[2016] UKUT 0298 (TCC)
Appeal number: UT/2015/0004

VAT –deductibility of input tax- whether provision of deposit accounts involved a supply by bank – whether supply was for consideration capable of quantification- whether investment by bank of funds received was an economic activity

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ING INTERMEDIATE HOLDINGS LIMITED **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: MR JUSTICE MORGAN
JUDGE SARAH FALK

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4A 1NL on 16, 17 and 18 May 2016

Kevin Prosser QC and James Rivett, instructed by PricewaterhouseCoopers LLP, for the Appellant

Kieron Beal QC and Peter Mantle, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The appellant, ING Intermediate Holdings Ltd, is the representative member of a VAT group. This appeal relates to voluntary disclosures made in respect of its VAT periods 10/02 to 03/11 inclusive to the effect that it was entitled to deduct input tax in a total amount of £6,032,280. HMRC refused the claims and the appellant's consolidated appeals against the refusals were considered and dismissed by Judge Mosedale in the First-tier Tribunal ("FTT") at [2014] UKFTT 938 (TC).

Overview- issues in dispute

2. The claims relate to a business known as ING Direct which was carried on in the UK successively by two companies in the VAT group. In essence the business involved taking cash deposits from retail customers and deploying the funds raised, mainly via the acquisition of bonds, in such a way as to make a profit. Up to 31 December 2003 the business was carried on by ING Direct (UK) NV. After that date and following a statutory merger under Dutch law the business was carried on by its parent company ING Direct NV. In common with the FTT we will use the acronym IDUK to refer to whichever of these companies carried on the business at the relevant time. Since nothing turns on it, we will also not draw a distinction between IDUK and the appellant, which as the representative member of the VAT group was the entity which would be treated as making and receiving any relevant supplies for VAT purposes.

3. The input tax in dispute arose on expenses incurred in relation to deposit taking. The key issues before the FTT and before us can be summarised as follows:

(1) whether the deposit taking activity involved a supply of services by IDUK or was merely the lending of money to IDUK in a way that did not involve a supply by IDUK for VAT purposes;

(2) whether, if there was a supply by IDUK, that supply was for consideration for VAT purposes which was capable of being expressed in monetary form (and the possible methods of doing so);

(3) if there was no supply by IDUK or no supply for consideration, whether the deployment by IDUK of the funds raised was an economic activity for VAT purposes;

(4) if there was an economic activity in those circumstances, whether and if so how a proportion of the input tax could be attributed to "specified supplies" made in the course of that activity and so qualify as deductible; and

(5) whether the recovery could extend to input tax incurred before the statutory merger, relying on regulation 109 of the Value Added Tax Regulations 1995 (SI 1995/2518) (the "VAT Regulations").

It was accepted before the FTT and before us that if IDUK had made supplies for consideration (issues (1) and (2)) then HMRC had correctly denied recovery of the disputed input tax on the basis that the expenses incurred had a direct and immediate link with exempt supplies made in the course of the deposit taking activities.

4. The FTT decided that IDUK had made supplies for consideration so that it did not strictly need to deal with the other points. It did however express the view that IDUK would not have being carrying on an economic activity if it had not been making supplies to depositors and that IDUK would also have failed on the regulation 109 issue.

5. An additional question before the FTT which was also raised before us was whether, even if IDUK succeeded on other aspects, its appeal should be dismissed on the basis that it had not produced sufficient evidence to prove the quantum of its claim and had not taken steps prior to the hearing to establish that the hearing would be a hearing in principle only. The FTT did not need to reach a conclusion on this point either but indicated that if it had then it would also have been inclined to dismiss the appeal on that point.

6. There was one further issue argued before the FTT and referred to at [183] to [185] of the FTT decision. This related to the decision of the ECJ in *Le Crédit Lyonnais v Ministre du Budget* (case C-388/11) [2014] STC 245. HMRC argued before the FTT that the effect of the decision was that any input tax recovery could only be made from the Spanish tax authorities. HMRC did not seek to pursue this point before us.

7. We should say at the outset that we are grateful to both Mr Prosser QC and Mr Beal QC for their clear and helpful submissions. We also pay tribute to the FTT for its clear findings of fact and its clear and impressive statement of its reasons for its decision.

The facts

8. The relevant facts are set out in the FTT decision. The description that follows is a summary of the salient points.

The banking trade

9. The ING Direct business was a retail banking trade which was established in about May 2003. The trade comprised taking cash deposits from private individuals and using the funds to acquire bonds and securities as described further below. Deposits were on terms that they could be withdrawn without notice.

10. The FTT found that the retail banking operations involved a "normal retail banking service" but with two distinctions. These were that IDUK only offered deposit accounts and that it had no walk-in branches. Instead it offered a 24 hour telephone and internet banking service. It also attracted customers by offering a higher interest rates than most or all of its competitors and by its marketing

catchphrase of "no fees, no exceptions". Depositors were protected by the Dutch deposit guarantee scheme.

11. With the exception of account opening and deposits made by cheque, depositors could only interact with the bank and undertake transactions on their accounts by telephone or on the internet. A limited number of facilities were made available. Depositors could not receive cheque books, debit or credit cards or overdraft facilities. Although transfers to the account could come from any other bank account, including by a cheque payable to a depositor which was drawn by a third party, there was no ability to make a payment from the account to a third party. Instead withdrawals had to be made via a transfer to another IDUK account or to a linked account held by the depositor at another bank. Depositors were required to have a current account with another UK bank or building society which acted as the linked account.

12. Up to 31 December 2003 the vast majority of the cash received was loaned by ING Direct (UK) NV to the Spanish branch of its parent company ING Direct NV. This branch was referred to by the acronym EICC. EICC was responsible for investing the funds. EICC continued to do this from 1 January 2004 but no loan was required since the banking operations were then carried on in the same legal entity. Investment strategy became increasingly controlled by IDUK during the period in dispute. The FTT found that oversight of the investment activity included monthly strategy meetings, weekly operational meetings and daily phone contact with EICC.

13. EICC invested the funds in debt instruments. The bonds and securities acquired were low risk fixed term securities. The FTT found that the majority of these were acquired by subscription with the rest purchased in the secondary market, and that they were normally retained until maturity. A small percentage of the funds was held in short term deposits to meet liquidity needs. Some of the issuers of the debt securities were based outside the EU. It is the acquisition of these instruments that IDUK maintains involved "specified supplies".

14. From October 2006 some additional business lines were developed. IDUK became an insurance intermediary and in addition started offering loans secured by mortgages. Funds used in the latter were obviously no longer available for placement by EICC.

The expenses

15. IDUK incurred significant expense in its deposit taking activities. This included significant expenditure on advertising campaigns, construction of a head office and two call centres, IT systems and services and employment of staff, including recruitment costs. The FTT found at [26] that these expenses were incurred to attract the deposits. It is a proportion of the VAT incurred on these costs that is the subject of the dispute.

Terms and conditions

16. The FTT had before it two sets of customer terms and conditions. One version dated from May 2011 and the other from 2013, by which time the business had been sold to Barclays and renamed Barclays Direct. There was no direct evidence of the terms used for periods covered by the appeal, but neither party suggested that there was any material difference. Among other things, the FTT found that the terms permitted deposits of between £1 and several million, allowed up to 10 withdrawals a day on no notice and in amounts up to the full amount in the account, and made statements available online or by post on request. The terms required the depositor to have a current account in the UK which acted as a "linked" account.

17. No cash fees or charges were levied on depositors. The FTT noted that there was one account in respect of which 90 days' interest would be forfeited if funds were withdrawn without notice. This could more properly be viewed as an adjustment to the interest rather than a fee or charge. However, the approach in the terms and conditions was a little more nuanced than the "no fees" marketing catchphrase. The terms which the FTT referred to provided that there were "currently no fees or charges…However, we may introduce or vary charges…". We were also shown a slightly different formulation in the Barclays set, the non-business account versions of which said that there were "currently no fees or charges" but provided that the bank "may introduce or vary charges" in line with the condition that permitted it to vary the terms of the agreement on two months' notice.

18. The FTT noted that the terminology of the terms and conditions was one of service by IDUK, with references to "customer" throughout and in some clauses to the "service" provided. The FTT found at [33] that the terms of the agreement with the customer were very different to those that would exist in a mere contract of lending, and were fairly typical of what one would expect to find in a retail banking contract, albeit one with less standard terms in that it offered only deposit accounts and had no walk in branches, instead attracting customers by its rates, 24 hour service and absence of fees.

The legislation

19. Both before us and the FTT, discussion of the relevant legislation focused principally on the provisions of Council Directive 2006/112/EC, known as the Principal VAT Directive ("PVD"). Strictly the relevant Directive for periods up to 31 December 2006 was the Sixth VAT Directive (77/388/EEC). It was agreed however that there were no relevant differences in respect of the matters in dispute and so, like the FTT, we will refer to provisions of the PVD.

