VAT focus

BlackRock: single supply, dual use – apportionment?

Speed read

***BlackRock* (Case C-231/19) concerns VAT on a single supply of investment management services used to manage both special investment funds (SIFs) and non-SIFs. In that case, the CJEU ruled that the potential for dual use meant the exemption for the management of SIFs cannot apply, so the supply was standard rated in its entirety. The decision in *Luxembourg* to the effect that a supply could in principle be exempt only in part was dismissed as irrelevant. The suggestion from *BlackRock* is that all dual or multi-capable services that may be 'used in the same way for the management of special investment funds as for the management of other funds' are by definition excluded from the SIF exemption; however, this seems unduly restrictive, and no doubt the exemption will continue to develop.**

Etienne Wong
Old Square Tax Chambers
Etienne Wong has been advising on VAT since 1989, with particular focus on finance, real estate, funds, crypto assets, renewables and new technology. He is a barrister with Old Square Tax Chambers at 15 Old Square. Email: ewong@15oldsquare.co.uk; tel: 020 7242 2744.

BlackRock Investment Management (UK) Ltd ('BlackRock') manages investment funds. It uses services purchased from the US to do this, namely an IT platform known as Aladdin.

Reverse charge

Where services are received from outside the UK, the reverse charge under VATA 1994 s 8 is engaged. Under the reverse charge, the recipient of the services (provided they are a business, like BlackRock) is treated as both supplying and receiving the services (and, as the deemed supplier, it is required to account for VAT on them).

The reverse charge does not, however, apply where the services fall within one of the exemptions specified in VATA 1994 Sch 9.

Items 9 and 10 of Sch 9 Group 5 enact article 135(1)(g) of the Principal VAT Directive (or PVD) to exempt 'the management of special investment funds'. This is a somewhat opaque exemption, and there is much uncertainty over what is encompassed by the term 'management' and what amounts to a 'special investment fund' (see the articles 'VAT and the evolution of the special investment fund' and 'VAT and SIFs: what does "management" mean?' (Alex Tostevin & Etienne Wong) in *Tax Journal*, 16 November 2018 and 18 January 2019, respectively).

BlackRock argued that the services it had received from the US (the Aladdin services) fell within the exemption provided for by article 135(1)(g) and thus outside the scope of the reverse charge. On 15 August 2017, the First-tier Tribunal (FTT) held that the services were, in principle, exempt as the management of special investment funds (*BlackRock Investment Management v HMRC* [2017] UKFTT 633).

But that was only half the battle.

Single supplies

In order for services to be exempt as the management of special investment funds, two conditions need to be satisfied:

- the activities in question must amount to 'management'; and
- the funds being managed must be 'special investment funds' (or SIFs) within the meaning of the exemption.

BlackRock had been using the Aladdin services to manage both funds that were SIFs and funds that were not SIFs. If the Aladdin services used to manage SIFs were distinct from the services used to manage non-SIFs, i.e. if there had been (at least) two sets of services, or (to use VAT-speak) two supplies – the VAT position would have been relatively straightforward – the supply used to manage SIFs would have been exempt (and outside the scope of the reverse charge), and the supply used to manage non-SIFs would have been subject to the reverse charge (and standard rated).

The complication in *BlackRock* was that both BlackRock and HMRC regarded the Aladdin services as a single set of services, i.e. a single supply. A single supply is normally taxed at a single rate, so the question with a single supply of investment management services used to manage both SIFs and non-SIFs is whether the dual use means the exemption cannot apply, so the supply is standard rated in its entirety. Or if the exemption covers the whole of the supply (including the standard rated 'elements'). Or whether the general principle (that a single supply is taxed at a single rate) is displaced, so the supply is apportioned between its standard rated and exempt 'elements'.

That in essence was the question referred to the CJEU (Case C-231/19).

Exceptions

A little more than ten years before the *BlackRock* case, in *Talacre Beach* (Case C-251/05), which concerned the supply of caravans and their contents, the taxpayer argued that because the supply was a single supply, the VAT treatment applicable to the caravans should also apply to their contents (with the result that the whole of the supply would be subject to VAT not at the standard rate, but the zero rate). The CJEU rejected this argument and held that although there was a single supply, the contents could not benefit from the zero-rating treatment accorded the caravans. This meant that although there was a single supply, the supply was, exceptionally, subject to two rates (the standard rate and the zero rate).

About five years later, in the so-called *French Undertakers* case (*Commission v France* (Case C-94/09)), which concerned whether the domestic law of France was right to restrict the reduced rate of VAT only to the transportation by an undertaker of the body or whether (as the European Commission argued) it should extend to the other funeral services supplied by the undertaker as well (on the basis that the services supplied by the undertaker were a single supply and thus susceptible to a single rate), the CJEU held that, in the circumstances of that case, France was at liberty to apply the reduced rate selectively. The single supply by the undertaker was, therefore – again, exceptionally – subject to two rates (the standard rate and the reduced rate).

In its own case, BlackRock argued that the general principle that a single supply was subject to a single rate was not an absolute rule but rather a matter of legislative interpretation. A purposive construction of article 135(1)(g), it argued, required an apportionment to reflect the dual use of the Aladdin services, with the result that multiple rates should apply.

