXA CJEU* and the other decisions relied on by Target now need to be considered in light of *DPAS*. Mr Cordara accepted that to the extent that the CJEU, at [28] of *AXA CJEU*, appeared to express the view that the service (had it not constituted debt collection) fell within the ambit of "transactions concerning payment", such a conclusion is no longer tenable in light of the decision of the CJEU in *DPAS*.

DPAS

65. DPAS had provided services to dentists similar to those which Denplan had provided and which were the subject of *AXA CJEU*. In light of that decision, Denplan changed the contractual arrangements under which it provided the services to both dentists and their patients. DPAS contended that, under the new contracts, it made a standard rated supply of services to dentists and a separate exempt supply of payment services to their patients. The dental plan payment services involved, in essence, directing, pursuant to a direct debit mandate, that money was taken by direct debit from patients' bank accounts and paid into DPAS's own bank account and instructing its bank to make payments, less an amount for DPAS's remuneration, to the dentists. At [10], the CJEU observed that DPAS's way of implementing the plan was materially the same procedure (including the involvement of BACS) as was operated by Denplan in *AXA CJEU*.

66. DPAS accepted that its supplies to the dentists were taxable but argued that its supplies to patients were exempt for VAT purposes on the basis that they were transactions concerning transfer or payments within Article 135(1)(d). The Upper Tribunal referred two questions to the CJEU. The first question was whether DPAS's supplies were exempt pursuant to Article 135(1)(d). The second was what were the principles for determining whether a service such as that performed by DPAS falls within the scope of "debt collection". The CJEU answered the first question in the negative and, therefore, found it unnecessary to deal with the second question.

67. In relation to the first question, the CJEU reiterated that the transactions exempted under Article 135(1)(d) are defined according to the nature of the services provided, and not in terms of the person supplying or receiving the services. The CJEU held at [31]:

> "Accordingly, the exemption is subject, not to the condition that the transactions be effected by a certain type of institution or legal person, but to the condition that the transactions in question relate to the sphere of financial transactions."

68. Second, the CJEU endorsed, at [33], the conclusion reached in *SDC* that:

> "… a transfer is a transaction consisting of the execution of an order for the transfer of a sum of money from one bank account to another … characterised in particular by the fact that it involves a change in the legal and financial situation existing on the one hand, between the person giving the order and the recipient and, on the other, between

> those parties and their respective banks and, in some cases, between the banks. Moreover, the transaction which produces that change is solely the transfer of funds between accounts, irrespective of its cause. Thus, a transfer being only a means of transmitting funds, the functional aspects are decisive for the purpose of determining whether a transaction constitutes a transfer within the meaning of Article 135(1)(d) of the VAT Directive."

69. At [38], the CJEU held:

> "… a supply of services may be regarded as a 'transaction concerning transfers' or as a 'transaction concerning payments' within the meaning of Article 135(1)(d) of the VAT Directive only where it has the effect of making the legal and financial changes which are characteristic of the transfer of a sum of money. By contrast, the supply of a mere physical, technical or administrative service not effecting such changes will not come within that concept."

70. Applying those principles to the facts, the CJEU concluded, at [40] and [41], that, in requesting the patients' banks to make transfers to its own bank account and then asking its own bank to transfer amounts to the dentists and insurers (in all cases using BACS), DPAS did not itself effect the legal and financial changes which characterise the transfer of a sum of money. The CJEU held that:

> "DPAS does not itself carry out the transfers or the materialisation in the relevant bank accounts of the sums of money agreed in the context of the dental plans at issue in the main proceedings, but asks the relevant financial institutions to carry out those transfers."

71. The Court, in this respect, endorsed the opinion of the Advocate-General who, at [41] and [42] of his opinion, concluded that the action of DPAS (in requesting from a financial institution pursuant to a direct debit mandate that a sum of money be collected from the patient's account and paid to DPAS, which then asks its bank to transfer the sum, net of remuneration, to the dentist and the patient's insurer), while "essential for completing the transfer of the payment", did not in itself result in the legal and financial changes which are characteristic of the transfer of a sum of money but was merely a step prior to the transactions concerning payments and transfers covered by Article 135(1)(d).