20. Relevant extracts from the legislation are set out in the Annexes to this decision as follows: Annex 1- PVD extracts; Annex 2- the relevant domestic primary legislation in the Value Added Tax Act 1994 ("VATA"); Annex 3- secondary legislation comprising regulations 103 and 109 of the VAT Regulations and the relevant provisions of the Value Added Tax (Input Tax) (Specified Supplies) Order 1999.

The input tax claims

21. Before discussing the substantive issues in dispute it is worth saying something about the nature of the appellant's appeal. As already explained it arose from HMRC's refusal to accept voluntary disclosures made in respect of a number of VAT periods. The background to these disclosures was an agreement between the appellant and what was then HM Customs & Excise in 2004 to the effect that no input tax was deductible in respect of IDUK's business on the basis that it made only exempt supplies. That agreement formed a part of a wider agreement on input tax deductibility for the VAT group pursuant to the VAT Regulations (a "special method"). In effect the appellant wanted to revisit this agreement on the basis that its view was that IDUK was not simply making exempt supplies which carried no right to deduct input tax. The appeals against HMRC's refusal to agree this were brought under s 83(1)(c) and (e) VATA, which respectively permit appeals over the amount of input tax which may be credited and the proportion of input tax allowable. Mr Prosser indicated that on reflection paragraph (e) was the more appropriate provision, but what the appellant was really seeking to do was to get HMRC to accept that a revised special method was required.

Issue (1)- was there a supply of services?

The parties' submissions in summary

22. Mr Prosser for the appellant submitted that IDUK made no supplies to depositors for VAT purposes. Not everything done for consideration is a supply of services for VAT purposes, notwithstanding that the domestic legislation might suggest otherwise at s 5(2)(b) VATA. The deposits were simply loans to the bank. It was clear that a borrower of money does not supply services for VAT purposes merely by accepting borrowed money and repaying it at interest: *BLP Group plc v CCE* (Case C-4/94) [1995] ECR I-983, [1995] STC at [25] of the ECJ judgment. This was the case notwithstanding that there were other features, such as the provision of security by the borrower or (as in this case) the provision of information about the amounts outstanding, or the taking of steps to facilitate advances or repayments. Instead, the correct analysis was that the depositor supplied credit services to the bank, albeit that these would generally be outside the scope of VAT because the depositor would not be carrying on an economic activity for VAT purposes. From the bank's perspective it was simply raising funds to use in its economic activities.

23. Mr Prosser submitted that, whilst the FTT had correctly accepted that a mere borrowing did not involve a supply by the borrower and that there must be a "transaction" in a VAT sense within Article 24(1) of the PVD, it then made an error by equating this with any transaction giving rise to consumption and by identifying the test as whether the borrower supplied something in addition to its promise to pay interest and repay principal. Instead the correct approach was to consider the essential nature or characteristics of the transaction.

24. The principal case law authority relied on by Mr Prosser for this proposition was the judgment of Briggs J in *MBNA Europe Bank v HMRC* [2006] EWHC 2326

(Ch), [2006] STC 2089, which relied in turn on a passage from the judgment of Jonathan Parker LJ in *Tesco plc v Customs and Excise Comrs* [2003] EWCA Civ 1367, [2003] STC 1561 and the opinion of Advocate General Tizzano in *CCE v Mirror Group plc* (Case C-409/98) [2001] ECR I-7175, [2001] STC 1453, which refers to the "economic purpose" of a contract. Here the economic purpose was simply to provide and obtain the use of the depositor's money. What IDUK provided did not serve any additional purpose: easy access facilities just made making and repaying deposits easier, and statements merely told the depositor how much he was owed. References to IDUK providing "services" to its "customers" were simply labels and did not determine the analysis.

25. Mr Prosser accepted that the features he relied on were not peculiar to the deposit accounts offered by IDUK and were likely to be common to many deposit accounts. In response to questions from the Tribunal, he suggested that while current accounts might also share some of the features there was a material distinction. In contrast to the deposit accounts offered by IDUK, current accounts offered the facility to make payments to third parties by various means. That facility might be regarded as the provision of a payment service for VAT purposes.

26. Mr Beal submitted that the FTT had reached a decision premised on factual findings which could not be challenged, relying in particular on comments of Lawrence Collins J in *VTech Electronics (UK) plc v HMRC* [2003] EWHC 59 (Ch), [2003] All ER (D) 274 at [85] to [91] on the scope of the *Edwards v Bairstow* principle. The approach the FTT took involved no error of law. Purpose was not the correct test to apply. Instead the focus should be on the contractual terms and testing whether they represent the substance and reality: *HMRC v Newey* (Case C-653/11) [2013] STC 2432 and *Secret Hotels2 v HMRC* [2014] UKSC 16, [2014] STC 937. Rather than analysing the transaction as the provision of credit to IDUK within Article 135(1)(b) of the PVD it should be regarded as falling within Article 135(1)(d) ("transactions…concerning deposit…accounts").

Edwards v Bairstow

27. This point can be disposed of briefly. Neither side has challenged any of the FTT's finding of facts. There is no dispute about what facilities the bank provided, or that they were provided to depositors. The question at issue is one of legal classification: did the facilities provided amount to the provision of a service for VAT purposes by the bank, or was there merely a borrowing by the bank? In our view that is clearly a legal question. If support was needed for the proposition beyond the significant amount of jurisprudence on the question of whether a supply has been made for VAT purposes then we agree with Mr Prosser that it can be found in *HMRC v David Baxendale* [2009] EWCA Civ 831, [2009] STC 2578 at [8] to [10], citing *Dr Beynon and Partners v Customs and Excise Comrs* [2004] UKHL 53, [2005] STC 55 at [26] and [27]. The same point was noted in *MBNA Europe* at [98]. The Court of Appeal made clear in *David Baxendale* that the function of the appeal court in this context is to decide the correct VAT consequences of the contractual arrangements having regard to the material background facts. The FTT's findings of fact are clearly relevant (and some circumspection is appropriate before interfering with the decision

reached) but a challenge to its legal conclusions is not limited by *Edwards v Bairstow* principles.

Case law on the supply concept

28. Mr Prosser's submissions relied heavily on *MBNA Europe* so it is worth considering it in some detail. The primary question in that case was whether MBNA Europe made supplies for VAT purposes when it assigned credit card receivables to a securitisation structure. The FTT decided that there were no supplies because the bank was effectively providing security for a loan. On appeal to the High Court, Briggs J agreed that there were no supplies but for different reasons. The bank was not borrowing and giving security- and indeed it was vital to the legal analysis of the structure that it did not do so and instead made outright assignments- but the assignments were still not supplies. Instead they were assignments made for the purpose of providing a securitisation service to MBNA Europe, and were no more than a precondition to that supply. Whilst the assignment was capable of being a supply in isolation, the context meant that it lost that character.

29. Commenting on Article 6(1) of the Sixth Directive, which is in similar terms to Art 24(1) of the PVD ("supply of services shall mean any transaction which does not constitute a supply of goods"), Briggs J said:

> "[16] Read literally, para (1) of art 6 would appear to mean that any transaction of any kind (other than a supply of goods) constitutes a supply of services, although pursuant to art 2 it will only be subject to VAT if effected for consideration. As will appear however, para (1) of art 6 has not been interpreted with that degree of remorseless logic. Its apparently limitless breadth is circumscribed by reference to the essential nature and purpose of VAT. This is best expressed in the following passage in the opinion of Advocate General Jacobs in *Kretztechnik AG v Finanzamt Linz* (Case C-465/03) [2005] STC 1118, [2005] 1 WLR 3755:
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> '52. Although art 6(1) of the Sixth Directive defines a supply of services as any transaction which does not constitute a supply of goods, that definition clearly cannot be taken to its literal extreme. It might be more reasonable to interpret it as intended to define a service as anything supplied which is not a good.
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> 53. VAT is a tax on turnover and on consumption. Only supplies which form part of a taxable person's turnover and are stages in a chain normally ending in consumption by a final customer can be subject to the tax.'
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> That was part of the reasoning in an opinion supporting the conclusion (with which the ECJ concurred) that the issue of shares by a company to a subscriber for money did not constitute a supply by the company. The ECJ based its reasoning on the similarity between such an issue and the subscription of capital to a partnership, which had by an earlier decision been held not to constitute a supply. As a result, the relevant part of the Advocate General's opinion was not commented upon by

> the ECJ, and the decision is too recent for it to have been approved or disapproved in any later case.
>
> [17] If 'supply of services' merely means a supply which is not a supply of goods, then art 6(1) provides little assistance in defining the concept of supply itself. The real insight into the concept is afforded by para 53 of the opinion, since it encourages the reader to approach the question whether a particular type of transaction gives rise to a supply by asking whether an affirmative answer is consistent with the nature and purpose of VAT as a system of taxation. I do not consider that the Advocate General intended the reference to a chain to be an invariable feature of a supply. Some services (such as a barrister's opinion paid for by a solicitor) are supplied as part of a chain. Others, such as a solicitor's advice direct to his client, are not."

