Blurring the lines

Indirect Tax



30 June 2021

Until recently, there was a clear distinction in EU law between economic and business activities. Michael Taylor and David Anderson ask what kinds of activity are now within the scope of VAT following recent CJEU rulings

Key Points

What is the issue?

Until recently there was a clear distinction in EU law between ‘economic activity’ and ‘business activity’. A recent CJEU judgment in Wellcome Trust Ltd, however, has blurred that distinction.

What does it mean for me?

With the UK VAT regime no longer bound by EU law, there could be considerable uncertainty as to what ‘business’ really means for UK companies. This could mean that certain activities now fall within the scope of VAT, whereas previously they did not.

What can I take away?

Given the disparity in the definitions of ‘business’, depending on whether it appears in UK or EU legislation, this could cause confusion about how companies can ensure that they comply with their VAT accounting obligations in the post-Brexit era.

Until recently there was a clear distinction in EU law between ‘economic activity’ and ‘business activity’. However, a recent judgment of the Court of Justice of the European Union (CJEU) has blurred that distinction. With the UK VAT regime no longer bound by EU law, there could be considerable uncertainty as to what ‘business’ means for UK companies.

Economic activity

Economic activity is the concept on which the whole of the VAT system turns. The Principal VAT Directive 2006/112/EC defines economic activity as ‘any activity of producers, traders or persons supplying services’, including the ‘exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis’. Anybody engaged in economic activity is a ‘taxable person’, and it is a taxable person ‘acting as such’ who is obliged to charge VAT on his supplies of goods or services. To this end, the CJEU has repeatedly held that a ‘taxable person acts as such where he acts for the purposes of his economic activity’; for example, see Klub OOD (Case C-153/11).

Conversely, any activity that is undertaken by a taxable person which is not economic activity is non-economic activity, and this activity falls outside the scope of VAT altogether.

Well-known examples of non-economic activity include buying, holding and selling shares, making charitable donations, and undertaking non- commercial construction work.

Business activity

The EU law concept of ‘business activity’, however, is subtly different. The judgment of the CJEU in VNLTO (Case C-515/07) explained that a taxable person is engaged in business activity where it is acting in respect of its ‘main corporate purpose’.

It therefore follows that ‘business activity’ is a slightly wider concept than economic activity, and that a taxable person’s economic activity and his non-economic activity can both constitute business activity so long as such activities serve the taxable person’s corporate purpose.

This subtle distinction between ‘business’ and ‘economic’ was reaffirmed by the CJEU in Landkreis Potsdam-Mittelmark (Case C-400/15). The court stated that ‘a distinction is made between economic and non-economic activities according to criteria that are different from those distinguishing between business use and use for non-business purposes, in particular for private purposes’.

Blurring of the lines

Until recently, therefore, there was a clear distinction in EU law between ‘economic activity’ and ‘business activity’. A recent judgment of the CJEU, however, has blurred that distinction, and with the UK VAT regime no longer bound by the provisions of the EU’s Principal VAT Directive or the CJEU’s decisions on VAT, there could be considerable uncertainty as to what ‘business’ really means for UK companies. This could mean that certain activities now fall within the scope of VAT, whereas previously they did not.

Wellcome Trust Ltd: a taxable person acting as such?

In its recent decision in the case of Wellcome Trust Ltd (Case C-459/19), the CJEU considered whether the phrase ‘taxable person acting as such’ in Article 44 of the Principal VAT Directive should have the same meaning – that is, a taxable person who is engaged in economic activity – as it has everywhere else in the Directive, and in particular Article 2 (which sets out the scope of VAT as applying to, inter alia, ‘the supply of services for consideration within the territory of a member state by a taxable person acting as such’). Perhaps surprisingly, the court concluded that the phrase in fact referred to business and not economic activity.

The Wellcome Trust is a charitable trust which makes grants for medical research. It funds these grants through a range of investments, in respect of which it receives investment management services from both inside and outside of the EU. The Trust

sought to recover VAT it had accounted for under the reverse charge mechanism on supplies of investment management services received from outside of the EU. The basis for its claim made under VAT Act 1994 s 80 was that, in an earlier decision (Case C-155/94), the ECJ (as it then was) had held that the Trust's investment activities did not fall within the scope of 'economic activities' for the purposes of VAT and, accordingly, the Trust was not a 'taxable person acting as such'.