72. In the course of its judgment in *DPAS*, the CJEU referred extensively to its earlier decision in Case C-607/14 *Bookit Ltd v HMRC* ('*Bookit*'). *Bookit* concerned the supply to the purchasers of cinema tickets online or by telephone of card handling services, one element of which involved the transmission of a settlement file to the merchant acquirer bank, which led to funds being credited to Bookit's bank account. The CJEU concluded, at [51], that the service provided by Bookit was merely technical and administrative and at [52], that:

> "… the fact that such a service is provided by electronic means, and in particular the fact that the transmission of the settlement file entails the automatic triggering of the payments or transfers under consideration, cannot alter the nature of the service provided and, therefore, does not affect the application of the exemption at issue."

73. Applying *Bookit*, the CJEU in *DPAS* held, in [45] and [47], that the services provided by DPAS in that case were administrative in nature and could not come within

the exemption in Article 135(1)(d) of the PVD for transactions concerning payments and transfers.

74. The decision of the CJEU in *DPAS* is, in our judgement, clear and unambiguous. Where the relevant service at issue involves the giving of an instruction to a financial institution to effect a payment, it does not constitute an exempt supply even though it may be a necessary step in order for the payment to be made.

75. In the present case, every transfer of funds made by a borrower to Shawbrook is effected by the borrower's financial institution debiting the borrower's account by the relevant amount and Shawbrook's bank crediting a matching sum to Shawbrook's account (together with matching debits and credits effected by other banks sitting between one or other of the borrower's and Shawbrook's bank and the Bank of England, as explained by Laws LJ in *FDR* at [37]). Target's role is limited to passing the necessary information to BACS to enable it to give the relevant instructions to the borrower's bank and Shawbrook's bank so that the transfer of funds can take place. That is indistinguishable from the role played by Denplan – so far as payments made by the patients are concerned – in giving the relevant instruction to the patient's bank pursuant to the direct debit mandate in order for patient's bank to cause the payment to be made to Denplan's bank.

76. Mr Cordara submitted that the analysis offered by Laws LJ at [42] of *FDR* nevertheless holds good and that it is Target, therefore, that effects the transfer of funds from the borrower's bank account to Shawbrook's bank account. He relies in support on the fact that there is nothing in the decision of the CJEU in *DPAS* which interferes with the conclusion reached in *SDC* and the fact that *FDR* and *EDS* were merely applying the principles set out in *SDC*. We reject this submission. While it is true that the CJEU in *DPAS* confirms and restates the principles stated in *SDC*, it provides further elaboration of those principles which is inconsistent with the conclusion reached (expressly) in *FDR* and (tacitly) in *EDS* that a party who provides instructions to BACS to transfer funds between bank accounts can be said to be effecting the transfer of those funds. As noted in *Bookit* (and also in Case C-130/15 *National Exhibition Centre v HMRC* [2016] STC 2132 at [47]), the fact that the procedures are automated does not alter the nature of the service supplied. Specifically, we do not consider that the fact that BACS is pre-authorised (no doubt pursuant to the terms its participating banks have agreed with it as part of the terms and conditions of membership) to effect debits and credits from the accounts of the participating banks alters the legal conclusion that it is BACS and/or the banks themselves that effect the transfer of funds and not the entity (Target, in this case) that provides the instruction to BACS containing the necessary information upon which BACS can act.

77. Mr Cordara contends, however, that *DPAS* is fundamentally different from the present case, and that Target, in contrast to Denplan, does indeed itself effect the legal and financial changes which are characteristic of the transfer of money.

