

VAT - composite supplies

1. Introduction

VAT is supposed to be a tax on the final consumer. In the UK, the standard rate of VAT is 20% which on a comparison of other European states is in the middle. Hungary, for example, has the highest standard rate at 27% and Luxembourg has the lowest at 15% but every state has reduced rates and those reduced rates can make a very substantial difference to the sale price charged by the vendor. For example, it is no accident that Amazon located in Luxembourg where there is a reduced rate of 3% for downloadable material (CDs etc). This gives Amazon a substantial commercial advantage in comparison to a UK based high street supplier which must charge VAT at 20%.

This podcast has been prepared on the basis of the UK legislation which is in force at 31 August 2013. In tax, the law can change with Finance Acts, Statutory instruments and decisions of precedent which includes not only decisions of the British Courts but also the European Courts.

Whilst every care has been taken to ensure the accuracy of the content of this work, no responsibility for loss occasioned to any person acting or refraining from action as a result of the material in this publication can be accepted by the author, editors, publishers or AAT

The views expressed are the personal views of the author and should not be taken necessarily to represent the views of AAT. Neither AAT nor the author are liable for breach of contract, negligence (including negligent misstatement) or otherwise for any loss resulting from any error, omission or inaccuracy in the information supplied, or for any loss resulting from any act done (or not done) in reliance on the information supplied.

VAT is a tax on transactions, so the VAT treatment of a supply can only be decided by analysing the transaction.

A composite or multiple supply is a single supply with more than one component. The UK has reduced rates the most widely known being zero rating which is available on supplies defined within Schedule 8 of VATA 1994. VAT is charged at one rate on all the consideration which is determined by identifying what is the major component of the what is supplied. For example, if a newspaper which is zero rated gives its buyers a free music CD, the major component which determines the nature of the supply is the zero rated newspaper. By way of contrast, if a CD was accompanied by a booklet which commented on the CD, all would be standard rated at 20% because the principal supply is that of the CD and its electronic music content.

Different components may have mixed liabilities to VAT if supplied separately. The different components may be a mixture of goods and services. If a separate charge is made for part of the supply, this does not necessarily mean that there is a multiple supply. Supplies should not artificially be split nor should they be artificially combined if they are really independent.

2. Composite supplies and why it matters

A multiple supply (also known as a combined or composite supply) involves the supply of a number of goods or services. The supplies may or may not be liable to the same VAT rate. If one of the component supplies had a zero rate and the other had a standard rate, there might be a commercial advantage to try to treat the major element of the supply as the zero rated item. Individual examples need to be considered on an individual basis and as a result few of the decisions in this complex area of VAT practice establish precedent decisions.

Probably the leading case is that of *Card Protection Plan Ltd v C & E Commrs* [1994] BVC 20 in which at p. 28, Balcombe LJ in the Court of Appeal said that whether an element is an integral part of an overall supply 'is necessarily a question of impression on which different minds may reach different conclusions'. Travel on public transport like a train is zero rated (Schedule 8, VATA 1994). If a train business provides zero-rated travel from London to Edinburgh, it need not declare a proportion of output tax on its receipts if the journey includes a cup of coffee which if supplied separately would be standard rated. The complementary cup of coffee provided to all passengers is ancillary to the travel, which is what the customer paid for. The cup of coffee (or tea) serves no other purpose than to make travelling more comfortable: i.e. it is incidental to the main supply. The same result would apply if the ticket price included a complementary

meal and drink because the major component which the rail traveller is buying is the zero rated element of transport between Edinburgh and London.

If the journey is on the train, say the Flying Scotsman steam engine, from Edinburgh to Birmingham and includes a five-course meal with wine and champagne, the customer probably receives two supplies: (1) zero-rated travel and (2) standard-rated catering and output tax at 20% needs to be accounted for on this catering element requiring an apportionment of the total price paid.

If a supply is seen as insignificant or incidental to the main supply, then for the purposes of VAT it is usually ignored – the liability is fixed by the VAT rate applicable to the main supply (or supplies).

