VAT focus

DPAS: VAT exempt payment services revisited

Speed read

The recent advocate general's opinion in *HMRC v DPAS* (Case C-5/17) raises two important issues. What is the correct approach in seeking to apply the exemption for transactions concerning payments or transfers? And what, if any, implications can be drawn from the fact that a taxpayer chooses to restructure transactions to avoid the adverse VAT consequences of an earlier decision of the courts? On the latter point, the Advocate General's suggestion that the 'economic reality' of the supplies was not altered by 'playing around with wording of the contracts' may again encourage HMRC to challenge such restructurings.

Martin Shah
Simmons & Simmons
Martin Shah is a corporate tax partner at Simmons & Simmons LLP and leads the financial services tax practice. VAT forms a key part of his practice, with a focus advising financial institution and asset management clients, including on contentious matters. He chairs the Law Society's VAT and Duties Sub-Committee. Email: martin.shah@simmons-simmons.com; tel: 020 7825 4638.

Gary Barnett
Simmons & Simmons
Gary Barnett is a senior professional support lawyer in the corporate tax group at Simmons & Simmons LLP. Before becoming a professional support lawyer, he advised on a wide range of corporate tax and VAT matters. Email: gary.barnett@simmons-simmons.com; tel: 020 7825 3313.

In 2011, the CJEU held in its decision in the *AXA Denplan* case (*HMRC v AXA UK Plc* (Case C-175/09) [2010] STC 2825) that, although supplies made by Denplan, a dental plan administrator, to dentists might 'in principle' fall within the exemption for 'transactions concerning payments or transfers', they were excluded from that exemption as those services amounted to standard rated 'debt collection'. The fact that Denplan collected payments as they fell due meant that they were collecting debts on behalf of the dentists concerned. In addition, the CJEU concluded that a debt did not have to be overdue for its collection to amount to standard rated 'debt collection' within the exclusion to the VAT exemption.

DPAS is another company providing dental plan services. Following the *AXA Denplan* decision, DPAS decided to restructure its contractual arrangements to ensure that its plan administration services were provided to the dental patients rather than to dentists. As a result of this restructuring, it contended that its supplies of services to patients, for which it charged a plan fee, qualified as the exempt provision of transactions concerning payments or transfers within article 135(1)(d) of the Principal VAT Directive. Its supplies to patients were, essentially, payment facilitation involving the collection of direct debit payments and paying on amounts due to the dentists. In addition, since this supply was made to the debtor patients, rather than to the creditor dentists, it could not amount to excluded 'debt collection'. In *DPAS v* HMRC [2013] UKFTT 676, the First-tier Tribunal (FTT) agreed with DPAS and held its services were correctly exempted from VAT.

On appeal, the Upper Tribunal referred back to the CJEU the correct interpretation of the exemption for 'transactions concerning payments or transfers' ([2016] STC 857). On the one hand, the tribunal noted the CJEU's statement in the earlier *AXA Denplan* decision that Denplan's services in recovering payments for dentists would 'in principle' have been exempt had it not amounted to excluded debt collection. On the other hand, the tribunal noted that it was difficult to reconcile that statement with the narrow, functional analysis of the exemption adopted by the CJEU in the subsequent cases of *Bookit* (Case C-607/14) and *National Exhibition Centre* (*NEC*) [2016] STC 2132.

Furthermore, the Upper Tribunal considered that there was 'real doubt' as to the scope of the exclusion for debt collection. In particular, it was unclear whether, objectively, the same type of activities undertaken by Denplan in providing services to dentists, and which constituted debt collection, ceased to constitute debt collection when undertaken by DPAS in providing services to patients. HMRC contended that it is the nature of the services that is determinative, rather than the person supplying or receiving them. DPAS argued that, by its very nature, debt collection services can only be provided to the creditor. As a result, the Upper Tribunal also decided to refer to the CJEU the question of the correct construction of 'debt collection' in this context.

Exempt payments or transfers

The AG's opinion, released on 21 March 2018, admits head-on that the acceptance by the CJEU in the original *AXA Denplan* case – that the supplies by Denplan were, in principle, within the exemption for 'transactions concerning payments or transfers' – cannot be reconciled with either the earlier or later case law of the court on the scope of that exemption.

However, the AG has no doubt that the correct approach to the scope of the exemption can be found in the *Bookit* and *NEC* cases and not in the *AXA Denplan* case. In particular, the court made it very clear that 'transactions concerning payments or transfers' must have the effect of making the legal and financial changes which are characteristic of a payment of transfer of a sum of money. That should be contrasted with the supply of a mere physical, technical or administrative service relating to the making of a payment or transfer, which would remain subject to VAT.

In the case of DPAS, it was clear that it did not effect any transfers or payments. DPAS merely carried out administrative tasks concerned in moving money between bank accounts, such as requesting the bank to make the transfers and recording what transfers had been made by others. DPAS did not itself debit or credit the respective bank accounts. In fact, the AG noted that, in practice, the services provided by DPAS were less closely linked to 'payments or transfers' than the card handling services provided by Bookit and NEC, which were found to not fall within the exemption.

Ultimately, DPAS did not carry out the payment or transfer. It merely asked the relevant financial institutions to do so. The fact that DPAS obtained the authority to request the transfer of money in the name and on behalf of the patient, from the patient's bank, did not transform such a request into a payment or transfer. These were mere preliminary technical and administrative activities.

