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Education charity's new training centre was economic activity attracting £135,000 VAT bill

Longridge on the Thames v. The Commissioners for Her Majesty's Revenue & Customs
[2016] EWCA Civ 930

Article by David Bowden

The day after the Government met at Chequers to agree a first cut of a Brexit plan, a judgement is handed down by the Court of Appeal which is music to hard Brexiteer's ears. A charity constructed a new training centre. It was not registered for VAT. It was charged £135,000 VAT on the construction costs. The HMRC turned down the tax payer's application for a VAT refund. The taxpayer then took its case to the First Tier Tribunal who ruled in its favour saying that as a charity it was not engaged in economic activity so that an exemption applied. The HMRC's first appeal to the Upper Tribunal was dismissed. The Court of Appeal has now overturned those tribunals' decisions. In doing so it has had to have undue regard to a number of decisions from the CJEU in Luxembourg rather than the more benevolent approach of UK courts to charities. The Court of Appeal has refused to refer this case to the CJEU for a ruling. It is unclear if the Supreme Court will take this case on final appeal.

Longridge on the Thames v. The Commissioners for Her Majesty's Revenue & Customs
[2016] EWCA Civ 930 1 September 2016
Court of Appeal (Arden & Tomlinson LJJ and Morgan J)

What are the facts?
Longridge ('the taxpayer') provides water-based and outdoor activities predominantly for young people at its site in Marlow. It is a registered charity and is not registered for VAT. It spent over £760,000 building a new training centre. It tried to reclaim £135,000 VAT it paid from HMRC. The taxpayer relies heavily on volunteers. Around 30,000 young people take part in the taxpayer's courses every year including some which physical disabilities or special needs. Although charges are made there are discounts and waivers.

What does the Value Added Taxes Act 1984 say about what is a business activity?
Section 4 deals with '*Scope of VAT on taxable supply'* and provides that:

> '4(1) *VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.*'

Section 94 of VATA 1994 defines '*business*' as including '*any trade profession or vocation'.* Section 30 provides for certain supplies by a taxable person to be taxable at the zero rate. Group 5 of Schedule 8, headed '*Construction of Buildings, etc.'* contains this item:

> '2. *The supply in the course of the construction of –*
> *(a) a building ... intended for use solely for ... a relevant charitable purpose'*

What does the EU legislation say on this?
The 40 years of EU rules on VAT were consolidated in 2006 in a Directive **2006/112/EC** ('the VAT Directive'). Article 9(1) defines '*taxable person'* as meaning:

> '*any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. Any activity of producers, traders or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as "*economic activity*". The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity*.'

Article 132 sets out public interest exemptions stating that:

> '1. *Member States shall exempt the following transactions:*
> *… (h) the supply of services and goods closely linked to the protection of children and young persons by bodies governed by public law or by other organisations recognised by the Member State concerned as being devoted to social wellbeing,*
> *(i) the provision of children's or young people's education, school or university education; vocational training or retraining, including the supply of services and of goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the Member State concerned as having similar objects;*
> *…(m) the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education*.'

4. Article 133 permits a Member State at its discretion to qualify exemptions otherwise within the A132 scope, stating that:

> '*Member States may make the granting to bodies other than those governed by public law of each exemption provided for in points ...(h), (i) ...(m)... of Article 132(1) subject in each individual case to one or more of the following conditions:*

> *(a) the bodies in question must not systematically aim to make a profit, and any surpluses nevertheless arising must not be distributed, but must be assigned to the continuance or improvement of the services supplied;…*
> *(c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT;*
> *(d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT*.'

What has been the difference in approach to UK and EU courts?
Very broadly when it has come to charities, the UK courts have adopted a more liberal or generous interpretation of the VATA 1984 or its exemptions and have tried to find that they were not carrying on a business or if they were there was no direct link to what they did and the turnover generated. The EU courts have however had to interpret the VAT Directive which is framed in slightly different terms, saying there is no special rule for charities and stating that where there is a permanent activity in return for remuneration then this is an '*economic activity'* caught by the VAT Directive

Why did HMRC reject the taxpayers claim for a VAT refund?
HMRC said that despite the taxpayer's charitable status, it was carrying on a business and refused the VAT refund request under the VATA 1984.

