[2018] UKFTT 226 (TC)

TC06459

Appeal number: TC/2016/00656

VAT – whether supplies made by appellant of loan administration services to a bank are exempt supplies under Article 135(1)(d) PVD or Item 1 or 8 Group 5 Schedule 9 VATA, or are standard rated either as debt collection or on another basis – whether loan accounts are current accounts – held supplies standard rated as debt collection and accounts are not current accounts – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TARGET GROUP LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE SARAH FALK

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 5 to 7 March 2018

Roderick Cordara QC, instructed by Pricewaterhouse Coopers LLP, and Mr Christian Bell of that firm, for the Appellant

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

DECISION

1. This is an appeal against a decision by HMRC that loan administration services supplied by the appellant ("Target") to a UK bank, Shawbrook Bank Limited ("Shawbrook") are standard rated supplies for VAT purposes, rather than exempt supplies as claimed by Target.

2. HMRC's decision was made in response to a request for a non-statutory clearance made by Target in May 2015. The original decision was issued on 31 July 2015. This concluded that taxable services were supplied, comprising the management of loan accounts. Following further correspondence HMRC upheld their original decision on review by a letter dated 8 January 2016, and Target appealed to the Tribunal.

3. In brief summary, Target's contractual arrangements with Shawbrook relate to four categories of loans provided by Shawbrook to customers in the course of its lending business (each referred to as a portfolio). Target's description of its supplies in its Notice of Appeal was "loan account administration services". In essence, the services that Target provides cover the entire lifecycle of the loans covered by the arrangements, apart from the making of the initial loan or any further advance. Target establishes loan accounts using its own systems, communicates with borrowers as an undisclosed agent of Shawbrook, and deals with payments by borrowers and all administrative issues that arise during the life of the loan. Target has limited discretion. The terms of the loans, including interest rates, are set by Shawbrook. Although Target is involved in dealing with arrears, any enforcement action would be a decision for Shawbrook.

4. There is no dispute between the parties that the services provided by Target to Shawbrook comprise a single (composite or complex) supply for VAT purposes, rather than multiple supplies. What is in dispute is the precise nature of the supply, and more particularly whether it qualifies for exemption from VAT. The areas of dispute include, in particular, whether Target's supplies are excluded from exemption as debt collection, and whether the loan accounts fall to be treated as current accounts.

5. There was one preliminary point. HMRC had made an application on 22 February 2018 to file an amended Statement of Case. A draft of the amended document had been provided to Target in October 2017, and Target did not object. The application was accepted at the hearing.

The legal background

The legislation

6. Article 135(1)(d) of the Council Directive 2006/112/EC (the Principal VAT Directive, or "PVD") requires Member States to exempt the following transactions:

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

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

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

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

I will refer to these as "Item 1" and "Item 8" respectively.

8. Target's case is that the services it provides to Shawbrook comprise "transactions… concerning…payments, transfers, debts" and/or "transfer(s) or… dealing(s) with money" within Article 135(1)(d) and Item 1, or alternatively that they comprise the operation of a current account falling within Article 135(1)(d) and Item 8, and are not carved out from exemption as debt collection.

9. It is also relevant to refer to Article 135(1)(b) of the PVD, which exempts:

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

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

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

10. It is convenient to refer at this stage to the most significant case law relating to the approach to VAT exemptions and the interpretation of what is now Article 135(1)(d) and Item 1.

General: interpretation of exemptions

11. The general approach to the interpretation of VAT exemptions is well-established. As explained by the Court of Justice (CJEU) in *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën* (Case 348/87) [1989] ECR 1737 ("*SUFA*"):

> "11. … the exemptions constitute independent concepts of Community law which … should be placed in the general context of the common system of VAT introduced by the Sixth Directive.

> 13. … the terms used to specify the exemptions envisaged by Article 13 of the Sixth Directive are to be interpreted strictly since they constitute exceptions to the general principle that turnover tax is levied on all services supplied for a consideration by a taxable persons."

12. This passage was cited by Chadwick LJ in the Court of Appeal in *Expert Witness Institute v Customs and Excise Commissioners* [2002] STC 42 at [16], and he went on say the following at [17] and [19]:

> "17… A "strict" construction is not to be equated, in this context, with a restricted construction. The Court must recognise that it is for a supplier, whose supplies would otherwise be taxable, to establish that it comes within the exemption; so that if the Court is left in doubt whether a fair interpretation of the words of the exemption cover the supplies in question, the claim to the exemption must be rejected. But the Court is not required to reject a claim which does come within a fair interpretation of the words of the exemption because there is another, more restricted, meaning of the words which would exclude the supplies in question.
>
> …
>
> 19. …I reject the premise that the proper approach to construction does require the court to confine the scope of an exemption if it can. The task of the court is to give the exempting words a meaning which they can fairly and properly bear in the context in which they are used."

Case law on "transactions concerning…payments, transfers"

13. *Sparekassernes Datacenter v Skatteministeriet* (Case C-2/95) [1997] STC 932 ("*SDC*") related to the supply by SDC of services to banks which included the execution of money transfers. The CJEU set out a number of principles, including that:

> (1) In view of the linguistic differences between the various language versions of Article 13B(d)(3), the scope of the phrase "transactions … concerning" cannot be determined on the basis of an exclusively textual interpretation, and reference must be made to the context in which the phrase occurs and consideration given to the structure of the Sixth Directive (paragraph [22]);
>
> (2) the transactions that are exempt under Article 13B(d)(3) are defined by the nature of the services provided, not by or to whom they are provided, except where they cover services which, by their nature, are provided to customers of financial institutions (paragraphs [32] and [48]);
>
> (3) the manner in which a service is performed, whether electronically, automatically or manually, does not affect the application of the exemption (paragraph [37]);
>
> (4) the services provided by SDC to customers of the banks (as opposed to its own customer, being the bank) are "significant only as descriptors and as part of the services provided" by it to the banks (paragraph [47]);

(5) the fact that a constituent element is essential for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt: to be exempt, a package of services must "form a distinct whole, fulfilling in effect the specific, essential functions" of an exempt transaction (paragraphs [65] and [66]);

(6) a transfer involves a change in the legal and financial situation, and since a transfer is only a means of transmitting funds the functional aspects, rather than the cause of the transfer, are decisive (paragraphs [53] and [66]); and

(7) it is necessary to distinguish a "mere physical or technical supply, such as making a data-handling system available to a bank", or "technical and electronic assistance to the person performing the essential, specific functions": these are not exempt; in particular the court must examine the extent of the supplier's responsibility, and whether it is "restricted to technical aspects" or "extends to the specific, essential aspects of the transactions" (paragraphs [37] and [66]).

14. *Customs and Excise Commissioners v FDR Limited* [2000] STC 672 ("*FDR*") related to credit card services supplied by FDR to banks, being either issuers (banks who issued credit cards to cardholders), acquirers (banks who paid merchants, normally retailers, who accepted cards) or banks acting in both capacities. FDR maintained merchant and cardholder accounts, posting credit and debit entries on each, effecting payments to merchants and reconciling accounts between issuers and acquirers under a netting-off procedure under which the net amount to be transferred to or from a bank was determined each day and transferred to or from its account by FDR. The Court of Appeal upheld the decision of the VAT and Duties Tribunal that credits and debits to the accounts of the payee and payer were "transfers" within the exemption, as was the netting-off procedure and the operation of the cardholder and merchant accounts. Laws LJ, giving the only judgment, referred to two earlier UK cases, *Momm v Barclays Bank International Ltd* [1977] QB 790 and *Libyan Arab Foreign Bank v Bankers Trust Co* [1989] QB 728, which considered account transfers as a means of payment and concluded at [37] that:

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

15. More recently, in *Proceedings brought by Nordea Pankki Suomi Oyj* (Case C-350/10) [2011] STC 1956 ("*Nordea Pankki*"), the CJEU explained the requirements for a service to come within the Article 13B(d)(3) exemption for "transactions… concerning… payments, transfers":

> "24. According to settled case law, in order to be characterised as exempt transactions for the purposes of points 3 and 5 of art 13B(d) of the Sixth Directive, the services provided must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of a service described in those points. As regards transactions concerning transfers, within the meaning of art 13B(d)(3) of that directive, the services provided must have the effect of transferring funds and entail

changes of a legal and financial character. A service exempt under the directive must be distinguished from a mere physical or technical supply, such as making a data-handling system available to a bank. To that end, the national court must examine in particular the extent of the responsibility of the supplier of services vis-à-vis the banks, in particular the question whether that responsibility is restricted to technical aspects or whether it extends to the specific, essential aspects of the transactions (see, to that effect, *SDC* (para 66), and *CSC Financial Services Ltd v Customs and Excise Comrs* (Case C-235/00) [2002] STC 57, [2001] ECR I-10237, paras 25 and 26).

25. The court has also held that a transfer is a transaction consisting of the execution of an order for the transfer of a sum of money from one bank account to another. It is characterised in particular by the fact that it involves a change in the legal and financial situation existing between the person giving the order and the recipient and between those parties and their respective banks and, in some cases, between the banks. Moreover, the transaction which produces this change is solely the transfer of funds between accounts, irrespective of its cause (see, to that effect, *SDC* (para 53)).

26. Furthermore, according to the case law of the court, that analysis relating to transactions concerning transfers or payments within the meaning of art 13B(d)(3) of the Sixth Directive applies, in principle, *mutatis mutandis* with regard to transactions in securities within the meaning of art 13B(d)(5) thereof (see, to that effect, *CSC Financial Services* (para 27), and *Skandinaviska Enskilda Banken* (para 33)[1]).

27. Thus, nothing prevents services entrusted to operators external to financial institutions, which therefore do not have a direct link with the clients of those institutions, from being exempt from VAT (see, to that effect, *SDC* (para 59)) provided that those services, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of the financial transactions described in art 13B(d)(3) and (5) of the Sixth Directive."

16. *ATP PensionService A/S v Skatteministeriet* (Case C-464/12) [2014] STC 2145 ("*ATP*") concerned the provision of administrative services in connection with pension fund management, including the creation of accounts for pension fund customers and the crediting of amounts to, and the withdrawal of amounts from, those accounts. One of the questions was whether the creation of and crediting of amounts to the accounts, as well as withdrawals, were VAT exempt. After reiterating that exemption depended on the nature of the services provided and not on the persons supplying or receiving the service (paragraph [78]), and that a transfer is characterised by the fact that it involves a change in the legal and financial situation between the relevant persons (paragraph [79], referring to *Nordea Pankki*) the court held at paragraphs [80] and [81] that no particular method of transfer was required, and that transfers could be made by accounting entries as well as by a physical transfer of funds. The CJEU went on to conclude at paragraph [85] that the reference to

[1] *Skandinaviska Enskilda Banken AB Momsgrupp v Skatteverket* (Case C-540/09) [2011] STC 1125.

payments and transfers in Article 13B(d)(3) covered services by means of which the rights of pension customers were established through the creation of accounts within the pension scheme system and the crediting of those accounts.

