[2011] UKFTT 633 (TC)

TC01475

Appeal number: TC/2010/9440

Value Added Tax –Sports Club Membership -Non Payment of monthly fees –Denial of access to club facilities –Whether taxable services provided by club if access denied-Whether sums recovered from member compensation payments –Yes-Whether payments made for membership rights and facilities –No –Appeal Allowed –Overpaid output tax recoverable.

FIRST-TIER TRIBUNAL

TAX

ESPORTA LTD **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: DR K KHAN (Judge)
JULIAN STAFFORD FCA

Sitting in public in London on 20 and 21 July 2011

David Scorey, counsel, instructed by PwC Legal LLP, for the Appellant

Hui Ling McCarthy, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against Her Majesty's Revenue and Customs ("HMRC") refusal of 31 August 2010 of the Appellant's voluntary disclosure claim submitted on 26 March 2010. The Appellant is claiming repayment of £1,319,461.73 in respect of wrongly paid output tax for the VAT periods 05/06 to 12/09 inclusive.

2. The claim concerns the late payment of membership fees recovered from the Appellant's members through external debt collecting agencies. When submitting their VAT returns for the VAT periods in question, the Appellant treated the late paid fees as standard rated membership fees - accounting for output tax but now take the view that their late paid membership fees are not in fact consideration for any supply made by the Appellant but rather constitute damages or compensation for breach of contract -and thus fall outside the scope of VAT.

3. The contracts in question relate to members who have joined for a minimum twelve months period and fail to make their monthly payments.

Background

4. Esporta is a health and fitness club operator throughout the United Kingdom. The chain has 63 health and fitness clubs. Members are given a choice of membership. Some members pay in advance (pre-pay) for a fixed term membership which could be for a twelve or twenty-four month period. This pre-paid category of membership is not in dispute in this Appeal. The VAT payable is levied on the entire amount at the start since the member purchases and pays the membership for the entire contract period at that time. There are other membership options available for a minimum term of membership. The most popular option is for a 12 month period with a three month notice termination period Under this contract, the member commits to pay for a fixed number of months ("the Commitment Period") which can be twelve or twenty four months. Before August 2010, there were shorter periods of three, six or nine months but these are no longer available. We are looking at the monthly contract with a Commitment Period in this Appeal. There is also offered, at some clubs, a monthly rolling membership contract but this is not part of this Appeal.

5. Esporta has an active marketing campaign to recruit new members since membership fees are a major source of revenue to the club. The campaign includes handing out leaflets, sports and running activities, promotions, club tours, open days and other activities collectively called the "Outreach Programme". Where a person expresses an interest in taking a membership of the club, a sales representative would explain the benefits of membership and provide a Welcome Pack and a tour of the club. The Welcome Pack includes a membership application form which sets out the members' details and detail of the membership being applied for as well as a membership agreement, terms and conditions and other information relevant to the membership. Once the relevant documents are completed, the information is put into

Esporta's database called "Clubcentric" which processes the information and produces a membership card, if approved. The membership card which is given to the new member is required to gain access to the club facilities through a swipe card system at the entrance to the club.

Terms and conditions

6. All members must agree the club's terms and conditions which are provided in the Welcome Pack. In order to make the terms more user-friendly they were revised over time. There have been three main versions of the terms and conditions. These are:

1. The May 2005 terms and conditions ("the 2005 Terms")
2. The March 2009 terms and conditions ("the 2009 Terms")
3. The December 2010 terms and conditions ("the 2010 Terms")

7. The terms were revised over time to meet certain plain English and clarity requirements and after feedback from members and staff. The 2005 Terms and the 2009 Terms are similar but the 2009 Terms introduced a new section 4 to cover the situation where a member takes advantage of the advance payment arrangements (a discount for pre-payments). The 2010 Terms sought to provide revised terms which were easier to read, shorter and written in plain English and were endorsed by the Plain English Campaign. The 2010 Terms were substantially the same as those which existed in January 2010 and the revision was not substantive.