What ruling did the First Tier Tribunal give?
In a lengthy reserved judgment **[2013] UKFTT 158 (TC)** following a 4 day hearing handed down on 28 February 2013, Tribunal Judges Edward Sadler and Nigel Collard allowed the taxpayer's appeal. It concluded that:

> *'115. We can deal with the lower floor of the Training Centre shortly. The Appellant's intention was to provide the facilities it houses in the lower floor principally for use by young people attending its courses. It also intended to provide limited toilet facilities for adults attending its courses (although such use soon became impractical). It is clear therefore that the Appellant intended to use the lower floor in the course and for the purpose of its activity which we have concluded was not the carrying on of a business. We cannot see that there is any case that there is a distinct use of the lower floor separate from the Appellant's general activity.*
> *116. We therefore conclude that the lower floor of the Training Centre is a building intended for use solely for a relevant charitable purpose within the terms of Items 2 and 4 of Group 5 of Schedule 8 to VATA 1994.'*

What ruling did the Upper Tribunal make on HMRC's 1st appeal?
In a reserved judgement **[2014] UKUT 504 (TCC)** handed down In February 2015, Mrs Justice Rose sitting in the Upper Tribunal dismissed the HMRC's appeal after a 2 day hearing. She was equally clear in concluding:

> '*48. In my judgment the First-tier Tribunal applied the correct test in evaluating the facts as it found them. There are no grounds for disturbing its conclusion that Longridge does not carry on an economic activity at the site*.'

What was the issue before the Court of Appeal?
The issue for the Court of Appeal was on which side of the line the taxpayer charity fell and to decide what test or process should genuinely non-economic activity be ascertained?

What submissions did HMRC make?
The HMRC made a large number of submissions as to why the taxpayer charity was engaged in economic activity or furtherance of a business and they can be summarized as follows:

- There is an economic activity for VAT purposes unless there is no direct link between the service and the payment that the service recipient makes,
- Economic activity is wide in scope and objective in nature,
- There is a presumption that an activity is economic where it is permanent and carried out in return for remuneration,
- There has to be a sufficient direct link between the supplier's charges and the goods or services,
- It is irrelevant that the taxpayer acted in the public interest or had a charitable motive,
- It is irrelevant that the taxpayer had no business motive and was reliant on grants and donations,

- Mere receipt of remuneration is enough to establish economic activity,
- The size of the taxpayer was substantial in size, was conducted in a professional manner with a full time chief executive and was an activity of a kind provided by commercial enterprises who do seek to profit from them,
- The way the charity charges its users is irrelevant to deciding if it is engaged in economic activity, and
- Various VAT decisions from UK courts should be disregarded entirely as they have '*not kept pace with CJEU jurisprudence*'.

What submissions did the taxpayer make?
The taxpayer whilst saying that the 2 tribunals came to the correct decision made these additional points:

- The finding of fact made by the FTT that the taxpayer was not engaged in a business or economic activity was one that was open to it to make on the facts it found and is not open to challenge on appeal,
- The meaning of '*business activity'* is an objective one and it is not permissible to have regard to the taxpayer's motives,
- The taxpayers charges to service users were significantly less than cost,
- To decide if there is 'economic activity' a tribunal can take into account terms or features of the taxpayer's offering which leads it to conclude that the *manner* in which those activities are undertaken is different to that undertaken by someone else in the ordinary course of the market,
- The subsidized charges made by the taxpayer was something the FTT could properly have regard to in determining that there was no '*economic activity*',
- UK case law supports the taxpayer's case that charities are not ordinarily engaged in '*economic activity'*,
- '*Economic activity'* should be narrowly construed to exclude those who provide services at a concessionary rate, and
- The CJEU cases relied on by HMRC can be distinguished on their facts.

What had the CJEU in Luxembourg previously decided in *Finland?*
In *European Commission v Finland* **Case C-246/08**, **[2009] ECR 1 – 10605** the CJEU looked at the provision by the state of free or subsidised legal aid in return for a sum calculated not as a proportion of the true cost of the legal services provided but rather by reference to a person's means. Overall individual contributions amounted to 8% of the Finland's total cost in providing the legal aid.

