FEATURE ARTICLE – UK

VAT's trickiest borderline – HMRC Brief 10 (2022) on business and non-business activities

In this article, Terry Dockley examines HMRC's recent VAT brief on business and non-business activities.

Arguably the borderline between business and non-business is the most significant in VAT because it determines whether or not an activity falls within the scope of the tax at all. At the same time it is one of the hardest to discern. This makes HMRC's attempt to set out its revised policy in a Brief covering two A4 sides extraordinarily ambitious. Or has the writer erroneously confused and conflated the two meanings of the word 'Brief'? HMRC addresses five groups, three of which it defines by reference to 'business', including 'an organisation or a business carrying out non-business activities'! By the end of the Brief, I suspect many readers will be more confused than before they started.

This article will seek:

- To clarify who should be interested in the subject covered by the Brief;
- To outline where the case law on this subject currently stands; and
- To suggest how the Brief might have been made more helpful.

Who should be interested?

Charities

The Brief will be highly relevant to many charities, especially in these times of rising fuel and power prices. Any charity that can demonstrate at least 60 per cent non-business use of its fuel and power can buy at the reduced rate of 5 per cent. A charity buying or commissioning the construction of a new building or annex can require the supplier to apply the zero rate if their intention is to use the building 'solely' for non-business purposes. (HMRC interpret 'solely' to mean at least 95 per cent.) The Brief refers to *Wakefield College* ([2018] STC 170. In that case, HMRC reported that VAT amounting to some £120m over 50 cases turned on disputes relating to this relief and the availability of zero-rating.

Charities and other not-for-profit bodies

More widely, the business/non-business question is relevant for many not-for-profit organisations that are not yet VAT-registered. It helps them determine whether they should or could be, for instance:

- If they import services from outside the UK; or
- If they are paid amounts in excess of the registration limit; and/or
- If they incur significant amounts of VAT in the course of their activities and their funding is from VAT-registered businesses or, for example, local authorities, who may be able to recover any VAT if it were charged to them. This includes the group referred to by HMRC in the Brief as businesses that receive 'grants or subsidies'.

VAT incurred for non-business purposes cannot be recovered even if it is *de minimis*.

Case law

The Brief indicates that civil servants must be under intense political pressure not to mention EU law, even when it is directly relevant and a department has correctly chosen to follow it. HMRC mentions two UK cases, *Wakefield* and *Longridge* ([2016] STC 2362), but not the underlying retained EU VAT law, comprising the Principal VAT Directive ('the PVD') and the case law of the Court of Justice. In *Wakefield*, the Court of Appeal gave a helpful summary of where the case law stood, covering both UK and EU decisions. The Brief is in keeping with that analysis in using a '2-stage test'. However, the Brief's brevity makes it much harder to follow than the judge's reasoning in the Court of Appeal.

According to Lord Justice Richards, there are two questions to be addressed:

Question 1 – is there a supply of goods or services for consideration?

This question derives from Article 2 of the PVD, which states that a supply of goods or services 'for consideration' falls within the scope of VAT if it is made 'by a taxable person acting as such'.

'For consideration' has been interpreted by case law to mean that there is a 'direct link' between the supply made and the consideration given by the recipient of the supply. HMRC's previous practice treated this as the end of the story: the provision of goods or services for consideration on a continuous basis amounted to a business. But this has been refined by case law with the result that, while there must be a direct link, by itself that does not conclude the matter. The direct link is a 'necessary' but not 'sufficient' test on its own. Step 2 considers whether the supply is part of an 'economic activity' within Article 9 of the PVD. In this context, economic activity is the equivalent of what the UK VAT Act calls 'a business'. As the Brief demonstrates, 'business' has many different meanings, which makes it a potentially more confusing term.

Question 2 – is there an economic activity?

This part of the test requires the supply to be made for the purposes of 'obtaining income therefrom on a continuing basis'. The Court of Appeal, and the present Brief, have each followed the Court of Justice in adding to the confusion by adopting the term 'remuneration', supposedly to help determine whether a supply has been made for these purposes. However, it is hard to see how this additional jargon assists the process of determining whether a supply forms part of an economic activity. 'Remuneration' is absent from both the English language version of the PVD and from the UK VAT Act.

More helpfully, in the Dutch case of *Borsele* (Case C-520/14 [2016] STC 1570) the Court of Justice noted that 'Comparing the circumstances in which the person concerned supplies the services with the circumstances in which that type of service is usually provided may … be one way of ascertaining whether the activity concerned is an economic activity'. In addition, 'Other factors, such as, inter alia, the number of customers and the amount of earnings, may be taken into account'.

In *Borsele,* the Court found that a local authority providing school transport services had not been carrying on an economic activity, even though some parents contributed to the cost of this service. The Court provided the following guidance on how it reached this decision:

- Only three percent of the costs were recouped from the service users;
- The link between the consideration and the service was not sufficiently direct; and
- The authority did not operate in the transport market generally and in this context was itself more like a final consumer.

This was limited guidance but goes much further than the Brief, which provides none beyond the existence of the 2-stage test. We only know that HMRC will not place so much emphasis on its own ancient business test, but we don't really know what its new approach will be.

How the Brief could have been more helpful

Whether an activity amounts to a business will always require a very fact-specific answer, making general guidance harder to provide. Nonetheless, instead of detailing the historic cases, HMRC could have referred to the Court of Appeal's reasoning in *Wakefield College* as an example of a possible approach, while stressing that each case will be different.

Wakefield was about the construction of a building for a further education college in which it ran courses for students for a fixed, subsidised fee. Lord Justice Richards decided that the provision of the courses was a

business activity. As a result, the construction of the building was standard-rated and did not qualify for zero-rating. The following had guided the judge in reaching this decision:

- The provision of the courses was the College's sole activity. It was not ancillary to anything else;
- The provision of courses for subsidised fees was a significant part of the College's 'business' and the fees the students paid were substantial in both absolute terms and as a proportion of the College's total income;
- The fees were set by reference to the cost of the courses and were not means-tested; and
- There was no reason to think the College was not typical of those participating in this market.

While exactly the same tests would not necessarily be relevant to any other case, they do help to give an indication of the types of issues that HMRC should be considering in assessing whether someone is carrying on an economic activity or business.

If we take the PVD and the economic activity case law together we find there is a bit of a mess. We have seen that the scope of VAT extends to the supply of goods or services 'by a taxable person acting as such' (Article 2). Article 9 defines a taxable person to mean 'any person who, independently, carries out in any place any economic activity, *whatever the purposes or results of that activity*' (emphasis added). But how does that fit with the qualification later in the same Article that an activity will only be economic when carried on 'for the purposes of obtaining income therefrom on a continuing basis'? The UK statutes do not help clarify the meaning of 'business' either.

So why, post-Brexit, does HMRC not seek a new radical approach to determine where the UK should draw the line around its own VAT system? The current borderline provides no certainty, especially while HMRC's 'guidance', especially this latest Brief, is so unsatisfactory.

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