8. The 2005 Terms set out key clauses dealing with, inter alia, the duration of the contract, facilities, fees, and termination by the club. The 2009 Terms are materially similar to the 2005 Terms, but the termination provisions were re-numbered, the fee clauses amended and there was added a new clause 4. The 2010 Terms, while showing changes in the style and format, were substantially the same as those existing at the time i.e. the January 2010 terms. The format and style of the 2010 terms made the contract much more readable since there was a question and answer layout.

9. Members pay fees to the club for the use of their facilities and services. The fees are paid through a direct debit claim for payment of monthly membership. If monthly payment is not made (as shown by a failed direct debit payment), after a discussion with the member on the reasons for non-payment, the defaulting member's swipe card will be stopped and the member will be unable to get access to the club's facilities through the swipe card system. Access to all facilities and services are stopped until the payment of the arrears is made or some agreement is reached between the member and the club regarding the outstanding payments and membership.

10. The club prefers to retain membership and encourages the member to pay their outstanding monthly contributions. If membership is re-activated on payment of the outstanding contributions (about 1% of cases) then the membership card is activated to allow entry into the club and its facilities. However a majority (99%) of defaulting

members never choose to re-activate their membership once there has been non-payment of the membership contributions. The club's preferred option is not to lose members and therefore it does not terminate the membership of the defaulting member. Rather, there follows a series of debt notification letters to the member seeking payment. If payment is not made by the defaulting member after 90 days the matter is referred to a third party debt collection agency called ARC (Europe) Ltd ("ARC"). At the end of 90 days, debts in excess of £50 are referred by ARC to a third party collection agency called Scotcall. Scotcall send out debt notification letters which are more forthright than the letters sent by ARC. After a further 90 days, debts in excess of £500 which remain unpaid are referred back to ARC. The claim in this Appeal concerns sums recovered from defaulting members by external debt collection agencies and the output tax on such sums which the Appellant says has been overpaid in the periods 05/06 to 12/09. The Appellant says that such sums are damages or compensation for breach of contract.

The law

11. Taxable Supplies of Services

(1) Article 2(1)(c) of Directive 2006/112/EC ("the Directive") in relevant part defines the subject matter of the tax:

> "(1) The following shall be subject to VAT:
> …
> (c) the supply of services for consideration within the territory of a Member State by a taxable person acting as such."

(2) Article 24(1) of the Directive defines the supply of services as follows:

> "(1) 'Supply of services' shall mean any transaction which does not constitute a supply of goods."

(3) The provisions of the Directive are implemented by VATA 1994 section (1) of which provides:

> "(1) Value Added Tax shall be charged, in accordance with the provisions of this Act –
> (a) on the supply of goods or services in the United Kingdom … ."

(4) Section 5 VATA 1994 defines the meaning of supply of services as follows:

> "(2)(b) anything which is not a supply of goods but which is done for consideration (including, if done so, the granting, assignment or surrender of any right) is a supply of services."

12. References to other law and cases

Case Law

1. *White & Carter (Councils) Ltd v McGregor* (1962) AC 413 (HL), [1961] 3 All ER 1178
2. *Apple and Pear Development Council v Customs and Excise Commissioners* (Case C-102/86) [1986] STC 192
3. *Holiday Inns (UK) v Customs and Excise Commissioners* (1993 VTD 10609)
4. *Tolsma v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509
5. *Lubbock Fine & Co* (Case C-63/92) [1994] STC 101
6. *Hometex Trading Ltd* (1995 VTD 13012)
7. *Finance and General Print Ltd v HMCE* (1995 VTD 13795)
8. *Croydon Hotel & Leisure Company Ltd* (1997 VTD 14920)
9. *C&EC v Redrow Group plc* [1999] STC 161 (HL)
10. *CCE v Mirror Group Plc* (C-409/98) & *CCE v Cantor Fitzgerald International* (C-108/99) [2001] STC 1453
11. *Kennemer Golf* (Case C-174/00) [2002] STC 502
12. *Société Thermale d'Eugénie-les-Bains v Ministère de l'Économie, des Finances et de l'Industrie* [2008] STC 2470
13 *OFT v Abbey National plc and others* [2009] UKSC6
14. *RCI Europe v Revenue and Customs Commissioners* (Case C-37/08) [2009] STC 2407
15. *Reed Employment Ltd v RCC* [2022] UKFTT 200 (TC)
16. *MacDonald Resorts Limited v HMRC* (Case C-270) [2011] STC 412
17. *OFT v Ashbourne Management Services Ltd and others* [2011] EWHC 1237 (Ch)