78. First, he contends that it is a crucial difference that the entity to whom Target is supplying its service is a bank, whereas Denplan was providing its service to dentists and patients. Shawbrook, a bank, has outsourced to Target aspects of its own (exempt) banking function, whereas Denplan was "consuming" the services of its bank, rather than supplying any services to it. We disagree. In the first place, as we have already noted, it is well established that the identity of the recipient of the service is irrelevant. Second,

we consider that this contention mischaracterises the role played by Shawbrook. While it is true that Shawbrook (a bank) has outsourced part of its functions to Target, the functions which have been outsourced do not include any of the steps which a bank will ordinarily undertake in effecting transfers of funds. Shawbrook, as lender, has delegated to Target the function of recovering payments of interest and principal from borrowers, but Shawbrook has not delegated (because it did not carry out this function itself) the function of effecting those payments. Instead, all relevant payments are effected between (1) the borrower's bank and (2) Shawbrook's bank. Neither of those banks has outsourced to Target any part of their functions, and Target is not providing a service to either of those banks.

79. Secondly, Mr Cordara submits that an essential difference from *DPAS* is that Target sits between the borrower and Shawbrook, causing payment to be made directly from the borrower's bank account to Shawbrook's bank account, whereas Denplan caused payments to be made by the patients to it before separately passing on an equivalent sum (less deductions) to the dentist. We do not accept that this creates a relevant distinction. In particular, there is no material difference between Denplan's actions in issuing the instruction to BACS to effect payment from the patient's bank account to it and Target's actions in issuing instructions to BACS to effect payment from the borrower's account to Shawbrook's account. The fact that the relevant payment in *DPAS* constitutes performance of only half of the service provided to the dentist (the second half being the onward payment from Denplan to the dentist) is not relevant to the question whether the instruction to BACS is to be equated with effecting the transfer of funds.

80. Mr Cordara submitted in the alternative that the mere inputting of accounting entries by Target in the loan account was sufficient to effect a transfer or payment, in the sense of making the legal and financial changes which are characteristic of the transfer of a sum of money. We disagree. We consider that the loan account was no more than a ledger, recording the effect of payments made by customers to Shawbrook but not effecting such payments. It is true that most financial transactions are effected by entries in one or more bank account (it being rare indeed for financial transactions to involve an in specie transfer of money), but that is materially different to the inputting of accounting entries by Target in this case.

81. As explained by Staughton J in *Libyan Arab Foreign Bank*, at 750 E-H,

> "Any account transfer must ultimately be achieved by means of two accounts held by different beneficiaries with the same institution."

82. In *FDR*, at [37], Laws LJ, having referred to that passage from Staughton J's judgment, continued:

> "The value of these statements (which have, according to counsel's researches, never been doubted) is that they show that, if one leaves aside transfers in specie (of coin, goods or other property), a transfer of money means no more nor less than the entry of a credit in the payee's account and the entry of a corresponding debit in the payor's account. There may be − will be − problems in cases of error or fraud in the posting of entries to the accounts. But however those may fall to be resolved, there is no further, elusive, event by which the money is really transferred: no Platonic Form, of which day-to-day transfers are only shadows. The pro and con entries constitute the transfer. There is nothing else. I recognise, of course, that this reasoning boils down the

> reality to the simplest case. In truth, creditor and debtor may have accounts at banks A and B respectively; banks A and B may themselves have accounts at banks C and D respectively; and it may be only when one comes to banks J and K that one finds both of them having accounts at the Bank of England. But the logic is unaffected."

83. The accounting entries under discussion in *Libyan Arab Foreign Bank* and in *FDR* (which are the means by which funds are transferred) are fundamentally different from accounting entries in the loan account in this case, which merely record transfers, or more accurately the consequence of transfers, which take effect elsewhere.

84. The distinction is apparent from the facts of *FDR* itself. At [17] of his judgment, Laws LJ recorded the two things FDR did in connection with payments by the cardholder to the issuer: first, it posted the debit to the cardholder account and, second, where the cardholder paid by direct debit, it provided for BACS to debit the cardholder's ordinary bank account and credit the issuer's account, with the relevant amount. It was only upon the debiting and crediting of the cardholder's and issuer's bank accounts that payment was effected. If the posting of a debit to the cardholder's account was enough to effect payment from the cardholder to the issuer, then there would be no need for the BACS transaction at all. Conversely, if BACS transaction did not take place, then the posting of the debit to the cardholder's account would (as Mr Cordara accepted) need to be reversed, because it did not reflect reality.