The debt collection carve out: Axa

17. *HMRC v Axa UK plc* (Case C-175/09) [2010] STC 2825 (CJEU) and [2012] STC 754 (CA) related to a payment handling service provided by a member of the Axa VAT group, Denplan Limited, to dentists. The service related to payment plans under which a patient would agree with his or her dentist to pay a monthly amount in return for a certain level of dental care. Denplan agreed with the dentist to collect the payment from the patient as the dentist's agent via a direct debit arrangement and transfer it to the dentist. It charged a fee to the dentist (calculated as a percentage of each payment received), and the dispute was whether VAT was chargeable on the fee. The Court of Appeal referred some specific questions to the CJEU about the scope of the exemption in Article 13B(d)(3). At that stage no one had raised the potential application of the carve out from that exemption for debt collection activities, and both the VAT and Duties Tribunal and High Court had considered the payment handling fee to be exempt. The CJEU reformulated the questions raised into a more general issue of the applicability of the exemption and concluded on the facts presented that the debt collection carve out applied.

18. After concluding at paragraph [23] that the service provided was a single supply for VAT purposes, the economic purpose being to transfer the sum due from the patient to the dentist, the CJEU went on to consider the scope of the exemption, stating the principles to apply as follows at paragraphs [25] to [27] (case law references excluded):

> "25 It is also clear from the case-law that the terms used to specify the exemptions set out in Article 13 of the Sixth Directive are to be interpreted strictly, since they constitute exceptions to the general principle that VAT is to be levied on all goods and services supplied for consideration by a taxable person. Nevertheless, the interpretation of those terms must not deprive the exemption in question of its intended effect…
>
> 26 It should also be noted that the transactions exempted under Article 13B(d)(3) of the Sixth Directive are defined in terms of the nature of the services provided and not in terms of the person supplying or receiving the service... The exemption is therefore not subject to the condition that the transactions be effected by a certain type of institution or legal person, where the transactions in question relate to the sphere of financial transactions...
>
> 27 Finally, the Court has ruled, as regards various exemptions under Article 13B(d) of the Sixth Directive, that, in order to be regarded as exempt transactions the services in question must, viewed broadly, form a distinct whole, fulfilling the specific, essential functions of a service described in that provision …"

19. The CJEU went on to say at [28] that the purpose of the service in question was to benefit Denplan's clients, the dentists, by the payment of the sums due to them from their patients. Denplan was "responsible for the recovery of those debts" and provided a service of "managing those debts". As matter of principle that service constituted "a transaction concerning payments" which was exempt unless it was "debt collection or factoring". The latter phrase needed to be interpreted in the light of the spirit of the provision and more generally the scheme of the Directive (paragraph [29]). Although the Article 13 exemptions needed to be interpreted strictly, "debt collection or factoring":

> "30 …is to be interpreted broadly as it is an exception to such derogation, with the result that the transactions which it covers are subject to tax in accordance with the fundamental rule forming the basis of the Sixth Directive…"

The judgment continues:

> "31 According to the Court's case-law, the term 'debt collection and factoring' in Article 13B(d)(3) of the Sixth Directive refers to financial transactions designed to obtain payment of a pecuniary debt (see *MKG-Kraftfahrzeuge-Factoring*, paragraph 78[2]).
>
> 32 It follows from that case-law that the service in question in the main proceedings supplied by Denplan to dentists is covered by the term 'debt collection and factoring' in Article 13B(d)(3) of the Sixth Directive.
>
> 33 In fact, the object of that service is to benefit Denplan's clients, namely dentists, by payment of the sums of money due to them from their patients. That service is therefore intended to obtain the payment of debts. By undertaking the recovery of debts for the account of those entitled to them, Denplan frees its clients of tasks which, without its intervention, those clients, as creditors, would have to perform themselves, tasks consisting in requesting the transfer of the sums due to them, via the direct debit system.
>
> 34 Contrary to the Commission's submission, it is irrelevant that such service is supplied at the time when the debts concerned become due. The final words of Article 13B(d)(3) of the Sixth Directive cover the collection of debts of any nature, without limiting their application to debts which were not paid on their due date. Moreover, factoring, all forms of which are included in the terms 'debt collection and factoring' (see *MKG-Kraftfahrzeuge-Factoring*, paragraph 77), is not limited to debts in respect of which the debtor has already defaulted. It can also have as its object debts which have not yet become due and which will be paid on the due date.
>
> 35 In addition, in view of the interpretation of the exception to the derogation from the application of VAT given by the case-law cited in paragraphs 30 and 31 of the present judgment, it is also irrelevant to

[2] *Finanzamt Groß-Gerau v MKG-Kraftfahrzeuge-Factory GmbH* (Case C-305/01) [2003] STC 951.

> the treatment of the service in question in the main proceedings as 'debt collection and factoring' that it does not provide for coercive measures for the effective payment of the debts concerned
>
> 36 Having regard to the foregoing considerations, the reply to the questions referred is that Article 13B(d)(3) of the Sixth Directive is to be interpreted as meaning that the exemption from VAT provided for by that provision does not cover a supply of services which consist, in essence, in requesting a third party's bank to transfer to the service supplier's account, via the direct debit system, a sum due from that party to the service supplier's client, in sending to the client a statement of the sums received, in making contact with the third parties from whom the service supplier has not received payment and, finally, in giving instructions to the service supplier's bank to transfer the payments received, less the service supplier's remuneration, to the client's bank account."

20. When the case returned to the Court of Appeal the unanimous conclusion was that, despite the absence of an express reference to debt collection in the UK legislation, that carve out applied as a matter of UK law, either by applying a conforming interpretation to Item 1 (Arden LJ at [49] and [50]) or by treating Item 1 as only transposing the exemptions rather than the carve out, which was all that it needed to do (Rimer LJ at [56]). Furthermore, the CJEU had understood the material facts and there was no case for a further reference or adjudication by the Court of Appeal, even though the payment handling service provided was not debt collection in the usual sense. Arden LJ said the following at [51]:

> "As to the effect of the ruling in the present case, in my judgment, it is clear that the Court of Justice concluded that the words "debt collection" in the carve out have a meaning capable of being applied to "transactions concerning payments" within the exemption in article 13B(d)(3) (judgment, paragraph 28, last sentence). It then has to be decided whether the actual transaction in question falls within the exemption or the carve out, and this will depend on its precise facts. If it falls within the exemption it will fall outside the carve out, and vice-versa (see final sentence of paragraph 28). The Court of Justice does not define the purpose of the exemption. It is unnecessary to decide on this appeal what the full scope of the exemption might be. However, for the purposes of this judgment it may hypothetically be taken to be normal retail banking activities (and indeed that is one way of reading paragraphs 24 to 27 of the judgment of the Court of Justice in *Nordea*). On that hypothesis, the carve out takes out of the scope of the exemption any separate supply of services which is more properly regarded as a service of debt collection."

21. Rimer LJ referred at [58] to "debt collection" being an autonomous concept for the purposes of Article 13B(d), and that what the CJEU was saying at [28] was that if the service provided was not debt collection or factoring it would have fallen within the exemption.

EDS

22. Target places significant reliance on the Court of Appeal decision in *Customs and Excise Commissioners v Electronic Data Systems Limited* [2003] STC 688 ("*EDS*"). Like Target, EDS supplied administrative services to a bank in respect of loans, described as "loan arrangement and execution services" (paragraphs [8] and [130]). EDS's principal functions were to receive initial applications for loans and record details of applicants, validate the applications using the bank's credit rating system, produce and forward loan agreements (signed on behalf of the bank), direct debit mandates and other documents to borrowers who passed the validation process, verify documents received from borrowers, release funds to borrowers, and collect payments on behalf of the bank using the direct debit system. The interest rates and the maximum and minimum sums that could be lent to any one borrower were fixed by the bank (with EDS performing the necessary calculations to apply interest to loans), and the bank also retained the functions of advertising and dealing with arrears. EDS's fees were based on the volume of commercial activity rather than the amounts of the loans.

23. Customs rejected EDS's claim that the services it supplied were exempt within Article 13B(d)(3). The VAT and Duties Tribunal allowed the appeal and the Court of Appeal agreed with their conclusion.

24. Jonathan Parker LJ, giving the only judgment, reviewed the European case law (including in particular *SDC*), concluding that whilst the exemptions must be construed strictly a purposive approach was required to ascertain their fair meaning, the context should not be ignored and a restricted interpretation was inappropriate (paragraphs [126] to [129]). Based on the guidance in *SDC* he concluded as follows at paragraph [136]:

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

The evidence

25. I heard evidence from three witnesses, Robert Evans, Ian Ferguson and Richard Glanville. All three provided witness statements including, in the case of Mr Evans and Mr Ferguson, a number of exhibits relating to the details of Target's activities in respect of Shawbrook.

26. Mr Evans joined Target in 1988 and was until April 2017 the Consultancy and Product Director of Target, with primary responsibility for various client facing tasks. Although he was not involved in the day-to-day provision of the services he was clearly familiar with them. Mr Ferguson was until September 2017 Target's Servicing Director. He joined Target in 2015 in that role and was responsible for service delivery, with oversight of a number of teams including those with detailed knowledge of Target's processes and systems. Both Mr Evans and Mr Ferguson left Target during 2017 and as a result of this Mr Glanville provided an additional short witness statement. Mr Glanville joined Target in September 2017 and replaced Mr Ferguson. He now has the title of Client Operations Director. His evidence confirmed that he agreed with the witness statements provided by Mr Evans and Mr Ferguson, and in particular the continued accuracy of the descriptions they gave of Target's business and how it performs its servicing role for Shawbrook.

27. All three witnesses were clear and straightforward, and I accept their evidence as to matters of fact.

28. The documentary evidence included, in particular, an "Amended and Restated Master Servicing Agreement" ("ARMSA") between Target and Shawbrook, together with supporting schedules setting out the "Definition of Services" ("DoS") in respect of each portfolio of loans.

Findings of fact

The contractual arrangements

29. The copy of the ARMSA included in the bundles was unsigned and undated, although it was obviously prepared for signature in December 2014 and was designed to replace a previous version of the agreement entered into in December 2011, which in turn replaced earlier agreements entered into in 2010 and 2011. Both parties agreed that the document included in the bundles was entered into in 2014 and is the only version of the contractual arrangements that is relevant for the purposes of this decision.

30. The agreement is entered into between Shawbrook and a company called Target Servicing Limited, which I infer is a member of the Target VAT group. (For ease of reference I will use the term "Target" throughout to refer to both Target Group Limited and Target Servicing Limited, or whichever is appropriate.) The recitals describe Target as being "a provider of loan origination and account operation services" which "performs activities including the functions of: payment processing and servicing and portfolio management services", and explain that Shawbrook wished to procure certain services which Target wished to provide.

31. Clause 3 deals with the appointment of Target by Shawbrook to provide the "Services" in accordance with the terms of the agreement, grants Target authority to do everything that, acting reasonably, it deems necessary or desirable in respect of the provision of the Services (provided that, without prior written consent, it does not exceed the scope of its authority), and provides that during the term of the agreement Target will be the exclusive provider of the Services in relation to all short-term commercial loans, buy to let mortgages, commercial mortgages and all other secured and unsecured personal and consumer loans offered by Shawbrook. Clause 23.2 makes clear that, in carrying out the Services, Target has full authority to bind Shawbrook in accordance with the criteria and standards agreed with it, and that it shall conduct all correspondence on Shawbrook's letterhead and otherwise carry out all dealings and activities in Shawbrook's name and not in its own name. In other words, it acts as an undisclosed agent. Specific authorities ("Mandates") are granted in respect of certain matters, as set out in the DoS, but the definition of Mandates makes it clear that Target has no authority to grant loans.