30. Briggs J went on to refer to cases which, whilst addressing the question of consideration for a supply, in his view shed valuable light on the prior question of identification of the supply, including the *First National Bank of Chicago* case considered below in relation to issue (2) and *Finanzamt Groß-Gerau v MKG-Kraftfahrzeuge-Factory GmbH* (Case C-305/01) [2003] STC 951, [2003] ECR I-6729 which analysed a factoring arrangement and concluded that the factor provided a factoring service. He noted at [21] that he could not see that the ECJ would have accepted that there was also a supply by the trader assigning debts to the factor: that was just a necessary step to obtain the factoring service. After commenting that both parties had accepted that when a bank lends money the provision of security for the loan is not a supply by the borrower (as reflected in the Advocate General's opinion in *BLP*) he went on to say at [23]:

> "That is not to say that there cannot be mutual supplies arising from the same transaction. The best example consists of a barter of goods for goods. Whether that is the correct VAT analysis of any particular transaction will depend on an economic analysis of its essential nature, set against the nature and purpose of VAT as a form of taxation."

31. Briggs J went on to explain at [35] that the court was not hidebound by labels and must "ascertain the essential character" of the transaction. To illustrate the application of this principle under EU as well as English law he referred to a section of the Advocate General's opinion in *Mirror Group* which discussed the need to find the contract's "economic purpose, calculated to realise the parties' respective interests, lying at the heart of the contract".

32. Mr Prosser then relied on the following passage at [37]:

> "In my judgment the best summary of the combined effect of those principles, when used to perform the VAT analysis of a transaction for the purpose of answering the question who is making a supply of what to whom (and if necessary what kind of supply) is to be found in the following passage from the judgment of Jonathan Parker LJ in *Tesco plc v Customs and Excise Comrs* [2003] EWCA Civ 1367 at [159], [2003] STC 1561 at [159]:

'[159] So what is the correct approach in the instant case? There are number of pointers in the authorities referred to in Part 3 of this judgment, under heading (a) "*Authorities as to the approach to be adopted in analysing the relevant transaction*". The more significant of such pointers in the context of the instant case seem to me to be these: 1. The resolution of the issue as to the application of para 5 in the instant case depends upon the legal effect of the Clubcard scheme, considered in relation to the words of the paragraph (see *British Railways Board* especially [1977] STC 221 at 223, [1977] 1 WLR 588 at 591 per Lord Denning MR: see [34] above). 2. In considering its legal effect, the entire scheme must be examined (what is the "entire scheme" for this purpose being objectively determined by reference to the terms agreed) (see *Pippa Dee* especially [1981] STC 495 at 501 per Ralph Gibson J: see [33] above). 3. The terms contractually agreed may not be determinative as to the true nature and effect of the scheme (*Reed*, see [36] to [38] above): it is necessary to go behind the strictly contractual position and to consider what is the economic purpose of the scheme, that is to say "the precise way in which performance satisfies the interests of the parties" (see the Advocate General's opinion in *Mirror Group*, para 27: see [41] above). 4. Economic *purpose* is not the same as economic *effect*. The fact that two transactions have the same economic *effect* does not necessarily mean that they are to be treated in the same way for VAT purposes (see *Littlewoods* especially at para 84 per Chadwick LJ: see [42] above). 5. Equally, the economic *purpose* of a contract (what the Advocate General in *Mirror Group* called the "cause" of a contract: see para 27 of his opinion: at [41] above) is not to be confused with the subjective reasons which may have led the parties to enter into it (in so far as those subjective reasons are not obviously evident from its terms) (see *Mirror Group* para 28: at [41] above). The Advocate General went on to observe (an observation which seems to me to be particularly apt in the context of the tribunal's decision in the instant case):

> "... failure to distinguish between the cause of a contract and the motivation of the parties has been the source of misunderstandings, ... and has complicated the task of categorising the contracts at issue.'"

33. Mr Prosser argued that what IDUK offered depositors, beyond interest and the promise to repay principal, was simply ancillary or peripheral to the borrowing transaction, and no different in principle to the provision of security by a borrower or the assignment of the receivables in *MBNA Europe*. Those features might be important or even vital- in the same way as a lender may require security before advancing a loan- but they could not be treated as separate services because they simply facilitated the lending. The essential nature or characteristic was that of a lending and borrowing transaction. The depositor was providing credit and earning interest and the bank was obtaining use of the funds. The internet, phone and other facilities might be attractive to the depositor or even to an extent necessary but they did not affect the essential nature of the transaction and did not realise any additional interest of either party. They were not ends in themselves. Those facilities comprised largely a means of communication about the state of the account and the lender's instructions regarding loans and repayments.

34. Mr Beal disagreed, relying in particular on the following passage from the ECJ judgment in *Newey*:

> "40 Under Article 2(1) of the Sixth Directive, 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is to be subject to VAT. As regards, more specifically, the meaning of supply of services, the Court has repeatedly held that a supply of services is effected 'for consideration', within the meaning of Article 2(1) of that directive, and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient (Case C-270/09 *MacDonald Resorts* [2010] ECR I-13179, paragraph 16 and the case-law cited).
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> 41 It is also apparent from the case-law of the Court that the term supply of services is therefore objective in nature and applies without regard to the purpose or results of the transactions concerned and without its being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person (see, to that effect, *Halifax and Others*, paragraphs 56 and 57 and the case-law cited).
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> 42 As regards in particular the importance of contractual terms in categorising a transaction as a taxable transaction, it is necessary to bear in mind the case-law of the Court according to which consideration of economic and commercial realities is a fundamental criterion for the application of the common system of VAT (see, to that effect, Joined Cases C-53/09 and C-55/09 *Loyalty Management UK and Baxi Group* [2010] ECR I-9187, paragraphs 39 and 40 and the case-law cited).
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> 43 Given that the contractual position normally reflects the economic and commercial reality of the transactions and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' transaction within the meaning of Articles 2(1) and 6(1) of the Sixth Directive have to be identified.
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> 44 It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.
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> 45 That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions."

(Article 2(1) of the Sixth Directive corresponds to relevant parts of Article 2(1) of the PVD.)

35. In *Secret Hotels2* Lord Neuberger (who gave the only judgment) first considered the approach to interpreting an agreement under domestic law, under

which "the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense", and noted that "the label or labels which the parties have used to describe their relationship cannot be conclusive, and may often be of little weight" ([32]). The "right starting point" is to characterise the nature of the relationship between the parties in the light of the contractual documentation, then to consider whether that characterisation could be said to represent the "economic reality of the relationship in the light of any relevant facts", and finally to work out the result of that so far as the relevant provision of the PVD is concerned (in that case a special scheme for travel agents) ([34]). His Lordship then went on to find at [55] and [56] that the approach under EU law to the question at issue in that case, namely whether the taxpayer was acting as an agent or intermediary, is very similar: contractual obligations are the starting point and are of particular importance, but it is also necessary to have regard to all the details of the case, and the "economic and commercial realities" represent "a fundamental criterion". A contract which does not reflect "economic reality" and a "purely artificial arrangement" (*Newey* at [45], cited above) are similar to the domestic concepts of sham, rectifiable agreements, variation or rescission or establishing that a written agreement does not record the totality of a contractual relationship.

36. Although not cited before us, we note that Lord Neuberger referred to the same approach, namely to start with the contractual position and see whether the characterisation that results from that is vitiated by any relevant facts, in the recent decision of the Supreme Court in *Airtours Holiday Transport Ltd v HMRC* [2016] UKSC 21 at [47], and referred again at [49] to the passage in *Newey* set out above. Although Lord Clarke and Lord Carnwath dissented in that case we detect no disagreement on the general approach to take.

37. In our view the correct approach is clear from *Newey* and *Secret Hotels2*. The test is an objective one (see also on that *Commission v Finland* (Case C-246/08) [2009] ECR I-10605 at [37]). The contractual terms must be considered. It is also necessary to consider the "economic and commercial reality". If the terms reflect the economic and commercial reality then it is not necessary to go any further.

38. We do not see any inherent conflict between this approach and the approach taken by Briggs J in *MBNA Europe*. If "economic purpose" is read objectively then it can be seen as another way of expressing the need to consider the economic reality or, as Mr Prosser suggested, the "essential nature" of the transaction. The assignment of receivables is prima facie a supply and Briggs J was seeking to explain why, exceptionally, it was not a supply in the particular context because it was merely a precondition for a supply in the other direction. Against that background the focus on "essential nature" is fully understandable since the context was key. Briggs J clearly recognised that subjective motivation was not relevant. He also considered the contractual documentation in that case in detail and relied on it to find that the banks had made outright assignments.