The CJEU held this did not constitute an '*economic activity'*. The CJEU held that there was no sufficient '*direct link'* between the payment and the service provided. It also held that the mere fact that a person receives income from an activity does not mean that it was carrying on an '*economic activity*'. It further held that as a general rule an activity will be an '*economic activity'* where it is '*permanent and is carried out in return for remuneration which is received by the person carrying out the activity'*.

Are there any other prior domestic UK authorities of relevance?
There are 4 such authorities all concerning either charities or similar benevolent arrangements. In 3 of these cases, UK courts have decided there is no business and no VAT liability. These cases are:

C&E Commissioners v. Morrison's Academy Boarding Houses Association **[1978] STC 1** (Inner House of Scottish Court of Session – Lord Cameron)
Boarding fees were charged for accommodating pupils. This was held to be activity amounting to the carrying on of a business. It was carried on in a business-like way and with reasonable continuity. A lack of a profit motive was irrelevant. The boarding fees attracted VAT.

C&E Commissioners v. Lord Fisher **[1981] STC 238** (Chancery Division, Gibson J)
A host provided a shoot for friends on the basis that they contributed to the costs. The shoots were regular events. They were conducted in a business-like way and on a basis similar to commercial shoots. A court assesses these 6 criteria:

- The seriousness of the enterprise,
- the regularity of the activity,
- the substantiality of the activity,
- the organisational features or the enterprise,
- the predominant concern of the activity, and

- a comparison with commercial providers of the same service.

It was open to a VAT tribunal to conclude that this activity was not a business activity. The activity was carried on for pleasure and not as a business. The fact that the participants made substantial contributions to the shoot did not make it a business activity. No VAT was due.

HMRC v. Yarburgh Children's Trust **[2002] STC 207** (Chancery Division, Patten J)
A charity acquired a lease of premises where it provided day care facilities for children for which it charged a fee. In setting this fee the charity drew a balance between keeping the facilities affordable and meeting its operating costs. Neither acquiring the lease nor making the child care charges was a business. You look at the transaction in its wider context and consider its observable terms and features. The landlord was not motivated by profit. The charitable purposes of the taxpayer were part of those observable terms and features. The fact that the charity made charges was not determinative and its motive was not relevant. No VAT was due.

HMRC v. St Paul's Community Project Limited **[2005] STC 95** (Chancery Division, Evans-Lombe J).
A charity provided nursery places at concessionary rates. In determining any VAT liability you look at the charity's predominant concern. It did not conduct a business. No VAT was due.

Are there any other prior CJEU authorities of relevance?
The CJEU cases however have in general strained to find there is an '*economic activity'* and thus a VAT liability. As well as *Finland* these authorities are:

Floridienne SA v Belgium Case **C-142/99, [2000] STC 1044**
You look at the wider circumstances in which a parent company held shares in its subsidiaries. The management of these shareholdings does not of itself constitute an economic activity but it may do so where the parent company is also making interest-bearing loans to its subsidiary. It all depends on the facts. An economic activity has to have a commercial purpose characterised by a concern to maximise returns on capital investments. A holding company passively managing a portfolio of investments and subsidiaries in the same way as a private investor is not carrying an economic activity. A profit motive is irrelevant. There is no direct link between dividends and an investment in shares because dividends depend on the profits of the subsidiary.

BBL SA v. Belgium **[2004] ECR I-10157 (**Advocate-General Poiares Maduro**)**
'*Economic activity'* means an activity likely to be carried on by a private undertaking on a market, organised within a professional framework generally performed in the interest of generating profit.

What principles did the court apply in coming to its ruling?
The court applied the 6 *Fisher* criteria suitably modified to take into account later judgements of the CJEU on what is '*economic activity'*.

What ruling Lady Justice Arden give?
Arden LJ starts by correctly noting that:

'*…the domestic authorities have developed in a way which means that they now diverge in some respects from the test to be applied in determining whether an activity of providing services to a recipient who makes a payment constitutes an economic activity resulting in a liability to VAT. In* Finland*…, the focus was on whether there was a sufficiently direct link between the payment and the service. The* Fisher *criteria …. by contrast omit reference to the connection or proportionality of the payment to the service.*'

She appears to offer a ray of hope when she says: '*It is clear that even under the direct link test there will be cases where the activities of an organisation, such as a charity, providing services at a concessionary rate, do not amount to economic activity*.' But then she goes on to trash the taxpayer's hopes in this case with these hollow words:

'*The differences between the test of direct link and the Fisher criteria are material. This can be seen in relation to the use of volunteers. In its determination, the FTT considered that a critical distinction between Longridge's business and that of an economic activity for VAT purposes was that Longridge uses volunteers to a significant extent.….But this feature of Longridge's business, praiseworthy that it no doubt is, has little or no bearing on the direct link test*.'

