[2019] UKFTT 548 (TC)

TC07342

VAT – exempt supply of payment services – whether services supplied to other party to contract for services - whether contractual terms reflect economic reality of transactions - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2015/06277

BETWEEN

AMERICAN EXPRESS SERVICES EUROPE LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE GREG SINFIELD
MRS JANET WILKINS

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 4 – 7 and 10 December 2018

Roderick Cordara QC and Andrew Legg, counsel, instructed by Ernst & Young LLP, for the Appellant

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

DECISION

INTRODUCTION

1. The Appellant ('AESEL') is part of the American Express corporate group ('Amex Group'). AESEL is a card issuer, ie an entity that issues American Express cards to persons ('cardmembers') who use them as a form of payment for goods and services subject to terms and conditions of use. In that role, AESEL made supplies of payment services. There was no dispute that AESEL supplied the payment services to another member of the Amex Group but the parties disagreed about which one of two other members of the Amex Group received the services supplied by AESEL.

2. AESEL considered that it supplied the payment services to American Express Travel Related Services Company, Inc ('TRSCo') which is established outside the European Union ('EU'). Accordingly, AESEL made claims for input tax credit in VAT accounting periods from December 2010 to December 2014. The amount of VAT in dispute is £57,633,216.

3. In a decision dated 9 September 2015, the Respondents ('HMRC') took the view that AESEL made its supplies of payment services to American Express Payment Services Limited ('AEPSL') which, it was agreed, is established in the EU. Accordingly, HMRC refused AESEL's claim. AESEL now appeals against that decision.

COMMON GROUND

4. It was common ground that AESEL made supplies of payment services which were exempt under Article 135(1)(d) of Council Directive 2006/112/EC (the 'Principal VAT Directive' or 'PVD'), which exempts, among other things, transactions concerning payments and transfers, in return for consideration. The consideration for those supplies was the 'Issuer's Rate' (also referred to within the Amex Group as the 'billing credit').

5. It was also common ground that, during the material time, AEPSL was established inside the EU and TRSCo was established outside the EU. The significance of the place of establishment of AEPSL and TRSCo is that if AESEL supplied the payment services to a customer established outside the EU then AESEL was entitled, under Article 169(c) PVD, to credit for the input tax incurred on goods and services that were attributable to those supplies. However, if AESEL's services were supplied to a person established in the EU then AESEL was not entitled to credit for such input tax.

THE ISSUE

6. The only issue in this appeal is whether AESEL supplied the payment services to TRSCo or to AEPSL.

7. For reasons set out below, we have concluded that the payment services were supplied to TRSCo and, accordingly, AESEL's appeal is allowed.

APPROACH TO IDENTIFYING WHO RECEIVED A SUPPLY FOR VAT PURPOSES

8. There is no guidance in the Principal VAT Directive or the Value Added Tax Act 1994 on how to determine who is the recipient of a supply. This may seem surprising when the issue of whether goods or services have been supplied to a particular person (or a person with particular characteristics) can be fundamental to the correct functioning of the VAT system. Where there is more than one potential recipient, such as in the case of tripartite or multi-party contracts, identifying who has been supplied may determine whether VAT is deductible or whether it is chargeable in the first place. Deciding who has received a supply is particularly problematic in the case of services because their intangible nature can make it difficult to identify to whom they are supplied where there a number of possible recipients.

9. The importance of the issue of who has received a supply and the difficulties to which it gives rise have, unsurprisingly, led to a lot of litigation. Courts in the United Kingdom and Luxembourg have had to consider who received a supply on several occasions. Both parties referred to the following cases:

(1) *HMRC v Loyalty Management UK Ltd, Baxi Group Ltd v HMRC* Joined cases C-53/09 and C-55/09, [2010] STC 2651 ('*LMUK CJEU*')

(2) *HMRC v Loyalty Management UK Ltd* [2013] UKSC, [2013] STC 784 ('*LMUK SC*')

(3) *WHA Ltd v HMRC* [2013] UKSC, [2013] STC 943, UKSC ('*WHA*')

(4) *HMRC v Newey* Case C-653/11, [2013] STC 2432 ('*Newey CJEU'*)

(5) *Secret Hotels2 Ltd v HMRC* [2014] UKSC, [2014] STC 937 ('*SH2*')

(6) *HMRC v Airtours Holidays Transport Ltd* [2016] UKSC [2016] STC 1509 ('*Airtours*')

(7) *U-Drive Ltd v HMRC* [2017] UKUT 112 (TCC), [2017] STC 806, ('*U-Drive*')

(8) *Adecco UK Ltd v HMRC* [2017] UKUT 113 (TCC), [2017] STC 787 ('*Adecco UT'*), confirmed on appeal [2018] EWCA Civ 1794, [2018] STC 1722 ('*Adecco CA'*)

10. In *Adecco UT* at [36], the Upper Tribunal expressed the view that "… it is not necessary to subject earlier authorities …to detailed examination when that task has already been so clearly and comprehensively carried out by Lord Neuberger [in *Airtours*]." Both parties referred us to what Lord Neuberger said at [47] of *Airtours*:

> "… in the subsequent case of [*WHA*] where at para 27, Lord Reed said that "[t]he contractual position is not conclusive of the taxable supplies being made as between the various participants in these arrangements, but it is the most useful starting point". He then went on in paras 30 to 38 to analyse the series of transactions, and in para 39, he explained that the tribunal had concluded that "the reality is quite different" from that which the contractual documentation suggested. Effectively, Lord Reed agreed with this, and assessed the VAT consequences by reference to the reality. In other words, as I said in [*SH2*], para 35, when assessing the VAT consequences of a particular contractual arrangement, the court should, at least normally, characterise the relationships by reference to the contracts and then consider whether that characterisation is vitiated by [any relevant] facts."

11. At [43] of *Adecco UT*, the Upper Tribunal observed that "…it is clear from *Airtours* that determining the nature of a supply and who is making and receiving it is a two-stage process". The UT explained:

> "The starting point is to consider the contractual position and then consider whether the contractual analysis reflects the economic reality of the transaction. If, as a matter of contract, a party undertakes to provide services to another person in return for consideration from the other or a third party then there is, subject to the question of economic reality, a supply to the other person for VAT purposes. If the person who provides the consideration is not entitled under the contractual documentation to receive any services from the supplier then, unless the documentation does not reflect the economic reality, there is no supply to the payer. The contractual position normally reflects the economic reality of the transactions but will not do so where, in particular, the contractual terms constitute a purely artificial arrangement."

12. The Upper Tribunal's description of the proper approach was cited without criticism by the Court of Appeal in *Adecco CA* at [35] which upheld the conclusion of the Upper Tribunal. Both Mr Cordara, who appeared with Mr Legg for AESEL, and Mr Mantle, who appeared for HMRC, accepted that, as indicated by *Airtours* and *Adecco CA*, determining who makes and receives a supply is a two-stage process which starts with consideration of the contractual position and then looks at whether that is consistent with the economic and commercial reality of the transactions.

EVIDENCE

13. AESEL served statements from six witnesses who described various aspects of the Amex Group business and produced contractual and related documents which we refer to below. HMRC did not produce any witness evidence. Four of the witnesses for AESEL gave evidence at the hearing as follows:

(1) Christophe Le Caillec was executive vice-president and chief financial officer of Global Consumer Services Group at American Express, based in New York. With one or two minor corrections, he confirmed the witness statement of Paul Hough, the executive vice-president and deputy Chief Financial Officer for American Express who had retired since giving his witness statement. Mr Le Caillec's evidence described the structure and an overview of the American Express business as it relates to the card transactions, their contractual arrangements and implementation.

