VAT review for April

Exempt education

Article 132(1)(i) of the Principal VAT Directive provides for the exemption of ‘the provision of children’s or young people’s education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the member state concerned as having similar objects’. Two recent cases provide further guidance on the scope of this exemption.

SAE Education case

The exemption is implemented in the UK by restricting it to supplies by an ‘eligible body’ defined as including ‘a United Kingdom university, and any college, institution, school or hall of such a university’. In SAE Education Ltd v HMRC [2019] UKSC 14, the Supreme Court has provided guidance on the scope of the UK implementation of this exemption to bodies which are not constitutionally part of a university.

SAE is part of a global institute, the School of Audio Engineering, which provided higher education in audio and digital media technologies. In the UK, it provided one such course in conjunction with Middlesex University. HMRC contended that SAE was not an ‘eligible body’ as it was not a ‘college’ of Middlesex University and therefore its course was not exempt from VAT.

The Supreme Court noted that the UK legislation must read in line with the Principal VAT Directive. Member states must exempt transactions involving the provision of university education by ‘bodies governed by public law having such education as their aim’ and by other organisations recognised as having ‘similar objects’ to such bodies. The domestic UK legislation must be construed in a manner consistent with the objectives of the EU rules and, in the context of university education, that objective is to ensure that access to higher education is not hindered by the increased costs that would result if those services were subject to VAT.

Whilst member states have a discretion as to which bodies, other than those governed by public law, to recognise as eligible to provide exempt education, that discretion is not unlimited and must be exercised in a way that is consistent with general principles of EU law, such as fiscal neutrality.

In particular, the Supreme Court held that organisations could not be excluded from the scope of the exemption simply on the basis that they are not constitutionally part of a University or provide education as a commercial activity. To do so would undermine the purpose of the exemption and the principle of fiscal neutrality. Instead it is necessary to examine the characteristics of those educational services and the context in which they are delivered rather than the precise nature of the legal and constitutional relationship between the body that provides them and its university.

The court identified five factors that are likely to be important in determining whether a body qualifies as a ‘college of a University’ for these purposes:

- whether they have a common understanding that the body is a college of the university;
- whether the body can enrol or matriculate students as students of the university;
- whether those students are generally treated as students of the university during the course of their period of study;
- whether the body provides courses of study which are approved by the university; and
- whether the body can in due course present its students for examination for a degree from the university.

In this particular case, the Court held that the FTT had been correct to conclude that SAE was a ‘college’ on the basis that its activities were sufficiently integrated into those of Middlesex University and that it shared the university’s objects.

The driving school case

Separately, the CJEU has held that driving school lessons are not covered by the requirement to exempt school and university education in article 132 (A&G Fahrschul-Akademie GmbH v Finanzamt Wolfenbuttel (Case C-449/17)).

The taxpayer in this case was a company operating a driving school. It contended (supported by Italy and Spain) that driving school lessons should be covered by this exemption, just as much as the general education received by young people at school or university.

The CJEU has rejected this contention. The concept of ‘school or university education’ refers ‘generally to an integrated system for the transfer of knowledge and skills covering a wide and diversified set of subjects, and to the furthering and development of that knowledge and those
skills by the pupils and students in the course of their progress and their specialisation in the various constituent stages of that system. In contrast, driving tuition is not a part of the general education system nor does it cover 'a wide and diversified set of subjects … characteristic of school or university education'.

Had the court held that driving tuition was the equivalent to 'school or university education', it would have been necessary to consider whether the taxpayer in this case qualified as 'an organisation having similar objects'. The court did not comment on this issue, but interestingly the AG had suggested that if the driving tuition had been equivalent to exempt education then it must follow that the taxpayer had similar objects to public bodies providing such education. 'Every organisation providing education within that system has, in that sense, objects similar to bodies governed by public law since the wording of the provision in question is based on the assumption that that system is generally made up of bodies governed by public law'.

