Dragons defeated

Indirect Tax



01 November 2016

Adrian Houstoun reviews the Court of Appeal’s decision to allow HMRC’s appeal in Longridge on Thames

Key Points

What is the issue?

A charity's liability to VAT will depend on whether its activities are economic activities. This case examines the factors that determine whether an activity is categorised as economic or not.

What does it mean to me?

The character of the charity's activity must be judged objectively, with motive being irrelevant to the decision.

What can I take away?

Charities with future building projects where they may have hoped for the construction costs to be zero-rated ought to review their model carefully.

The Court of Appeal has issued its eagerly anticipated judgement in the case of *Longridge on the Thames v HMRC* [2016] EWCA Civ 930. Both earlier decisions, in the First-tier Tribunal and the Upper Tier Tribunal respectively, found in favour of Longridge but, disappointingly for the charity sector, the Court of Appeal has now reversed the earlier decisions and decided for HMRC. The decision will have wide ramifications for a number of charities.

Longridge is a charity set in a unique riverside location near Marlow, Buckinghamshire, and provides a range of water sports and land-based activities aimed at young people of all abilities. As well as 12 acres of water meadows, it has its own island, which provides a sheltered backwater in which young people can experience the river with confidence. Its website says that all income generated from its activity days goes to support its charity work with young people from disadvantaged backgrounds, and invites support for its charitable work by using one of its centres for a family activity day, birthday party or holiday adventure day etc. The First-tier Tribunal described Longridge's activities as follows: '[Longridge] provides a wide range of day and residential courses and activities principally (but not exclusively) based on water-borne activities, for schools and colleges, scout, guide, cadet and youth groups, individual young people, families and birthday party groups, and adults (individually, in groups, or by corporate use). Corporate use takes place when the facilities are not being used by young people or families. In addition, on occasion during the summer the Appellant organises special day events. The principal water activities are dinghy sailing, kayaking, canoeing, rowing and sculling, bell-boating and dragon boating and rafting. For all courses and most activities the Appellant provides an appropriately qualified instructor (either a paid employee, contractor or a volunteer). Courses for adults include coaching courses. Courses are accredited by a range of organisations. Accommodation is provided in the form of

space for camping, bunk-house accommodation, some single rooms and a building which can be used as a dormitory. Meals are provided at the cafe on the site.'

The case was about the availability of the zero-rate of VAT in respect of the construction of new charitable buildings. For a building to qualify for the zero-rate of VAT it must be used by a charity for charitable purposes and not for generating business income. It is probably fair to say that there is a fine dividing line between charitable use and business use. Activities that do not make a profit, or activities where any profit is only used to further the aims and objects of the charity, can still be business activities.

Longridge, in order to improve its facilities had decided to build a new training centre, and engaged a contractor to build on Longridge's site a building ('training centre') comprising, on the ground floor, toilet, changing and shower facilities, and on the upper floor, an area to be used primarily for training courses and meetings. The Training Centre was constructed during 2010. Longridge considered that the supplies made by the contractor in constructing the training centre should be zero-rated under VATA 1994 Sch 8 Group 5 Items 2 and 4, on the grounds that the building was intended for use solely for relevant charitable purposes within the meaning of Note (6) to Group 5, and approached the Commissioners for confirmation that such was the case to enable Longridge to issue the necessary zero-rating certificate to the contractor. However HMRC took the view that the nature of Longridge's activities were such as to amount, in whole or in part, to business activities, and that accordingly the training centre was not intended for use solely for relevant charitable purposes, and that they could not therefore issue a zero-rating certificate to the contractor. Hence the dispute was, at first, referred to the First-tier Tribunal.

HMRC claimed that on the basis of the *Three Counties Dog Rescue* decision (*Three Counties Dog Rescue v HMRC* (TC0165) (the case in which a charity re-homed abandoned dogs, where HMRC argued that the payment received from the new owner was charitable but where the Tribunal found that the payment was for the service and that the charity was in business) the construction should be standard rated because the building was used to generate revenue on a regular basis. HMRC claimed that Longridge was acting in a business-like manner: it is active on a considerable scale; it has sophisticated and commercial terms of business; it is professionally managed by a full-time CEO and fundraiser who operates within a business plan; in the most recent years operating income of Longridge had been

between 80% and 98% of operating expenses; it seeks out customers beyond its charitable remit whose fees will subsidise the provision of activities to those within its charitable remit; and the type of activities it provides, and the way in which it provides them, are consistent with those provided by commercial providers. The First-tier Tribunal decided that because Longridge only recovered cost or a proportion of cost in its charges, and because the charging was ancillary to its main charitable objects/aims, that it was carrying out a non-business activity and that the building did therefore qualify for zero-rated construction costs. Being an important decision, HMRC appealed to the Upper Tribunal and probably did so with a justifiable amount of confidence; however the Upper Tribunal declined to overturn the First-tier decision.