(2) John Koslow was vice-president of Global Treasury Operations at American Express, based in New York. He gave evidence about the Treasury functions relevant to AESEL's business and the payment and settlement of card transactions. He also explained policies affecting the intercompany funding arrangements.

(3) James Sherrell, who was the Financial Controller for several American Express entities in the UK, including AESEL, but by the time of the hearing had become part of the global accounting policy and advisory team in American Express. His evidence concerned how payments were made and accounted for between AESEL and TRSCo and how AESEL made cash advances to AEPSL.

(4) Jonathan Hipkin was the Financial Controller overseeing the Global Network Services and International Insurance Services businesses. His evidence related to the role of AEPSL in the card business and its relationship with TRSCo.

14. At the hearing, the witnesses' statements stood as their evidence in chief and they answered questions put by Mr Mantle in cross-examination. We found all the witnesses who gave evidence for AESEL to be credible and fully accept their evidence which we have taken into account in our description of the activities of AESEL, TRSCo and AEPSL below.

15. For completeness, we note that two witness statements were provided by Ruth Felsing, the Global Head of Indirect Tax at American Express. In so far as it did not cover matters dealt with by other witnesses, Ms Felsing's evidence dealt mainly with matters relating to a judicial review application which are not relevant to this appeal. At the hearing both Mr Cordara and Mr Mantle, who appeared for HMRC, agreed that Ms Felsing's evidence did not take matters any further and she was not called. Accordingly, we have not had regard to her witness statements in this decision.

FACTS

16. There was no agreed statement of facts in this case but the material facts were largely undisputed. Based on the witness and other evidence, we find the facts to be as set out below.

Relevant Amex Group entities and their roles

17. AESEL is a member of the Amex Group based in the UK. As a card issuer, AESEL issues cards to new and existing users of American Express cards (referred to in the American Express documentation as cardmembers) in the UK and the majority of countries in Europe, the Middle East and Africa ('EMEA'). The cards issued by AESEL are charge cards, credit cards and prepaid cards. Although there are clear differences between charge cards, credit cards and prepaid cards both for the cardmember and for AESEL, these differences are not material to the issues in this appeal and, in this decision, we simply refer to 'cards'. The use of a card by a cardmember in the course of making a purchase from a merchant initiates a series of obligations and events (explained further below). The cardmember becomes liable to pay AESEL the amount charged to the card by the merchant when the cardmember purchased the goods or services. AESEL becomes liable to pay the amount charged to the card in relation to the transaction to the merchant but, importantly for the purposes of this appeal, not directly to the merchant. AESEL makes the payment through other members of the Amex Group. In exchange for making the payment, AESEL charges a fee known as the 'billing credit' (also referred to in the contractual documents as the 'issuer's rate').

18. AEPSL is a member of the Amex Group based in the UK. It is a merchant acquirer. As an acquirer, AEPSL enters into agreements with merchants who accept or agree to accept American Express cards as payment for goods or services. AEPSL is the only acquirer of American Express card transactions in the UK and also acts as acquirer in most of Europe (in some jurisdictions, there are third party acquirers). There are non-EU established acquirers for merchants outside EMEA. Under the agreement, when a merchant accepts a card as payment for the supply of goods or services, AEPSL becomes obliged to pay the amount of the transaction to the merchant in consideration for a fee payable by the merchant (referred to in American Express as the discount revenue) which is set-off. In turn, AEPSL has a right to receive a payment from TRSCo equal to the amount that the cardmember has spent with the merchant.

19. TRSCo (referred to in American Express as the network operator) is incorporated and established in the USA. TRSCo is the main operating entity within the Amex Group. TRSCo owns the key trademarks and other IP that are required to conduct the card business. It also owns the great majority of the systems infrastructure and employs or procures the services of the people necessary to maintain the systems. TRSCo has agreements with issuers and acquirers (except in the US where TRSCo is itself both issuer and acquirer in relation to some transactions). Issuers agree to make payments to TRSCo (in return for payment of a fee by TRSCo) and TRSCo agrees to pay the acquirers (in return for payment of a fee to TRSCo). TRSCo acts as settlement counterparty for all transactions on its network, whether entered into by American Express entities or third parties.

20. American Express Europe Limited ('AEEL') was formerly an acquirer in EMEA but, during the period under consideration in this appeal, it provided a clearing house service where payments are made and received in different currencies. Under the Master Intercompany Balance Agreement ('MIBA'), which is discussed further below, AEEL is a conduit for TRSCo in respect of such card transaction payments. For example, where an AESEL cardmember uses the card in a non-UK merchant which operates in a currency other than sterling, eg US dollars, AEEL (possibly with another entity, American Express Exposure Management Limited) will procure the dollars necessary to pay the merchant. AESEL pays the equivalent amount in sterling to AEEL. In this situation, AESEL does not make a direct payment to the non-UK acquirer. AEEL's role is a treasury function and a subdivision of AEEL is called the EMEA Treasury Division. AEEL also pays amounts to AESEL in relation to amounts charged to cards issued by third party issuers and on non-UK cards used in the UK. Mr Sherrell's evidence was

that everything flows through intercompany accounts so that the outstanding position at the end of every month can be seen. For example, cash advanced from AESEL to AEPSL is recorded through intercompany accounts in AEEL, as a conduit of TRSCo, and vice versa. Mr Cordara submitted that AEEL's involvement was a detail which we did not need to worry too much about and did not affect the analysis of the supplies by AESEL under consideration in this appeal. We understood Mr Mantle to take the same view.

Relevant contracts

21. Both parties focused on the Card Issuer Agreement between AESEL and TRSCo under which AESEL contracted to supply the payment services, during the relevant period. Mr Mantle described it as the most relevant contract whereas Mr Cordara said that it was the only relevant contract. Other contracts were, however, made available to us and were the subject of submissions.

Card Issuer Agreement

22. Under the Card Issuer Agreement, which was effective from 1 January 2005, TRSCo authorised AESEL to engage in the "Card Issuing Business" in several EMEA markets. In Attachment 1 to the Card Issuer Agreement, 'Card Issuing Business' is defined as meaning:

> "… the business engaged in by an Issuer whereby the Issuer (i) issues Cards to its Cardmembers pursuant to an agreement with the Cardmember, (ii) authorizes its Cardmembers to charge purchases of goods and services by means of the Card at Service Establishments, (iii) accepts and settles Charges transacted by its Cardmembers, which have been captured and processed by an Acquirer, (iv) either by itself or through a certified processor, renders at least monthly statements of account to its Cardmembers, and (v) renders related services to Cardmembers."

23. All capitalised terms in the Card Issuer Agreement are defined in Attachment 1 to the agreement. "Acquirer" is defined as follows

> "Acquirer means an Amex Entity or any Person authorized by an Amex Entity to enter into a contract with a S/E [service establishment or merchant] pursuant to which (i) a Cardmember is entitled to charge purchases of goods or services at such S/E by means of a Card and (ii) the S/E agrees to transfer such Charges to such Person or its designee."

24. "Amex Entity" is defined to encompass TRSCo and "any Person controlling, controlled by or under common control with [TRSCO]…". It was AESEL's position that the term "Acquirer" in the Card Issuer Agreement was clearly not restricted to AEPSL.

