APPORTIONMENT OF CONSIDERATION

FOR SUPPLIES IN UK VALUE ADDED TAX

1. Introduction

1.1. United Kingdom VAT law is currently part of the harmonised VAT system operated by all Member States of the European Union ("EU").

1.2. Domestic legislation, principally the Value Added Tax Act 1994 ("VATA") and subordinate legislation made under it, transposes EU VAT law whose main source is now Council Directive 2006/112/EC ("the Principal VAT Directive", or "PVD").

1.3. VAT is charged on the supply of goods and services, on acquisitions of goods from other EU Member States and on importation of goods from non-EU countries. The rules governing the place of supply of services also produce the result that certain services received from abroad are taxed in the UK under the "reverse charge" (tax shift) mechanism.

1.4. VAT on the supply of goods and services is charged on the "taxable amount". This is the consideration received by the supplier from the recipient or from a third party. "Supply" and "consideration" are autonomous concepts of EU law.

1.5. In the UK, VAT is charged at three rates: standard (20%), reduced (5%), and zero (0%). A supplier may deduct in full any VAT incurred ("input VAT") on the cost components of making such supplies. In addition, some suppliers are exempt. In principle, input VAT attributable to exempt supplies is non-deductible.

1.6. The features of commerce are diverse. They often give rise to transitions involving several different elements which, if supplied separately, might each attract a different VAT liability. From the inception of VAT, this has given rise to much litigation. The essential question is whether a composite (or complex) transaction, namely one comprising a cluster of features and acts, must be treated as a single supply (having a single VAT liability), or as a multiple (mixed) supply (having different VAT liabilities). In the case of a multiple supply, where a single price is charged the consideration must be apportioned between the separate VAT liabilities.

1.7. These features of the VAT system have created opportunities for value-shifting, transaction-splitting, and other forms of tax planning/avoidance.

1.8. PVD contains no express rules for the treatment of complex transactions.

1.9. Section 19(4) VATA provides:

> *"Where a supply of any goods or services is not the only matter to which a consideration in money relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it."*

1.10. The underlying principles for determining whether a transaction consists in a single, or in a multiple, supply are judge-made, principally by the Court of Justice of the European Union ("CJEU") in the course of giving 'preliminary rulings' when cases are referred by the domestic court of a member state.. The CJEU's approach has developed over a number of stages. From a vast number of cases, the following selection is intended to illustrate some of the key principles.

2. Principal/Ancillary

2.1. The seminal authority is Case C-349/96, *Card Protection Plan v Customs and Excise Commissioners* [1999] STC 270 ("*CPP*"). This concerned the treatment of a subscription paid by the customer to receive a package of benefits in the event of loss or theft of the customer's credit cards etc. The CJEU stated that, in principle, each element (of goods or services) should be treated as a supply which is separate and distinct. However, it is necessary to have regard to the essential features of the transaction and to all the surrounding circumstances. What constitutes, for the typical customer, the principal service? Was it a type of insurance (as argued by the taxpayer); or (as argued by the tax authorities) a card registration/convenience service? The CJEU stated that the tax liability of the principal service prevails *in particular* where other elements are "ancillary". An element is ancillary if, for the typical customer, it does not constitute an aim in itself, but a means of better enjoying the principal service. The CJEU gave a wide interpretation of insurance which, for reasons of fiscal neutrality, does not depend on whether the provider is an authorised insurer under domestic law.

2.2. When the case returned to the House of Lords, it was held that the principal element was insurance with other elements being ancillary. There was a single (VAT exempt) supply of insurance: see [2001] STC 174.

3. "Overarching" Supply

3.1. The principal/ancillary rule, however, does not meet all cases. In *College of Estate Management v CCE* [2005] STC 1597, the taxpayer supplied distance-learning courses whose elements were online tutorials, assignments and assessments and a pack of printed course materials. Supplies of education are exempt. The taxpayer sought to reclaim input VAT on the costs of the printed material, arguing that it was making a separate (zero-rated) supply of the printed material.

3.2. The House of Lords held that, as used in *CPP*, "ancillary" means "subservient", "supporting" or "ministering to". Its meaning should not be strained. The Tribunal had been wrong to categorise the printed material as merely "ancillary". It was an essential part of the course and comprised most of the cost. However, the essential (or "overarching") nature of the supply was education. The printed material was part of the medium through which that supply was delivered. Accordingly, the courses constituted a single (exempt) supply of education.

3.3. Similar reasoning is found in cases such as *Dr Beynon and Others v CCE* [2005] STC 55 (administration by a medical practitioner of dispensed drugs); and *Byrom (t/a Salon 24) v HMRC* [2006] STC 992 (massage parlour services, including room hire).