39. In our view Briggs J was putting forward a helpful explanation of the undisputed point that not everything done for a consideration is a supply for VAT purposes, and pointing out that contractual terms are not necessarily determinative.

Scope of the exemptions: provision of credit and bank accounts

40. Mr Beal relied on the fact that Article 135(1) of the PVD specifically exempts transactions concerning deposit as well as current accounts at paragraph (d), and deals separately with the granting and negotiation of credit at paragraph (b). This he suggested was intended to demonstrate a distinction: the granting of credit is a different kind of transaction from depositing money with a bank. (The domestic equivalent of these provisions are in items 1, 2, 2A and 8 of Group 5 Schedule 9 VATA.)

41. We are not persuaded by this. Whilst the terms of Article 135 are of some relevance, what we are concerned with is the prior question of whether there is a supply. It is clear that that has to be answered without reference to the text of the exemptions: *MBNA Europe* at [24]. In addition, there is nothing that compels the conclusion that the paragraphs are mutually exclusive. As a matter of law a depositor does provide credit to a bank. As the FTT recognised that might involve a supply by the depositor in certain cases, albeit that a private depositor would not have any economic activity for VAT purposes. However, we do not need to reach a final conclusion on the correct VAT classification of any supply by the depositor because it is quite possible for both parties to a transaction to make supplies for VAT purposes.

Conclusions on Issue (1)

42. We have concluded that the FTT did not make an error of law in deciding that IDUK was supplying services to depositors for VAT purposes. The FTT did not make an error of law either in directing itself as to the approach it should adopt or as to the application of that approach to its findings of fact. Further, we consider that the FTT's detailed reasoning on this issue was essentially correct. In view of the comprehensive arguments which were addressed to us, we will set out our own reasoning in our own words but we reach the same result on this issue as that reached by the FTT. For this purpose, we will (of course) adopt the FTT's findings of fact which were not challenged on this appeal.

Scope of the supply concept

43. As a preliminary comment it is worth making the point that it has repeatedly been made clear that the supply concept is a broad one: see for example *Van Tiem v Staatssecretaris van Financiën* (Case C-186/89) [1993] STC 91 at 106, [1990] ECR I-4363 at 4386 at [17], which states that article 4 of the Sixth Directive (see now Article 9 of the PVD) confers a very wide scope on value added tax, comprising all stages of production, distribution and the provision of services. This reflects Article 1(2) of the PVD, which provides that VAT is a "general tax on consumption". Article 2(1)(c) specifies that a supply of services for consideration is subject to VAT if it is made in a Member State by a taxable person acting as such, and Article 24(1) defines a supply

of services as "any transaction which does not constitute a supply of goods". This is clearly a broad concept.

The contractual terms

44. It is clear to us from *Newey* and *Secret Hotels2* that we should start with the contractual terms. In our view the terms and conditions on which deposits were taken by IDUK were clear and entirely consistent with services being provided to depositors as customers.

45. As the FTT noted at [31] there are references throughout to the depositor as customer and the contract refers to the "service" IDUK provided. The FTT referred to some examples. Others in the May 2011 version include references to "our Interactive Telephone Banking Service", the "customer service number", and provisions addressing situations where the bank had "suspended any of [its] services". We do not think that this is mere labelling. We regard this language as appropriate to describe what IDUK agreed to provide to a customer. There are a number of provisions that impose obligations on the bank, for example as to how and when deposit and payment instructions would be dealt with, the number of deposits or withdrawals that could be made in a day, security, confidentiality, access to information about the account, the provision of statements and complaint handling. There are far fewer obligations on depositors beyond the eligibility criteria for account opening. There was an obligation on depositors to use reasonable care to keep security details safe, some obligations in relation to PIN numbers and obligations to notify IDUK of problems in accessing their account. The fact that the terms contemplated that fees or charges could be introduced is also of some relevance: if no services were being provided then it is not obvious what any fees would be charged for.

Commercial reality

46. Although deposit taking clearly involves borrowing from depositors as a matter of law, as a matter of commercial reality the depositor can readily be regarded as the bank's customer. As between the depositor and the bank, the depositor is not merely a person who puts the bank in funds in order to enable the bank to carry on a profitable activity. IDUK's trade was banking: its deposit taking activities were a core part of that trade. Of course, and as is the case with any bank, it sought to make a profit from the use of those funds, but its deposit taking activities remained a core part of its trade. This was also reflected in the significant resources required for those activities. To focus only on what IDUK did with the funds raised does not seem to us to accord with economic or commercial reality, nor indeed accurately to describe the essential characteristics of the deposit taking activities or its banking trade more broadly. IDUK's "turnover" as a bank realistically included its deposit taking activities and its depositors were realistically consumers (see the passage from *MBNA Europe* citing Advocate General Jacobs in *Kretztechnik* set out at [29] above).

47. A bank's business model differs from a conventional chain of supply where the price paid by the consumer represents the final price in the chain, each supply in the

chain being potentially subject to VAT on the value added, with the overall effect that VAT applies to turnover. Generally, and leaving aside negative interest rates, a bank does not make a profit from deposit taking business by any direct charge to a customer, but instead by making profitable use of the funds. But this does not necessarily mean that it is in the same position as any business that raises funds to enable it to carry on that business: here the raising of funds by way of deposit taking was the essence of IDUK's business and its depositors were, and were rightly regarded as, its customers.

48. In our view the commercial reality was therefore in line with the contractual terms: IDUK provided services to depositors.

Distinctions from borrowing with no supply

49. Mr Prosser made a number of submissions to the effect that none of the facilities that IDUK provided was sufficient to affect the essential characteristic of the transaction as one of borrowing, which is not a supply for VAT purposes. Whilst we agree that, individually, many of the features in question could at least in theory be present in a "pure" borrowing and lending transaction, what is important is the overall effect on the characteristics of the transaction. This must be the case whether looking at contractual terms and testing them against economic and commercial reality, or (although we do not think it is a separate test) looking at the "essential nature" of the transaction in the way Mr Prosser suggested we should.

50. We have concluded that although, in legal terms, borrowing and lending was involved, the key characteristic of the transactions between IDUK and depositors was that IDUK was providing accounts with the features described by the FTT, and that this is qualitatively different to something that is only a borrowing and lending transaction. We do not think that those features are analogous to the provision of security by a borrower or the assignment of receivables in *MBNA Europe*. The features were not just a precondition to loans being made, but determined the character of the transactions.

51. In our view the features that support the conclusion that IDUK provided services to its depositors as customers or consumers, rather than merely borrowing from depositors, are:

a) IDUK undertook to accept deposits. Provided a depositor had opened an account with a minimum of £1, IDUK was contractually obliged to accept further deposits as the depositor wished. It would be very unusual for a mere borrowing transaction to be driven entirely by the lender's wish to lend a particular amount and for the borrower to be obliged to borrow at the lender's whim. It is however a key feature of a bank account.

b) More generally, all activities on an account were at the depositor's instigation: he or she determined when either deposits or withdrawals were made. IDUK could not require any deposit to be made beyond the initial £1 and, short of

closing the account (usually on two months' notice), IDUK could not compel any repayment. Again, this would be unusual for a mere borrowing transaction.

c) A number of deposits and withdrawals could be made to and from the same account. Rather than being treated as individual borrowing transactions, they would have been treated as transactions affecting a single balance on the account. This feature describes the essential characteristic of a bank account. Although a similar result might be achieved under a "revolving" loan agreement under which amounts can be drawn, repaid and redrawn, we would expect that to occur at the instigation of the borrower.

d) IDUK set all the terms and conditions, including of course interest rates. The terms for any particular product would have been unaffected by the identity of the particular depositor and the product would have been available only on those standard terms. We would not expect a borrower in a lending transaction to set the terms in this way.

e) IDUK did all the work: it kept the records of how much it owed, produced statements and supplied information to the depositors. A lender would not ordinarily leave it to the borrower alone to determine what the lender was owed.

f) IDUK provided a cheque clearing facility in relation to third party cheques.

52. We do not think that it matters that a similar economic result might, at least in theory, have been achieved by a borrowing and lending transaction that did not involve IDUK providing services. It is clear that transactions with the same economic or business effect need not be treated in the same way for VAT purposes: *Lex Services plc v Customs and Excise Comrs* [2003] UKHL 67 at [27], [2004] STC 73 at [27], per Lord Walker of Gestingthorpe.

53. Overall, the provision of information by IDUK to depositors, together with the facility to make withdrawals and deposits, were not only contractually described as services but in reality amounted to services, and went well beyond what might be expected in a mere borrowing transaction. As a matter of contract and in reality IDUK provided banking services in the form of deposit accounts.

Issue (2)- consideration- existence and valuation

Was there any consideration?