25. 'Charge' means "the total price… for purchase of goods or services at a S/E …" made by a Cardmember using his card.

26. S/E (or 'Service Establishment') meant a merchant and is defined as:

> "… any Person that has entered into a contract with an Acquirer wherein such Person agrees (i) to permit any Cardmember to charge purchases of goods and services at or with such S/E and (ii) to transfer such Charges to an Acquirer."

27. Both parties identified Article 7 of the Card Issuer Agreement as the key clause in this appeal. Article 7.01 and 7.02 are as follows:

> "Settlement of Charges, Credits and Chargebacks between Acquirers and AESEL; Issuers Rates
>
> 7.01 Presentment and Acceptance of Charges; Issuer's Rates

> All charges of AESEL Cardmembers shall, after acceptance of the Charges by [TRSCo] or its designee, be cleared for and presented by [TRSCo] (on behalf of the Acquirer) to, and accepted by, AESEL without recourse to [TRSCo], other Amex Entities or other Acquirers except in accordance with the Chargeback policy, at a price equal to the face amount thereof less the applicable Issuer's Rate which is set out in Exhibit B (plus, in the case of Charges incurred in a foreign currency, a Currency Conversion Factor in an amount notified by [TRSCo] to AESEL.
>
> 7.02 Issuer's Rates Subject to Change
>
> The Issuer's Rates set forth in Exhibit B are based, among other things, on Amex Entities' current Merchant Discount policy, on assumptions concerning the cost of handling AESEL cardmembers' transactions, on AESEL cardmember projected and actual spending patterns and on certain regional costs incurred by the UK branch of AESEL and may be adjusted by [TRSCo] at any time with adequate notice to AESEL."

28. By a side letter agreement dated 14 December 2010, TRSCo agreed with AESEL that TRSCo would "continue to pay AESEL an issuer's rate of 1.56% of the AESEL consolidated Cardmember Billings." The amount equal to the issuer's rate is the billing credit and is deducted from the Charges payable by AESEL to TRSCo.

29. Article 7.03 requires AESEL to remit payment for the Charges to TRSCo or its designee. It specifies the time when payment should be made. Where a Charge is presented to AESEL before 12 noon then AESEL must pay the debit notification on the same day or, if it is not a business day, before 12 noon on the next business day. Where the Charge is presented to AESEL after 12 noon, then ASEL must pay the debit notification before 12 noon on the next business day.

30. Under clause 11.04, the Card Issuer Agreement is governed by the laws of the State of New York but neither party suggested that anything turned on this.

31. The Card Issuer Agreement also contains a 'No Agency' clause. Article 11.09 states:

> "No agency. [TRSCo] and AESEL agree that in performing their obligations pursuant to this Agreement they are in the position of independent contractors. This Agreement is not intended to create, nor does it create and shall not be construed to create, a relationship of partners or joint venturers between [TRSCo] and AESEL."

32. Mr Mantle submitted that it was clear that Article 11.09, the 'No Agency' clause, is only concerned with the relationship between TRSCo and AESEL, not with any relationship between either of them and AEPSL. We did not understand Mr Cordara to disagree with that proposition.

33. Article 11.10 states that the headings in the Card Issuer Agreement are for convenience of reference only and, in the event of any conflict between the heading and the text of the Agreement, the text shall prevail.

Licence Agreement

34. The Licence Agreement, made between AEPSL and TRSCo and dated 1 October 2007, governs AEPSL's role as an acquirer. It was amended, by a side letter, between TRSCo and AEPSL, dated 30 October 2009. As amended, it provides as follows.

35. By Article 2, TRSCo authorises AEPSL to enter into S/E agreements with merchants.

36. Article 3.1 provides:

> "All Charges incurred by all Cardmembers at AEPSL S/E's and purchased by AEPSL in accordance with Article 7 below, shall be sold by AEPSL and purchased by TRSCo at a price equal to the face value of the Charge less one and nine tenth percent (1.9%). This is effective from 1st November 2009. All sales of Charges shall be without recourse, except as provided herein."

37. Article 4 provides for the settlement of the Charges. Article 4.1 states:

> "AEPSL shall remit to TRSCo generally on a daily basis unless mutually agreed all charges required to be purchased and sold pursuant to Article 3 hereof."

38. Article 4.4 states that any transfer of funds necessary to carry out the provisions of Article 4 would be made pursuant to "procedures agreed on by the parties."

39. Article 7.1 states:

> "AEPSL shall purchase all charges made by cardmembers on any card and submitted to AEPSL by AEPSL S/E's and shall pay for such charges in accordance with the schedule of payments set forth in the agreements with such service establishments."

Business Operating Procedures

40. The Card Issuer Agreement between AESEL and TRSCo defines the "Agreement" between them as including "the Manuals", which is a reference to the Amex Group's Business Operating Procedures (the 'BOP'), and thereby gives it binding status. The BOP is also incorporated into the Licence Agreement between TRSCo and AEPSL via reference to "Operating Policies and Procedures" which must be complied with for settlement to take place.

41. The BOP frequently refers to AEGNS which stands for American Express Global Network Services, a "business unit" within TRSCO and thus where the BOP says "AEGNS", it can be read as TRSCo.

42. The BOP essentially establishes the network rules by which charges are cleared and settled in the system between issuers and acquirers. In the Introduction to the BOP in paragraph 1.6 and Figure 1.1 at page 10, it states that: "the terms under which Transactions are settled are set out separately in bilateral agreements between each Participant [i.e. acquirer or issuer] and [TRSCo]".

43. Chapter 1, paragraph 1.5 describes the network operator type services provided by TRSCo. Paragraph 1.6 and Figure 1.1 explain the "Transaction Life Cycle". The introduction at paragraph 2.1 makes clear that it sets out both "Acquirer-specific policies and rules" and "Issuer-specific policies and rules".

44. Chapter 5 of the BOP is headed "Authorizations". Paragraph 5.3 describes the authorisation services provided by TRSCo. Paragraph 5.4 states "[AESEL] accepts responsibility and liability for all transactions within its licensed BIN range that are authorized as follows…". By paragraph 5.8, the network operator can give stand-in authorizations when [AESEL] is unable to respond to an authorization request due to downtime.

45. The relevant chapter in the BOP dealing with the clearing and settlement of charges within the payment network is Chapter 6. It refers to "Participants" who are defined in the BOP in Table 14.1 as "an entity which is an issuer or an acquirer or both".

46. Paragraph 6.1 states that "For each Participant, the terms under which Transactions are settled are set out separately in agreements between each Participant and [TRSCo]".

47. Paragraph 6.2 gives an overview of the Amex Group clearing and settlement system and confirms that "all transactions that are submitted by Participants must flow through the Network clearing process". Paragraph 6.2 provides:

> "Settlement and Funds Exchange are the financial processes of computing Settlement totals and moving funds between Participants based on the Transactions cleared for the Settlement period … The Network applies the fees associated with Acquirer's Rate/Issuer's Rate/Network Rate and the foreign exchange to arrive at a Settlement position for each Participant. If funds are due to the Participant, the Network sends payment instructions to the Network's Settlement Bank instructing it to transfer the Settlement amount to the Participant's Settlement account. If funds are due to the Network, the Network sends payment instructions to each Participant's designated Settlement Bank or authorized agent instructing them to transfer the Settlement amount to the Network's Settlement Bank account".

