

## Case Alert

# Target Group Limited

[2023] UKSC 35 - 11 October 2023

### Supreme Court provides definitive ruling that outsourced loan administration services provided to a bank are standard rated.

This judgment marks the end of the line for Target Group ("Target"), which lost appeals in the First Tier Tribunal, Upper Tribunal, Court of Appeal and now the Supreme Court.

Target Group administers loans made by Shawbrook Bank. Target's services include operating individual loan accounts and instigating and processing payments due from borrowers. The appeal concerns whether the outsourced loan administration services provided by Target fall within the VAT exemption for financial services.

Target contended that its services fall under the financial services exemption for two reasons:

**The Payments/ Transfers issue**, that by giving instructions which automatically and inevitably resulted in payment from the borrower's bank accounts to Shawbrook's bank accounts via the Bankers' Automated Clearing System, the services were exempt; and

**The Loan Issue**, that the inputting of entries into the borrower's loan accounts with Shawbrook were exempt.

Despite the UK's departure from the EU, the Court drew upon the case law of the Court of Justice of the European Union (CJEU) in resolving the resolution of the **Payments/Transfers issue**.

In *Sparekassernes Datacenter* ('SDC') (Case C-2/95) [1997] ECR I-3017, it was held that "viewed broadly" and as "a distinct whole", to be exempt, the services must:

- (i) have the effect of transferring funds and,
- (ii) change the legal and financial situation of the relevant parties.

This left open the question of whether the services must in themselves have that effect and make that change ("the narrow interpretation") or whether it was sufficient for them to have that causal effect ("the wider interpretation").

In the Court of Appeal decision of *FDR Limited* ('FDR')[2000] STC 672 the wider interpretation was considered appropriate. However the Supreme Court has now considered the CJEU case law since SDC in detail and concluded that it makes it clear that the narrow interpretation is the correct one.

This is established in particular by the cases of *Bookit Ltd* ('Bookit II') (Case C-607/14); *National Exhibition Centre Ltd* (Case C-130/15) [2016] ("NEC"), and *DPAS Ltd* (Case C-5/17).

The narrow interpretation accords with the rationale of the exemption to apply to situations where there are difficulties determining the consideration of financial services and therefore the tax base for VAT liability. It seeks to exempt services that themselves effect the transfer of funds and change the legal and financial situations of the relevant parties. The exemption must also be interpreted strictly [55].

It follows that the giving of instructions is not enough even if that inevitably results in a payment or transfer and the services necessitate being involved in the carrying out or execution of the transfer or payment – its "function and performance".

Given this conclusion, the Court said it is apparent that domestic law (the Court of Appeal) took a wrong turn in FDR and the conclusions from that case are now overturned.

### **The loan accounts issue**

Target submitted the making of accounting entries is the standard modern means of effecting movements of value and that unilateral accounting entries may be sufficient to effect a transfer of payment.

Target characterises its role as debiting and crediting the borrower loan accounts with Shawbrook and thereby making changes to the financial and legal situation of the parties so as to fall within the exemption.

This position however was undermined by the FTT's factual findings that the entries in the ledgers were of "expected payments" which were "assumed to be made". This meant such an entry cannot effect a payment or transfer or result in a change of the legal position of the parties. The loan account was no more than a ledger, recording the effect of payments made by customers to Shawbrook but not effecting such payments.

***Comment: The long-awaited judgment will be disappointing for banks and outsourcers and may lead to related changes to HMRC guidance, as part of HMRC challenges to VAT exemptions applied by businesses within the financial services sector. In light of this, practical recommendations include:***

- ***Both suppliers and recipients of services should undertake upfront reviews of transaction flows to help ensure VAT exemptions are appropriately accessed (e.g., in relation to the "Payments/Transfers" and "Loan accounts" issues, and for intermediary services in respect of the granting of credit).***
- ***Suppliers of services should review the VAT treatments applied, including documenting positions taken or updating VAT accounting where appropriate.***
- ***Similarly, financial institutions receiving such services should do likewise (e.g., when reviewing the VAT treatments self-applied to "reverse charge" services received from overseas and the potential cost base impact).***

***On a more general note, the final comment about the FTT's finding of (unhelpful) facts is very telling for anyone interested in the appeal process. The Upper Tribunal and the Courts have no powers to hear new factual evidence, so it is vital to provide all the documentary and witness evidence of facts in the FTT hearing. It remains to be seen if outsourcers can learn from the Court's comment, to demonstrate that the services do effect the payments or transfers, rather than just record them.***



**Kevin Martin**  
Partner

T +44 (0) 20 7728 3163  
E [kevin.martin@uk.gt.com](mailto:kevin.martin@uk.gt.com)

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