VAT focus

Ouroboros: VAT, HMRC, business, non-business

Speed read

Four years after *Wakefield College*, in which the Court of Appeal set out the correct approach for determining whether an activity is a business activity for VAT purposes, HMRC updates its internal manual: the *VAT Business/Non-Business Manual* specifically. The former 'business test', derived from the 40-year-old *Lord Fisher* case, has finally been updated. HMRC now refers to a new set of factors to take into account when considering whether an activity is business for VAT purposes. It also discusses how non-business activities impact on VAT recovery, but its guidance oversimplifies the law almost to the point of misrepresenting it. In particular, its position on businesses that carry out the occasional non-business activity.

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Back in the 1970s, Lord Fisher organised shoots for himself, his friends and relations. He acknowledged, in the eponymous VAT case ([1981] STC 238), that by accepting contributions to the cost of the shoots from his guests, he was doing something (allowing them to join the shoots) for a consideration, which, of course, is the very definition of a supply of services (see VATA 1994 s 5(2)(b)). That was not enough on its own to trigger a VAT charge, however; in order for the supply to be a taxable supply, it had to be made in the course or furtherance of a business (as required under VATA 1994 s 4(1)).

In the event, the High Court held that whatever Lord Fisher was doing was not a business for VAT purposes: it was merely 'an activity for pleasure and social enjoyment'. In its judgment, it reaffirmed the principle that:

> '... in determining whether any particular activity constitutes a business it is necessary to consider the whole of that activity as it is carried on in all its aspects ...',

and set out six indicia for the purposes of such determination. Those indicia are why we are still talking about the case today. But more on the indicia later; for now, let's simply register the High Court's approach in how in effect it applied a two-stage test, asking:

- first, whether there was a supply; and
- then, whether that supply was made in the course or furtherance of a business.

This approach was echoed in *Yarburgh Children's Trust* [2002] STC 207 (*Yarburgh*), in which the High Court observed that the 'business' question 'could not be answered by reference only to the fact that a service was provided at a price. That is the beginning not the end of the inquiry'.

The case turned on whether the grant of a lease by the taxpayer to a playgroup was a business for VAT purposes. The court looked at the EU prototype from which the UK 'business' concept derived – 'economic activity' – and how it was defined in what is now article 9(1) of the Principal VAT Directive (PVD), the second limb especially, which provides that:

> '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',

and concluded that while the letting of a property would in principle be an economic activity if it amounted to the 'exploitation' of that property, the grant by a charity of a lease that 'only came into being in order to satisfy the requirements of lottery funding … designed simply to facilitate the use of the … building by a second charity' did not amount to the 'exploitation' of that property for the purposes of obtaining income therefrom. It was not a business for VAT purposes.

Then came *Longridge on the Thames* [2016] EWCA Civ 930 (*Longridge*). In that case, the Court of Appeal accepted HMRC's submission that 'domestic authorities [such as *Lord Fisher* and *Yarburgh*] where the courts [had] looked at the wider context in order to determine whether the provision of services for a money payment constituted an economic activity' was not consistent with EU law, and found in favour of a 'general rule', under which something done for payment (i.e. a supply of services) would be an economic activity unless displaced by evidence to the contrary.

HMRC oversimplifies almost to the point of misrepresenting this complex subject

There was much debate over whether the *Longridge* judgment was right in its interpretation of EU law, and less than two years later, a differently constituted Court of Appeal clarified the position (in *Wakefield College* [2018] EWCA Civ 952 ('*Wakefield*')). This time, the Court of Appeal accepted the taxpayer's submission that 'European case law [required] a two-stage test', and held as follows:

- 'Whether there is a supply of goods or services … and whether that supply constitutes economic activity … are separate questions. A supply for consideration is a necessary but not sufficient condition for an economic activity. It is therefore logically the first question to address.'
- 'Satisfaction of the test for a supply for consideration … does not give rise to a presumption or general rule that the supply constitutes an economic activity [although the same outcomes may often be expected].'
- In considering whether a supply constitutes an economic activity, '[t]he issue is whether the supply is made for the purposes of obtaining income therefrom on a continuing basis.'
- The 'business' test 'requires a wide-ranging, not a narrow, enquiry.'

Lord Fisher and *Yarburgh*, déjà vu.

HMRC's *VAT Business/Non-Business Manual*

More than four years after the *Wakefield* judgment, HMRC updated its *VAT Business/Non-Business Manual*.

The two-stage test laid down in *Wakefield* is

HMRC's old and new tests

[A] *Lord Fisher*	[B] Post-*Wakefield*
[1] Is the activity a serious undertaking earnestly pursued?	[1] Is a purpose of the consideration to create income?
[2] Is the activity an occupation or function, which is actively pursued with reasonable or recognisable continuity?	[2] Is there an intention to make a profit?
[3] Does the activity have a certain measure of substance in terms of the quarterly or annual value of taxable supplies made (bearing in mind that exempt supplies can also be business)?	[3] Is the payment so low as to be a concession?
[4] Is the activity conducted in a regular manner and on sound and recognised business principles?	[4] Is the activity conducted based on sound business principles?
[5] Is the activity predominately concerned with the making of taxable supplies for a consideration?	[5] What is the scale of the activity?
[6] Are the taxable supplies that are being made of a kind which, subject to differences of detail, are commonly made by those who seek to profit from them?	

summarised at VBNB30200. Interestingly, the question at stage two, rather than being framed (widely) as whether the supply in question constitutes an economic activity, is framed (more narrowly) as whether the supply is made 'for the purpose of obtaining income'. Curiously, it does not mention the 'exploitation' element, which forms a key part of the definition of 'economic activity' in PVD article 9(1) (not to mention the *Yarburgh* judgment) – a material omission, one might argue. The approach also begs the question whether framing the question so tightly cuts across the Court of Appeal's statement in *Wakefield* that the 'business' test 'requires a wide-ranging, not a narrow, enquiry'.

