TAXREP 11/02

VAT: FINANCE EXEMPTION

Memorandum sent in March 2002 to Customs by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in February 2002.

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VAT: FINANCE EXEMPTION

GENERAL COMMENTS

1. We welcome the opportunity to respond formally on the changes to Group 5, Schedule 9, VATA 1994 proposed in your letter dated 25 February 2002.

2. We are content with the general thrust of the changes, about which we comment in more detail below. However, we would have preferred it if the opportunity had been taken to make more substantial changes to Group 5, because it still contains major divergences from the Sixth Directive, in particular with regard to phrases such as "any dealing with money"; such divergences may well lead to future disputes. We reiterate our general view that the words of the Directive should be used, amplified only as required by Article 13 of the Directive to contain conditions "for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse.".

3. Our particular concerns in the context of the present proposals are the drafting of Item 1 of Group 5 and the undue emphasis placed on the phrase “the management of credit”, at which much of the proposals are directed. That phrase is found in the Sixth Directive only in Article 13B(d)(1) which reads: “the granting and the negotiation of credit and the management of credit by the person granting it”.

4. It does not appear in later parts of Article 13B(d), and, in particular, it is not found in Article 13B(d)(3): “transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring” (our emphasis). Quite apart from the fact that “the management of credit” is difficult to define, it is only used in the context of the person granting the credit and in most instances it does not represent a separate supply from the granting of the credit itself, but merely a separate occasion of charge. So far as persons other than the person granting the credit are concerned, the phrase tells us nothing other than that there is no exemption under Article 13B(d)(1). It does not tell us that exemption is not available under other parts of Article 13B(d), for which, as we have noted, the phrase is irrelevant.

5. Note 1A to Group 5 has, however, the effect that services coming within the descriptions listed are excluded from exemption altogether, except when supplied by the person granting the credit. Many of the activities comprised in what the finance sector would regard as the management of credit fall within Article 13B(d)(3). In Group 5, these activities are in Item 1 and we think it wrong to exclude (by Note 2A) services which amount to the management of credit but which are exempt under Article 13B(d)(3). In our view, each exemption has to be given an independent meaning in Community Law. Therefore, Article 13B(d)(3) should not be interpreted by reference to Article 13B(d)(1) (see Card Protection Plan [1999] STC 270 at 281: para 27 of AG’s Opinion).

6. In short, we believe that the present and proposed wording of Group 5 restricts the scope of the exemption beyond that in the Directive and to an extent greater than that required "for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse”.

7. As an aside, we would note that the restrictive way in which the exemptions in Article 13B(d) are being applied in the UK imposes additional costs on the UK financial sector businesses that outsource part of their activities and places them at a disadvantage in comparison with competitors elsewhere in places such as the USA and could contribute to the decision of those businesses to migrate. We suggest that a less restrictive and more favourable interpretation within the legal framework of the Directive is worthy of consideration.

DETAILED COMMENTS

8. Subject to the comments made earlier, we welcome the clarification in Note 1A of Group 5 that the exclusion from the exemptions for preparatory services relates only to a separate supply of preparatory services. Where preparatory services are ancillary to an exempt financial service and do not constitute an aim for the customer in purchasing the service, the VAT treatment will depend on the main service. Strictly, though, inserting the word "separate" does not make a difference. It was already reasonably clear that the note only applied where there was a separate supply of preparatory services.

9. The deletion of the tainting provisions from Note 2B is also welcome. However, we would be interested to know how Customs are going to deal with those taxpayers who challenged the provisions as ultra vires the Sixth VAT Directive. We are of course aware that the dispute relating to authorisation charges by VISA has been settled. But we would like to know how other challenges are being dealt with and whether Customs are prepared to make repayments of tax to those who accounted for VAT whilst relying on the tainting provisions.

10. We note the deletion of valuation services from Note 2B. Under the existing provisions the separate supply of a valuation service in relation to "a credit ... operation" (i.e. lending) is deemed to be the "management of credit." When supplied by the person who grants the credit this is an exempt supply. We would be interested to know whether Customs intends to repay VAT to lenders who have charged valuation fees to their mortgage customers and have accounted for VAT on the supply.

11. The changes still leave the legislation providing an incomplete definition of the management of credit. Certainly some of the key features of such a service are mentioned. However, the most important part, debt servicing, is still missing. This does not equate with monitoring the debtor's payment record. It involves dealing with all the customer contact during the currency of the loan. In other words the legislation misses out the expensive part of the management of credit. However, we remain unconvinced that it is necessary to define the management of credit in the UK legislation. There remains the potential for the Notes in Group 5 to cause future disputes between traders and Customs. It would of course be helpful to include Customs' opinion as to what the term means in a Customs' Notice.

12. Finally, we welcome the change in the final indent under Note 2B to correct an error in the legislation relating to monitoring a debtor's payment record. This reflects

our pointing out to Customs that the legislation incorrectly refers to a creditor's rather than a debtor's payment record.

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