4. "Closely Linked/Economic Whole"

4.1. The approach of the House of Lords in *College of Estate Management* anticipated by a few days the judgment of the CJEU in Case C-41/04, *Levob Verzekeringen BV v Staatssecretaris von Financiën* [2006] STC 766. The taxpayer was an insurance-provider established in the Netherlands. Under the contract with the supplier, the taxpayer purchased computer software in the US which its staff imported into the Netherlands. The contract also provided for the supplier's engineers to travel to the Netherlands and configure and install the software into a fully-functioning IT system customised for Levob's use. The issue was whether there were two supplies: (1) of goods (outside the scope of Dutch VAT); and (2) services (liable to Dutch VAT under the reverse charge); or a single complex supply of services. The CJEU observed that the economic purpose (or cause) of the contract was for Levob to obtain a functional customised IT system. Therefore, the "services" element predominated. The transaction formed an economic whole. This should not be artificially split if to do so would distort the functioning of the common VAT system. The value of goods and services was, therefore, treated as consideration for a single supply of services subject to the reverse charge.

5. "Cause" of Contract

5.1. Economic purpose was further relied on by the CJEU in Case C-111/05 , *Aktiebolaget NN v Skatteverket* [2008] STC 3203. This concerned a contract to supply, install and commission a fibre-optic cable between Sweden and Denmark. The cable ran through the subsoil of each Member State, along the seabed of territorial waters and, for part of its length along the seabed of the continental shelf (which was not part of the sovereign territory of either Member State). The issue was whether there was a supply of goods or a supply of services. (The rules governing the place of supply, and therefore liability to VAT, are different.)

5.2. The CJEU reiterated the principles developed in earlier cases. The concept of a supply of goods is the transfer of the right to dispose of tangible property as owner. In the present case, the services formed an important element, but the cost of the cable formed the major component of the contract price. The CJEU emphasised that what the customer required from the contract was the right of ownership over the cable. *Levob* was therefore distinguished. Here, there was a single supply of goods.

5.3. Notwithstanding the single supply analysis, the special place of supply rules for installed goods treats the goods as supplied in the place where they are installed. The transaction, therefore, had to be apportioned: part of the supply subject to Swedish VAT; part subject to Danish VAT; and part (relating to the continental shelf) outside the scope of VAT.

5.4. As in the case where a transaction comprises a multiple supply, apportionment should be carried out using the simplest possible method: see *CPP*.

5.5. It is tempting to view the case law as relying on a matter of first impression. A single complex supply may be difficult to describe but should be recognisable when one sees it (an "Elephant" test)! Some decisions strive for a more principled approach, where a number of factors form part of the evaluation. Case law is not always consistent, however, on what factors are relevant.

5.6. The developing case law suggests that the CJEU is more ready to characterise a complex transaction as a single supply rather than a multiple supply. Although the CJEU may often give a strong steer, the final evaluation however is a matter for the domestic court.

6. Particular Factors

6.1. The evaluation by the CJEU of a range of competing factors is well-illustrated by Case C-117/11, *Purple Parking v HMRC* [2012] STD 1680. The taxpayer operated off-airport car parks. Customers were greeted at an "Arrivals" area. Transit by bus to and from the airport was provided. Customers' cars were parked and returned by the taxpayer's staff. The emphasis was on secure parking with 24-hour CCTV surveillance. An inclusive charge was made, based on the number of days the vehicle was parked. However, the transport infrastructure comprised the bulk of the taxpayer's costs. Domestic law provides a special Note displacing the normal VAT liability of transport (zero-rated) where its supply is linked to airport parking (standard rated). The taxpayer sought to reclaim a proportion of VAT paid, arguing that the Note breached the principle of fiscal neutrality.

6.2. The CJEU first addressed whether in principle the taxpayer's supply was a single composite supply of serviced parking, or two separate supplies of parking and transport.

6.3. A number of factors were identified as being relevant. The charging of a single inclusive price, while not determinative, indicated that the customer was paying for a single composite transaction. This was reinforced by the fact that the price was fixed by reference to the number of days during which the customer's vehicle was parked (and not by the distance from the airport or whether the customer availed himself of the transport or not). The fact that the cost components relating to the transport element were higher than those relating to the parking was not determinative. The CJEU emphasised that the "interest" of the parties was very important. The typical customer entered into the contract to obtain secure parking of his vehicle.