32. Clause 4 requires Target to provide the Services in accordance with the terms and conditions of the ARMSA, and to do so with reasonable care, skill and diligence using suitably qualified personnel. Shawbrook is responsible for ensuring that all applicable laws, including regulatory requirements, are complied with. Clause 4.5 contains another express statement that Target will act as agent of Shawbrook for the purpose of providing the Services.

33. Clause 6 imposes a number of obligations on Shawbrook, including requiring it to provide Target with all documents, information and assistance as Target reasonably requests to enable it to perform its obligations and giving it advance notice of changes to its products which could affect the Services. Various obligations are placed on Target, including a duty of reasonable cooperation and, in particular, a duty (after a short initial period in respect of each portfolio) to comply with agreed service levels, as set out in the DoS.

34. The "Services" are described as the "operation of individual loan accounts, processing payments received from Borrowers and the administration of Loans" as described in Schedule 1. "Loan Account" is separately defined as "an account operated by Target containing details relating to transactions occurring in respect of a Borrower's Loan including, into alia, charges, payments, interest, arrears, and sundry fees". Schedule 1 simply cross refers to the DoS in respect of the various portfolios of loans. There are four portfolios. Portfolio 1 comprises personal loans secured by second charges over residential property, Portfolio 2 contains all secured loans written under Shawbrook's commercial lending book, Portfolio 3 comprises unsecured home improvement and holiday home ownership loans, and Portfolio 4 covers other unsecured personal loans, including retail finance related loans. Portfolios 3 and 4 share the same DoS.

35. Charges are dealt with principally in clause 8. The provisions are not entirely straightforward but it was clarified at the hearing that, leaving to one side an initial set-up fee and a relatively modest minimum fee for each portfolio, as from 1 June 2014 pricing has been entirely on a "per loan" basis. The amount payable per loan

varies with the portfolio in question and (except in the case of Portfolio 1) the number of loans outstanding in that portfolio. A higher figure is charged for each loan in arrears. For example, Services in respect of Portfolio 2 loans are charged at £22.50 per loan, or £20 per loan if there are at least 4000 loans outstanding, and £40 per loan for those in arrears. Invoices are raised monthly on an estimated basis and then reconciled once the actual number of loans is known. Provision is also made for the reimbursement of certain third-party expenses. Clause 7 makes provision for a "Portfolio Deviation Fee" of (broadly) 80% of the expected fee in the event that the actual number of loans is more than 20% lower than the forecast number. The charges are all VAT exclusive, and pending resolution of this dispute Target is charging VAT. (Clause 8 contains provisions addressing this in further detail, including a provision to increase charges if VAT is not chargeable, no doubt reflecting the cost of what would then be irrecoverable input tax for Target, and a provision for VAT incorrectly charged to be refunded.)

36. The DoS are relatively detailed documents, but also cross refer to further internal procedure manuals which were not provided. However, it is clear from the DoS that details of how the services are provided, and what each party needs to do, are specified in detail. For example, the precise hours during which the Services must be made available are specified. It is also made clear what is out of scope, including marketing, requests to reissue cheques or BACS (Bankers Automated Clearing Services) instructions in respect of the original advance, and further advances. Obligations placed on Shawbrook include the provision of information about future business plans and changes, forecasted volumes, and timely and accurate details in relation to new loans.

37. There are clear processes for interaction between Target and Shawbrook, including a "change control" procedure for initiating any changes. I was shown an example where Target requested a change to the procedure for dealing with refunds due to customers, which resulted in Target being empowered to refund up to £300 without referral to Shawbrook. The change request included a significant level of detail about the detailed changes to processes that were proposed.

38. Each DoS makes it clear that the Services relate to the "overall operation of accounts, and the processing of payments and other transactions", and go on to specify a number of specific processes and how they should be dealt with, for example customer requests to make card payments, changes in bank account or other customer details, the issue of periodic statements, account closure, discharge of security (which Target arranges), overpayments and refund requests, the process of implementing and notifying customers of a change in interest rate, processing fee payments, and specific procedures for vulnerable customers. A further set of procedures apply to accounts in arrears, where Target must follow a specified strategy as well as applying certain fees. Target has scope to agree forbearance in accordance with a mandate agreed with Shawbrook, and to agree repayment plans with customers under which they make a series of payments towards their arrears balance. Any decision to write off a loan is for Shawbrook, as is any decision whether to instruct solicitors to take legal action. It is also for Shawbrook alone to decide whether to amend the terms of a loan (for example by reducing future payments and extending

the term). The definition of written-off loans in the ARMSA, which is relevant to the calculation of fees (because written-off loans are excluded), refers to loans which Shawbrook "reasonably" determines, in accordance with its internal procedures, shall be written-off on the basis that it is not economic to continue to collect any further payments.

The witness evidence

39. Mr Evans described the service Target provides as a full business process outsourcing ("BPO" service), which in the case of Shawbrook was an "end to end" service during the entire course of the loan life cycle following its origination by Shawbrook. Target's work starts immediately after a loan is made, with the creation of loan accounts and, from then on, their day-to-day operation and dealings with Shawbrook's customers up to the point of final repayment. Target has day-to-day control over and responsibility for operating the relevant loan accounts, which is the mechanism through which it maintains and continuously updates (and later reports on) the financial relationship and position between Shawbrook and its borrowers. Although loan origination is undertaken for some clients, for Shawbrook Target does not engage in matters relating to the original (or any further) advance, such as assessing credit worthiness, valuing potential security or otherwise deciding whether to make a loan, or indeed the process of making the advance.

40. Target uses its own specialised software (the "Centrac" system) to provide the services, together with specialist staff. Customer service teams answer the phone as Shawbrook and conduct correspondence on Shawbrook's letterhead. In effect, Target replaces or fills the absence of human and technical capability at its client to perform the activities it undertakes. It has a number of other banking and non-banking clients, some of whom simply use Target's loan administration IT systems but others of which, like Shawbrook, have a full outsourcing arrangement involving control of accounts.

41. Mr Evans emphasised the (obvious) importance, from a client's perspective, of ensuring that the service provider operates the loan accounts appropriately so that the correct financial position is recorded, the importance of the borrower retaining a positive relationship with the lender (through the undisclosed agency of the service provider) because that may lead to further business, and the importance of the service provider operating within regulatory rules and meeting agreed service levels. As regards the regulatory position, both Mr Evans and Mr Ferguson referred to Target's own regulatory approvals, but it was confirmed at the hearing that in respect of Shawbrook, and with an immaterial exception, Target operates under the "umbrella" of Shawbrook's regulatory approvals rather than its own.

42. It was clear from Mr Evans' evidence that the loan accounts are an integral part of the service that Target provides to Shawbrook. The loan accounts are the sole record of the financial relationship between Shawbrook and its borrowers. They are effectively ledgers which evidence the level of indebtedness, capture repayments and record other financial information including fees and interest charged. Target credits and debits the loan accounts with all relevant amounts (payments, fees and interest

etc). It applies various calculations to work out expected payments. Loan accounts are used as a basis of reporting to Shawbrook as well as for the production of statements for borrowers.

43. Target operates bank accounts on behalf of Shawbrook with banks that include NatWest and RBS and is responsible for matching payments to individual loan accounts, identifying any amounts that are not successfully matched by its systems and matching them manually, and identifying missing payments. The great majority of Shawbrook's customers have direct debit arrangement in place to make payments. Target is responsible for giving the instructions for payment to be made from borrowers' current accounts to the appropriate Shawbrook bank account. Target also operates separate accounts on a general ledger that are of greater immediate relevance to Shawbrook. Among other things these are used to record financial data such as payments in, perform reconciliation processes (for example between amounts paid into Shawbrook's bank accounts and amounts credited to individual loan accounts) and to provide reports of payments, transfers and balances to Shawbrook. Target has authority to transfer funds paid by borrowers into the incorrect account to the correct account.

44. Mr Evans made the point that, in contrast to a "classic" debt collection function which would simply involve pursuing repayment until a portfolio of debts was repaid, Target was remunerated by Shawbrook for doing the opposite, because the basis on which it is remunerated is linked to the number of loans outstanding. Where a borrower is in arrears under a secured loan, repossession and sale of the property is regarded as a last resort because it can result in irrecoverable costs and losses. For example, out of 915 non-routine administrative actions undertaken by Target in relation to the commercial mortgages portfolio in September 2016 (representing around 11% of the portfolio), only one related to enforcement.

45. It was clear from Mr Evans' evidence that Target takes a proactive approach in performing the Services, making suggestions for improvement where appropriate. In addition to the example referred to above of seeking and obtaining authority to refund overpayments of up to £300, an example was given of Target proposing and using SMS technology to remind borrowers that direct debit payments would shortly be collected, and therefore that they should check that they have sufficient funds in their account. Mr Evans confirmed that Target and Shawbrook work together on these matters to the benefit of each. Target had its own process improvement teams and a client relationship team which communicates with Shawbrook.

46. Mr Ferguson provided a more detailed description of how Target's services for Shawbrook are performed, including a description of the systems used. Like Mr Evans he emphasised that whilst Target's activities are wide-ranging they are essentially related to the operation of the individual loan accounts, and in particular the transactions which take place under the relevant loan agreements, with Target being an integral and critical part of the relationship between the lender and borrower. Without Target's service Shawbrook would simply have granted credit but would lack the operational capability to calculate and recover repayments, apply fees and charges and deal with interactions with borrowers.

47. Mr Ferguson described how, following release of funds by Shawbrook to borrowers (or at their direction), Target receives loan origination data from Shawbrook and uses it to create individual loan accounts. This data is received on a daily basis. As well as details of borrower and lender the loan account will include details of the outstanding balance, the interest rate and the details of the next expected repayment. Target will be responsible for making the initial call to the borrower to check the information and welcome them to Shawbrook, issuing a welcome pack including terms and conditions, and setting up direct debit instructions.

48. The starting point of the arrangements between Target and all its clients are that loan payments should be processed by direct debit wherever possible. As at 31 October 2016 there were live direct debit instructions in respect of 91% of the commercial mortgages and over 97% of other Shawbrook loans. Target is responsible for generating the instructions for direct debit payments, in the forms of a BACS file produced by Target's systems which contains electronic payment instructions to banks operating borrower bank accounts, which BACS processes automatically. However, payments are also accepted by Target in other forms, such as debit card payments and cheques, including on a one-off basis where payment is usually made by direct debit. As well as regular payments, Target has to process irregular payments, for example where a borrower is in arrears and is seeking to pay amounts towards clearing the arrears, makes an overpayment or is paying off a loan early. Target processes all payments made, reconciling and crediting them to the loan accounts. It uses both the BACS and CHAPS payment systems, which process instructions issued by Target (on behalf of Shawbrook), to move funds between Shawbrook's bank accounts where required, or to repay sums to the borrower where an overpayment has been made.

49. Mr Ferguson gave another example of Target's proactive approach, in that it suggested to Shawbrook that an online payment mechanism should be provided so that customers not making a payment by direct debit had an alternative straightforward means of payment, with lower cost for the business since it did not involve the customer service team dealing with a phone call.

