

## VAT focus

## Dollar Financial: internet conduit or intermediary?

## Speed read

The First-tier Tax Tribunal has accepted that electronic introductions of customers to a payday lender qualified as an exempt supply of the negotiation of credit in *Dollar Financial UK Ltd v HMRC* [2016] UKFTT 598. The tribunal considered that although the filtering of potential customers was very basic and potential customers were offered to the lender willing to pay the highest commission, the supplies nevertheless went beyond advertising or acting as a mere conduit and qualified as VAT exempt introductory services.


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The VAT finance exemptions predate, and cannot possibly have contemplated, the proliferation of the internet and the increasing prevalence of technology in the delivery of financial services. Inevitably, therefore, difficulties arise in applying these exemptions to today's financial services industry.

In particular, when the word 'negotiation' was included in article 13(B)(d) of the Sixth Council Directive, few would have envisaged the extent to which the internet would facilitate bringing together financial service providers and customers. Intermediaries which are sufficiently technologically savvy to raise their internet presence above those of underlying financial service providers are able to interpose themselves between providers and prospective customers without the physical and human infrastructure that a traditional advisory or broking business requires; and, through their electronic platforms, to carry out equivalent intermediary functions almost instantaneously.

Whilst such situations are initially difficult to reconcile within the concept of 'negotiation' in any traditional sense, the operation of the VAT system must, in practice, at least attempt to keep pace with modern business practices. A number of cases have already addressed this issue. Notably, in *Insurancewide.com and Trader Media* [2010] STC 1572, the Court of Appeal held, in the context of insurance, that, whilst a mere click-through service is not exempt (for example, where a website merely advertises a provider and enables a customer to click through to that provider), exemption can apply where

the introducer has obtained information from the potential customer and uses that information to identify a suitable provider.

The recent decision in *Dollar Financial UK Ltd v HMRC* [2016] UKFTT 598 (reported in *Tax Journal*, 16 September 2016) goes further, holding that exemption for 'negotiation of credit' can apply where a website brings together a potential borrower and a lender without any assessment of the suitability of the lender to the borrower's needs. The efficiencies of internet based technology potentially permit large scale indiscriminate referrals, with little or no incremental costs. As *Dollar Financial* demonstrates, a fundamental issue in establishing VAT exemption for web based intermediaries is distinguishing their services from an indiscriminate passing on of information. In effect, VAT exemption can apply where the supplier provides an introduction service, provided that it was not acting as a mere conduit.

## Background

The Dollar Financial UK Ltd (Dollar) group provided 'payday loans'. It paid commissions to a number of overseas 'lead generators' ('leadgens') for introductions to prospective borrowers. Visitors to a leadgen's website seeking a payday loan were invited to complete an online application form. Once submitted, this was passed electronically and within a few seconds to one of the leadgen's customers, which included Dollar. Where referred to Dollar, Dollar decided electronically (again within seconds) whether it wanted to accept and pay for the lead; and, if it did, the prospective borrower would be presented with the offer and terms of the loan on Dollar's website.

Each leadgen typically had relationships with various lenders, each with simple but potentially different criteria for determining borrower suitability. For Dollar, these criteria concerned the applicant's age, residency, monthly income, possession of a UK bank account and debit card, and a valid mobile phone number and email address. The leadgen's online application form covered the criteria for all of the leadgen's lender customers.

Once the online application form was submitted, the leadgen's site determined which potential lenders' requirements were met and offered the lead first to the lender paying the highest commission. If that lender did not buy the lead, it was offered in turn down the chain of potential lenders in order of commission until (hopefully) accepted. All of this was carried out electronically and within seconds.

Of leads offered to Dollar, only about 1% were purchased by Dollar. Many rejections resulted from the borrower already being known to Dollar; and 10% to 20% of rejections resulted from the borrower failing Dollar's basic lending criteria (which Dollar also checked, as mistakes might be made by the leadgen) or the credit check carried out by Dollar as a regulatory requirement.

Dollar had originally accounted for reverse charge VAT on the leadgen commissions. It subsequently sought to reclaim that VAT, arguing that the leadgen's supplies were exempt 'negotiation of credit' within article 135(1)(b) of Council Directive 2006/112/EC (as implemented by VATA 1994 Sch 9 Group 5 items 2 and 5). HMRC rejected that claim, essentially contesting that the leadgens were a mere conduit. Dollar appealed.

## Decision of the tribunal

Reviewing the case law, the tribunal accepted that 'negotiation' could encompass: introducing two parties to a financial product; negotiating the terms of such products; or concluding

a contract on behalf of a party. Here, exemption could only be for providing exempt introductory services. For these purposes, introductory services must be distinguished from mere advertising or acting as a mere conduit. The tribunal identified that the distinction could be through assessing the lender's suitability to provide the loan or the borrower's suitability to receive the loan – both were not required.

The judgment, therefore, focused on whether a leadgen acted as a mere conduit and associated issues, specifically addressing factual objections raised by HMRC.

First, HMRC argued that there was no 'real' assessment of potential leads. A leadgen would determine 'in a millisecond' whether the applicant satisfied Dollar's criteria. Dollar's criteria were neither complex nor required any exercise of judgement or discretion by the leadgen. In addition, Dollar duplicated the checks undertaken by the leadgen and there was only a 1% chance that a lead offered to Dollar would be purchased.