48. Paragraph 6.3.1 makes clear that "all transactions on an Issuer's card shall, after acceptance by [TRSCo] or its designee, be cleared and presented by [TRSCo] to, and accepted by, [AESEL] without recourse to American Express, American Express Entities or any Acquirer." Paragraph 6.3.2 states that "a single Settlement process will occur each Settlement Day between [TRSCo] and Participants".

49. "Settlement" is described in paragraph 6.4 as "the process by which the Network computes and advises Participants of the net totals that will be used for Funds Exchange" and "Funds Exchange" is "… the process by which Participants transfer funds based on the net value of the financial Transactions cleared for a given day or period."

50. Paragraph 6.4.2 states that "Any fees associated with the funds transfer (for example, bank charges) are the responsibility of the Participant." Paragraph 6.4.2.3 provides that if a transaction is in a foreign currency or in a country other than that where the card was issued, "[TRSCo] reserves the right to add a Foreign Currency Factor and/or a Foreign Transaction Factor, respectively, for the benefit of [TRSCo] into the value of the final Settlement Amount".

51. Paragraph 6.4.2.3.1 provides that foreign exchange gain or loss is the responsibility of TRSCo and that acquirers will receive funds in the currency in which the Charge was originally presented.

52. Paragraph 6.4.3.3 provides that TRSCo will be liable to pay compensation to a Participant [ie usually an acquirer] in a net credit position if TRSCo is late making payment. Paragraph 6.4.3.4 provides that TRSCo shall not have any liability to any Participant [ie an issuer or an acquirer] for any loss, cost or other damage arising out of the Settlement program. Paragraph 6.4.3.6 provides that a Participant that does not transfer the right amount to TRSCo will be liable to pay compensation to TRSCo. Mr Hough's evidence was that such compensation is retained by TRSCo and is not paid to issuers or acquirers.

53. We consider that the BOP is part of the contractual matrix by which the parties conduct the American Express card business and, in particular, the network. However, the BOP is not itself a contract but is designed to reflect and implement the contracts between the American Express entities. The BOP is an operating manual and should be construed as such. It is a document written by the business for those companies that use and operate the network, eg TRSCo, AESEL and AEPSL, and is intended to describe proper operating business practices.

Master Intercompany Balance Agreement

54. The MIBA is an agreement, dated 1 November 2009, which governs loans and advances by various Amex group companies between each other. Inter-company balances that arise between Amex group companies are subject to the MIBA unless special arrangements apply.

Mr Koslow's evidence was that the MIBA, implementing Amex Group Funding Policy in terms of intercompany funding, set out the basis for and the terms of loans made by AESEL when it made advances of funds to AEPSL, including payment of interest. Such advances were used by AEPSL to provide it with cash to meet its obligations to pay amounts due to merchants and its staff their wages.

55. Clause 2 of the MIBA states:

> "2.1 Each I/C Balance owing from a Payer to a Payee under [sic] shall be deemed to be owing under, and subject to the terms and conditions of, this Agreement.
>
> 2.2 There are no conditions precedent or other formalities required for the creation of an I/C Balance.
>
> 2.3 I/C Balances may exist in any currency."

56. Clause 4 of the MIBA provides for the payment of interest. Clause 6 provides that AEEL acts as the agent of the parties to the MIBA in the administration of the facility under the agreement. Both AESEL and AEPSL are parties to the MIBA as is AEEL acting through its EMEA treasury division. TRSCo is not a party to the MIBA.

Description of a typical card transaction

57. In his witness statement, Mr Hough described what happens in a typical card transaction by reference to a sequence of separate steps. That evidence was not challenged and we accept it. The steps set out below are taken from Mr Hough's witness statement and other evidence adapted to refer to the relevant Amex Group entities.

(1) A cardmember who wishes to pay for goods or services presents a card to the merchant by way of payment. The cardmember's data is entered into the merchant's payment system using a point-of-sale (POS) terminal/software or an e-commerce website.

(2) The card and transaction data are sent electronically by the POS terminal to the acquirer, ie AEPSL in this case, which passes the data through the payments system for processing.

(3) AEPSL sends the data to the payment card network operator, ie TRSCo, which forwards it to the issuer, which for the purposes of this appeal is AESEL, for authorisation.

(4) TRSCo's systems carry out the authorisation process according to pre-set criteria and then send the relevant data back to the issuer, AESEL, and acquirer, AEPSL.

(5) AESEL checks that the card is legitimate, has not been reported lost or stolen and that the account has the appropriate amount of credit/funds available to pay for the transaction.

(6) Once the checks have been carried out satisfactorily, AESEL generates an authorisation code and sends it to TRSCo. By sending the authorisation code, AESEL confirms that it will fund the cardmember's purchase provided the merchant and AEPSL follow the card scheme rules.

(7) TRSCo sends the authorisation code to AEPSL.

(8) AEPSL sends the authorisation code to the merchant.

(9) The merchant concludes the transaction with the cardmember.

(10) The merchant's POS system sends the data for the completed transaction to AEPSL.

(11) AEPSL forwards the transaction data to TRSCo.

(12) TRSCo forwards the transaction data to AESEL which updates the cardmember's account with the amount of the purchase.

(13) AESEL pays an amount equal to the cardmember's expenditure to, or to the order of, TRSCo and, in return, receives a fee (the billing credit).

(14) TRSCo pays or credits an amount equal to the cardmember's expenditure to AEPSL and, in return, receives a fee (referred to by American Express as the billing debit).

(15) AEPSL pays an amount equal to the cardmember's expenditure to the merchant and, in return, is paid a fee by the merchant.

(16) AESEL sends a monthly statement to the cardmember which includes all expenditure plus any fee and/or interest chargeable for the relevant month.

(17) The cardmember pays the amount shown as payable on the monthly statement to AESEL.

58. Steps (1) to (12) always happen in the order set out above. Mr Hough said that steps (13) to (17) always take place after step (12) but may happen in a different order and independently of each other. Further, the description above assumes that the acquirer is AEPSL. However, many of AESEL's cardmembers use their cards for overseas transactions in which AEPSL does not act as acquirer. In such cases, AESEL makes payments to TRSCO via AEEL.

Settlement of charges and inter-company payments

59. In his witness statement, Mr Koslow described how the obligations of AESEL and TRSCo to pay the Charges are settled by accounting entries which create or amend the inter-company balances thereby creating receivables payable to the appropriate entity. Mr Koslow illustrated the position by assuming that the inter-company balances between AESEL, TRSCo and AEPSL all started at zero and there was a single card transaction in the relevant period for £100 in an AEPSL merchant which paid a fee of 3% to AEPSL. The various accounting entries resulted in:

(1) AESEL owing TRSCo £98.44 (the £100 spend net of the billing credit of £1.56); and

(2) TRSCo owing AEPSL £98.10 (the £100 spend net of the billing debit of £1.90).

AEPSL also owes the merchant £97 (the £100 spend net of the 3% fee). In terms of consideration charged and retained: AEPSL charges the merchant £3 and retains £1.10 after paying the billing debit to TRSCo; TRSCo charges AEPSL £1.90 and retains £0.34 after paying the billing credit to AESEL; and AESEL charges and retains the billing credit of £1.56.