50. Target is also responsible for calculating the amounts of interest and principal repayments due, and for calculating and applying any fees. Because of the way payment processes operate, expected payments are initially assumed to be made by applying credits to the relevant loan accounts. Where it transpires that payment was not made, these entries are reversed by adding the relevant amount to the outstanding balance (split between interest and principal, assuming the missed payment related to both), together where appropriate with a fee. Mr Ferguson explained that where interest rates change (a matter for Shawbrook to decide) Target must update the interest calculations on all affected accounts and notify borrowers accordingly. Where Shawbrook makes an additional advance to a borrower Target follows the same processes as for a new lending arrangement, with the new outstanding loan amount replacing the previous balance. Where a borrower wishes to repay a loan early, Target is responsible for providing an early settlement quote. It also handles the entire process for any loan repayment, including discharge of security (using Shawbrook's approved panel of solicitors) and closure of the account.

51. Mr Ferguson described the procedure for dealing with missed payments and arrears. This is generally relevant only to a small percentage of the total loan accounts. Accounts in arrears generated around 10.6% of Target's total billings to Shawbrook in 2015.

52. Where a payment is missed Target is required, under regulatory obligations, to notify the borrower of the failure and seek an understanding of the reason, and then work with the borrower to agree an arrangement to repay the outstanding amount over an agreed period. Where a direct debit instruction fails a second attempt may be made to collect payment by that means. For any default a letter is produced in Shawbrook's name providing formal notification to the borrower and advising them of the fee that will be applied. Target also uses SMS messages where it has the borrower's mobile number, and attempts to contact the borrower by phone. Whatever method of communication is used the borrower is always advised to contact Shawbrook (i.e. Target) to explain the reason for the missed payment and agree a way forward. Where the reason for the missed payment is relatively easy to deal with, for example by updating bank details, the normal customer service team may deal with the matter. More complex cases are referred to Target's Arrears Team. Target must also ensure that ongoing regulatory requirements continue to be complied with during any arrears period, for example the generation of formal notices required under consumer credit legislation.

53. Target is provided with a certain level of authority by Shawbrook to negotiate how missed payments will be made up, with any longer term forbearance being referred to Shawbrook. Any changes to the terms of a loan, for example an extension to the loan period, would also be a matter for Shawbrook. If an account remains in arrears and no agreed way forward is arrived at, the Arrears Team will ultimately recommend to Shawbrook whether to take legal action. The process before this could take three to four months. The decision whether or not to take legal action or write off a loan is a matter for Shawbrook. If Shawbrook decides to take legal action, Target will work with a solicitors firm on a Shawbrook approved panel, providing information, keeping records and continuing to handle contacts with the borrower. The solicitors will brief Shawbrook, who will make all settlement decisions.

54. Mr Ferguson also described how overpayments are dealt with. Depending on the portfolio, borrowers are generally able to overpay a certain percentage of the balance (e.g. 10%) in any year without incurring an early repayment charge. Target deals with these, amending the loan balances and loan terms as appropriate, and issuing letters confirming the overpayment. Alternatively, borrowers may be eligible for a refund if they overpay more than was due. Target will notify the borrower in writing and arrange for payment to the borrower's account. As mentioned above Target has authority to process refunds of less than £300 without reference to Shawbrook.

55. There is regular contact between Shawbrook and Target, including monthly meetings to discuss Target's adherence to the agreed service levels, arrears management, opportunities for improvement and any other matters that have arisen. Target provides Shawbrook with regular reports, and Shawbrook also provides Target with forecasts of the total number of loans and balances.

56. As already mentioned, Mr Glanville's evidence confirmed that of Mr Evans and Mr Ferguson. In addition, Mr Glanville confirmed the accuracy of some additional information relating to the loan portfolio. The first related to the split between fixed and variable rate loans. The great majority of the loans are made on a variable rate basis: for example, as at 31 January 2018 only 521 loans were at a fixed rate, whereas there were over 170,000 variable rate loans. The second related to the length of loans. Unsecured loans have an average term of around six years. Secured loans range in length between three and 25 years, with an average of around 16.5 years.

57. In cross examination, Mr Glanville confirmed Target's proactive role and continued focus on improved customer experience, as well as on reducing costs. For example, an aspect of the transformation programme he is involved in aims to allow borrowers the ability to make payments or check the balance on their loan using an automated voice system.

Submissions

Target's submissions

58. Target's primary case was that the principal or core supply it makes to Shawbrook relates to payments and transfers in the same way as *EDS*, which related to similar customer-facing loan administration services. In the alternative, the principal or core supply relates to the operation of accounts (specifically, current accounts), or amounts to transactions concerning debts. To treat what Target does as debt collection would denature the exemption, because almost every payment involves the discharge of a debt. It would call into question a significant part of banks' activities, for example the collection of direct debits. Any facilitation for the payee's side would be caught.

59. Mr Cordara, for Target, submitted that it was critical to keep sight of the fact that Target's customer is a bank making supplies of exempt financial services. Target acts as a subcontractor of a very large part of Shawbrook's promised functions to its customers, in a supply that endures for the life of the loan from the moment after making the initial advance. The financial service Shawbrook provides begins rather than ends with the making of the initial advance. During the life of the loan there will be a significant number of interactions and legally significant events that make up the overall financial service provided by Shawbrook, which are captured within the bank account relationship. It was inappropriate to describe this complex service as debt collection.

60. The starting point of the analysis of the services was the description set out in the contract, but the consideration of the economic and commercial realities was a fundamental criterion: *Secret Hotels2 v HMRC* [2014] UKSC 16, [2014] STC 937 ("*Secret Hotels2*") and the joined cases *Loyalty Management UK and Baxi Group* (cases C-53/09 and C-55/09) [2010] STC 2651 ("*LMUK and Baxi*"). The emphasis in the contract was consistently on payment processing and the operation of the loan accounts. The witness evidence confirmed the economic and commercial realities: the client is seeking a service provider who can operate loan accounts appropriately to ensure the continuing flow of loan repayments, that the correct financial position

between the borrower and lender is maintained, updated and confirmed, and that a positive relationship is retained between the parties.

61. As is well established, there are two analytical routes to a single supply conclusion, namely a principal supply to which other elements are ancillary (*Card Protection Plan Ltd v Customs and Excise Commissioners* (Case C-349/96) [1999] STC 270 ("*CPP*")); and cases where the various elements of the supply are so closely linked as to form a single indivisible economic supply which it would be artificial to split (*Levob Verzekeringen BV & Anot v Staatsseccretaris van Financien* (Case C-41/04) [2006] STC 766 ("*Levob*")). In this case it did not matter which route was adopted, because on either basis the dominant or predominant element of the supply would define its fiscal status, but Target's position was that the core of its supply, or its principal element to which other elements are ancillary, falls within a fair interpretation of the exemption. Target's supplies as a data handler are comparable to those in other cases involving data centres for financial institutions, *SDC*, *FDR*, *ATP* and *EDS*. Although there is a factual distinction from *EDS* in that EDS was authorised to release the initial loan, in other respects the arrangements that Target has with Shawbrook are very similar. Target has oversight and responsibility for bank accounts into which loan repayments are made and from which overpayments can be repaid, and it has authority to move money between bank accounts where payments are made incorrectly. Its service focuses on the critical function of being the person responsible for altering the legal and financial position between Shawbrook and its borrowers.

62. HMRC was wrong to characterise the service Target supplied as debt collection. It did not fit the EU VAT definition, being a transaction solely concerned with the collection of a pecuniary debt (as opposed to transactions concerning debts, which are within the exemption). The first substantive European decision on the meaning of the term was *Finanzamt Groß-Gerau v MKG-Kraftfahrzeuge-Factory GmbH* (Case C-305/01) [2003] STC 951 ("*MKG*"), which related to factoring. After describing the "essential aim" of factoring as the "recovery and collection of debts owed to a third party" at [77], the Court said at [78] that the term:

> "… refers to clearly circumscribed financial transactions, designed to obtain payment of a pecuniary debt, which are clearly different in nature from the exemptions set out in the first part of art 13B(d)(3)…"

63. In *Axa* Arden LJ rightly contrasted "normal retail banking activities". Target's service is complex and it is highly relevant that it comprises a subcontracting of a critical part of an overarching exempt supply by a bank. Whilst exemptions need to be interpreted strictly, a strict interpretation must not deprive them of their intended effect. The CJEU has made clear that the concept of debt collection applies to services specifically designed to obtain the payment of a debt. If HMRC were correct then half of all banking activities would be at risk of being taxable. It was one thing to assist a supplier of a (non-financial) service to get its bills paid, but quite another to intervene as agent on behalf of the supplier of a financial service, involving the movement of capital and its gradual repayment over many years. Target's services go far beyond the simplistic collection and remittance activity performed by Denplan in *Axa*. Denplan had no involvement in the primary supply of dentistry, whereas Target assists in the process of lending and loan administration, which is part of Shawbrook's

primary supply to the customer. Furthermore, there is no fixed debt by way of simple consideration which Target is collecting. The amount lent is not consideration at all, and the consideration that is paid (interest and any fees) is subject to change. Target's role goes beyond that of a collector. The loan book is also not being run down: the loan portfolios are "open book" and additional advances can be added. Denplan levied a fee for each payment transaction, whereas Target's fees focus on the size of the portfolio and the number of accounts in operation.

64. Whilst an element of what Target does might be labelled debt collection, that was not the correct label for the overall service, and was not an accurate reflection of the primary economic purpose of the arrangements. Target's responsibility to make legal and financial changes to the position of the parties brings the service within the scope of the exemption and prevents it from falling within the debt collection carve out. For similar reasons related to the complexity of Target's role, if the service did not fall within the definition of transactions concerning transfers or payments it would still be better described as a transaction concerning debts rather than as debt collection: see *Barclays Bank plc v HMRC* (VTD 20528) [2008] ("*Barclays Bank*") where the focus was on the essential aim of the transaction viewed objectively. The reference is to debt collection, not debt settlement. The typical relationship with a borrower is a long-term one, which Target administers over the entire period. *EDS* cannot be distinguished simply on the basis that Target does not handle the initial advance at the start of that period. If HMRC were correct then the day one exempt output would be followed by years of taxable debt collection.

65. As regards HMRC's alternative submission that Target's activities amounted to the management of credit (see [67] and [72] below), words taken from a separate exemption on which Target was not relying could not cut down Article 135(1)(d). Management of credit was also quite different in concept from the granular (and function specific) financial events covered by Article 135(1)(d), and refers to something supplied by a lender which goes beyond the actual grant or negotiation of credit. No such additional service was being provided.