HMRC therefore appealed to the Court of Appeal, and this time HMRC won. The Court looked firstly at EU law and then at UK law, although the difference is probably not material. In respect of EU law the Court of Appeal said that there is no special rule for a charity. A charity does not enjoy blanket relief from VAT for its activities. Its liability to VAT will depend on whether its activities are economic activities. It may not be able to claim relief simply because it is carrying out a charitable activity. A profit motive is not required. Passive ownership is not an economic activity, the concept of which is objective in nature. To ensure legal certainty, the court must have regard to the objective character of the transaction and not to the intention of the taxable person. The purpose or result of the transaction is irrelevant as such for the purpose of determining whether an activity is within the scope of the Sixth Directive. Finally, in respect of EU law it said an activity is in general categorised as economic where it is permanent and is carried out in return for remuneration received by the person carrying out the activity. The activity must be carried out in return for remuneration and there must be a direct link between the service and the money received by the service-provider.

In respect of UK law the Court of Appeal looked in particular at four leading UK cases – *Morrison's Academy, Fisher, Yarburgh* and *St Paul's* and concluded 'In determining whether a person carries on economic activity, there is no doubt that there is no exception for activities carried out for the benefit of the public. Likewise the fact that the provider does not seek to make a profit is also irrelevant. There is no doubt that the courts must give effect to CJEU law and must do so despite domestic authorities or practice to the contrary.' The first judge therefore concluded that Longridge carried on an economic activity and that HMRC's appeal be allowed. The other two

judges agreed and the third judge also produced a list of general propositions for considering cases of this sort, and whether or not a supply for consideration takes place, which may be of interest to those in a similar situation, as follows:

- It only supplies goods or services, 'for consideration' which are subject to VAT;
- There must be a direct link between the supply and the consideration before it is right to hold that the supply is 'for consideration';
- Indeed, if there is no direct link between the supply and the consideration, the question of economic activity does not strictly arise as there is no consideration to form the basis of an assessment to VAT;
- VAT is charged on the amount of the consideration; it is irrelevant for the purpose of calculating the VAT payable whether the consideration for the supply is above or below the market value of the supply;
- As stated in EC v France where the CJEU obviously thought that lettings by local authorities at subsidised rents were an economic activity, it is irrelevant for the purpose of calculating the VAT payable whether the consideration for the supply is at a concessionary rate;
- Article 9 states that a taxable person is a person who carries on any economic activity, whatever the purpose of that activity;
- If a person supplies goods or services 'for consideration', i.e. satisfying the test of direct link referred to in (ii) above, and the activity is 'permanent', then there is a rebuttable presumption, or a general rule subject to possible exceptions, that the supply for consideration is an economic activity;
- The character of the activity (i.e. whether it is an economic activity) is to be judged objectively;
    - The subjective motive of the person making the supply does not influence the identification of the objective character of the supply; this follows from the proposition that the character of the activity is to be judged objectively;
    - A charitable activity can be an economic activity;
    - A non-profit making activity can be an economic activity.

As mentioned above, four UK cases were discussed by the Court of Appeal: *Morrison's Academy, Fisher, Yarburgh* and *St Paul's*. With two of these in particular, *Yarburgh* and *St Paul's*, HMRC has always attempted to deny that they set a precedent, as the outcome was decided based on the facts of these particular cases. *Yarburgh* and *St Paul's Community Project* involved charitable nursery schools with

very low fees set to cover minimal costs, and in the case of *Yarburgh*, it was run by the parents of the children that attended the nursery. The Tribunal found that they were operating for social and not commercial or economic purposes. However the decision made by the Court of Appeal in *Longridge* now adds weight to HMRC's view that *Yarburgh* and *St Paul's* are not cases to rely upon.

For charities with future building projects where they may have hoped for the construction costs to be zero-rated they ought to review carefully their model. It is very likely that if the building is used for any activity in respect of which payment is received for a service that HMRC will assert that that activity is not charitable but economic and that zero-rating status shall not apply. Such charities may look at their model and see if they can be financed by donations or grants and the overall impact it will have on their VAT and finances. There may be charities that have already given a certificate to their contractor and who ought to review their situation in case, following *Longridge*, they no longer qualify for zero-rating, unless they can alter their funding model.

Longridge could appeal but I consider it unlikely.