54. Mr Prosser for the appellant submitted that even if there was a supply of services by IDUK it was not made for consideration for VAT purposes. The only consideration for the deposits was the interest. The "no fees, no exceptions" marketing catchphrase covered non-monetary as well as monetary charges. Mr Beal argued, and the FTT accepted, that the deposits formed non-cash consideration for which the customer received banking services as well as interest.

55. Mr Prosser principally relied on *Kuwait Petroleum (GB) Ltd* (case C-48/97) [1999] ECR I-2323, [1999] STC 488. In that case Kuwait or the relevant independent retailer offered to supply both petrol and vouchers in return for payment, the vouchers being exchangeable later for "free" gifts. The ECJ held that it was for the national court to determine whether, at the time of purchasing the fuel, the parties had agreed that part of the price paid would constitute the value given in return for the vouchers (or, later, the redemption goods). However, the court gave a strong indication at [30] and [31] that there were two factors which made it difficult for Kuwait to maintain that the vouchers were not supplied free of charge. The first was that the redemption goods were described as gifts. The second was that it was not contested that the retail price of the fuel was the same whether or not the purchaser accepted the vouchers, and that this was the only price referred to on the invoice.

56. We did not understand Mr Prosser to argue that the banking services were supplied for no consideration in contractual terms. He disagreed with Mr Beal's suggestion that the absence of evidence on that point in *Kuwait* was key. He appeared to accept that there was contractual consideration, so IDUK did have an obligation to provide the services, but he said that this was not the test for VAT purposes. Depositors had paid the "price" (the advance of credit) in exchange for interest, rather than interest and banking services: the banking services were provided under the contractual agreement but free of charge. The terms of the deposits were the same irrespective of the extent to which the services were used. Mr Prosser said that this corresponded to *Kuwait*, where the customers bargained for petrol and the vouchers were made available without payment.

57. Consideration for VAT purposes is a European law concept. There must be a legal relationship between the supplier and the recipient entailing reciprocal performance, the remuneration received by the supplier constituting the value actually given in return for the supply (*Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] ECR I-743, [1994] STC 509 at [14]).

58. Applying this test, we have concluded that the FTT was correct to decide that there was consideration for the supply of banking services. A key distinction from the *Kuwait* case is that the banking services were integral to the arrangement. They were not an "optional extra". No depositor could avoid using the services at least to some extent, both in depositing and accessing funds. To deposit funds he or she would either need to use the phone or internet service or send a cheque by post which IDUK would then need to clear. To make a withdrawal a depositor had to use the phone or internet service. Similarly, to obtain information about the state of the account he or she would have needed to use the phone or internet service or would have had to request the alternative of statements by post.

59. It was also perfectly apparent when a depositor opened an account that the services would be provided. Indeed part of IDUK's marketing approach was to emphasise the services provided. In terms of the test in *Tolsma*, the reciprocal performance comprised the deposits being made in exchange for the promise to pay interest and to provide the services. The fact that a depositor is unlikely to have consciously addressed his mind to the question of whether he was providing

consideration makes no difference. Any depositor would have understood that IDUK was providing some services which the depositor would use to a greater or lesser extent, at least to facilitate deposits and withdrawals, and that deposits were made on the terms that those services would be available. A reasonable depositor would also have appreciated that IDUK would be seeking both to cover its costs and to make a profit, and therefore that the rates of interest offered would need to reflect that. The fact that the rates offered were highly competitive does not detract from this since of course competitors also had costs.

60. We also do not agree that the "no fees" catchphrase made the position analogous to the "free" vouchers in *Kuwait*. We agree with the FTT that this meant no separate monetary fees or charges. The clear bargain between the parties was that if a deposit was made the depositor would (in addition to the obligation to repay) receive in exchange interest together with the services.

Could the consideration be valued?

61. It is clear that, in order to comprise consideration for VAT purposes, consideration must be capable of being ascertained in monetary terms (*Naturally Yours Cosmetics Ltd v Commissioners of Customs & Excise* (Case 230/87) [1988] ECR 6365, [1988] STC 879 at [16]). The same paragraph in that case also states that consideration has a subjective value. This means that what is being tested is the consideration actually agreed and adopted by the parties and not a value assessed according to objective criteria: *Lex Services* at [17] to [19], per Lord Walker.

62. This is the extent of the test. The fact that the amount of the consideration may be incapable of being determined at the time of the supply is not fatal (*MacDonald Resorts* (Case 2-270/09) [2010] ECR I-13179, [2011] STC 412), nor is the fact that it may be difficult to ascertain it, the fact that the parties may not have expressly or impliedly attributed a particular value (*Lex Service* at [21]), or the fact that the recipient of the supply may never know the amount (*Argos Distributors* (Case C-288/94) [1996] ECR I-5311, [1996] STC 1359 at [49]). Difficulty in calculating the consideration is one of the motivations behind the financial services exemption: *Velvet & Steel Immobilien und Handels GmbH v Finanzamt Hamburg-Eimsbüttel* (Case C-455/05) [2007] ECR I-3225, [2008] STC 922 at [24]).

63. It is not necessary to the decision in this case that we determine the amount of the consideration, because the supplies were exempt. It is sufficient that we determine whether the FTT correctly concluded that the consideration was capable of valuation. In fact, the FTT did consider two potential methodologies and reached a conclusion between them. It was clearly necessary to consider the potential approaches to valuation in order to answer the question whether quantification was possible. Some additional methodologies were put to us in argument which were not put to the FTT. We have referred to these below for the same reason, but we have not reached a conclusion as to the correct method. To do so would neither be necessary for our decision nor appropriate in the absence of further evidence. We do note however that the approach taken by the FTT is potentially open to criticism for the reasons

mentioned below, and that those criticisms might be addressed by one of the alternatives that was not put to the FTT.

64. The four methods discussed before us were as follows:

a) *The cost of supplying the services*: This was the approach that found favour with the FTT, applying *Empire Stores* (Case C-33/93) [1994] ECR I-2329, [1994] STC 623. In that case a catalogue retailer offered non-catalogue goods in exchange for promotional services supplied by customers. One of the questions was how to determine the amount of the consideration for the supply of the goods, being the value of the promotional services. The CJEU held that the consideration had a value equal to what the supplier was prepared to spend on the goods, since this was consistent with the subjective approach. It was the value the supplier of the goods attributed to the services received. Applying that approach in this case, the FTT concluded that the value of the supply of the bank's services was what the bank spent on providing them. Those amounts were capable of being ascertained and could, if necessary, be apportioned between depositors. Mr Prosser criticised this approach with some force, on the basis that even assuming costs were allocated among depositors not per head but by reference to the amount and term of the deposits made, that would still lead to the potential for deposits to be valued very differently depending on the level of business generated. This was because costs would not increase in line with deposits, so as business increased the value of the deposits on this approach would go down. In contrast to *Empire Stores*, where there was a clear direct cost, the costs here were indirect and could not sensibly be related to individual deposits. Mr Prosser argued that the effect of this approach would be to result in effective double counting when supplies made in the course of IDUK's investment activities was included.

b) *The bank's gross margin*: This was the alternative approach considered by the FTT, based largely on *First National Bank of Chicago* (Case C-172/96) [1998] ECR I-4387, [1998] STC 850. FNBC had entered into foreign exchange swaps for which it charged no fees, instead seeking to make a profit from the spread between bid and offer rates and the ability of its traders to make profits on dealings which reflected those differences. After making it clear that any technical difficulties in determining consideration cannot by themselves justify the conclusion that no consideration exists, the ECJ concluded that despite the absence of specific fees there was consideration, and that this was the amount that FNBC could "take for itself" from the transactions. It determined that since the bid and offer prices for currencies were different the consideration FNBC took for itself was included in the calculation of the rates. The amount of the consideration was the overall result of the transactions over a given period of time.