A case which clarifies the principles of identifying and dealing with VAT is *Tumble Tots (UK) Ltd v R & C Commrs* [2007] BVC 179. Members of a playgroup received a T-shirt (children's clothing is potentially zero rated) and a magazine (potentially zero rated) as well as the right to attend classes which would be standard rated. The Court decided that there was a single standard rated supply of the right to belong to the playgroup and the T shirt and magazine were incidental to that main supply. No one who was not in the playgroup would have bought the T shirt or magazine separately. The principles which emerge from the cases are:

- (1) the identification of the taxable supply or supplies made as a particular transaction is, at least where it is under a contract, limited to the goods and or services provided in return for the payment;
- (2) prima facie every supply of a good or of a service must normally be regarded as distinct and independent;
- (3) nonetheless the functioning of the VAT system would be distorted if what is in substance a single service from an economic point of view was artificially split;
- (4) the relevant transaction must be analysed with due regard to all the circumstances in which it takes place. Over-zealous dissection and analysis of particular clauses should be avoided;
- (5) the essential features of the relevant transaction must be ascertained in order to determine whether the taxable person is supplying the customer with several distinct principal services or with a single one;
- (6) that the goods and/or services are supplied in consideration of a single price may suggest that, for VAT purposes, there is a single supply, but this is not decisive;
- (7) where elements of the consideration are ancillary to another element or elements identified as the principal service, there is a single VAT supply of the principal service of which the ancillary elements will be treated as part. A service will be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but is a means of better enjoying the principal service supplied.

If we expand a little on item (3) above, the courts have had to consider cases which involved artificial splitting as well as cases where there was artificial mixing of supplies. There is a single supply where one or more elements are seen to provide the principal service, and the others are regarded as ancillary. A service must be regarded as ancillary to the main service if it does not constitute for customers an aim in itself, but is a means of better enjoying the principal service.

There is a truism in tax that in many cases it ain't what you do it's the way that you do it that can arrange a tax advantage. In *BSkyB* the company tried to apportion the subscription price between a standard rated supply of TV entertainment and a zero rated listings magazine. They failed because it was a single composite supply and the magazine was incidental to the TV entertainment subscription. But in *Telewest Communications plc v C & E Commrs* [2005] BVC 156 the arrangement gained by separating the zero-rated magazine from a standard-rated supply of TV services. It did this by having a separate company provide the magazine. Although the operating companies supplying the TV service collected the magazine subscriptions on behalf of that separate company, the Court of Appeal held there to be two supplies and the House of Lords refused to hear an appeal from HMRC.

Any exemption from VAT must be strictly interpreted and applied. Those supplies which benefit from exemption are defined in Schedule 9 VATA 1994 and include education. But if the trader is exempt, that

trader cannot recover input tax that it incurs. If that trader does incur input tax, for example on the construction of a building or even the repair of a lecture theatre, the input tax is effectively an additional cost. Education may involve lectures, practical work and self-study reading books and notes which the education course provider supplies. On the latter items there was uncertainty which was removed by Finance Act 2012 which makes it clear that the provider of education cannot apportion the consideration paid by students between zero rated but taxable notes and the exempt supply of education. In *College of Estate Management v C & E Commrs* [2005] BVC 704, the college lost its contention that part of the student fees should be treated as a zero rated supplies of written material.

Ten years ago, many shops started to claim that they would charge say 2.5% of the consideration received as an exempt supply of card processing services. This was challenged quickly by the then Customs and Excise (now HMRC after the merger of Customs and Excise with the Inland Revenue in 2005). Attempts to treat as included in the retail price of positive-rated goods an exempt fee for handling a credit card have failed *Debenhams Retail plc v C & E Commrs* [2004] BVC 554.

In *Bookit Ltd v R & C Commrs* [2006] BVC 605 the company Bookit Ltd was a member of the Odeon Cinema group with its own VAT registration. It handled sales of cinema tickets on Odeon's behalf by telephone or via the Internet. Bookit:

- (1) gave the customer information about film times, ratings and seat availability. The tribunal decided that it did this as agent for Odeon;
- (2) agreed to sell the tickets. Again, this was as agent for Odeon;
- (3) took the customer's credit card details, which it transmitted to Girobank for clearance. Here, the tribunal saw Bookit providing a service to the customer; and
- (4) informed Odeon of the tickets sold. This was, again, something Bookit did for Odeon as its agent. A booking fee per ticket was charged, the dispute was whether it was a supply of standard-rated ticket-selling services (which are VATable) or, as Bookit successfully maintained, of exempt financial services.