66. In the alternative, Mr Cordara submitted that Target was operating current accounts. It is clear that what is involved are accounts, and that Target operates them as agent for Shawbrook, a bank. Unlike the dentists in *Axa* Shawbrook is subcontracting a core part of its financial services function. An account is simply a series of obligations in transactions between two parties, credits representing what the bank has promised to repay the account holder, and *vice versa* for debits. The accounts in this case are obviously current accounts, "current" (courant in French) just referring to them being running accounts, reflecting the mutual debt position as it evolves over time. The UK and continental case law draws no distinction between current accounts in credit or debit, secured or unsecured or carrying interest in either direction. A current account may be overdrawn for years. HMRC wrongly focuses on access-related features which many current accounts have, such as a cheque book or debit card. These are just a means of access and do not define the concept of current account. Those means of access also change significantly over time. There is no policy reason for HMRC's restrictive approach, which would also throw into doubt the correct treatment of products such as offset mortgage accounts. Account needs to

be taken of the context in which the reference to current and deposit accounts occurs in Article 135(1)(d), in the same paragraph as references to payments, transfers, debts etc. It is also important to bear in mind that for VAT purposes the identification of the key features of a contract depends on ascertaining its economic purpose (or cause of the contract) calculated to realise the parties' interests, not subjective motivation: *Tesco v Customs and Excise Commissioners* [2003] STC 1561 ("*Tesco*") at [41], referring to the opinion of Advocate General Tizzano in *Mirror Group* and *Cantor Fitzgerald* [2001] ECR I-7175/7257, ECJ. Target's interaction with Shawbrook's customers through the operation of accounts is intrinsic and essential to its supply to Shawbrook.

HMRC's submissions

67. HMRC's case was that, if Target's supply fell to be treated as "transactions…concerning… payments, transfers, debts" (which was for Target to prove) then it was excluded from the exemption as debt collection. In the alternative, if Target's contention was that the service was not debt collection because of additional elements, then what was supplied amounted to credit management services which would be taxable in any event. Management of credit is exempt only when carried out by the person granting it, under Article 135(1)(b) of the PVD and Item 2A of Group 5 of Schedule 9 VATA. Article 28 of the Sixth Directive had included a transitional provision permitting Member States to continue to exempt management of credit by a person other than the person granting the credit, but the transitional period had expired in 1991 (see *SDC* at [4]). This is a clear indication that such supplies are intended to be taxable.

68. Ms McCarthy, for HMRC, submitted that the starting point is the contractual arrangements (*WHA Limited and Anr v HMRC* [2013] STC 943 at [27], *HMRC v Secret Hotels2 Ltd* at [31] and [32]), but consideration of the economic realities was a fundamental criterion (*LMUK and Baxi* at [39]). Exemptions must be strictly construed whilst being given a fair interpretation. The purpose of the exemption for financial transactions was explained in *Velvet & Steel Immobilien und Handels GmbH v Finanzamt Hamburg-Eimsbüttel* (Case C-455/05) [2008] STC 922 ("*Velvet & Steel*") at [24] as being:

> "… to alleviate the difficulties connected with determining the tax base and the amount of VAT deductible and to avoid an increase in the cost of consumer credit…"

69. It was not for HMRC to come up with a label or description of what was supplied: the burden was on Target to show that its supplies to Shawbrook fall within the exemption and are not taken out of it by the debt collection carve out. However, properly understood, Target's supplies comprise elements of debt collection along with other technical or administrative elements connected with the operation of loan or mortgage accounts, none of which qualify for exemption. Whilst a number of the functions that Target undertakes might answer to the description of transactions concerning payments or transfers, a number are merely administrative (and clearly taxable in nature), and those that could answer to the description are clearly centred around the collection of debts. It is critical that Target is not involved in the making of

loans: in contrast in *EDS* the Court of Appeal classified the core supply as the making of loans. *EDS* therefore does not assist. What Target supplies to Shawbrook is not materially different to the services considered in *Axa*, the economic purpose being to collect payments from borrowers on Shawbrook's behalf.

70. It was not correct that a finding in favour of HMRC would deprive the concept of "transactions concerning debts" of meaning. As explained in *Barclays Bank* at [12], that expression would cover a simple assignment of a debt not in the course of factoring. Similarly, it was not the consequence of HMRC's argument that the exemption for transactions concerning payments or transfers would be denatured. In each case the correct classification would turn on the circumstances. It was not apt to compare the position of a third party supplier such as Target with the situation where financial institutions perform their own services directly. In the latter case there is no supply to the financial institution at all.

71. Target's submission that its supplies are too complex to constitute debt collection approached the analysis in the wrong way. The correct approach was to analyse the elements comprising Target's supply and to ask whether any of those elements qualify for exemption. Only if they do is it necessary to go on to the next stage of determining which element is the principal service (*CPP*) or which element(s) predominate overall (*Levob* or *FDR*). Target's submission that what it does is much more complex than mere debt collection would apply equally to the question whether what it does comprises transactions concerning payments, transfers or debts: if what it supplies cannot be categorised in that way then it would be taxable in any event.

72. If Target's contention that what it did was broader than debt collection was correct, then the proper description was credit management. Target's own description was loan administration, and *Abbey National plc v Customs and Excise Commissioners* (Case C-169/04) [2006] STC 1136 confirmed that the term management is broad enough to include administration.

73. Target's alternative reliance on the exemption for transactions concerning current accounts was plainly misconceived. Target manages loan or mortgage accounts, a different category altogether. In the alternative, account operation is not the principal or predominant element of the supply. The exemption in relation to current and deposit accounts is clearly explained by reference to the difficulties alluded to in *Velvet & Steel*. Those difficulties do not arise here. Properly understood, the operation of loan or mortgage accounts amounts to much the same activity as credit management, and is taxable if not carried out by the person granting credit. In any event the ultimate purpose of the contract is for the collection of loan repayments, and it is for this that Target is paid. Any element of this that could be said to amount to account operation is simply a means to that end or a better way of Shawbrook enjoying the principal part of the supply.

Discussion

74. In the paragraphs that follow I deal with the questions that have arisen in the following order:

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

(2) whether what is supplied includes "transactions…concerning… payments, transfers, debts" (or the equivalent in Item 1);

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

(4) the scope of the debt collection carve out; and

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

The correct approach to classification

75. There was some debate at the hearing about the correct approach to classifying a single complex (or composite) supply. As already mentioned Ms McCarthy submitted that the first step was to analyse the elements of the supply and ask whether any of those elements qualify for exemption. Only if they do does the next stage arise, which is to determine which element (taxable or exempt) is either the principal element, with all other elements being ancillary (*CPP*), or which element(s) predominate overall (*Levob* or *FDR*). Whilst Mr Cordara agreed that a "bottom up" approach was needed which considers the individual elements, he maintained that there is a one step analysis, namely what is the preponderant or overriding character, or predominant nature, of the supply. As Laws LJ indicated in *FDR* at [54] there is a danger of "over-elaboration and needless complexity".

76. Ms McCarthy relied on the First-tier Tribunal (FTT) decision in *Paymex Ltd v HMRC* [2011] UKFTT 350 (TC) to support her approach, in particular paragraphs [145] and [146] which summarise the conclusions reached. That case related to a company that provided services to debtors in connection with individual voluntary arrangements (IVAs), the question being whether Article 135(1)(d) applied. Paragraphs [145] and [146] read as follows, so far as relevant:

> "145. We have found that the service supplied by Blair Endersby, covering both the Nominee and Supervisory stages in the IVA process, constitutes a single supply. We have found further that this single supply is made up of a number of elements, of which part is negotiation of debts and part is transactions concerning payments, and not debt collection. Although there are other elements to the service, including advice on the suitability of an IVA, overall supervision of performance of the IPA and reporting to creditors and, up to 6 April 2010, the court, and those elements are themselves integral and key to the overall process, it is clear to us that all these aspects of the service are ancillary to the core elements of negotiation and payment handling, and that accordingly, viewed overall, the supply is exempt as falling within article 135(1)(d) of the Principal VAT Directive.
>
> 146. We do not consider that it is necessary for us to decide as between negotiation and payment handling which is the dominant element of the supply. Both are exempt, and it is only necessary for us to determine whether the dominant elements are those that are exempt or those that are taxable (*FDR*). However, were it necessary for us to have done so, we would find that negotiation is the core supply…"

77. It is understandable that Ms McCarthy pressed the two stage approach, because it effectively emphasises or underlines a key HMRC argument, namely that the only way that Target can demonstrate that it falls within the scope of Article 135(1)(d) is through the ""transactions…concerning…payments, transfers, debts" wording, but on HMRC's approach those elements of the supply that may answer to this description are carved out from exemption as debt collection, other elements being irrelevant. On that basis the second stage is therefore never reached. However, whilst it is clearly an approach to consider I do not think it is necessarily definitive. In particular it does not deal adequately with a situation where it is only a combination of elements that can be characterised as falling within an exemption (or potentially as being taxable rather than exempt), rather than any individual element.

78. The correct approach to classification was recently considered in detail by the Upper Tribunal in *Metropolitan International Schools Ltd v HMRC* [2017] UKUT 0431 (TCC), to which I referred the parties at the hearing. *Metropolitan International* was a decision concerned with the correct characterisation of a single composite supply, either as a supply of books (as the FTT had held) or as a supply of educational services (as HMRC maintained). The Upper Tribunal found that, in the light of the CJEU decision in *Mesto Zamberk v Financní reditelstvi v Hradci Kralove* (Case C-18/12) [2014] STC 1703 ("*Mesto*"), the primary test for determining the character of a supply was to determine its "predominant" element, and noted at [64] that it was not easy to imagine circumstances where the principal/ancillary test would generate a different answer. The Tribunal also discussed a submission by Counsel for HMRC that it was necessary to capture the typical consumer's aim in purchasing the goods or services in question, based on the economic realities (in the sense of what such a consumer thinks that he or she is acquiring), which the Tribunal referred to as the "overarching" supply test, and accepted at [76] to [78] that this was a point that should be taken into account, and might even be justifiable in some cases as a separate test. The Tribunal noted at [67] that this concept was derived largely from UK tax cases, including the House of Lords decision in *College of Estate Management v Customs and Excise* [2005] STC 1597.

79. *Mesto* related to the entrance fee charged for access to an aquatic park, which included a swimming pool divided into lanes and equipped with diving boards, a paddling pool, water slides and other sporting and recreational facilities. One of the questions referred to the CJEU was whether the access granted could constitute a supply of services closely linked to sport, and thus exempt. The court emphasised at [27] the need to have regard to all the circumstances in which the transaction takes place. The court explained that the categorisation of a single complex supply requires identification of its predominant elements, and that this must be determined from the point of view of the typical consumer, "having regard… to the qualitative and not merely quantitative importance" of the different elements (paragraphs [29] and [30]). The question as to whether such a single supply fell within the exemption needed to be determined:

> "… from the point of view of the typical consumer, who must be determined on the basis of a group of objective factors. In the course of

> that overall assessment, it is necessary to take account, in particular, of the design of the aquatic park at issue resulting from its objective characteristics, namely the different type of facilities offered, their fitting out, their number and their size compared to the park as a whole." (paragraph [33])

80. The CJEU went on to explain that this included taking account, for example, of whether the aquatic areas lend themselves to swimming of a sporting nature or to recreational use. The fact that the intention of some visitors does not relate to the predominant elements of the supply does not call that determination into question. The focus is on the "objective character" of the transaction (paragraphs [34] to [36]).