Arden LJ then goes on to view it all through the prism of the CJEU cases. She says that the general rule as to economic activity '*can be displaced by evidence that there was no direct link between the service and the payment or by other evidence which shows that there was no economic activity'.* As to the charges levied by the taxpayer to users of its services she says:

'*Even after deductions were made … for available grants and donations, the amount of the charge was more than nominal in amount and was directly related to the cost of the activity being provided. In those*

> *circumstances, in my judgment, the charges did not prevent the application of the direct link test leading to the result that there was an economic activity in this case.*'

She noted in particular that the FTT described the taxpayer '*as conducting and seriously pursuing its activities on a regular basis and having prudent financial management. It also referred to the scale of its activities, which was substantial, and the fact that it operated in a market where similar services were supplied on a commercial basis….. they support the impression of economic activity. The concessionary charges were also not an indicator against the existence of an economic activity because the economic activity springs from the receipt of income, not profit.*'

As to the taxpayer's charitable objectives and its heavy use of volunteers, Arden LJ cold-heartedly rules that:

> '*economic activity is assessed objectively and so the concern of Longridge... is not enough to convert what would otherwise be economic activity into an activity of a different kind for VAT purposes. The reduction in costs due to the work of unpaid volunteers would also not lead to that conclusion.*'

Given all this her stark conclusion is that '*in my judgment, Longridge conducted an economic activity for VAT purposes and the right order in this case would be to allow the appeal of HMRC*' and that the taxpayer '*was carrying on economic activity or business for VAT purposes.*'

What else did Mr Justice Morgan add?
Morgan J gave a 5 page judgement concurring in the result with Arden LJ but adding some additional explanation noting that '*this appeal is of some importance…in relation to charities'*.

Will this case be referred to the CJEU?
No. Arden LJ said that '*in my judgment, this Court can give effect to CJEU jurisprudence without the need for any preliminary ruling by the CJEU. Neither party pressed this Court to make a reference. Accordingly I conclude that we should not make an order for a reference for such a ruling*.'

Will there be a final appeal?
This would seem a classic zig-zag case that would interest the Supreme Court of the United Kingdom.

At the moment the 2 lower tribunals have come out supporting the taxpayer and the judge count is 3-3. Arden LJ's ruling that '*there is no special rule for a charity'* seems not only very harsh but also flies in the clear face of the language in both the VATA 1984 and the VAT Directive. For the taxpayer to win it will only need to persuade 3 Supreme Court judges. The tribunal having found the facts and applied them, it does not seem right for the Court of Appeal to try and disturb this. HMRC neglected to cite in the FTT a critical case of *Finland* which it somehow found for the Upper Tribunal.

The domestic cases that Arden LJ refers to are all either High Court, Court of Appeal or Court of Session ones. This tricky issue of what is an '*economic activity'* and where the line has to be drawn for VAT purposes is not something that either the House of Lords or Supreme Court has had to consider before. It will be most attractive for the Supreme Court to carve out something for the taxpayer that restores the FTT decision which will find favour in an ever hard-Brexit environment without also at the same time needing to trouble the CJEU for a preliminary ruling.

Are there any other general issues related to this case?
It is not only in the VAT field, that the EU provides fuzzy meanings as to what is and is not a business activity leaving it with national courts and regulators to attempt to mop up the mess it has created. In the Consumer Credit Directive **2008/48/EC** '*consumer'* is defined as '*a natural person who, in transactions covered by this Directive, is acting for purposes which are outside his trade, business or profession*'. This same quite hopeless definition is also in the Unfair Contract Terms Directive **93/13/EEC.** Whilst in the Consumer Guarantees Directive **1999/44/EC** a slight variant but equally vague definition appears of '*any natural person who, in contracts covered by this Directive, is acting for purposes which are not related to his trade, business or profession'*.

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