6.4. The CJEU regarded certain factors as non-determinative or unhelpful. If the charge had been separated between parking and transport, that did not create a separate supply analysis; nor did the possibility that, in other circumstances, the two elements are capable of being supplied separately. (Query, however, whether there would be separate supplies if the customer could choose not to accept, and pay for, the transport element?) The principle of fiscal neutrality requires that similar

transactions are not to be taxed differently. The assessment of whether two transactions are truly similar is for the domestic court. However, fiscal neutrality is a principle of interpretation and does undermine the concept of supply or extend the scope of an exemption: see also Case C-44/11, *Deutsche Bank v HMRC* [2012] STC 1951 (discretionary portfolio management involving purchase and sale of securities held to be a single standard rated supply).

6.5. In *Purple Parking*, therefore, the CJEU favoured a single composite supply (standard rated) of serviced airport parking.

7. Legislative "Carve-outs"

7.1. Domestic legislation may, in accordance with the principles of the EU law, impose different taxation on part of a supply (a "carve-out"). In Case C-04/09, *EC Commission v France* [2012] STC 573, ("The French Undertakers' case") the PVD permitted Member States to deviate from the exemption for undertakers' services. France chose to limit the exemption to actual transport of the deceased. This was upheld by the CJEU, provided the domestic legislation in point was that of a special legal regime and the "carve-out" was for a "concrete and specific aspect of the supply."

7.2. The earlier case of Case C-251/05, *Talacre Beach Caravan Sales v CCE* [2005] STC 1671, presented the French undertakers' situation in reverse. Domestic law zero-rates the supply of residential caravans. However, a carve-out excludes (and thereby standard-rates) certain fittings and contents. The taxpayer challenged the carve-out as breaching *CPP* principles. The CJEU rejected this argument and upheld the validity of the carve-out.

7.3. Other examples of special rules and carve-outs are:

7.3.1. The treatment of printed matter when the supply is closely linked to a supply of services (Notes (2) and (3), Group 3, Schedule 8, VATA).

7.3.2. Exclusion of certain luxury items incorporated into new (zero-rated) houses (Note (22), Group 5, Schedule 8, VATA) and related 'blocking' of input VAT deduction (to ensure the customer bears the burden of VAT on these items).

7.3.3. Similarly, in residential caravans and houseboats (Note to Group 9, Schedule 8, VATA).

7.3.4. Transport linked to parking (see Notes (4A) to (4D), Group 8, Schedule 8, VATA) and 6.1 above, *Purple Parking*).

7.4. The UK courts have emphasised the need to interpret the "carve-out" provision carefully. Thus, the taxpayer's attempt to obtain zero-rating for power and water supplied to caravan pitches failed in *Colaingrove (No. 3) v HMRC* [2017] EWCA Civ 332. The Court of Appeal held that the statutory provisions which zero/reduced-

rated domestic supplies were nevertheless focused on distinct supplies rather than useage.

8. Some problem areas

8.1. Recently, some further difficulties have arisen with composite supplies. The UK courts have traditionally taken the view that where separate elements are supplied by two or more suppliers, this can never be a single composite supply: see *Telewest v CCE* [2004] STC 517. The effect of this case, however, was reversed by statute: Notes (2) and (3), Group 3, Schedule 8, VATA: see 7.3 above).

8.2. The *Telewest* approach must now be in doubt following some observations of the CJEU in Case C-607/14, *Bookit v HMRC* (No. 2) [2016] All E R(D)78. In that case, the taxpayer provided a ticket-booking service for cinemas operated by its parent, Odeon Cinemas. Customers paying by credit card were charged a "card payment handling fee". The issue was whether such fee was VAT exempt as a financial service. The CJEU observed that it was open to the domestic court to find that supply of the tickets and the booking services formed a single economic whole to which the card handling was ancillary. The CJEU made this observation notwithstanding that, plainly, Odeon and the taxpayer were separate legal entities.

8.3. The UK courts have accepted that a single course of conduct by one party is capable of creating a supply to two separate persons: see *Redrow Group plc v CCE* [1999] STC 161. (This is so despite potential difficulties about place of supply and input VAT deduction). The CJEU has not favoured such an approach (see, for example, Case C-53/08, *LMUK v HMRC* [2010] STC) until recently. In case C-699/15, *Brockenhurst College* (CJEU, 4 May 2017) the taxpayer supplied exempt education to its students. Those students undertaking catering courses were required to prepare meals which were supplied to members of the public in the College's restaurant. The issue was whether the meals were supplies relating essentially to education and VAT exempt. The CJEU held that the VAT liability of the principal supply (educating the students) could attach to the ancillary element (supply of the meals), even though the meals were supplied to different recipients.

8.4. In conclusion, it should be said that there have been discussions about codifying the applicable principles. Until then, however, the developing case law has not always illuminated what Advocate General Fennelly in *CPP* referred to as "the mystic twilight of VAT".

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