Second, HMRC identified that there was no legal relationship between the borrower and leadgen. Indeed, the lead was sold to the highest bidder and there was no attempt by a leadgen to obtain the best deal for a borrower.

### Mere introduction?

HMRC's first set of contentions were intended to point to the leadgen's involvement being insufficient to amount to 'negotiation'. The lack of anything but basic filtering criteria, the double checking of that criteria by Dollar, the overwhelming number of rejections and the automatic nature of the transactions were all indicative of the leadgen providing Dollar with an essentially indiscriminate offer of introductions to borrowers; and, in doing so, acting as a mere conduit.

The tribunal rejected these arguments. The fact that the assessment was made 'in milliseconds' was irrelevant as, clearly, a computerised system could properly assess the application in that timeframe, unlike a human. The duplication of lending criteria checks and Dollar's acceptance of so few leads again did not mean that the filtering actually carried out by a leadgen was irrelevant. The tribunal accepted Dollar's evidence that it would not contract with a leadgen unless it was satisfied the leadgen would apply Dollar's basic lending criteria; and that it would terminate the leadgen's contract if it regularly introduced borrowers not meeting its criteria. That indicated the importance to Dollar of only filtered borrowers being introduced to it. The evidence was that the filtering by leadgens was effective and useful to Dollar.

Moreover, the tribunal observed that Dollar made loan offers to all accepted leads, with around half of those offers resulting in loans. As such, the leadgens were an important source of business and it could not be said that leads rarely led to loans (which might indicate indiscriminate introductions).

This left the most important question: were the leadgen's checks sufficient to make their supply one of negotiation rather than mere introduction? On this point, the tribunal considered that a filter that simply asked for basic information would not be sufficient (e.g. name, address). However, the level of information required depended on the complexity of the product concerned; and here the product (a short term loan of a few hundred pounds) was not complex.

The criteria the leadgen applied were sufficient (bar the credit check) to enable Dollar to decide whether or not to make a loan offer. This was not a case where Dollar would, in practice, lend to anyone. It had simple lending criteria, such as minimum monthly income of £900 and the holding of a UK debit card. Equally, whilst the leadgen only operated as a partial filter (with Dollar carrying out the credit check), this was not fatal. Case law does not indicate that an intermediary must carry out a complete assessment of suitability of the borrower for an introduction to

be exempt negotiation. Whilst Dollar's criteria were simple, they were not the same as all the other potential lenders and they were not so simple that no real filtering took place.

The fact that the leadgen applied no judgement or discretion to the process did not affect the conclusion. There was no suggestion in the case law that discretion is a necessary element of the intermediation exemption.

### Lack of relationship

HMRC's second set of arguments was designed to show that a leadgen did not act for the borrower in making an introduction. The tribunal dismissed this as irrelevant. Case law indicates it is sufficient if the intermediary has a legal relationship with the borrower or the lender and, in this case, the leadgen's relationship was clearly with the lender. Although a leadgen offered a lead to the highest bidder, it also filtered borrowers so as to only offer them to lenders whose criteria were met. As such, the tribunal found, as a matter of law, that it is not essential for an intermediary to undertake an assessment of both borrower and lender; it suffices to undertake an assessment of one or other. Therefore, selling the (filtered) lead to the highest bidder, without any assessment of whether that lender was offering a good deal to borrowers, did not of itself prevent the leadgen's services from being exempt. On this point, the tribunal agreed with the earlier decision in *Smarter Money* (2006) VTD 19632, in which leads were sold to a mortgage broker, rather than directly to a lender.

### No precise dividing line

The tribunal in *Dollar Financial* accepted that precisely where the dividing line lies between being a mere conduit and an exempt intermediary is unclear from case law. However, a pragmatic approach must be taken, in which the level of filtering applied by an introducer should be compared to the level of complexity of the financial product offered.

Dollar's products were sub-prime, payday loans, a feature of which is low sums lent for short durations. In a case such as this, where the product is relatively straightforward, simple filters would be sufficient to meet the criteria. However, lenders providing more sophisticated lending products, especially secured loans, will inevitably have more detailed, stricter lending requirements; and an 'intermediary', filtering borrowers based on the same simple filters as Dollar, seems very likely to fall the wrong side of the line.

Although every case will differ factually, *Dollar Financial* is of utility in identifying relevant principles to apply in distinguishing exempt introduction from acting as a mere conduit. In particular, establishing that the filter applied by the introducer is meaningful and actually important to the lender, and that the introductions paid for resulted in the offering of loans, will assist greatly in showing that the introducer is performing a valuable introductory service rather than merely acting as a conduit, indiscriminately passing on potential customers.

Cases such as this, where pre-internet era concepts are applied to modern financial services delivery demonstrate a pressing need for modernisation of the VAT finance exemptions. Unfortunately, the EU Commission's modernisation programme for the finance and insurance exemptions, launched in 2007, has not progressed since 2011, being overtaken by the proposed FTT. Its resurrection should be prioritised. ■

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