Applying this approach, a possible method might be to look at the difference between the interest payable to depositors and the amount EICC was able to earn on the funds deployed. Mr Prosser also criticised this approach as appearing to result in double counting when IDUK's investment related

outputs are included. We note that in *FNBC* the ECJ was considering the difference between bid and offer rates quoted by the bank to its customers. In that sense the bank had clearly attributed a value to the consideration and the ECJ's focus on that was consistent with the subjective approach required. In this case the margin made by IDUK would have depended entirely on how successful the bank was in deploying the funds. Depending on what it did it could make a profit or a loss, and any profit it made would depend on how successful EICC's activities were. Put another way, there was "value added" by the bank's investment activities that did not derive directly from the deposit taking activity. We accept that in *FNBC* the ECJ concluded that the consideration was the actual profit made over a set period rather than the theoretical amount determined using the spread relevant to the particular transaction, and that a comparison can be made with this case in that IDUK would also undoubtedly have set the interest rates it offered in a way that took account of the return it hoped to make on the funds deposited. However, we can nevertheless see a difference between the two. The basis of the ECJ's decision that actual profit should be considered took account of the fact that any particular spread was theoretical: a trader was unlikely to be in a position to make the precise amount indicated by the spread since rates changed constantly. In this case there is nothing equivalent to the spread which clearly indicates how IDUK valued the consideration on a subjective basis. Nevertheless, the decision in *FNBC* is clear and provides at least a basis to maintain that a profit based approach is possible.

c) *Economic cost of funds*: This was an alternative suggested by HMRC before us. The value of the deposits to the bank could be expressed as the time value of money, T. The bank must have valued T in determining the interest (I) it was prepared to pay. If C was the amount of the non-monetary consideration for the services then the value of T could be expressed as equal to I plus C, so that C was the difference between T and I. HMRC suggested that T could be determined by working backwards from IDUK's economic, financial and other costs (including costs across other business sectors) to produce a figure for the economic cost of securing funds. We understood this approach to be different to approach a) since it would not look simply at the actual expenses incurred in a particular period, but more at how IDUK valued the cost of funds derived from deposits. Whilst we can see that it is possible that such a method might address Mr Prosser's criticism of approach a) we would not be in a position to comment further on the appropriateness of it without significant additional evidence.

d) *Alternative sources of funds:* HMRC also suggested a further alternative. This would be to make a comparison between deposits and alternative means of raising funds, such as a commercial loan. It might be expected that the interest rates paid on deposits would be lower than interest payable on other available sources of funding, and the differential might be the appropriate value for the supply of services to depositors.

65. As already mentioned there is no requirement for us to determine the appropriate method. We can see scope for criticism of alternative a) and it is not clear to us that determining the amount of the consideration by reference to the profit that EICC managed to generate from its activities is necessarily consistent with the subjective approach in this case. Given that the focus is on the value IDUK (subjectively) placed on the deposits we think that the question would best be answered by additional evidence as to the methods IDUK used to do that. If it did in fact make comparisons with alternative sources of funds then we can see that approach d) might well be the most appropriate, albeit that we would expect the comparison not simply to take account of the interest differential but also other factors such as the average length of deposits and regulatory or other differences that affected the overall cost of either source of funds. If IDUK did not approach the business in that way then approach c), which looks at the methodologies used to determine rates and requires an overall economic analysis, might be more appropriate, or some variant of that.

66. What we are clear about is that, whilst determining the consideration might be complex, it would not be impossible. It is also no bar that the depositor would at no stage be able to determine what the value was. Accordingly we have concluded that there was consideration which was capable of being expressed in monetary form.

67. Our conclusions on issues (1) and (2) are sufficient to dismiss the appeal. We have included some comments on the remaining issues because they were argued before us and in case there is a further appeal.

Issue (3)- was there economic activity?

68. We have found this a difficult issue which is not clearly answered by the European case law. Had it been necessary for us to reach a conclusion on it we would have considered whether a reference to the ECJ was appropriate, either by us or with the benefit of additional findings of fact to clarify the questions to be referred.

69. HMRC's position was that if IDUK had succeeded in arguing that it made no supplies for consideration to depositors, then its activity of investing the funds raised was a pure investment activity that did not involve an economic activity. It relied in particular on *Harnas & Helm CV v Staatssecretaris van Financiën* (Case C-80/95) [1997] ECR I-745, [1997] STC 364 and *Wellcome Trust Ltd* (Case C-155/94) [1996] ECR I-3013, [1996] STC 945.

70. The appellant argued that it was carrying on a banking trade, and that VAT clearly extended to traders. It was in a very different position to Wellcome Trust, which was precluded from trading. In addition the majority of its activities were in the form of the provision of credit, and it was clear from the cases that that was an economic activity. Mr Prosser stressed the references in Article 9(1) of the PVD to economic activity including any activity of "traders" and the "exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis". He relied in particular on *Régie Dauphinoise-Cabinet A Forest SARL v Ministre du Budget* (Case C-306/94) [1996] ECR I-3695, [1996] STC 1176,

Floridienne SA v Belgian State (Case C-142/99) [2000] ECR I-9567, [200] STC 1044 and *Empresa de Desenvolvimento Mineiro SGPS SA (EDM) v Fazenda Pública* (Case C-77/01) [2004] ECR I-4295, [2005] STC 65.

71. The facts found by the FTT are relatively limited on this issue. It made some findings about how the activity was conducted as between EICC and IDUK which made it fairly clear that the funds were actively managed. It also found at [13] that the investments "were in low risk, fixed term bonds and securities, either by way of subscription (the majority) or purchased on a secondary market", and that IDUK normally retained the securities until maturity. A small percentage of the funds was also invested in short term deposits so that IDUK could meet its liquidity needs. Mr Prosser relied on the reference to "subscription" as a finding that, in the majority of cases, IDUK (via EICC) was in legal terms making a loan or providing credit to the issuer of the securities.

72. *Régie Dauphinoise* related to a property management business that received advances from the co-owners and lessees for whom it managed properties which it invested for its own account with financial institutions. The court said:

> "15 It follows from Article 2 of the Sixth Directive, which defines the scope of VAT, that only activities of an economic nature are subject to that tax. Under Article 4(1) a taxable person is any person who independently carries out one of those economic activities. The concept of "economic activities" is defined in Article 4(2) as comprising all activities of producers, traders and persons supplying services, and in particular the exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis. Finally, it follows from Article 2(1) that a taxable person must be acting "as such" if a transaction is to be subject to value added tax.
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> 16 In the present case, as has already been observed in paragraph 6 of this judgment, Régie becomes owner of the sums entrusted to it by the co-owners and lessees for whom it manages the properties, even though it remains under obligation to repay. Moreover, the constant renewal of treasury placements ensures that the balance in the bank accounts held by Régie is relatively stable. Its placements with financial institutions may therefore be regarded as services supplied to those institutions, consisting in the loan of money for a fixed period, duly remunerated by the payment of interest.
>
> 17 Unlike the receipt of dividends by a holding company, in respect of which, in Case C-333/91 *Sofitam* [1993] I-3513, paragraph 13, the Court held that, not being consideration for an economic activity, it did not fall within the scope of VAT, interest received by a property management company on placements made for its own account of sums paid by co-owners or lessees cannot be excluded from the scope of VAT, since the interest does not arise simply from ownership of the asset, but is the consideration for placing capital at the disposition of a third party.

> 18 It is true that services such as placements made with banks by the manager of a condominium would not be subject to value added tax if supplied by a person not acting as a taxable person. However, in the case at issue in the main proceedings, the receipt, by such a manager, of interest resulting from the placements of monies received from clients in the course of managing their properties constitutes the direct, permanent and necessary extension of the taxable activity, so that the manager is acting as a taxable person in making such an investment."

(Articles 2 and 4 of the Sixth Directive correspond to Articles 2(1) and 9(1) of the PVD.)

73. Mr Prosser emphasised the statement at the end of [17]. In the same way here, he said, IDUK was making capital available to third parties.

74. In *Floridienne* the taxpayers Floridienne and Berginvest owned subsidiaries to which they supplied management services and also made loans to certain of them. The Belgian Government claimed that that the income from the loans to the subsidiaries constituted the direct, permanent and necessary extension of a taxable activity comprising the supply of services, in particular management services, to the subsidiaries. Commenting on this, the court said:

> "26. In that regard, it must be observed that the Court has held that interest received by a property management company on investments, made for its own account, of sums paid by co-owners or lessees cannot be excluded from the scope of VAT, since the interest does not arise simply from ownership of the asset but is the consideration for placing capital at the disposition of a third party (Case C-306/94 *Régie Dauphinoise - Cabinet A. Forest v Ministre du Budget* [1996] ECR I-3695, paragraph 17).
>
> 27. Since Article 2(1) of the Sixth Directive excludes from the scope of VAT transactions in which the taxable person is not acting as such, loan transactions, such as those in point in the main proceedings, are subject to VAT only if they constitute either an economic activity of the operator within the meaning of Article 4(2) of the Sixth Directive or the direct, permanent and necessary extension of a taxable activity, without, however, being incidental to that activity within the meaning of Article 19(2) of the directive (see, to that effect, *Régie Dauphinoise*, paragraph 18).
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> 28. Where a holding company makes capital available to its subsidiaries, that activity may of itself be considered an economic activity, consisting in exploiting that capital with a view to obtaining income by way of interest therefrom on a continuing basis, provided that it is not carried out merely on an occasional basis and is not confined to managing an investment portfolio in the same way as a private investor (see, to that effect, Case C-155/94 *Wellcome Trust v Commissioners for Customs and Excise* [1996] ECR I-3013, at paragraph 36; and Case C-230/94 *Enkler v Finanzamt Homburg* [1996] ECR I-4517, paragraph 20) and provided that it is carried out with a business or commercial purpose characterised by, in particular, a concern to maximise returns on capital investment.