85. It is true that, in some cases, a unilateral entry in an account might have the effect of making the legal and financial changes necessary to effect a transfer. The only example cited to us, however, was Case C-464/12 *ATP PensionService A/S v Skatteminsisteriet* [2014] STC 2145 ('*ATP*'), a decision of the CJEU, which is clearly distinguishable from the present case. ATP provided services to pension funds, including opening of accounts in the pension scheme system at ATP for the benefit of employees, the provision of facilities for the handling of payments from employers, so that all pension contributions for the employees of each employer could be paid into the pension fund account at a financial institution using an online service or a payment card, and crediting the pension contribution to the individual pension customer's account in the pension scheme system at ATP, including regular updating of the account with inward payments and income recorded. The relevant question for the Court was whether the creation of accounts for pensioners and crediting those accounts with contributions paid by the employer could constitute transactions concerning payments and transfers within Article 13B(d) of the Sixth Directive.

86. At [70], the CJEU said:

> "It appears prima facie that some of those services are not of a purely technical nature; rather, through the opening of accounts in the pension funds system and the crediting to those accounts of the contributions paid, they establish the rights of pension customers vis-à-vis the pension funds. The transactions by which contributions are credited to the pension customers' accounts appear to have the effect of transforming the claim held by a worker vis-à-vis his employer into a claim that the worker holds vis-à-vis the pension fund."

87. This finding was crucial to the CJEU's conclusion at [82]:

> "As mentioned in paragraph 70 above, some of the services in respect of which eligibility for VAT exemption is contested in the case before the referring court, such as transactions crediting contributions paid into pension customers' pension scheme accounts, are not of a purely technical nature but appear to establish the rights of pension customers vis-à-vis pension funds by transforming the claim held by a worker vis-à-vis his employer into a claim held by that worker vis-à-vis the pension fund of which he is a member."

88. Whether or not the crediting of contributions did in fact "establish" the rights of pension customers (as opposed to merely reflecting or recording them) was a matter to be determined by the domestic court. Whatever the right answer to that question, however, it has no relevance to the entries made by Target in the loan accounts in this case. It could not be suggested that the act of inputting a credit entry in a loan account made any change in the legal and financial relationship between Shawbrook and the relevant borrower unless (or until) there had been an actual transfer of funds from the borrower's bank account to Shawbrook's bank account.

89. In conclusion, we consider that the services supplied by Target to Shawbrook are not transactions concerning payments or transfers within Article 135(1)(d) of the PVD but are standard rated supplies for VAT purposes.

90. After the completion of this decision in draft, but before it was sent to the parties, we received a letter sent on behalf of Target enclosing an unofficial translation of a recent decision of the CJEU in Case C-42/18 *Finanzamt Trier v Cardpoint GmbH* and a copy of the opinion of the Advocate-General in that case. We have reviewed these and consider that they are consistent with our conclusion that the services provided by Target are not transactions concerning payments or transfers.

Debt collection

91. As we have concluded that the loan administration services supplied by Target to Shawbrook are not services within Article 135(1)(d) of the PVD, we do not need to decide whether Target's services would be excluded from the exemption as debt collection.

Disposition

92. For the reasons given above, Target's appeal is dismissed.

Costs

93. Any application for costs in relation to this appeal must be made in writing and served on the Tribunal and the person against whom it is the order be made within one month after the date of release of this decision as required by rule 10(5)(a) and (6) of the Tribunal Procedure (Upper Tribunal) Rules 2008. As any order in respect of costs will be for a detailed assessment, the party making the application need not provide a schedule of costs claimed with the application as required by rule 10(5)(b) of the Rules.

The Hon Mr Justice Zacaroli

Judge Greg Sinfield
Upper Tribunal Judge

Release date: 15 November 2019