60. Mr Koslow explained that AEPSL is entitled to payment of the £98.10 from TRSCo at any time. TRSCo does not have a sterling bank account or any funds in the UK and to demand payment from TRSCo would run counter to the American Express Cash Management Policy. AEPSL is therefore provided with funds by AESEL making advances of the amounts to AEPSL. In the example given above, AESEL transfers cash of £97 to AEPSL just in time for it to make payment to the merchant. From an American Express Treasury perspective, the movements of cash from AESEL to AEPSL to pay merchants on a just in time basis are no different than the movements of cash from AESEL to AEPSL to meet its wage bill (which it also did).

61. In cross-examination, Mr Koslow was asked why AEPSL would want to borrow that money rather than be paid what it was owed under the Licence Agreement. Mr Koslow's evidence was that AESEL is the primary (but not the only) source of funding for American Express within the UK. Since AESEL had sterling and AEPSL required sterling but TRSCo did not have any sterling or maintain any sterling bank accounts related to the card business. Mr Koslow explained that making the payments in sterling via TRSCo would require a restructuring. It would require a movement of money from AESEL to TRSCo, with the sterling being converted into dollars and then another foreign exchange transaction when TRSCo converted those dollars back to sterling in order to transfer the sterling to AEPSL. Mr Koslow said that it would be inefficient and higher risk which is why it was not the methodology that the Amex Group used, from a liquidity management perspective, to ensure that AEPSL has the funds it needs to meet its obligations as they become due.

Historical treatment of payment services

62. In his skeleton and submissions, Mr Cordara described the previous arrangements under which payment services were provided, HMRC's previous ruling issued in 2000 and 2001 on the VAT treatment of the payment services and the procedural background to the present appeal. Mr Cordara did not rely on HMRC's previous ruling in the appeal but urged us to take account of the past matters as showing the complete continuity of the way that the Amex Group conducted its business and, specifically, in relation to the role of TRSCo.

63. We do not consider that the historical treatment of the payment services assists us in this case. This appeal is concerned with whether AESEL supplied payment services to TRSCo or to AEPSL during VAT accounting periods from December 2010 to December 2014. The only relevant contracts are those that were in force during that period. Mr Mantle submitted, correctly in our view, that the answer to the question in this appeal must be the same whether the previous ruling given by HMRC was right or wrong. Accordingly, we have not taken the previous contractual arrangements or HMRC's previous ruling into account in this decision.

CONTRACTUAL POSITION

64. The parties differed in their analysis of the relevant contracts and reached different conclusions about which entity, AEPSL or TRSCo, received the supplies of payment services made by AESEL having regard solely to the terms of the contracts.

Submissions

65. In summary, Mr Cordara submitted that the Card Issuer Agreement was the only relevant contract. The only other party to the Card Issuer Agreement was TRSCo. Under that contract, AESEL supplied payment services and received the billing credit in consideration for that supply. Mr Cordara contended that there could not be any doubt that the correct contractual position was that AESEL made supplies of payment services to TRSCo which paid AESEL for those services.

66. Mr Cordara submitted that there was no basis on which to conclude that AESEL's services were provided to anyone other than TRSCO. AESEL had always provided these services (and accounted for VAT accordingly) to its contractual counterparty TRSCO, which is the American Express network operator located in the United States of America. TRSCO is the only network operator for the global American Express business, which enables customers to use their cards around the world in a commercially efficient manner. TRSCO also owns the global brand. Mr Cordara submitted that it made sense, that AESEL, as one of a handful of Amex Group issuers around the world, would interact in this manner with TRSCO, which is the global hub and sits at the centre of the Amex Group web. AESEL contended that HMRC's analysis disregarded the structure of the American Express business, its commercial practice and the relevant contractual, accounting and payment arrangements. AESEL submitted that

HMRC's analysis rewrote the commercial reality represented by the global business structure of American Express.

67. In summary, HMRC's position was that the Licence Agreement between AEPSL and TRSCo and the BOP were all relevant. Under both the Card Issuer Agreement and the Licence Agreement, AESEL, TRSCo and AEPSL are required to follow the procedures established by the BOP. HMRC's case was that whether the Card Issuer Agreement was considered alone or in the context of the other contractual documents, AESEL supplied the payment services to AEPSL.

68. Mr Mantle submitted (and we did not understand Mr Cordara to disagree) that the core aspects of the payment services supplied by AESEL are, first, that AESEL must make payments of money (remittances) and do so within a matter of hours of a valid demand for payment. The second is that AESEL must make those payments (and make them in the specified timeframes) regardless of when, or whether (unless AESEL is entitled to a Chargeback), AESEL's cardholder pays AESEL in respect of his/her purchase made using the card. The payment services are thus akin to the service labelled by the CJEU as "that of guaranteeing payment for goods purchased by means of a card" in [9] of *Chaussures Bally v Belgium* (Case C-18/92) [1997] STC 209 ('*Bally*') and exempt. The essence of the payment services is the making of payments by AESEL.

69. Mr Mantle contended that Article 7.01 of the Card Issuer Agreement is explicit in describing TRSCo as acting on behalf of the Acquirer, ie AEPSL, in clearing and presenting the Charges for acceptance and payment by AESEL. He submitted that, taking the necessary objective approach, those words could not be ignored. He also submitted that the words should not be treated as insignificant because of the subjective (current) opinions of employees of the Amex Group. Article 7.01 makes clear that TRSCo, when it sets in train the provision of the payment services by AESEL, acts not on its own behalf but on behalf of AEPSL. Mr Mantle said that this interpretation was also, unlike AESEL's, consistent with the heading of Article 7 "Settlement of charges, Credits and Chargebacks between Acquirers and AESEL".

70. Mr Mantle submitted that the natural meaning of the phrase acting "on behalf of" someone, is reasonably clear. It means that the actor is not acting for itself. There is no need to go further and ask whether TRSCo was acting as the agent of AEPSL, as a matter of English common law, with all the duties and rights that involves, whether pursuant to some other contract or pursuant to the Card Issuer Agreement. That is not necessary in order to undertake the VAT characterisation based on contract, ie to decide whether the payment service is supplied by AESEL to TRSCo or to the Acquirer, ie AEPSL. It is enough that TRSCo is not acting on its own behalf but acting on behalf of the Acquirer when it receives the payment service. That payment service should be characterised as supplied to and received by the Acquirer. Mr mantle contended that the contractual obligation is not to provide the payment service to TRSCo but to the Acquirer. There is nothing inconsistent with that in the terms of the Card Issuer Agreement and that characterisation fits with Article 7.03 as well. The obligation on AESEL is not a specific obligation to make a payment to TRSCo because, as can be seen from Article 7.01, TRSCo is not acting on its own behalf when receiving the payment service (but the payment can be to TRSCo). The Card Issuer Agreement requires that payment must be to a person designated by TRSCo.

71. Mr Mantle submitted that the relevant paragraphs in the BOP also need to be considered. In particular, paragraph 6.2 provides that all transactions submitted by participants must flow through the network clearing process. Paragraph 6.3.1 goes on to make clear that the relevant transactions that are being cleared and settled are between the Acquirer and Issuer (see also paragraph 1.6 and Figure 1.1). He stated that the network operator, TRSCo, occupies a

different function (see paragraph 6.4): "the Network computes and advises the [Issuers and Acquirers] of the net totals" of funds to be exchanged. The key parties in the settlement of transactions are the Issuer and the Acquirer. Mr Mantle contended that it is therefore AESEL, as Issuer, and AEPSL as Acquirer, who are, respectively, the supplier and recipient of the payment service by reference to both Article 7 of the Card Issuer Agreement and the BOP, which is part of the Card Issuer Agreement and incorporated in the Licence Agreement between AEPSL and TRSCo. As both AESEL and AEPSL subscribe to the BOP, all "Participants", i.e. all Amex Group issuers and acquirers are contractually bound by the BOP.