> 29. Moreover, the making by a holding company of loans to subsidiaries to which it supplies administrative, accounting, information technology and general management services cannot be subject to VAT on the ground that it is the direct, permanent and necessary extension of the supply of services within the meaning of the judgment in *Régie Dauphinoise*. Such loans are neither necessarily nor directly linked to services thus supplied.
>
> 30. Furthermore, where a holding company merely reinvests dividends received from its subsidiaries and outside the scope of VAT in loans to those subsidiaries, that in no way constitutes a taxable activity. The interest on such loans must, on the contrary, be considered merely as the result of ownership of the asset and is therefore outside the system of deductions."

75. In *EDM* the ECJ held, referring to *Régie Dauphinoise*, that both the annual granting of interest-bearing loans by a holding company to companies in which it held shares, and placements by it in bank deposits or securities such as Treasury notes and certificates of deposit, constituted economic activities. It commented as follows:

> "65. On the other hand, in accordance with the Court of Justice's case-law, interest received by a holding company in consideration of loans granted to companies in which it has shareholdings cannot be excluded from the scope of VAT, since that interest does not arise from the simple ownership of the asset, but is the consideration for making capital available for the benefit of a third party (see, to that effect, *Régie Dauphinoise*, para 17).
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> 66. As regards the question whether, in such a situation, a holding company supplies that service in the capacity of a taxable person, the Court of Justice has held, at para 18 of the judgment in *Régie Dauphinoise*, that a person carrying out transactions which constitute the direct, continuous, and necessary extension of the person's taxable activity, such as the receipt by a managing agent of interest resulting from the placements of monies received from clients in the course of managing those clients' properties, acts in that capacity.
>
> 67. That is with stronger reason the case when the transactions concerned are carried out with a business or commercial purpose characterised by, in particular, the wish to maximise returns from capital invested.
>
> 68. It is clear that an undertaking acts thus if it uses funds forming part of its assets to supply services constituting an economic activity within the meaning of the Sixth Directive, such as the granting of interest-bearing loans by a holding company to companies in which it has shareholdings, whether those loans are granted as economic support to those companies or as placements of treasury surpluses or for other reasons.
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> 69. Interest paid to an undertaking in consideration of bank deposits or placements in securities such as Treasury notes or certificates of deposit likewise cannot be excluded from the scope of VAT, since the interest paid does not arise from the simple ownership of the asset but constitutes the consideration for making capital available for the

> benefit of a third party (see, to that effect, *Régie Dauphinoise*, para 17). It follows from the preceding paragraph that an undertaking acts as a taxable person if it thus uses funds forming part of its assets.
>
> 70. Therefore, it must be held that the annual granting by a holding company of interest-bearing loans to companies in which it has a shareholding and placements by that holding company in bank deposits or in securities, such as Treasury notes or certificates of deposit, constitute economic activities carried out by a taxable person acting as such within the meaning of arts 2(1) and 4(2) of the Sixth Directive."

76. In *Harnas & Helm* the taxpayer held shares and bonds issued by entities in the US and Canada. It claimed a deduction for VAT incurred in connection with loan transactions made by it, but the claim was rejected by the national court on the ground, inter alia, that the plaintiff had not carried out any economic activity. The ECJ noted at [14] and [15] that the concept of 'exploitation' within the meaning of what is now article 9(1) of the PVD refers to all transactions by which it is sought to obtain income from the property in question on a continuing basis, that the Court has also specified that the mere acquisition and holding of shares in a company is not to be regarded as an economic activity (see *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen Arnhem* (Case C-60/90) [1993] STC 222 at 238-239, [1991] ECR I-3111 at 3137, para 13), and that the mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership.

77. The ECJ went on to refer at [16] to three cases where transactions referred to in article 13B(d)(5) of the Sixth Directive (see now article 135(1)(f) of the PVD-transactions in shares and debentures) may fall within the scope of VAT, namely where they are effected as part of a commercial share dealing activity, in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired, or where they constitute the direct, permanent and necessary extension of the taxable activity (citing *Polysar*, *Wellcome Trust* and *Régie Dauphinoise*). It then concluded that the Netherlands government was right to point out that the activity of a bondholder may be defined as a form of investment which does not extend further than straightforward asset management. The income from the bonds derives from the mere fact of holding them, which entitles the holder to payments of interest. That could not be regarded as a return on an economic activity or transaction carried out by the bondholder, since it derives from the mere ownership of the bonds. It concluded at [20] that:

> "…art 4(2) of the Sixth Directive is to be interpreted as meaning that the mere acquisition of ownership in and the holding of bonds, activities which are not subservient to any other business activity, and the receipt of income therefrom are not to be regarded as economic activities conferring on the person concerned the status of a taxable person."

78. Mr Prosser argued that IDUK's position was different. It both had an active trade and it also subscribed bonds. It was therefore lending money and satisfied the test at [17] in *Régie Dauphinoise.* The reference at [18] to the activity being a direct,

permanent and necessary extension of the property management activity taxable activity was not in fact a qualification, as shown by the cross reference to only the first of the two paragraphs in *Floridienne* at [26] and *EDM* at [69].

79. We are not persuaded that *Régie Dauphinoise, Floridienne* and *EDM* can be read in this way. The taxpayer company in *Régie Dauphinoise* had a property management business and the ECJ clearly held at [18] that the placements of money were an extension of that activity. We do not think that the comments at [17] should be read in isolation. Both *Floridienne* and *EDM* also cross refer to [18] as well as [17] in *Régie Dauphinoise*. In *Floridienne* the ECJ confined its key comments at [28] to loans made to subsidiaries, qualified those comments at [29] and [30] and then went on at [31] to say that it was for the national court to decide how the particular transactions at issue should be categorised in accordance with its guidance at [26] to [30]. *EDM* is perhaps less clear, and as indicated below does contain some suggestions of a broader approach, but it is also apparent from the judgment that EDM was not a pure holding company and had an active business, and in addition it was held to have an economic activity in granting loans to companies in which it held shares. The conclusion at [70] refers to those loans in conjunction with bank deposits and securities.

80. In our view *Harnas & Helm* is clear authority that the acquisition and holding of bonds is not of itself an economic activity. It is also by no means clear to us that it should make a difference that IDUK subscribed for the majority of the bonds it acquired. Although subscription rather than purchase does legally involve the making of a loan to the issuer, in commercial reality there may be very little difference between being the initial subscriber to a bond and purchasing it in the secondary market. Depending on the facts it may be the case that (for example) the subscriber has no greater influence over the terms of the bonds than a subsequent holder, and may undertake both as part of the same investment activity without any real distinction being drawn between the two. It would also seem somewhat unrealistic for the test to depend on the precise mechanics of a bond issue (for example whether the initial arranger subscribes the bonds itself as agent or as principal before immediately selling them on) or on whether the acquirer manages to buy them at the point of issue or (say) three days later because the issue was initially oversubscribed. It is also the case that in a sense any holder of bonds, including a secondary holder, is extending credit to the bond issuer.

81. We do however agree with Mr Prosser that the bank was clearly operating in the course of its banking trade and that it is therefore not in the same position as an entity like Wellcome Trust, which was not permitted to trade and was therefore regarded as in an analogous position to a private investor. There is force in the argument that the three categories referred to in *Harnas & Helm* at [16] (commercial share dealing, direct or indirect involvement in management, or the direct, permanent and necessary extension of taxable activity) should not therefore be regarded as closed. This is supported by the fact that the ECJ in *EDM* decided that bank deposits and placements in Treasury notes and other securities was an economic activity without any express qualification of that as being only by way of extension of a taxable activity, and by some of the other comments in that case, in particular the reference to economic

activity "such as" the granting of interest-bearing loans to companies in which a holding company owns shares at [68] and perhaps the reference to business or commercial purpose at [67]. However, in our view, reaching a conclusion on this point would require additional guidance from the ECJ. In any event the point does not arise in this case because we have decided that the deposit taking activity was an economic activity. Against that background the investment activities give no difficulty, because they can properly be regarded as a direct extension of that activity even if they would not comprise economic activity in isolation.

Issue (4)- attribution

82. Both parties accepted that a finding that services were supplied to depositors for consideration has the result that all the input tax claimed by IDUK is properly attributable to those exempt supplies on the basis that it has a direct and immediate link to those supplies, irrespective of the ultimate purpose of the transaction. This was the FTT's conclusion at [176] based on the *BLP* case and we agree with it.

83. The FTT did not go on to consider what the analysis would have been if IDUK had succeeded on issues (1) to (3), though it did note at [176] that ultimately the provision of the banking services led to the deposits used to fund the investments. The appellant's case was that a proportion of the input tax incurred was recoverable as attributable to specified supplies under s 26(2)(c) VATA and the Value Added Tax (Input Tax) (Specified Supplies) Order 1999. Mr Beal conceded before us on behalf of HMRC that some element of attribution to specified supplies would be possible in principle if the appellant had succeeded on the other issues, but there was no agreement as to how this would be done and some lack of clarity about the extent of the concession. We do not propose to make any further comment on this issue. It is not necessary for the decision and was not argued in detail before us.

