VAT and customer loyalty schemes

The Upper Tribunal has held that where a loyalty scheme was run by a “separate operator”, then the VAT incurred on a redemption payment by that operator was a cost component of running the loyalty scheme rather than third party consideration.

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The Upper Tribunal has considered the VAT consequences of a points based customer reward scheme for hotel accommodation in *Marriott Rewards and Whitbread Group v HMRC* [2018] UKUT 129. The Tribunal considered that where the scheme is run by a “separate operator” as here, then the VAT incurred on a redemption payment by that operator will be a cost component of running the loyalty scheme rather than third party consideration.

The decision contains further useful analysis on the question whether a payment in a tripartite situation will amount to third party consideration and also the question whether supplies amount to supplies connected with land or advertising services.

Background

The Marriott Hotel chain ran a points based customer rewards programme (the Program) under which customers earned points for staying at Marriott hotels and could later spend those points for free hotel accommodation at Marriott hotels. The scheme was run by a US company, Marriott Rewards LLC (MR). Marriott hotels were typically not owned by Marriott itself but were typically franchised to local hotel operators which were allowed to use the Marriott branding. In the UK, one such participating hotel was run by Whitbread Group.

Under the Program, when a customer stayed at a participating hotel, that hotel would pay monies to MR so that MR would issue points to that customer. Where the participating hotel was a UK hotel, that UK hotel accounted for VAT on this payment under the reverse charge provisions. Participating hotels would also accept points in payment for a hotel stay by a customer. When a UK hotel (such as Whitbread) accepted payment in points, it included VAT on invoices to MR in respect of services supplied in providing the customer with hotel accommodation.

MR sought to recover the VAT it had been charged by UK hotels under the Program on the basis of the Thirteenth VAT Directive (as implemented by VATA 1994 s.39). It is a requirement for recovery that the amounts would be input VAT if the person was a UK taxable person. HMRC denied MR a repayment on the basis that the VAT charged to them by redeeming hotels was not their input VAT. The amounts paid by MR amounted to third party consideration for supplies of hotel accommodation to customers.

In the alternative, HMRC argued that no VAT was chargeable on those supplies by UK hotels on the basis that the supply was correctly made in the US. As such, any recovery of that VAT would need to be made by the redeeming hotels under the provisions of VATA 1994 s.80 and not by MR.

Third party consideration?

The Upper Tribunal decision contains a useful review of the case law on loyalty schemes and third party consideration.

At the outset, the Upper Tribunal noted that since payments for the issue of points gave rise to VAT and the redemption of points also gave rise to VAT, if HMRC were correct that the redemption payments amounted to "third party consideration" with no right to input VAT recovery, that would give rise to "sticking tax" and result in HMRC being entitled to "more VAT than was properly due to them" under the scheme of the VAT system.

Analysing the case law on loyalty schemes, the Upper Tribunal noted a difference between "sub-contractor" models and "separate operator" models. In the sub-contractor model, a trader issues points to its customers but then pays a sub-contractor to issue rewards on redemption of those points. The case of *Baxi* is an example, where the ECJ held that the payment by Baxi to its sub-contractor on redemption of points by Baxi's customers was third party consideration (up to the value of the sum expended by the sub-contractor for the goods provided). However, points schemes may be operated by a business entirely separate from the traders involved. An example is *LMUK* involving the Nectar scheme where LMUK issued points to customers of quite separate retailers. In the LMUK case, the Supreme Court held that the payments made to redeemers by LMUK were necessary to fulfil LMUK's contractual obligations and as such were not third party consideration at all. As such, in a "separate operator" model such as that operated by LMUK, the payment by LMUK on redemption is clearly a cost component of its own economic activity in running the scheme and therefore deductible.

The Upper Tribunal considered that the Program, was a "separate operator" scheme was indistinguishable from the LMUK scheme. The payment by MR to a redeeming hotel was not for the provision of hotel accommodation by that hotel but rather for the acceptance of points by the redeeming hotel under the contractual framework of the Program. As such, the Upper Tribunal dismissed HMRC's argument that the payments by MR were third party consideration rather than payments for supplies made to MR and, as such, gave rise to its own input VAT.

Place of supply

The Upper Tribunal noted that the supply in this case was essentially a supply of accepting the redemption of points by the redeemer. MR argued however that those supplies were "connected with immovable property" in the UK. This was rejected by the Upper Tribunal. A connection with immovable property requires there to be specific immovable property and in this case redeeming hotels merely undertook to provide a hotel room, not any specific hotel room. Whilst the payment from MR is actually made after the provision of a specific hotel room has been provided, nevertheless the payment is still for the redeemer to accept points from a customer for a hotel room. (It would have been different if the consideration had been third party consideration for the supply of the hotel room to the customer, of course!)

Accordingly, the Upper Tribunal held that the place of supply was the US where MR was based and as such did not give rise to recoverable input VAT under the Thirteenth VAT Directive.

Whitbread's appeal

In a joined appeal, Whitbread sought to recover overpaid output VAT, arguing that the supplies were outside the UK but for the period prior to 2010 (when the VAT place of supply rules changed). However, it contended that its supplies as a

redeemer to MR were supplies of advertising services and, as such, supplied where the recipient MR belonged.

Essentially, Whitbread argued that the whole nature of the Program ran by MR was clearly that of promotion and advertising and that its role in the process both in issuing rewards and redeeming rewards was necessarily part of that promotion and advertising. Whilst accepting that the purpose of the Program as a whole was advertising, the Upper Tribunal considered that it was self-evident that a trader that sells goods or services to a customer is not “advertising” in any relevant sense. In accepting the redemption of points, redeeming hotels such as Whitbread were merely fulfilling their contractual obligations to MR. There was no element of advertising in that acceptance and that conclusion was not affected by the fact that the Program as a whole was a form of advertising. Indeed, the Upper Tribunal accepted the FTT’s conclusion that MR itself did not have a business of advertising, despite being the operator of the Program.

Accordingly, the Upper Tribunal also dismissed Whitbread’s appeal that it should be entitled to recover output VAT paid in periods prior to 2010.

Comment

The decision contains a useful explanation of the various types of loyalty or reward scheme and their likely VAT consequences. The correct characterisation of supplies made within such a scheme will depend on the contractual arrangements and whether there is the necessary degree of reciprocity to give rise to a supply of redemption services and prevent the redemption payments simply amounting to third party consideration.

The decision also contains useful comment on the question whether a supply is connected with immovable property and whether a supply may be of advertising services (which may still move the place of supply to where the customer belongs in the case of a supply to a non-EU non-business recipient).