72. In response, Mr Cordara submitted that the phrase "on behalf of the Acquirer" in clause 7.01 of the Card Issuer Agreement did no more than reflect the pivotal role that TRSCo plays in the card payments system between AESEL as issuer and the various Acquirers (including AEPSL). He contended that TRSCo could not be an agent of AEPSL, in a strict legal sense or otherwise, since the words "on behalf of [AEPSL]" were contained in a contract, the Card Issuer Agreement, to which AEPSL was not a party. Further, there was nothing in the Licence Agreement between TRSCo and AEPSL (and HMRC have never suggested that there was) that could have made TRSCo an agent or other representative of AEPSL.

73. Mr Cordara contended that the BOP clearly describes the separate relationship between TRSCo and the issuers, and TRSCo and the acquirers. For example, the Introduction to the BOP at page 10, provides as follows: "the terms under which Transactions are settled are set out separately in bilateral agreements between each Participant [i.e. acquirer or issuer] and [TRSCO]". He submitted that the passages from Chapter 6 of the BOP quoted above make clear that it is TRSCO that has the relevant contractual relationships with both issuers and acquirers.

Discussion of contractual position

74. The central plank of HMRC's case on the contractual position is that the words "on behalf of the Acquirer" in Article 7.01 of the Card Issuer Agreement mean that AESEL should be regarded not as making supplies of payment services to TRSCo but as making them to AEPSL. Mr Mantle did not seek to argue that TRSCo was an agent of AEPSL as a matter of English common law and he was right not to do so. The generally accepted definition of agency can be found in Bowstead on Agency (15th edn) page 1 and reads as follows:

"Agency is the relationship which exists between two persons, one of whom expressly or impliedly consents that the other should represent him or act on his behalf, and the other of whom similarly consents to represent the former or so to act."

75. We were not shown any agreement under which AEPSL and TRSCo agreed that TRSCo should act on AEPSL's behalf nor was there anything to suggest that TRSCo had represented that it was AEPSL's agent. We find that, on the materials presented to us, TRSCo was not an agent of AEPSL as a matter of English common law.

76. Mr Mantle's primary submission on this point is, in effect, that the words "on behalf of the Acquirer" were enough to deflect the supply of payment services by AESEL away from TRSCo, the only other party to the contract under which they were made, and towards AEPSL. In our view, that is an astonishing proposition. It would mean that, even where no agency relationship existed, the parties to an agreement to supply services could nominate who was to be treated as the recipient of the supply at will. That would open the door wide to avoidance and, in our view, such a construction should not be accepted unless no other were possible.

77. In fact, we consider that the words "on behalf of [AEPSL]" cannot bear the meaning contended for by HMRC. In our view, when read in context rather than in isolation, the meaning of those words in Article 7.01 is plain. The clause provides that, having accepted the

charges of AESEL Cardmembers, TRSCo clears the charges and, acting for the benefit of AEPSL, presents those charges to AESEL which is bound to accept them. It seems clear to us that Article 7.01 is describing the fulfilment of a service that TRSCo provides to AEPSL, namely the service of processing and presenting charges acquired by AEPSL to AESEL, the card issuer, which is bound to pay them (less a charge). It does not suggest that TRSCo is, in some way and without being an agent of AEPSL, a mere conduit for the provision of the payment services by AESEL to AEPSL or that TRSCo is bypassed entirely. Our conclusion is that the correct contractual analysis of the Card Issuer Agreement is that AESEL makes supplies of payment services to TRSCo and not to AEPSL.

78. Mr Mantle's alternative submission was that the Card Issuer Agreement, the Licence Agreement and the BOP should be regarded as part of a single contractual matrix. So regarded, the BOP, which both AESEL and AEPSL are bound to observe, makes clear that Card Issuers, such as AESEL, supply the payment services to Acquirers, such as AEPSL, through the network which is operated by TRSCo. On that analysis, TRSCo does not receive any payments or payment services from issuers on its own behalf but is a supplier of the network services to the issuers and acquirers. The difficulty with this analysis is essentially the same as in the case of the Card Issuer Agreement viewed alone. Such an approach would allow parties, in cases where a number of persons might be seen as recipients or beneficiaries of services, to specify which should be regarded as receiving the supply for VAT purposes by wording contractual and related documentation accordingly. In our view, however, nothing in the BOP suggests that TRSCo has no role or should be disregarded and replaced by AEPSL. The BOP seems to us to envisage a multi-party arrangement involving three categories of participant, namely Card Issuers, Acquirers and a Network Operator. Such a structure does not require any agency relationship although it could involve such a relationship. It seems to us that under the Card Issuer Agreement, the Licence Agreement and the BOP, AESEL supplies services to TRSCo while TRSCo supplies its services of operating the network to AEPSL.

79. In conclusion, we consider that the correct contractual analysis is that AESEL made supplies of payment services to TRSCo. That does not, however conclude the appeal and we now consider whether the contractual position corresponds with the economic and commercial reality of the transactions.

ECONOMIC AND COMMERCIAL REALITY

80. We start by considering the meaning of the phrase "economic reality" or "economic and commercial reality". Both phrases are used in the authorities and it does not appear that the words "and commercial" are intended to add anything. We then consider whether the commercial and economic reality revealed by the facts means that our conclusion, based purely on interpretation of the Card Issuer Agreement and other contractual documents, that AESEL supplies payment services to TRSCo cannot stand.

Meaning of economic and commercial reality

81. In *LMUK CJEU*, the Court of Justice observed, at paragraph 39 of the judgment, that "consideration of economic realities is a fundamental criterion for the application of the common system of VAT … as regards the identification of the person to whom goods are supplied". That approach was applied to services by the Court of Justice in *Newey CJEU* at paragraph 42 of the judgment).

82. We respectfully agree with Lord Reed's observation, at paragraph 67 of *LMUK SC*, that:

> "Economic reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipient of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded a priori."

83. As the Court of Justice observed in *Newey CJEU* at paragraphs 43 – 45, the contractual position normally reflects the economic and commercial reality of the transactions but will not do so where, in particular, those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions.

84. HMRC have never suggested that that the relevant contracts in this case were a sham nor do they allege any abuse of rights of the type described by the ECJ in C-255/02 *Halifax Plc and others v Commissioners of Customs and Excise* [2006] ECR I-1609 (‘*Halifax’*). Mr Cordara submitted that where no abuse or artificiality is alleged, there is no scope for redefining the relevant transactions “for the purpose of assessing VAT” so as to undo abusive features (as per Lord Sumption at [41] of *HMRC v Pendragon Plc* [2015] UKSC 37, [2015] STC 1825).

85. We do not accept that the absence of artificiality means that there is no room to consider the economic and commercial reality of the transactions. As the use of the words “in particular” by the Court of Justice in *Newey CJEU* show, artificiality is not the only test of economic reality. As Henderson LJ noted in *HMRC v Newey (t/a Ocean Finance)* [2018] EWCA Civ 791 (‘*Newey CA*’), when it had returned to the UK and reached the Court of Appeal, at [101] “total artificiality is not an invariable requirement, but rather a paradigm example of where the contractual terms do not reflect economic and commercial reality.”