VBNB30200 itself even acknowledges that:

'Even if an activity involves supplies which are provided for consideration with the purpose of obtaining an income therefrom, an activity will not be business for VAT purposes in certain circumstances',

citing where 'the taxpayer did not participate in the market … [for example,] where the supplies are provided as part of a regulatory or Governmental activity, fulfilling the functions of the state' and 'where there is no potential commercial competition for the goods of services supplied' as examples of such circumstances.

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It is no doubt true that 'whether something is done for the purpose of obtaining income' is an easier question for the average taxpayer than 'whether something is an economic activity', but the risk of preferring user-friendliness to precision is, of course, not applying the law correctly.

HMRC used to refer (at VBNB22000) to the six indicia set out in *Lord Fisher*. Then, in *Longridge*, it argued – in part, rightly – that 'the *Fisher* criteria [had] not kept pace with CJEU jurisprudence'. It is not surprising, therefore, that, in the post-*Wakefield* world, HMRC now refers (in VBNB30300) to a new set of factors to take into account when considering whether an activity is business for VAT purposes. What *is* surprising – and not a little confusing – is that, while it can no longer be accessed via the contents page of the *VAT Business/Non-Business Manual*, VBNB22000 can still be found via a Google search and appears still to be extant.

See the table above for the two tests, old and new, set side-by-side.

A1 is aimed at distinguishing an economic activity from an activity for social enjoyment and is rarely helpful in a more general context and is rightly retired. A2, A3 and A4 are in substance replicated as B3, B4 and B5. B1 is taken straight out of *Wakefield*; B2 is meant to elaborate on B1 but, as framed, may result in cognitive dissonance – even HMRC itself acknowledges at VBNB20250 that: 'While the intention of generating income is a [relevant factor], that is not the same as the intention to generate a profit.'

A5 has been of questionable utility in practice and is rightly retired. A6 asks in essence whether the person in question is a participant in a market – which the Court of Appeal in *Wakefield* accepts is a relevant question – and it is curious to see it absent on the new list.

Comparing the two sets, the progression from *Lord Fisher* to *Wakefield* seems more evolutionary, the differences not quite as binary as *Longridge* suggested.

VAT recovery

As HMRC notes at VBNB20200, the 'business' question impacts not only on whether VAT is payable on an activity, but also on 'whether VAT incurred on purchases can be deducted as input tax or not'.

Very broadly, under VATA 1994 s 26(1) and (2), a taxpayer is entitled to recover so much of the VAT he incurs as is attributable to taxable supplies. VAT that is attributable to exempt supplies is clearly excluded. This is expressly confirmed in reg 101(2)(c) of the Value Added Tax Regulations, SI 1995/2518, which also excludes VAT incurred on supplies that are used or to be used in 'carrying on any activity other than the making of taxable supplies'. This is the basis on which VAT attributable to non-business activities (where no taxable supplies are made) is excluded.

In VBNB20700, HMRC states that:

'A non-business activity is likely to arise where:

…

(2) goods or services are not provided for consideration. This could be because:
1. goods and services are provided but for no charge;
2. payment is made, but no goods or services are provided
…
(4) the activity is otherwise outside the scope of VAT …'

In *Sveda* (Case C-126/14), the taxpayer constructed a path in an area of outstanding natural beauty and opened it to the public for no charge. In *Associated Newspapers* [2017] EWCA Civ 54, the taxpayer, to boost the circulation of its newspapers, gave vouchers to certain readers for no charge. In *Frank Smart* [2019] UKSC 39, the taxpayer received farm subsidies but provided nothing in return. In *Larentia + Minerva* (Case C-108/14), the taxpayer received profit distributions – dividends, essentially – which, as HMRC notes in VBNB22120, are payments arising from a non-business activity (and thus outside the scope of VAT).

The *VAT Business/Non-Business Manual*, on its face, would suggest that, in each of these cases, the taxpayer would not be able to recover the VAT it incurs in relation to the transaction in question, and yet in all these cases, the taxpayer was successful in recovering such VAT.

In light of the continuing gap between what the law is and how HMRC perceives it, more cases are likely to emerge – no matter how hard HMRC spins the topic in its manual

The position with businesses that carry out the odd non-business activity is clearly nowhere near as black and white as HMRC suggests. On *Sveda*, HMRC says (at VBNB30500) that:

'Businesses that incur VAT costs in relation to non-taxed transactions or non-business activities may claim they are entitled to full recovery of their VAT costs quoting the Court decision in *Sveda* … There was a clear finding by the court … that [*Sveda*] was a wholly commercial enterprise and would use the asset entirely for its fully taxable business. It had no non-business activities or purpose with which to link the costs incurred. The decision in *Sveda* does not establish a new test for deduction of VAT.'

This, however, oversimplifies almost to the point of misrepresenting this complex subject (see the Supreme Court judgment in *Frank Smart* for comparison). And the cases cited above are not the only authorities that adopt a more nuanced approach. *The Towards Zero Foundation* case [2022] UKFTT 226 is the latest addition, and in light of the continuing gap between what the law is and how HMRC perceives it, more cases are likely to emerge – no matter how hard HMRC spins the topic in its manual. ■

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