The AG considered that the statement by the CJEU in *AXA Denplan* that the supplies in that case were 'in principle' within the exemption, without any examination of the supplies, had not been intended to broaden the scope of the exemption in any way. As such, that statement could not assist DPAS in this case.

Accordingly, the AG recommended that the CJEU should rule that services provided by a dental plan payment administrator to dental plan patients consisting of the facilitation of payments do not fall within the exemption for payments or transfers.

Debt collection and economic reality

Having opined that the services did not amount to payments or transfers, it was strictly unnecessary for the AG to go on to consider the question of whether the restructured supplies by DPAS would amount to debt collection. Nevertheless, the AG considered the point and had some strong (and arguably controversial) remarks to make.

The AG first noted that the literature provided by DPAS to its customers, both dentists and patients, stressed that the changes it had made were 'purely administrative' and made 'no practical difference to the current arrangements'. From this context, the AG opined that the restructuring should be considered 'irrelevant' for the purposes of applying the VAT rules, on the basis that the application of the VAT system is based on the 'economic reality' of the services. As such, it was unnecessary to have recourse to the principle of abuse of rights in this context, since the correct interpretation of the arrangements was the one based on the economic reality. If the services were debt collection before the restructuring, they remained debt collection post the restructuring.

Comment

The opinion of the AG on the scope of the exemption for payments or transfers will probably come as no surprise. Whilst the facts in DPAS were essentially on all fours with the *AXA Denplan* case in which the CJEU had indicated the exemption applied 'in principle', the later decisions in *Bookit* and *NEC* have clearly indicated a narrower, function-based approach to the exemption is necessary. The 'in principle' approach by the CJEU in *AXA Denplan* belied the fact that there was no specific analysis as to the exemption's application in that case beyond the focus on the 'debt collection' exclusion.

It is now clear that an intermediary that functionally merely requests payments under the authority of a mandate does not make a payment or transfer. It is the bank that actually effects the payment or transfer.

Nevertheless, the precise borderline will always remain somewhat difficult to define. Although the functional analysis emphasises the importance of the bank (or other account holder) in the payment or transfer process, it remains true that the application of the VAT exemptions is determined by the nature of the service and not the nature of the provider. As such, it is clear, in principle at least, that a 'payment or transfer' can be made by a non-financial institution.

The question is, given the narrow functional analysis applied by the courts, in what circumstances may a non-financial services business actually effect a payment or transfer? The AG in *DPAS* refers to the *ATP* case (Case C-464/12), in which the CJEU accepted that certain services provided to a pension fund by a non-bank (consisting of the management of workers' individual accounts and contributions paid by employers) would have fallen within the exemption. In the *ATP* case, the court said: 'That interpretation does not presuppose any particular method for effecting transfers, which may be done using accounting entries. That is so in the case of transfers between customers of a single bank, or between accounts of a single individual who acts as both the person giving the order and the recipient.'

It might also be noted that the exemption for 'payments or transfers' also extends, in principle, to the 'negotiation' of such activities. Whilst there is no problem contemplating the concept of 'negotiation' in relation to other exemptions, such as the granting of credit, it is far less obvious how it may apply to a payment or transfer. Indeed, given the AG's conclusion in *DPAS* that its services should be considered standard rated technical and administrative services, notwithstanding DPAS's interactions with the dental patients' banks, one might question whether any form of activity can fall within exempt 'negotiation' of a payment or transfer.

The opinion of the AG on the question of 'debt collection' and more particularly the effectiveness or otherwise of the VAT restructuring entered into by DPAS is perhaps of wider interest. In principle, the restructuring by DPAS was not especially aggressive or complex. The Upper Tribunal at an earlier hearing had accepted that the restructured supplies made by DPAS were correctly regarded as made to dental patients. The fact that, apart from the contractual arrangements, the services did not change their character from the earlier (non-exempt) services did not change that conclusion.

However, the AG clearly considered that these contractual changes did not impact the 'economic reality' of DPAS's supplies. These were 'debt collection', whether provided to the dentists or their patients. In fact, the AG was somewhat scathing as to the approach taken by DPAS, suggesting that the application of economic reality 'would also preclude, in those circumstances, merely playing around with the wording of the contracts having the ability to change the categorisation of a supply of services even though the economic reality has remained unchanged'.

Of course, we have previously seen HMRC seek to argue that a taxpayer's deliberate reconstruction of its contractual arrangements, designed to reduce its VAT burden, should be taken into account when considering those arrangements from the perspective of the abuse of rights doctrine (not least before the FTT in *DPAS*). While the courts have accepted that this can be a relevant consideration when looking at the second part of the abuse test (essential aim), it should not affect a determination of the first part of the test (accrual of a tax advantage contrary to the purpose of the VAT provisions). In particular, the courts have forcefully pointed out that it would not accord with the principle of fiscal neutrality, or the requirement for legal certainty, if the VAT treatment of arrangements could differ depending on whether a taxpayer had undertaken similar transactions through a different structure, and those past transactions gave rise to a more onerous liability to VAT.

The AG's uncritical acceptance that the 'economic reality' of a transaction may not be altered by 'playing around with wording of the contracts' may, however, place such restructurings in a new light and persuade HMRC to revisit these arguments, if it is in any way supported by the ultimate decision of the CJEU. ■

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