The Court of Appeal held that the services supplied by Bookit to cinema-goers, in return for the sum above the ticket price were exempt card handling services within VATA 1994, Sch. 9, Grp. 5, item 5 as interpreted in accordance with Note (5). HMRC have accepted this judgment (Business Brief 18/2006 (30 October 2006); Notice 701/49).

Because VAT is a transaction based tax, it is essential that traders get it right when the transaction occurs. Mistakes, especially if HMRC believe that the mistake has arisen from a failure to take reasonable care, potentially could incur penalties under Schedule 24, FA 2007. But in practice a knowledge of the principles can enable a trader to obtain a commercial advantage. A trader might save VAT by combining a standard-rated supply in a car with the principal supply of zero-rated transport. In *Virgin Atlantic Airways Ltd v C & E Commrs* [1995] BVC 93, there was a single zero-rated supply of an airplane ticket supplied with a standard-rated chauffeur-driven limousine for the journey between the airport and the passenger's initial point of departure such as his house to the airport.

British airways faced a challenge on its complementary supply of catering during flights but it was successful in arguing that the price paid was for zero rated transport and the catering was incidental.

This remains a difficult area in practice and potential mistakes are embarrassing and potentially might place the trader within the penalty regime. In cases of doubt, I recommend approaching the **National Advice service** (NAS) to seek a ruling. Over the years, my experience of dealing with the NAS has been extremely variable. Sometimes the service has been excellent but at others they just refer the enquirer to a leaflet and do not answer the question. In composite supplies they often refer to **VAT Information Sheet 2/2001** which is entitled 'Single or multiple supplies – how to decide'.

The advantage of seeking a ruling is that it demonstrates that the trader has taken reasonable care. If at some future point a visiting officer from HMRC decides that your treatment was incorrect, the VAT position may need to change from that point onwards. However, so long as your view prior to that point was tenable and you can demonstrate that reasonable care was taken, the penalty regime will not apply and changes will be prospective but not retrospective.

In *Rowe & Maw (a firm) v C & E Commrs* (1975) 1 BVC 51, a solicitor's rail and air travelling costs were separately itemised as disbursements on the bill sent to the client but that did not make them zero-rated. They were expenses of the solicitor, not separate supplies to the client. It was unsuccessfully contended that such costs were zero-rated. By way of contrast, a disbursement made by a solicitor acting as agent of the client such as the payment of stamp duty when the client bought a house would be outside the scope for the client who is the end user.

In *C & E Commrs v Plantiflor Ltd* [2002] BVC 572, Plantiflor sold plants by mail order. Customers could collect the plants, in which case no delivery charge arose. Alternatively, Plantiflor arranged delivery via Parcelforce and a charge was made for post and packing – the £1.63 which Parcelforce billed for delivery. Plantiflor's contract with Parcelforce specified that Plantiflor acted as agent for the customers.

Analysing the supply, that contract with Parcelforce was a red herring because Plantiflor made a single standard rated supply of bulbs and delivery. They had to account for VAT on the consideration received for delivery.

In *United Biscuits (UK) Ltd (t/a Simmers) v C & E Commrs* [1992] BVC 54, the court held that the supply of biscuits in a tin was a single zero-rated supply of biscuits, the tin being merely the packaging.

Cases cited in this podcast that are useful in arguing to support a contention on composite supplies.

Card Protection Plan Ltd v C & E Commrs [1994] BVC 20

C & E Commrs v Plantiflor Ltd [2002] BVC 572

College of Estate Management v C & E Commrs [2005] BVC 704

Debenhams Retail plc v C & E Commrs [2004] BVC 554

Rowe & Maw (a firm) v C & E Commrs (1975) 1 BVC 51

Telewest Communications plc v C & E Commrs [2005] BVC 156

Tumble Tots (UK) Ltd v R & C Commrs [2007] BVC 179

United Biscuits (UK) Ltd (t/a Simmers) v C & E Commrs [1992] BVC 54

Virgin Atlantic Airways Ltd v C & E Commrs [1995] BVC 93

Derek Allen

31 August 2013