81. I think it is clear that the starting point is to identify the individual elements of a single complex supply. Whether that supply falls to be treated as exempt will generally (but not necessarily exclusively) be determined by reference to predominance, but this might either be a single predominant element or in some cases a combination of elements. The test is an objective one, from the perspective of a typical consumer, and based on the contract and the economic realities. I agree with Mr Cordara that the reference by Advocate General Tizzano to "economic purpose", referred to by Jonathan Parker LJ in *Tesco* (see [66] above) is relevant. Also relevant are the descriptions referred to by the same judge in *EDS* at 130, where he referred to the expression "single or core supply" used by Laws LJ in *FDR* at [62] and to the references to "the essential feature of the scheme or its dominant purpose" and "main objective" by Lord Slynn in the House of Lords decision in *CPP*, [2001] STC 174 at [25] and [26].

Whether what is supplied includes "transactions…concerning…payments, transfers" within Article 135(1)(d)

82. Although HMRC did not formally concede this point at the hearing, adopting what was described as a neutral stance on the issue, they also did not seek to argue that what was supplied did not include elements falling within this description or its equivalent in Item 1 of Group 5 of Schedule 9 VATA.

83. Mr Cordara's submissions focused primarily on the reference to "transactions…concerning...payments, transfers", rather than the reference to debts. He relied on the principles set out in *SDC*, as applied in *FDR*, *EDS* and *ATP* in particular, and the evidence provided by Mr Evans and Mr Ferguson, including the evidence that the loan accounts are controlled and maintained by Target and provide the sole record of the position between Shawbrook and the borrower. The key, he said, is Target's authority and responsibility to effect changes to the parties' legal and financial situations.

84. I have concluded that Target has established that what is supplied includes an element or elements comprising "transactions…concerning...payments, transfers". The operation of the loan accounts, and specifically the crediting and debiting of entries to those accounts, involves changes in the legal and financial situation between Shawbrook and the borrowers which fulfil the specific, essential functions of payments or transfers, going beyond a mere physical or technical supply. In

particular, Target is responsible for matching payments made into Shawbrook's bank accounts to individual loan accounts and crediting them accordingly. It also debits those accounts with the principal amount due, as well as interest and any fees. There is no other record of these amounts or the precise level of indebtedness outstanding at any time. Target has responsibility extending beyond technical aspects to the creation of credit and debit entries. Importantly, *ATP* demonstrates that the concept of transfer does not require any physical transfer of funds: accounting entries are sufficient.

85. In reaching this conclusion I have taken into account the most recent CJEU case law on the subject, *HMRC v National Exhibition Centre* (Case C-130/15) [2016] STC 2132 ("*NEC*") and *Bookit v HMRC* (Case C-607/14) ("*Bookit*"). I have also read the Advocate General's opinion in *HMRC v DPAS* (Case C-5/17), released following the hearing in this case, which considers both *NEC* and *Bookit*. In summary, *NEC* and *Bookit* make it clear that where a service provider itself debits or credits an account directly, or intervenes by way of accounting entries on the accounts of the same account holder, that permits a finding that there is a transfer or payment within Article 13B(d)(3) (paragraphs [37] and [38] of *NEC* and [42] and [43] of *Bookit*). In contrast in those cases a card processing service provided in connection with ticket purchases, whilst resulting in, and essential for completing, an exempt transaction, did not meet the test. This was because the service provider neither debited or credited accounts, nor intervened by way of accounting entries, or even ordered them since in those cases it was the purchaser of the tickets who decided that his account should be debited by using his payment card (paragraph [42] of *NEC* and [47] of *Bookit*). There was simply a demand or request for payment, or in essence an exchange of information between a trader and merchant acquirer, rather than something that could be regarded as executing a payment or transfer (paragraphs [43] and [48] of *NEC* and [48] and [53] of *Bookit*). The service provider also did not assume any responsibility or liability for achieving a transfer or payment (paragraph [45] of *NEC* and [50] of *Bookit*).

86. *DPAS* relates to a dental plan similar to the one considered in *Axa*, except that the contractual arrangements had been restructured following the decision in that case. The Advocate General concluded that a statement in *Axa* that what Denplan supplied constituted "as a matter of principle" transactions concerning payments was not reconcilable with other case law, including *NEC* and *Bookit*, which confirmed the test described in *SDC*. DPAS merely asks relevant financial institutions to carry out transfers (pursuant to direct debit mandates provided by dental patients, and by requesting that its own bank transfer amounts on to the dentists), rather than doing anything which itself results in legal and financial changes. It is the relevant financial institutions who make those changes.

87. I do not think that *DPAS* is directly relevant. In particular, Mr Cordara is relying on the test described in *SDC* and subsequent cases that apply it on the "payments, transfers" question. However, *NEC* and *Bookit* do suggest that some elements of what Target does that might on the face of it be regarded as "transactions…concerning…payments, transfers" are less clearly so than might be assumed. In particular, and although I heard no argument on the point, I have considered whether transfers between Shawbrook's bank accounts (which I infer

comprise instructions to Shawbrook's own relationship banks, including NatWest and RBS, to make such transfers), instructions for amounts to be collected by way of direct debit, and arrangements to refund overpayments, are closer to the situation described in *NEC* and *Bookit* than to a transaction properly to be treated as concerning payments or transfers. Overall, however, I have concluded that these elements do fall to be treated as "transactions…concerning…payments, transfers". This is because Target itself uses the BACS and CHAPS payment systems, rather than effectively instructing or requesting a financial institution to do so. (See the useful description of the BACS systems in *FDR* at paragraphs [23] and [24], and the conclusion at paragraph [42] that the submission of tapes to BACS amounted to transfers.) In addition, Target does assume responsibility or liability for achieving a transfer or payment in those situations. What is done goes beyond an exchange of information or request for payment. *NEC* and *Bookit* can be distinguished on that basis.

Whether what is supplied includes the operation of current accounts

88. I have concluded that the service that Target supplies does not involve the operation of current accounts within item 8 of Group 5 of Schedule 9, or in the language of Article 135(1)(d) "transactions…concerning…current accounts". (I should mention that Mr Cordara suggested that the wording of the UK statute might be wider than the PVD on this point, but he made it clear that he was not pressing that point before this Tribunal. I also do not think it makes a difference to the key question to be decided, namely whether the relevant accounts are current accounts.)

89. The concept of a "current account" has been considered in a number of cases. Mr Cordara referred me to a number of UK authorities and some continental authorities to support what I consider to be uncontroversial points, including that current accounts can perform a credit function (and indeed may be overdrawn for lengthy periods, and sometimes permanently), that amounts owed by account holders can be secured, and that current accounts in credit can carry interest. He suggested that the key features are simply that (1) there is a running account to which the rule in *Clayton's Case* (1816) 1 Mer 585, 608 applies, (2) there is automatic set off and (3) absent special agreement, there is a need for either party to make a demand before seeking recovery.

90. Ms McCarthy referred me to the High Court decision in *Office of Fair Trading v Abbey National plc and others* [2008] EWHC 875 (Comm), a decision which was ultimately reversed by the Supreme Court ([2009] UKSC 6). That case concerned the fairness of certain current account charges levied by banks. In the High Court Andrew Smith J described the nature of current accounts – or at least the current accounts he was considering – as follows:

> "42. It is convenient before going further to say something about the general nature of current accounts such as those that are the subject matter of these proceedings, although each of the Banks has (as is common ground between the parties before me and I am to assume) standard terms which govern its contractual arrangements with its

personal current account customers and those terms define the parties' rights and obligations.

43. It is a basic characteristic of a customer's current account with a bank that the bank is under an obligation to receive money, cheques and payments by other methods into the customer's account and to effect repayment to the customer and payments to third parties to the customer's order and as the customer's agent. This observation reflects the classic description of the relationship between a bank and a customer with a current account given by Atkin LJ in *N Joachimson v Swiss Bank Corp* [1921] 3 KB 110 at p 127, 90 LJKB 973, [1921] All ER Rep 92 and the description by Lord Atkinson in *Westminster Bank Ltd v Hilton* (1926) 136 LT 315, 43 TLR 124. It applies to all of the accounts with which I am concerned.

44. It is inherent in the nature of such an arrangement that the account between the bank and the customer will show at any time either a credit for the bank and debit for the customer or a debit for the bank and a credit for the customer (or, I suppose, perchance, a nil balance). Thus, in *Rolls Razor Ltd v Cox* [1967] 1 QB 552 at p 574E-F, [1967] 1 All ER 397, [1967] 2 WLR 241, Winn LJ said:

> ". . . the relationship of banker and customer upon a current account implies from its very nature an intention on the part of both parties that debits and credits arising between them shall be brought into a running account on which by reason of the customary method of keeping such account, there will at any given moment be an outstanding debit or credit balance."

45. The customer is not obliged, in the absence of contrary agreement, to maintain or increase a credit balance in the account – that is to say, to lend to the bank. Nor is the bank under an obligation to lend to a current account customer or to allow him overdraft facilities unless it has agreed to do so: *Bank of New South Wales v Laing* [1954] AC 135 at p 154, [1954] 1 All ER 213, [1954] 2 WLR 25.

46. Banks provide a variety of facilities by which money can be paid into current accounts and payments or withdrawals made from them. Thus, customers or third parties can deposit or pay money (by way of cash or by way of cheques or other payment instructions) into accounts at a branch, by post or by electronic means. Cash can be withdrawn at a branch, through automatic teller machines ("ATMs") or through "cash-back" arrangements between banks and retailers. Payments to third parties can be made in a variety of ways, by standing order and direct debit, by cheque, by bank draft, through CHAPS (the Clearing House Automated Payment System), by use of a debit card and through arrangements made by telephone or internet banking. Cheques are generally cleared by the Banks through the clearing house system, a rule of which, I understand, is that, if a cheque is not returned through the system, it is to be paid.

47. Banks receive two kinds of instructions from customers for withdrawals or payments from current accounts. There are "live" transactions, which are received by banks when they are given by the customer, and include withdrawals at a branch or an ATM, some

> payment instructions given by telephone or by internet, and CHAPS payments. There are also "off-line" transactions, where banks receive the customer's payment instructions in batches, often through a clearing house in the case of cheques or through BACS (Bankers Automated Clearing Services) in the case of standing orders or payments by direct debit.
>
> 48. Banks generally provide further facilities to current account customers, including arrangements whereby customers can readily monitor their accounts in various ways (by sending bank statements, by providing information at ATMs, and by telephone and by internet arrangements).
>
> 49. Often banks provide their customers with cheque guarantee cards and debit cards. Many retailers will not accept cheques unless they are guaranteed by a card. Cheque guarantee cards have a limit upon the amount of the cheque which can be supported by them. In the case of debit cards, sometimes a retailer must have a transaction specifically authorised by the bank that has issued the card if its value exceeds the retailer's "floor limit", and payments by debit card may be either "live" or "off-line", depending upon whether or not the payment is authorised by the bank when the customer uses his debit card.
>
> 50. I have not set out an exhaustive list of the facilities that banks provide to current account customers, but this general description applies to all the Defendant Banks and is sufficient for present purposes. The precise facilities provided by different banks vary, albeit in relatively minor respects, and also vary depending upon the type of current account that the customer has or, for example, the customer's age or status: for example, there are accounts directed to students or graduates, and some banks refuse to allow overdraft facilities to customers who are not aged 18 years."