Issue (5)- regulation 109

84. This point is also not necessary for our decision but was considered before the FTT and argued before us. We will comment on it briefly.

85. In summary, regulation 109 of the VAT Regulations permits input tax that has not been attributed to taxable supplies because the taxable person "intended to use" the goods or services in making exempt supplies to be reattributed to taxable supplies if within a six year period and "before that intention is fulfilled" he uses or forms an intention to use the goods or services to make taxable supplies. Regulation 108 contains a mirror provision for inputs initially attributed to taxable supplies. These provisions are separate from the rules in Part XV of the VAT Regulations (regulations 112 to 116), known as the Capital Goods Scheme, which is a regime for input tax reclaimed on specified high value items (including supplies of land and buildings with a minimum value of £250,000 and computer equipment with a minimum value of £50,000) to be adjusted over a fixed period according to changes in the extent to which the item is used for taxable supplies.

86. The appellant's argument on regulation 109 seemed to be that although input tax, incurred by ING Direct (UK) NV on supplies to it during 2003, had initially been used in making exempt supplies in the form of loans to EICC in the EU, from 1 January 2004 the business (now carried on by ING Direct NV) began to make some specified supplies outside the EU and the relevant goods or services (on which input tax had been incurred) had not been fully used by that date. It was argued that the intention to use the inputs for exempt supplies had not therefore been fully fulfilled, and this was enough to engage regulation 109. (We should mention that it was not explained on what basis the loans to EICC would have been exempt supplies, rather than disregarded supplies under the VAT grouping rules.)

87. In our view the FTT was right to find that regulation 109 applies where there is a change of intention before the goods or services are first used, and not later. We agree with comments to this effect by Lord Clyde in *HMRC v Royal & Sun Alliance* [2003] UKHL 29, [2003] STC 832 at [58] and also agree with the FTT that Lord Hoffmann was not intending to suggest otherwise at [47]. Even if it succeeded on the other issues, IDUK would not therefore be able to attribute input tax incurred on supplies while ING Direct (UK) NV carried on the business in 2003, which were used (if IDUK's arguments were correct) in making exempt supplies, to a later use of the same supplies, even if those supplies continued to benefit it when it later made specified supplies.

88. We consider that our conclusion clearly follows from the language used in regulation 109. It is however also supported by the context and by practical considerations. If regulation 109 permitted a taxpayer to adjust input tax deductions on a change of intention at any point before the intention is fully fulfilled it would not only significantly cut across the Capital Goods Scheme but could also give rise to real difficulties in operation. In particular it is unclear how (if at all) input tax would be apportioned between an initial exempt use and later taxable use, or vice versa in the case of regulation 108. In contrast, the Capital Goods Scheme, contained in the same set of regulations, is intended to address this issue.

Quantum

89. As previously indicated HMRC also argued that even if IDUK succeeded in principle its appeal should still be dismissed since it had not established quantum. The FTT reached no decision on this point and we have concluded that it would not be appropriate to comment on what is in effect a case management issue which does not require a decision. We accordingly express no view on whether it would or would not have been appropriate to dismiss the appeal on that point.

Disposition

90. In conclusion we find that the FTT decision discloses no error of law which requires it to be set aside. The FTT was right to conclude that IDUK supplied services to its depositors and that it did so for a consideration which is capable of being valued. We accordingly dismiss the appeal.

MR JUSTICE MORGAN

JUDGE SARAH FALK

RELEASE DATE: 5 JULY 2016

Annex 1- Principal VAT Directive

Article 1(2)

The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.

The common system of VAT shall be applied up to and including the retail trade stage.

Article 2(1)

The following transactions shall be subject to VAT:

…

(c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such;

…

Article 9(1)

'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.

Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity.

Article 24(1)

'Supply of services' shall mean any transaction which does not constitute a supply of goods.

Article 73

In respect of the supply of goods or services… the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.

Article 135(1)

Member States shall exempt the following transactions:

(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;

(b) the granting and the negotiation of credit and the management of credit by the person granting it;

(c) the negotiation of or any dealings in credit guarantees or any other security for money and the management of credit guarantees by the person who is granting the credit;

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

(e) transactions, including negotiation, concerning currency, bank notes and coins used as legal tender, with the exception of collectors' items, that is to say, gold, silver or other metal coins or bank notes which are not normally used as legal tender or coins of numismatic interest;

(f) transactions, including negotiation but not management or safekeeping, in shares, interests in companies or associations, debentures and other securities, but excluding documents establishing title to goods, and the rights or securities referred to in Article 15(2);

(g) the management of special investment funds as defined by Member States;

(h) the supply at face value of postage stamps valid for use for postal services within their respective territory, fiscal stamps and other similar stamps;

(i) betting, lotteries and other forms of gambling, subject to the conditions and limitations laid down by each Member State;

(j) the supply of a building or parts thereof, and of the land on which it stands, other than the supply referred to in point (a) of Article 12(1);

(k) the supply of land which has not been built on other than the supply of building land as referred to in point (b) of Article 12(1);

(l) the leasing or letting of immovable property.

Annex 2- VATA 1994

Section 1(1)

Value added tax shall be charged, in accordance with the provisions of this Act—

(a) on the supply of goods or services in the United Kingdom (including anything treated as such a supply),…

Section 4(1)

VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

Section 5(2)

Subject to any provision made by that Schedule and to Treasury orders under subsections (3) to (6) below—

(a) "supply" in this Act includes all forms of supply, but not anything done otherwise than for a consideration;

(b) anything which is not a supply of goods but is done for a consideration (including, if so done, the granting, assignment or surrender of any right) is a supply of services.

Section 24(1)

Subject to the following provisions of this section "input tax", in relation to a taxable person, means the following tax, that is to say—

(a) VAT on the supply to him of any goods or services;

…

being… goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

Section 25(2)

Subject to the provisions of this section, he is entitled at the end of each prescribed accounting period to credit for so much of his input tax as is allowable under section 26, and then to deduct that amount from any output tax that is due from him.

Section 26(1)-(3)

(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on

supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(a) taxable supplies;

(b) …

(c) … such exempt supplies as the Treasury may by order specify for the purposes of this subsection.

(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above…

Section 31(1)

A supply of goods or services is an exempt supply if it is of a description for the time being specified in Schedule 9 and an acquisition of goods from another member State is an exempt acquisition if the goods are acquired in pursuance of an exempt supply.

Section 83(1)

… an appeal shall lie to the tribunal with respect to any of the following matters:

…

(c) the amount of any input tax which may be credited to a person:

…

(e) the proportion of input tax allowable under section 26:

…

Schedule 9 Group 5

Item No.

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.

2. The making of any advance or the granting of any credit.

2A. The management of credit by the person granting it.

…

6. The issue, transfer or receipt of, or any dealing with, any security or secondary security being—

(a) shares, stocks, bonds, notes (other than promissory notes), debentures, debenture stock or shares in an oil royalty;

. . .

8 The operation of any current, deposit or savings account.

Annex 3: Regulations

Regulation 103(1) VAT Regulations

(1) Input tax incurred by a taxable person in any prescribed accounting period on goods imported or acquired by, or goods or services supplied to, him which are used or to be used by him in whole or in part in making—

(a) …

(b) supplies specified in an Order under section 26(2)(c) of the Act…

shall be attributed to taxable supplies to the extent that the goods or services are so used or to be used expressed as a proportion of the whole use or intended use.

Regulation 109(1) and (2) VAT Regulations

(1) This regulation applies where a taxable person has incurred an amount of input tax which has not been attributed to taxable supplies because he intended to use the goods or services in making either—

(a) exempt supplies, or

(b) both taxable and exempt supplies,

and during a period of 6 years commencing on the first day of the prescribed accounting period in which the attribution was determined and before that intention is fulfilled, he uses or forms an intention to use the goods or services concerned in making taxable supplies or, in the case of an attribution within sub-paragraph (a) above, in making both taxable and exempt supplies.

(2) Subject to regulation 110 and where this regulation applies, the Commissioners shall, on receipt of an application made by the taxable person in such form and manner and containing such particulars as they may direct, pay to him an amount equal to the input tax which has become attributable to taxable supplies in accordance with the method which he was required to use when the input tax was first attributed.

Value Added Tax (Input Tax) (Specified Supplies) Order 1999, Articles 2 and 3

2. The supplies described in articles 3 … below are hereby specified for the purposes of section 26(2)(c) of the Value Added Tax Act 1994.

3. Services–

(a) which are supplied to a person who belongs outside the member States;…

provided the supply is exempt, or would have been exempt if made in the United Kingdom, by virtue of … any of items 1 to 6 and item 8 of Group 5, of Schedule 9 to the Value Added Tax Act 1994.