**Sale and leaseback arrangements**

The Court of Session has held that, since VAT is a transactional tax, it is not permissible to have regard to the net effect of a composite transaction in determining whether a taxpayer has disposed of their 'entire interest' in a property for the purposes of anti-avoidance provisions in VATA 1994 Sch 10 para 36 (Balhousie Holdings Ltd v HMRC [2019] CSIH 7).

The taxpayer, Balhousie, originally acquired a care home by way of a zero-rated supply under VATA 1994 Sch 8 Group 5. In 2013, Balhousie entered into a sale and leaseback transaction of the care home to raise funds, in view of difficulties in raising bank funding. The arrangement involved the sale of the property by Balhousie to Target and the immediate leaseback by Target to Balhousie so that Balhousie could continue to operate the care home.

HMRC contended that the result of the sale and leaseback was to trigger anti-avoidance provisions in Sch 10 paras 35–37 resulting in a deemed taxable self-supply. These operate *inter alia* when a person who has received a zero-rated supply subsequently disposes of their 'entire interest in the relevant premises'. Balhousie argued that the transactions carried out by it should be treated as a composite transaction under which it retained an interest in the property pursuant to the *Ramsay* approach.

The Court of Session has held that, whilst the principles of purposive construction are as appropriate to VAT as to direct taxes, there are limits as to the application of the *Ramsay* principle to VAT. In particular, VAT is in essence a transactional tax and consequently each transaction in the chain of supply must be examined separately. As such, the direct tax principles under which a composite scheme may be taxed on the result of the scheme as a whole, ignoring inserted steps, are not appropriate in the context of VAT. The court also noted that 'a strictly objective approach is necessary in the context of VAT, which also differentiates it from the direct tax approach in *Ramsay* (based on subjective intentions).

The VAT rules must be applied transaction by transaction and a lease and lease back consists of two transactions. Under the first transaction, the taxpayer disposed of its entire interest in the property and that engaged the anti-avoidance legislation.

Turning to the purpose of those anti-avoidance provisions, the court held that there were good reasons for applying the provisions even on a mere disposal (without any immediate change of use) as following that disposal 'the person who received the initial zero-rated supply will normally have no control over the premises or their use'. It made no difference that the taxpayer had no avoidance intent and, indeed, continued to operate the care home as before, nor that the transaction could, in principle, have been structured as a secured loan without triggering the anti-avoidance provisions.

**Why it matters**

These decisions shed further light on the scope of the exemption for education and the scope for private bodies to supply such education. In particular, a question mark must remain over the UK’s transposition of article 132, though the decision of the Supreme Court on the meaning of the 'college' of a university in this context will go a long way to ensuring that the UK legislation is applied less restrictively than its literal reading might suggest.

A question mark must remain over the UK’s transposition of article 132, though the Supreme Court’s decision on the meaning of the ‘college’ of a university will go a long way to ensuring that the UK legislation is applied less restrictively than its literal reading might suggest.

**VAT and leasing contracts with an option to purchase**

HMRC has announced a change of policy in relation to the application of VAT to financing contracts that provide for the customer to pay a series of lease payments and then make a choice whether to pay a substantial payment to acquire the asset or to return the asset at the end of a period of hire. *Revenue & Customs Brief 1/2019* sets out how HMRC expect businesses to account for VAT on these contracts from 1 June 2019.

The announcement follows the 2017 decision of the CJEU in *Mercedes Benz* (Case C-164/16) concerning the correct VAT treatment of a finance purchase scheme called 'Agility'. HMRC contended that supplies under Agility amounted to supplies of goods pursuant to VAT Sch 4 para 1, which provides that if possession of goods is
transferred under agreements which ‘expressly contemplate that the property in the goods will pass at some time in the future’ then it amounts to a supply of goods.