This was rejected by the FTT, which held (at paras 229–230) that the circumstances in *Talacre Beach* and the *French Undertakers* case were entirely different:

'In the former case, the application of a single rate of tax to a composite supply would have extended zero rating in a manner directly contrary to a provision of Community Law. It was for this reason that different rates of tax had to be applied to the same single supply ... Similarly, [in] the *French Undertakers* case … the reduced rate of VAT applied by France was specifically authorised by Community Law … there is no proper comparison with the present appeal and [either] case.'

That disposed of the question whether a single supply could be apportioned between different rates. As for whether the dual use of the Aladdin services meant the exemption provided for by article 135(1)(g) could not apply or if it meant the opposite – that it would cover the whole of the supply – the FTT held that, because the funds BlackRock managed were predominantly non-SIFs (whether calculated by the number of funds or by the amount of assets under management), the correct rate of VAT was the standard rate.

The exemption did not apply – at all.

BlackRock appealed the case to the Upper Tribunal and the Upper Tribunal referred the case to the CJEU ([2018] UKUT 415 (TC)).

Luxembourg

In its appeal, BlackRock cited *Commission v Luxembourg* (Case C-274/15), which concerned PVD, article 132(1)(f) (the so-called cost-sharing exemption), which exempts:

'the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity …'

The question for the CJEU in *Luxembourg* was whether Luxembourg had properly transposed the cost-sharing exemption to domestic law.

The cost-sharing exemption applies to the services of an independent group of persons (an IGP). The wording of the exemption refers to members of the IGP being persons who carry on an exempt (or, broadly, non-business) activity. However, under Luxembourg law, a person who, in addition to carrying on exempt (or non-business) activities, also carried on a taxable activity could still be treated as a member of the IGP (and the cost-saving exemption would still apply) provided the member's annual taxable turnover did not exceed certain prescribed thresholds.

The question was whether this was right, and the CJEU held that it was not. However, it did also say (at para 53) that:

'the application of [the cost-sharing] exemption is not restricted to groups whose members exercise exclusively an activity which is exempt from VAT or in relation to which they are not taxable persons. Accordingly, the services rendered by an IGP whose members also carry out taxable activities may qualify for that exemption, but only in so far as those services are directly necessary for those members' exempt activities or activities in relation to which they are not taxable persons.'

In other words, the CJEU held that, in the case of a member who carried on taxable (as well as exempt (or non-business)) activities, the services supplied by the IGP to it might still be exempt, albeit only to an extent, with the remainder taxed at the standard rate.

The result is a supply that is, exceptionally, taxed at two rates. The question was whether *Luxembourg* helped BlackRock.

BlackRock

The short answer is 'no'. The CJEU in *BlackRock* held (at paras 37–39) that:

'[the *Luxembourg*] judgment is irrelevant … In [*Luxembourg*], the [CJEU] gave a ruling on a complaint alleging an infringement of Article 132(1)(f) of the VAT Directive … That provision … defines the scope of application of the exemption from VAT that it lays down in accordance with the destination of the supplies of services concerned. It thus provides for a differentiated tax treatment depending on that destination ... By contrast, the exemption provided for in Article 135(1)(g) of the VAT Directive is defined exclusively in relation to the nature of the supply in question, in the present case operations for the management of special investment funds. The wording of that provision does not therefore permit the tax treatment of a single supply to be dissociated according to its uses.'

This meant that the Aladdin services fell within the general principle, being that 'it follows from the very classification of an operation composed of several elements as a single supply that that operation must be subject to one and the same rate of VAT' (para 35).

The question was what that rate was and how it should be determined. The CJEU observed (at paras 41–46) that:

'The [UK] envisages the possibility that all of the supplies that BlackRock receives by means of the Aladdin platform should be taxed because the majority of those services are used for the management of funds which are not special investment funds. Conversely, following the same logic, if the majority of the funds managed by BlackRock are special investment funds, all of those supplies should be exempt from VAT … [but such] an outcome would be contrary to the strict nature of … the exemption provided for in Article 135(1) (g) of the VAT Directive … Therefore … the tax treatment of the supply of services cannot be determined according to the nature of the majority of the funds managed by the company concerned.'

This is no doubt a better technical answer than looking to whether the funds managed are predominantly SIFs or non-SIFs, but the question remains: what rate should apply where the funds managed include both SIFs and non-SIFs? To this, the CJEU said (at paras 48–49):

'In the present case … the service at issue was designed for the purpose of managing investments of various kinds and that, in particular, it may be used in the same way for the management of special investment funds as for the management of other funds. Therefore, that service cannot be regarded as specifically for the management of special investment funds. Consequently, a supply of services such as that at issue in the main proceedings does not meet the conditions to benefit from the exemption provided for in Article 135(1)(g) of the VAT Directive.'

While that does squarely address the VAT treatment of the Aladdin services, it also raises questions with regard to other investment management services: in particular, does it mean that all dual or multi-capable services which may be 'used in the same way for the management of special investment funds as for the management of other funds' are by definition excluded from the exemption provided for by article 135(1)(g)? Although that does appear to be what the CJEU is saying, it seems at the same time unduly restrictive. The debate will no doubt continue. And how the exemption develops from here, as with all the other questions on the management of special investment funds, only the future will tell. ■

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- VAT and SIFs: what does 'management' mean? (Etienne Wong & Alex Tostevin, 23.1.19)
- Cases: *BlackRock Investment Management Ltd v HMRC* (7.7.20)