91. This description was referred to by the Court of Appeal in the same case with apparent approval ([2009] EWCA Civ 116 at [6]). The Court of Appeal dismissed the appeal, but that decision was overturned by the Supreme Court. In the Supreme Court Lord Walker referred without comment at paragraph [23] to the description of the operation of current accounts in the High Court decision. Lord Phillips also included the following description at paragraph [53]:

> "…The operation of a current account by a Bank for its customer involves the provision of a number of different services. These include the collection of cheques drawn in favour of the customer, the honouring of cheques drawn by the customer, payments on behalf of the customer pursuant to the use by the customer of credit or debit cards and cash distribution facilities."

92. The reasons for my conclusion that the accounts created and operated by Target in this case are not current accounts for the purposes of the PVD or domestic VAT exemption are as follows:

(1) The term current account does not have a specific legal, as opposed to commercial, definition. It takes its meaning from the commercial world. I

am quite clear, and Mr Cordara did not disagree, that a banker (or indeed a typical individual with some familiarity with bank accounts – perhaps one of the many travellers on the modern version of the Clapham omnibus) would take the view that the accounts operated here are not current accounts, but loan accounts.

(2) I agree that some features of current accounts have changed considerably over the years. For example, the references to cheques and cheque guarantee cards in Andrew Smith J's description look largely out of date even a few years later, and it may be that cheque books are now not offered on some current accounts. But this goes to the means of access. I agree with Ms McCarthy that what is critical is functionality, not the means by which any particular function is achieved. In particular, the key functions of a current account include the ability not only to pay in and draw out funds by one or more methods, but also, and importantly, to pay third parties (again by one or more means) by drawing on funds or credit available. A typical current account may show either a debit or credit, or occasionally nil, balance, although the terms of some current accounts may well seek to prohibit debit balances for the customer. But subject to this a current account is not only a running account but one where the balance owing can vary from credit to debit. An important element of the functionality is that there is also a free ability on the part of the customer to vary the amount owed to it up and down. Although on some accounts there may be agreed limits such as a minimum balance, beyond that there will be no obligation to maintain or increase a credit balance. Similarly, and within any agreed overdraft limit, there will be no obligation for any overdraft to remain at a particular level.

(3) The loan accounts in this case do not have this functionality. I am prepared to accept for the purpose of argument that the loan accounts are running accounts and that set off operates in a similar way to a current account, although strictly these points would be determined by the all-important terms of the loan between Shawbrook and its borrowers (no samples of which were included in the documentary evidence), which might well have specific provisions regarding matters such as appropriation, for example that payments discharge charges or interest first. However, there is no ability to pay third parties. There is no general ability to draw out funds in any form or to go into credit. The only circumstance where this occurs is where an unauthorised overpayment is made. That is essentially a situation where a mistake has occurred, and that cannot affect the proper characterisation: unauthorised overpayments are not an economic purpose of the contract. Another aspect of this is that the customer has no general ability to pay into the account at will. Loans are generally for fixed periods with agreed repayment schedules, and early repayment charges apply for repayments above a certain level ([54] above). This is in marked contrast to any general understanding of a current account.

(4) Mr Cordara's approach would render the reference to deposit accounts in both the PVD and Item 8 otiose. Deposit accounts clearly satisfy Mr Cordara's suggested three criteria (see [89] above). But they do not have the functionality of current accounts, in particular the ability to pay third parties. They are also credit only accounts. (Some also of course have specific restrictions on access, albeit that this is not a defining feature and there is no reason why the terms of a deposit account may not permit it to be accessed without restriction. Others may have restrictions on the deposits that may be made, but again that is not a defining feature.) I note that Item 8 also refers to savings accounts, but HMRC's suggested explanation that this was included for the avoidance of doubt to cover deposit accounts with entities that are not strictly deposit takers, such as building societies, makes sense and in any event I would make the same comment about functionality in relation to anything that might be described as a savings account rather than deposit account.

(5) Whilst it is clear that the references to current and deposit accounts in Article 135(1)(d) need to be interpreted in their context (see for example *Expert Witness* at [19] and *SDC* at [22]), it does not follow that this means that they should be given a broad meaning, beyond what is required by a strict but fair interpretation.

(6) Mr Cordara's example of an offset mortgage account is not a matter for decision in this case. There was insufficient evidence available to determine whether HMRC are correct to suggest that such accounts operate by means of a current account linked to a separate mortgage account, but the point is not relevant. For what it is worth, I can see no difficulty in concluding that an arrangement under which the interest or other amounts payable under a mortgage may be reduced by credit balances in a current account does not prevent the current account operating as such, and being defined by reference to its functionality, in particular the ability to pay third parties and the ability to vary the balance, rather than simply make payments according to a fixed schedule.

(7) It is worth bearing in mind that lenders have another route to exemption, Article 135(1)(b) of the PVD and Items 2 and 2A of Group 5 of Schedule 9. The potential for a charge to VAT arises only in the context of outsourcing. It is not irrelevant to refer here to the description of the purpose of the exemption for financial transactions in *Velvet & Steel* (see [68] above). There will generally be no difficulty in ascertaining the level of VAT chargeable on a supply by a service provider.

(8) In summary, and using the concept of economic purpose referred to by Advocate General Tizzano in *Mirror Group* and *Cantor Fitzgerald* ([66] above), the economic purpose of a current account is to allow a customer to pay in varying amounts and to draw out amounts, including by payment to third parties. The economic purpose of the transaction between Shawbrook and its borrowers is quite different. That purpose is to lend a fixed amount on specified terms, including as to the rate of repayment and interest chargeable. Any additional advance is effectively dealt with as a

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

93. In reaching this conclusion I am conscious that in *FDR* the VAT and Duties Tribunal ((1999) VAT Decision 16040) concluded at paragraph [185] that credit card holders' accounts are current accounts within Article 13B(d)(3), commenting that debits and credits to those accounts are just as much transactions concerning current accounts as if the accounts were normal cheque accounts. The Tribunal reached the same conclusion as regards merchant accounts at paragraph [195]. The Court of Appeal found the point unnecessary to decide, although Laws LJ commented at [49] that he could see that "one might categorise the cardholder/merchant accounts as current accounts … with no great offence to linguistic usage". However, the VAT and Duties Tribunal decision is not binding on me, and Laws LJ's comments were not necessary for the decision. In any event, there are material distinctions between the accounts considered in *FDR* and the loan accounts in this case, in particular the obvious ability for a cardholder account to be used to make payments to third parties (normally the key function of the account) and the inherent ability for the balance on both types of accounts to vary regularly as transactions occur, effectively at the option of the cardholder or merchant, including in the case of the cardholder the flexibility within limits to choose how much to pay towards clearing the balance (or indeed going into credit).

The scope of the debt collection carve out

94. The question whether the debt collection carve out applies is key to this case. As made clear by *Axa* it qualifies not only the "transactions… concerning…payments, transfers, debts" exemptions under EU law but also Item 1 of Group 5 of Schedule 9.

95. In essence, Mr Cordara's submission is that *EDS* remains binding, and that the only difference between *EDS* and this case is that Target does not handle the initial advance, which he says is a very small part of the overall supply. HMRC disagrees and says that this distinction makes all the difference because the Court of Appeal treated the core supply as one concerning the making of loans.

96. Whilst I am clearly bound by *EDS* I am also bound by *Axa*, among other cases. In my view there are material differences between *EDS* and this case, which cannot simply be answered by (for example) pointing to the amount of time taken or effort required to make the initial advance as compared to the amount of time or effort required to administer loans thereafter.

97. It is important to focus on the very clear conclusion reached by the Court of Appeal at paragraph [136] of *EDS*, set out at paragraph [24] above. The services were described as "loan arrangement and execution services": the focus was clearly on the initial arrangements to put the loan in place. This is made even clearer by the description of the "core supply" or "specific essential function" as one of "administrative services in connection with ('concerning') the *making* of loans" (paragraph [136(2)], emphasis supplied).

98. It is also highly relevant that the basis for the exemption in *EDS* was "transactions… concerning…payments, transfers, debts". That must involve the supply being properly characterised as falling within this wording, on a strict but fair interpretation, as indeed made clear at paragraph [136(4)] in *EDS* where the making of payments and transfers is stated to be "absolutely central" to the core supply. The extent of the administrative services provided by EDS that went beyond this is irrelevant. The same applies in this case. However, Mr Cordara's submissions effectively amount to saying that whilst debt collection should be given a relatively narrow specific meaning, the "transactions… concerning…payments, transfers, debts" language should, with the support of *EDS* (among other cases) be given a broader meaning focusing on all aspects of the "end to end" administrative service supplied by Target. But that is the opposite of the correct approach to interpretation of both the exemption and the carve out. This is made clear in the CJEU decision in *Axa* at [25] and [30] (set out at paragraphs [18] and [19] above), where it is stated that the exemption must be construed strictly and the carve out broadly. This reflects the following summary in the earlier decision in *MKG*:

> "70. It is therefore necessary to view the final clause of Article 13B(d)(3) in its context and to interpret it in the light of the spirit of the provision in question and, more generally, of the scheme of the Sixth Directive.
>
> 71. As derogations from the general application of VAT, the exemptions envisaged in Article 13B(d)(3) of the Sixth Directive must be interpreted in a manner which limits their scope to what is strictly necessary for safeguarding the interests whose protection those derogations allow (see, to that effect, paragraph 63 of this judgment).
>
> 72. By contrast, as already stated in paragraph 58 of this judgment, exceptions to a rule derogating from the general application of VAT must be interpreted broadly."

99. Mr Cordara pointed to the Appendix to the Court of Appeal decision in *EDS*, which sets out extracts from the tribunal's decision in that case, and in particular paragraph [23] which describes the principal functions of EDS under the arrangements. Twelve items are set out, the first three of which relate to dealing with applications for loans, the fourth being the release of funds to the borrower and the remaining eight covering matters essentially corresponding to what Target does. However, only two of those relate directly to payments or transfers, item (5) being the collection of payments and item (6) being the collection of charges and fees. The remainder are other administrative functions, namely the calculation and application of interest, production of statements, closure of loans on repayment, maintenance of up-to-date borrower details, dealing with enquiries and complaints, and assisting the bank to define new loan structures or amend existing ones.

100. In my view the correct interpretation of *EDS* is that the focus in characterising the supply was on payments and transfers, and in particular on the making of loans. In the language used in more recent cases, services concerning payments or transfers were the predominant elements of the supply. The other administrative activities did not affect the characterisation of the supply, either because they were ancillary or because

it would be artificial to split them and treat them separately (the latter language is used in paragraph [136(3)], although the case predates *Levob* and other cases that develop that concept).

101. Likewise, and leaving to one side the current account issue, the availability of the exemption to Target relies on transactions concerning payments or transfers (or potentially debts) being the principal supply or the predominant element, or elements in combination, of the supply. Any other elements are irrelevant unless, on a proper interpretation, they affect the characterisation of the overall supply.

102. Mr Cordara placed significant reliance on the fact that Shawbrook is a financial institution and that Target is heavily involved in its core business, whereas in *Axa* Denplan had no involvement in the primary supply of dentistry and no relationship with dentists' clients except in relation to the payment arrangements. He also relied on the fact that the payments collected by Target include the repatriation of principal as well as consideration in the form of interest and charges, on Target's financial interest in maintaining loans in existence because it is remunerated on a per loan basis (in contrast to Denplan's fee structure which depended on the amount collected) and the fact that, rather than trying to run down the loan book as a conventional debt collector would, it is incentivised to do the opposite. The typical relationship with borrowers was a long term one and Mr Cordara submitted that it cannot be said that a long-term, multi-year, process amounts to debt collection.