The CJEU held that, in interpreting this requirement, a judgement must be made by the supplier at the outset of the contract as to what the customer, acting as a ‘rational economic actor’, would do when entitled to exercise a purchase option. Following this decision, HMRC has announced that they will determine the correct VAT treatment of such contracts based on the expected rational decision of the customer at the outset of the contract. This in turn will be based mainly on the level at which the final optional payment is set.

Accordingly, if at the start of the contract the final payment is set:

- at or above the anticipated market value of the goods at the time the option is to be exercised, the correct VAT treatment of the contract will be to treat it as a supply of leasing services from the outset and VAT must be accounted for on the full value of each instalment. There is no advance or credit, so there is no finance element; or
- below the anticipated market value, such that a rational customer would buy the asset when they exercise the option, it is a supply of goods, with a separate supply of finance. VAT is due on the supply of goods in full at the outset of the contract, the finance is exempt from VAT.

Why it matters
The change of practice is relevant to all business areas using similar arrangements, not just the motor industry. All new contracts from 1 June 2019 falling within the ambit of the business brief must be accounted for in accordance with the new ruling. However, the Brief provides businesses with a range of options for dealing with any overpayments or underpayments of VAT where existing contracts have been incorrectly treated as supplies of goods or services.

Attribution of marketing expenditure
The FTT has handed down a lengthy and detailed judgment concerning the correct attribution of various categories of marketing expenditure in connection with a business that sold fashion goods but also provided credit to customers on such sales (see N Brown Group plc v HMRC [2019] UKFTT 172). The decision covers a broad range of marketing spend including physical marketing materials, TV adverts, telemarketing, brand development, search engine optimisation, public relations and marketing research.

The decision should be considered by any partially exempt business with a view to determining whether their treatment of marketing costs is incorrect.

HMRC argued that the marketing expenditure was residual and needed to be attributed between the taxable supplies of goods and the exempt supplies of credit. The taxpayer argued, in essence, that the marketing expenditure was directly attributable to the sales of goods, unless it also contained a ‘reference to credit’.

The tribunal has, on the whole, rejected the taxpayer’s approach. Instead, the tribunal considered that, given the two-way relationship between goods and credit, material that seeks to stimulate demand for goods must also stimulate demand for credit and vice versa. As such, HMRC was correct in regarding the expenditure on marketing as residual. The one exception was expenditure on market research, since such research was much less directly related to communications to stimulate demand. Accordingly, in this case, the tribunal considered that such costs would only be residual if the matters being researched included both matters relating to the goods and to credit.

Why it matters
The decision should be considered by any partially exempt business with a view to determining whether their current or historic treatment of marketing costs is or was incorrect.

Notice 700/2: VAT grouping
HMRC has released an updated version of Notice 700/2 on group and divisional registration, which takes effect from 1 April 2019. The update contains amended guidance on the VAT charge that arises under VATA 1994 s 43(2A) where services are ‘bought-in’ through overseas establishments of VAT group companies. This also includes confirmation that an annual £7,500 de minimis limit will be applied before a s 43(2A) charge needs to be made.

Why it matters
This has been an increased focus from HMRC on VAT grouping and, in particular, the inclusion of overseas entities in UK VAT groups in recent years. The revised guidance indicates that HMRC may be more prepared to use its ‘protection of the revenue’ powers in this context in the future, as well as taking a much more stringent line on the activities of the UK arm of an overseas entity before accepting that it qualifies as a UK fixed establishment for VAT grouping purposes.

What to look out for
- MTD for VAT becomes mandatory from 1 April 2019 for all businesses except those that have been deferred until 1 October 2019
- HMRC will withdraw its policy of allowing insurers to exempt supplies of investment management to pension funds with effect from 1 April 2019, unless the pension fund qualifies as special investment fund.
- Revised guidance on VAT grouping and overseas entities takes effect from 1 April 2019 (see above).
- The closing date for comments on HMRC’s consultation on when and how reg 38 adjustments should be made is 15 April 2019.