Article 44 of the Principal VAT Directive sets out that the place of supply of services to a 'taxable person acting as such' is the place 'where that person has established his business'. The Trust considered that, since (per its earlier decision) it was not a taxable person acting as such, Article 44 did not apply and the place of supply was the place where the supplier belonged. Therefore, for services received from non-EU investment managers, reverse charge VAT should not apply.

In its decision, the court did not consider the travaux préparatoires. (These are the working documents that encapsulate the discussions of the EU institutions when creating legislation such as the Principal VAT Directive, and which are often used as interpreting aids by courts as they can show the intentions of these institutions.) In the Trust's submission, these showed that when the EU legislature was drafting Article 44, it not only rejected the 'business versus private' distinction, but also intended explicitly that 'the taxable person has to act as a taxable person in order to apply this [Article 44] rule'. Those documents had been informative to the First-tier Tribunal in its earlier decision granting the Trust's appeal. (The Upper Tribunal later referred the matter to the CJEU on HMRC's appeal.)

The CJEU disagreed with the Trust's analysis, after applying a close textual analysis of the provisions. It held that 'taxable person acting as such' in Article 44 had a different meaning to Article 2(1). The court considered that ordinarily the EU legal order required 'unity and consistency', such that 'the terms used by the measures adopted in the same sector must be given the same meaning'. However, it found that was not the case 'where the EU legislature has expressed a different intention' at [35].
The Court discerned a contrary intention in Article 43, which set out 'an extended and derogating definition of the concept of "taxable person" solely for the purpose of applying the rules concerning the place of supply of services' at [37]. Article 43(1), it held, provides that for the purposes of applying the place of supply rules:

‘a taxable person who carries out both taxable supplies of services, within the meaning of Article 2(1) of that directive, and activities “that are not considered to be taxable supplies of … services in accordance with [that provision] shall be regarded as a taxable person in respect of all services rendered to him”.’ [37].

It concluded that Article 44 represented an exception to the general meaning of that phrase. Given that it was common ground that the Trust carried out its activities for business, albeit non-economic, purposes, it was caught by Article 44 and the supplies were accordingly within the scope of EU VAT. In doing so, the CJEU held that the fact that it had previously held that the Trust’s investment was akin to a private investor was not the same as meaning that it was doing so on a private basis.

This begs the question: where else in the Principal VAT Directive and in EU law more generally does the phrase ‘taxable person acting as such’ now refer to business activity and not economic activity?

What does this mean for UK companies?

The situation in the United Kingdom is even more complicated because the UK Parliament has used the term ‘business’ to refer to both business activity and economic activity. For example, the VAT Act 1994 s 94 transposes and defines the Principal VAT Directive’s concept of economic activity as ‘business’. Indeed, the phrase ‘economic activity’ does not appear even once in the VAT Act 1994.
Since 1 January 2021, when the United Kingdom completed its of the Principal VAT Directive (as required by the Brexit legislation), where does this leave us?

The UK courts and ‘economic activity’

In the case of Longridge on the Thames [2016] EWCA Civ 930, the Court of Appeal considered the nature of ‘economic activity’. This is now the senior UK authority on this issue. It was common ground between the parties in this case – and the Court of Appeal confirmed at [104] – that ‘business’ in the VAT Act 1994 meant the same as ‘economic activity’ in the Principal VAT Directive. But what was the test for this concept?

At [109] of its judgment, the court laid out a series of principles which it derived from the case law of the CJEU and the UK courts. It found that economic activity occurs, in summary, where:

- supplies of goods and/or services are made for a consideration;
- there is a direct link between the consideration and the supplies; and
- the supplies for consideration are made on a permanent basis.

Further, the Court of Appeal held that the activity of a company can be ‘economic’ in nature even if its purpose is charitable or not-for-profit, and even if the company’s objective is subjectively non-commercial. It also held that the test is an objective one.

Questions for UK companies

So, what does this mean for UK companies? Given the disparity in the definitions of ‘business’, depending on whether it appears in UK or EU legislation, can we be sure that ‘business’ in the VAT Tax Act 1994 means ‘economic activity’ in the Longridge sense, or ‘business’ in the VNLTO sense of corporate purpose encompassing non-economic activity?

This could cause confusion about what kinds of activities are subject to VAT and how companies can ensure that they comply with their VAT accounting obligations in the post-Brexit era.