103. It is difficult to see that any of these points make a difference to the potential application of the debt collection carve out. Once it is accepted, as it has to be in the light of *Axa*, that debt collection covers amounts as they fall due rather than simply amounts that are overdue, then it must follow that the payments or transfers processed by Target can be described as the collection of debts. This is the case whatever the length of the relationship and irrespective of the fact that Shawbrook is a financial institution. (The extent of Target's activities and involvement in Shawbrook's business is considered further in the following section, dealing with the correct description of the overall supply.) The principal amounts paid by borrowers are just as much debt as interest and charges, and indeed perhaps more obviously so given the nature of a lending transaction. Each such transaction is a financial transaction "designed to obtain payment of a pecuniary debt" (*MKG* at [78] and *Axa* CJEU at [31]), and it is irrelevant that the services are supplied when the debts concerned become due (*Axa* CJEU paragraph [34]). Similarly, it is difficult to see the relevance of the fee structure. As stated in *Axa* CJEU at [33], the service is "intended to obtain the payment of debts".

104. Whilst Target does process overpayments (that is, amounts not currently due for payment) these are either voluntary repayments of principal or amounts effectively paid by mistake. In the former case I think it would still be possible to say that all or part of the outstanding debt, being the principal owed, is being collected. A debt clearly exists even though it is not yet due for payment. The latter situation is not one which can affect the proper characterisation of what Target does, because the making of mistakes is clearly not the economic purpose of the arrangements.

105. Mr Cordara made a number of submissions about the adverse repercussions he said would follow from a finding that there was debt collection, including that half of all banking activities and transactions such as direct debit collection would be caught, with it being almost impossible to disentangle debt collection from other activities. Whilst not the subject matter of this case, I should make clear that I did not find these points persuasive. The collection of direct debits would doubtless generally occur in the course of operating current accounts. Other banking related supplies the economic purpose of which involves in part collecting payments and in part other transactions may very well not be characterised as debt collection. A good example of this is *FDR*. FDR dealt with both the making and receiving of payments, and operated netting off procedures, effectively acting as a clearing house. In that case the Court of Appeal approved the tribunal's conclusion as to the nature of the core supply, which was that the principal service provided was the processing of card transactions and settling liabilities and claims under those transactions (paragraph [163] of the tribunal decision, referred to at paragraph [60] of the Court of Appeal decision).

106. Mr Cordara also relied on Arden LJ's distinction between what Denplan did and "normal retail banking activities", at paragraph [51] of the Court of Appeal decision in *Axa* (see paragraph [20] above), referring to paragraph [24] to [27] of *Nordea Pankki* (set out at paragraph [15] above). Paragraph [27] of that decision states that nothing prevents services entrusted to operators external to financial institutions from being exempt.

107. I do not think this assists Mr Cordara, for the same reasons as discussed above. Normal retail banking transactions, including the sort of transactions discussed in *FDR*, will be exempt on their own terms because the overall supply is not properly characterised as one of debt collection.

108. It is also worth making a reference to *Velvet & Steel* here. The absence of any difficulty in calculating the tax base is relevant and does not assist Target. Fiscal neutrality is also not an issue. Although the addition of VAT may make the outsourcing of processes by financial institutions more expensive than it would otherwise be, that will be only one element of any decision whether to outsource on cost or other grounds. There is no question of similar supplies being treated differently for VAT purposes, because in the absence of outsourcing there is no comparable supply.

The appropriate description of the single supply

109. In order for the services supplied by Target to Shawbrook to qualify for exemption, Target must satisfy the Tribunal that the nature of the supply properly falls within Article 135(1)(d) or Item 1 of Group 5 of Schedule 9, and is not excluded from exemption by the debt collection carve out. That essentially depends on identifying the predominant element or elements, based on the contractual arrangements and economic realities, and doing so objectively. Other ways of expressing the test include identifying the core supply, the essential feature or main objective, or the economic purpose (see [81] above). The statement by Advocate General Tizzano referred to in *Tesco* (see [66] above) expressed economic purpose in the sense of the "cause" of the

contract, calculated to realise the parties' respective interests. Simplifying further this might be described as what, in essence, is being acquired: what is the typical consumer seeking to obtain or achieve? The importance of the contractual arrangements is underlined by a number of recent cases, including *HMRC v Airtours Holidays Transport Ltd* [2016] STC 1509 at [47] to [50] and earlier cases including *HMRC v Newey* (Case C-653/11) [2013] STC 2432 and *Secret Hotels2*, subject of course to the question whether those arrangements reflect the economic realities.

110. Overall in my view, the essence of what is being acquired, and the main objective, is the collection of debts as they fall due, in the form of principal, interest, and where relevant charges or fees. In the words of *MKG*, the transactions Target performs are designed to obtain payment of pecuniary debts. That is what the lender is seeking to achieve. In order to realise that objective a significant number of activities are required, including the creation and operation of accounts, the processing of payments, dealing with customers both immediately following the loan being made and where required at subsequent stages, the provision of statements, the implementation of procedures for dealing with arrears, and so on. However, I do not agree that the extent of these activities affects the predominant nature of the supply as one of debt collection. As made clear in *Mesto*, regard must be handed to the qualitative and not merely quantitative importance of the different elements (paragraph [30]). In any event, many of Target's activities can sensibly be regarded as part of a debt collection service, and in the case of processing payments and keeping accurate records which attribute payments to individual borrowers, are essential to any debt collection activity. The supply of services by Target to Shawbrook therefore falls within the debt collection carve out to Article 135(1)(d).

111. I consider that this conclusion is consistent with the contractual arrangements and the economic realities. The definition of Services refers to the operation of loan accounts, processing payments and administration of loans (see [34] above). The references to Services in the DoS are broadly consistent with this ([38] above). Processing payments is obviously at the core of a debt collection function. The operation of loan accounts, in the sense of an accurate record of the position as between the lender and borrower, is obviously essential to record amounts received and (if not done by the creditor) to determine what amounts are due and when. Accurate record-keeping is clearly an essential part of effective debt collection. Similarly, effective loan administration, including maintenance of accurate records of borrower details as well as dealing with matters such as arrears, can sensibly be described as an intrinsic part of a service the economic purpose of which is to collect the amounts due to Shawbrook. In any event, the operation of accounts and other administrative steps are effectively a means to an end: the economic reality is that what the lender is seeking to achieve is the collection of debts.

112. There is no need to decide, for the purposes of this decision, whether the single supply is a principal supply to which other elements are ancillary (*CPP*) or whether this is a case where the various elements of the supply are so closely linked as to form a single indivisible economic supply which it would be artificial to split (*Levob*). I do not think it matters. I can see that, from the starting point of first identifying elements that may fall within the "payments, transfers" wording in the exemption and then

identifying whether those elements predominate but amount to debt collection, a *CPP* approach might appear to make sense, under which other elements not directly related to payments or transfers are ancillary. But if you simply ask whether the appropriate description of the main objective or essential nature of the arrangements from the consumer's perspective fairly falls within the concept of debt collection, then a *Levob* approach can be justified, not least because certain aspects not directly related to payments or transfers (albeit potentially relating to "debts", as also referred to in Article 135(1)(d)) might still sensibly be regarded as part of an overall debt collection service. These might include calculation of amounts due, communications with debtors, including those in arrears, and maintenance of borrower details such as address and bank information.

113. It is also strictly unnecessary for me to decide whether Target's services to Shawbrook would be exempt under Article 135(1)(d) and Item 1 if I was wrong about my conclusion that what it does amounts to debt collection. However, in case of any appeal I should state that, consistently with *EDS*, I would have concluded that the exemption applies. This is on the basis that the predominant nature of the supply falls within "transactions…concerning…payments, transfers". In particular, I have concluded that both the operation of loan accounts and the processing of payments, including via the submission of direct debit instructions to BACS, fall within this concept (see paragraphs [84] and [87] above). These aspects can fairly be described as core elements of the supply. If the supply cannot accurately be described as debt collection, then its predominant nature concerns the collection and processing of payments from Shawbrook's borrowers, including accurate recording of amounts due and received in loan accounts, which result in changes in the legal and financial situation of the parties.

114. As already mentioned HMRC put forward an alternative submission that, if Target's contention that what it does is broader than debt collection is correct, then the proper description is management of credit. It is not necessary for me to address this but I will make some brief comments in case they are relevant to any appeal. I accept that *Abbey National plc v Customs and Excise Commissioners* provides some support for HMRC's submission that management may extend to administrative acts. That case related to the exemption for the management of special investment funds in Article 13B(d)(6) of the Sixth Directive, which was held to cover services performed by a third party administrator if, viewed broadly, they form a distinct whole and are specific to and essential for the management of the funds. However, the context is important and the Court reached this conclusion very much with the purpose of the exemption in mind, being to facilitate investment for small investors by means of collective investment undertakings and ensure that the choice between that type of investment and direct investment was fiscally neutral. The relevant Directive covering the regulation of special investment funds also included a non-exhaustive list of functions to be treated as included in the activity of management (*Abbey National* at paragraph [13]). As Mr Cordara pointed out, I also note that unlike Article 135(1)(d) management of special investment funds can occur without any change to the fund's legal and financial position (*ATP* at [69]). *ATP* also illustrates the potential for overlap between the different exemptions.

115. This case is different. The existing exemption for management of credit in Article 135(1)(b) is confined to management by the person granting it. Target accepts that it cannot rely on that exemption, and that its case stands or falls under Article 135(1)(d), not Article 135(1)(b). Whether what Target does amounts to management of credit is only relevant to Article 135(1)(d) to the extent that, in interpreting the existing exemptions, regard should be had to the fact that Article 135(1)(b) specifically exempts the management of credit by the person granting it, and the fact that the ability of Member States to exempt credit management by non-lenders was removed in 1991. (In this context it is worth noting that Article 28 of and Annex F to the Sixth Directive, which made this change, also withdrew the ability of Member States to exempt debt collection from the same date.)

116. I accept HMRC's submission that, if there was otherwise doubt about the correct scope of Article 135(1)(d), the fact that management of credit by non-lenders has been specifically withdrawn from exemption would be of some relevance. Exemptions clearly need to be interpreted in the light of their context and the aims and scheme of the directive: see for example *Abbey National* at [59] and *EDS* at [126]. However, in principle exemptions are independent concepts (*SUFA* at paragraph [11]) and overlap between exemptions is possible (*ATP*). I do not accept that it is appropriate in a case like this to analyse in detail whether by analogy with *Abbey National* "management" of credit includes administrative activities, or whether the carefully prescribed activities that Target carries on, and the limited decision-making authority it is given, are such that what it supplies cannot be described as management. The reality is that there is no exemption either for management of credit by a non-lender, or for other loan administration services, unless what is done falls within Article 135(1)(d). The focus must be on that provision. Otherwise there is a risk of needless complexity, as cautioned against by Laws LJ in *FDR* at [54].

Conclusion and disposition

117. I have concluded that the loan administration services supplied by Target to Shawbrook fall within the debt collection carve out to Article 135(1)(d), and accordingly are not exempt. The appeal is therefore dismissed.

118. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SARAH FALK
TRIBUNAL JUDGE

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