86. While it appears to be clear that a contract designed to implement a purely artificial arrangement is unlikely to reflect the economic and commercial reality of a transaction, there is very little guidance on the meaning of economic and commercial reality where arrangements are not purely artificial.

87. In *Newey CJEU*, one of the questions was whether, notwithstanding the fact that under the contractual terms a company, Alabaster, was the recipient of supplies of advertising services provided by Wallace Barnaby, the contractual terms did not genuinely reflect economic reality and it was Mr Newey, and not Alabaster, who was actually the recipient of the supplies of advertising services provided by Wallace Barnaby. In paragraph 48 of the judgment, the Court of Justice indicated that it was “conceivable [on the facts stated in the reference] that the effective use and enjoyment of the services at issue in the main proceedings took place in the United Kingdom and that Mr Newey profited therefrom”. Henderson LJ provided more detail about the facts as stated in the reference in *Newey CA* at [62]:

> “As is apparent from this passage, the CJEU did not rule out the possibility that, in the light of its knowledge of the facts found by the FTT and reflected in the order for reference, the transactions in issue might constitute an abuse in the *Halifax* sense. The key paragraph for this purpose is paragraph 48, which requires account to be taken of the economic reality of the relevant business relationships between each of Mr Newey, Alabaster, the lenders and Wallace Barnaby, as well as the matters of fact mentioned in the third question referred to the Court. The third question reads as follows:
>
> ‘(3) In circumstances such as those in the present case, in particular, to what extent is it relevant:
>
> (a) Whether the person who makes the supply as a matter of contract is under the overall control of another person?
>
> (b) Whether the business knowledge, commercial relationship and experience rest with a person other than that which enters into the contract?
>
> (c) Whether all or most of the decisive elements in the supply are performed by a person other than that which enters onto the contract?

> (d) Whether the commercial risk of financial or reputational loss arising from the supply rests with someone other than that which enters into the contracts?
>
> (e) Whether the person making the supply, as a matter of contract, sub-contracts decisive elements necessary for such a supply to a person controlling that first person and such sub-contracting arrangements lack certain commercial features?'"

88. In paragraph 48 of *Newey CJEU*, the Court of Justice did not refer to all the matters of fact mentioned in the reference but focussed on two elements, namely where were the services effectively used and enjoyed and who benefited from them. This approach was reflected in *U-Drive*, where the Upper Tribunal considered, at [44], that whether U-Drive had an interest in the supply for which it was paying was relevant in assessing whether, in economic reality, the company received the supply.

89. Mr Mantle submitted that this stage of the analysis involves considering all the facts relevant to the economic and commercial reality of the transaction to see if any of those facts vitiate the conclusion based on a purely contractual analysis. We agree that we must have regard to all the circumstances, viewed objectively. It appears to us that, in ascertaining the economic and commercial reality of a transaction involving a supply of services, we should have regard to several factors. It is clear that such factors may include where the services are effectively used and enjoyed as well as who benefits from or has an interest in them in an economic or commercial sense. We consider that we should also ask why the consideration for the services is paid to determine the true nature and purpose of the transactions. Not every factor will be relevant in every case and there may be other factors.

Submissions

90. Mr Mantle submitted that we should have regard to the fact, which was not disputed, that both AESEL and AEPSL are indirect subsidiaries of TRSCo. Accordingly, AESEL, who makes the supply, is under the control of the person, TRSCo, with whom it contracts to provide the payment services and TRSCo also contracts with AEPSL which is also under TRSCo's control. Mr Mantle acknowledged that, in some jurisdictions, there are third party acquirers not under the control of TRSCo. He also accepted that there are issuers who are third parties.

91. Mr Mantle accepted that TRSCo has a role in the card settlement and clearing process in the EMEA region and provides services as the network operator. However, he submitted that, as a matter of commercial and economic reality, TRSCo's involvement is not as recipient of supplies of payment services from AESEL and onward supplier of such services to AEPSL. Mr Mantle contended that the allocation of the consideration paid by the merchant showed that TRSCo's role was very different to that of AESEL (and AEPSL). As can be seen from the example given at [59] above, TRSCo obtains consideration for its services of only £0.34 which is some 12% of the fee paid by the merchant to AEPSL while AESEL obtains £1.56 which is more than half of that fee and AEPSL retains £1.10 which is more than one third. Mr Mantle contended that this showed that the payment service supplied by AESEL to TRSCo and the service provided by TRSCo to AEPSL could not be the same or similar because the consideration was very different.

92. Mr Mantle submitted that, on the facts, it is AEPSL who benefits from the payment services supplied by AESEL. He was at pains to distinguish between a payment, eg the payment of consideration for a supply, and a payment service such as undertaking to guarantee to pay a specific amount as in *Bally*. He contended that the consideration for a supply can be given and received by netting off book entries but for there to be a payment service in this case some money actually has to be transferred from the bank account of one to another.

93. Mr Mantle contended that the commercial and economic reality demonstrated by the facts vitiated any conclusion (which he disputed), based purely on interpretation of the Card Issuer Agreement and other documents, that AESEL supplies payment services to TRSCo. That would require TRSCo to be providing the same or similar payment services to AEPSL which he contended could not stand.

94. HMRC's position was that, in economic and commercial reality, the essence of the payment services is the actual payment of the Charges, i.e. the amounts of AESEL's cardholders' card purchases, less any Chargeback amounts and the billing credit before payment. AESEL receives payments of the amounts of card purchases as well as charges and interest from its cardholders. AEPSL must pay the amount of the purchases made using the cards (less AEPSL's fee) to merchants. An actual transfer of funds by AESEL to someone else is of the essence. Mr Mantle submitted that could not be accomplished by entries in the accounting records of companies within the Amex group.

95. Mr Mantle submitted that it is important to keep in mind the nature of the payment service provided by AESEL in the context of the need for the money to move from AESEL, who received payment from its cardholders in respect of their purchases made using their cards, to AEPSL and other Acquirers, who must pay merchants in respect of those same purchases made by AESEL's cardholders using their cards. He emphasised that the nature of the payment services is an important consideration in any economically realistic consideration of the identity of the recipient of the supply by AESEL of the payment service.

96. Mr Mantle relied on case law relating to Article 135(1)(d) PVD, addressing what is sufficient and insufficient to amount to an exempt transfer or payment. As already mentioned, the parties agreed that the payment service provided by AESEL is an exempt service within the scope of that exemption. Mr Mantle contended that the scope of that exemption helps establish what the nature of the payment service must be in economically and commercially realistic terms. In particular, he referred to Case C-2/95 *Sparekassernes Datacenter (SDC) v Skatteministeriet* [1997] ECR I-3017 ('*SDC'*) and *CCE v FDR Ltd* [2000] STC 672 ('*FDR'*). Mr Mantle contended that, in *FDR*, which concerned outsourced card payment services provided to a card issuer, the Court of Appeal did not hold that netting off accounting entries could be characterised as transactions concerning payments and transfers within Article 135(1)(d) of the PVD. Mr Mantle submitted that the Court's view was that netting off accounting entries was something that could legitimately form part of an overall exempt service within Article 135(1)(d) because it resulted in the transfer of money from one person's bank account to another which effected a change in legal relationships.

97. Mr Mantle submitted that the true nature of AESEL's payment service, a form of payment guarantee service, is the making of payments. The actual transfer of the money (of the Charges Amount) is necessary for the American Express card system in the UK and EU to function and only takes place between AESEL and AEPSL when AESEL makes advances to AEPSL. AESEL does not pay any money to TRSCo. The advances are paid direct from AESEL's bank account to AEPSL's bank account because TRSCo does not have a sterling denominated bank account.

98. Mr Cordara submitted that the settlement of inter-company balances within the Amex Group (such as the payments of settlement sums from AESEL to TRSCo and the payment of settlement sums by TRSCo to AEPSL) is made by making accounting entries. He pointed out that, in Notice 700 at paragraph 14.2.2, HMRC stated:

> "Payment can include payment by book entry, for example, the off-setting of supplies or mutual debts. The tax point is when the entry is made. If the payment by book entry is in the form of an adjustment in your annual

> accounts, the tax point is the date the accounts are approved, provided no previous tax point has occurred"

99. He contended that TRSCo is the hub, both legally and economically, of the American Express card business. The obligations between AESEL and TRSCo ensure a flow of money, for consideration, that puts TRSCo in funds to meet its separate obligation to pay AEPSL the amount that it needs to meet its obligation to the merchant. Mr Cordara described these obligations as a string of contracts. Mr Cordara said that there were many such strings because there were many issuers and acquirers but only one TRSCo. He submitted that there is no way that a global operation such as the American Express business could exist without some kind of hub. He referred to the evidence of Mr Hipkin which was that AESEL would not know who the acquirer is or where it is located. Mr Hipkin said that AESEL simply receives details of a charge for which it takes on an obligation to pay TRSCo. TRSCo needs to know who the acquirer is in order to operate the network and, in particular, to carry out clearance and settlement services. TRSCo knows who that acquirer is because it has a contract with the acquirer.

100. Mr Cordara also contended that the transfers of money from AESEL to AEPSL were made pursuant to the Amex Group's cash management and treasury policies. AESEL receives cash from cardmembers. Mr Cordara said that it made commercial sense for all the Amex Group companies' cash requirements such as salaries, fees and other payments to be met by AESEL because it had the cash. Mr Cordara pointed out that the evidence was that the transfers by AESEL were not settlement of amounts due from AESEL to AEPSL as a result of cardholder spend. Mr Cordara submitted that if we accept that the movement of money between AESEL and AEPSL are advances then HMRC's case collapses.

Discussion

101. Mr Mantle's first point was that AESEL and AEPSL were both under the control of TRSCo. We do not accept that is a material consideration in this case. In our view, the fact that there are issuers and acquirers who are not under the control of TRSCo is a relevant factor when considering the economic and commercial reality of the transactions. The existence of third party issuers and acquirers that have the same or materially similar contractual arrangements with TRSCo as AESEL and AEPSL undermines rather than supports HMRC's position. It suggests that the contractual arrangements are genuinely commercial and have an economic reality independent of the relationship between Amex Group companies.

102. Mr Mantle contended that the disparity in the levels of consideration received by AESEL and TRSCo showed that TRSCo was supplying (and therefore receiving) a different service, ie not a payment service. While we agree that the level of consideration can be relevant in considering the economic and commercial reality of a transaction, we do not accept that the differences between the consideration obtained by AESEL and TRSCo shows that AESEL is not providing a payment service to TRSCo. We consider that there may be many reasons why one party in a contractual chain charges more or less than another for supplying services. One party may have miscalculated the price or may have made a deliberate decision to over or under charge, especially where the parties are related, or may incur lower costs because it merely passes the service on in a back to back supply. In our view, the differences in the levels of consideration obtained by AESEL and TRSCo do not indicate that the economic and commercial reality of the transactions deviates from the contractual position in this case.

103. Mr Mantle's primary submission on economic reality was that, in order to provide a payment service to TRSCo, AESEL must make a payment to TRSCo. The only relevant transfer of funds by AESEL is to AEPSL. We do not accept that there must be an actual transfer of money from AESEL's bank account to a bank account owned by TRSCo. In our view, the

settlement of amounts due by making accounting entries to change the inter-company balances are transactions concerning payments and transfers for the purposes of Article 135(1)(d) PVD. We think this is clear from the guidance provided by Laws LJ in *FDR* at [37] – [38]:

> "37. … if one leaves aside transfers in specie (of coin, goods or other property), a transfer of money means no more nor less than the entry of a credit in the payee's account and the entry of a corresponding debit in the payor's account. There may be - will be - problems in cases of error or fraud in the posting of entries to the accounts. But however those may fall to be resolved, there is no further, elusive, event by which the money is really transferred: no Platonic Form, of which day-to-day transfers are only shadows. The pro and con entries constitute the transfer. There is nothing else. I recognise, of course, that this reasoning boils down the reality to the simplest case. In truth, creditor and debtor may have accounts at banks A and B respectively; banks A and B may themselves have accounts at banks C and D respectively; and it may be only when one comes to banks J and K that one finds both of them having accounts at the Bank of England. But the logic is unaffected.
>
> 38. If this reasoning is right it is, I think, very significant for a sensible and intelligent understanding of *SDC*. It demonstrates that what the Directive imports by the term 'transfer' inheres in the notion of a 'change in the legal and financial situation' - an expression used in both paragraphs 53 and 66 - where that is a reference to the effects of the corresponding credit and debit entries in the accounts of the paying and receiving parties. This is a point which in my judgment possesses particular resonance when one comes to counsel's submissions relating to 'netting-off'."

104. The passage from VAT Notice 700 referred to by Mr Cordara is consistent with the passage from *FDR*. The adjustments made to the inter-company balances are part of the transfer of value from AESEL to AEPSL. The process involves TRSCo as network operator and netting off amounts due to and from the parties. The changes in value as a result of the netting off in the accounts are payments or transfers for the purposes of Article 135(1)(d) PVD.

105. We find that the role of TRSCo is central to the operation of the American Express card business. Mr Hough's evidence, which we accept, was that the presence of TRSCo at the centre of the supply chain provides valuable benefits to the Amex Group. TRSCo is able to ensure that common standards and practices, including the capture of the right transaction data, are applied across the card network. In Mr Hough's opinion, TRSCo's role is central to the operation of the network and the ability of cardmembers to use their cards globally to purchase goods and services. We find that, in that role, TRSCo also acts as a clearing house providing clearance and settlement services to issuers and acquirers. In order to give effect to those services, TRSCo requires and receives payment services from AESEL. The evidence shows that AESEL also provides funding for AEPSL by way of transfers of money from AESEL's bank account direct to AEPSL's bank account. We find that those transfers are advances or loans and not payments to AEPSL under any obligation to pay AEPSL for amounts spent by cardmembers using cards issued by AESEL at merchants acquired by AEPSL. It follows that, in our view, the economic and commercial reality of the transactions is entirely consistent with our analysis of the contracts.

DECISION

106. For the reasons set out above, AESEL's appeal is allowed.

COSTS

107. This case was allocated to the Complex case category under rule 23 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('FTT Rules') and AESEL has never requested that the proceedings be excluded from potential liability for costs under rule 10(1)(c)

of the FTT Rules. Accordingly, the Tribunal has power to award costs on an application or of its own motion. Any application for costs in relation to this appeal must be made in writing within 28 days after the date of release of this decision. As any order in respect of costs will, if not agreed, be for a detailed assessment, the party making an application for such an order need not provide a detailed schedule of costs claimed with the application as required by rule 10(3)(b) of the FTT Rules.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

108. 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 FTT Rules. 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.

JUDGE GREG SINFIELD
CHAMBER PRESIDENT

RELEASE DATE: 28 AUGUST 2019