Other materials

HMRC Manuals V1-3, section 7.7 "VAT Supply and Consideration"
Chitty on Contracts (Sweet and Maxwell, 30th Ed, 2008) paragraph 12-019
"Guidance on unfair terms in health and fitness club agreements", OFT Publication (2002)
"Are they fit to join? A guide to health club membership terms", OFT Publication (2002).

Appellant's submissions

13. The Appellant makes two core submissions. First that the amount recovered from a defaulting member, i.e. a member who fails to pay their agreed monthly

contribution, cannot be treated as consideration for a taxable supply of services. As the defaulting member is barred from accessing any of the club's facilities, there is no direct and immediate link between the monies recovered from the defaulting members and the service provided to that member by the Appellant. The absence of this link is fatal to a supply of services and there is no reciprocity of performance.

14. Secondly, the Appellant says that the sums recovered from the defaulting members should be treated as compensation or damages for breach of contract and therefore outside the scope of VAT. The Appellant has argued that by defaulting on the monthly payment, the defaulting member has breached a contractual term which allows the Appellant to treat the contract as rescinded and to seek damages or compensation from the defaulting member.

15. They say that the denial of access to the gym means, in effect, no payment no service. It also means that means there is no direct link between supply and payment.

16. The Appellant says that the contract does not guarantee the use of the gym. It provides access to use of the gym and, if a member is prevented from entering the gym (because they have not made the requisite monthly membership payments and their swipe card, when swiped at the entrance of the gym, denies access), the member is barred and cannot use the facilities. They say that having the club facilities in itself is not sufficient. It is the use of those facilities which is critical to the member and which creates the link to the member. A supply arises where there is a link between a payment and a service. When the member ceases to have access, the Appellant says that this represents an ending to the relationship between Esporta and the suspended member. It does not matter that the contract itself is not formally terminated since such formal termination is not required. All that is required is the absence of a supply. In such circumstances, any sums recovered constitute compensation for breach of contract as they are not directly connected with a supply of services for VAT purposes.

17. The Appellant refutes the Respondents argument that membership itself is a benefit since there is no benefit to membership on its own. The purpose of membership is to gain access to the gym. They refute the submission of the Respondents that the supply of services which attracts VAT is the supply of membership of a gym and the payments in question are simply payments of membership fees. The Appellant says that this reasoning is flawed because what is being supplied is access to the gym's facilities and in doing so there is no direct and immediate link between the monies recovered from the defaulting members and the services provided by the Appellant.

<u>The Respondents' submissions</u>

18. The Respondents say that Esporta, the Appellant, provides its members with services even when a member is in default. They are required to make available to their members premises and facilities which must be maintained to a suitable standard. They draw reference to the 2005 Terms and Conditions which states that

the club will make available "facilities" and the defaulting member will only be able to terminate their membership within a certain period if these facilities are not available. It is not relevant if the members use or do not use the facilities.

19. It is acknowledged that a defaulting member may be denied entry to the premises but there must still be premises and facilities. The Appellant can only stop collecting membership fees if the facilities are not available.

20. A defaulting member may have arrears, within the period of the contract, for membership fees. They say that nothing turns on the fact that the membership fees collected from defaulting members are, in the event, recovered in arrears rather than paid in advance as agreed under the membership agreement. This is because they are supplies of services which are subject to VAT rather than payments made by way of consideration for such supplies.

21. When a member defaults, the Appellant can terminate the member's membership or it can continue the member's membership for the period for which the member has committed to the club. If this choice is made, the payments are contractual payments rather than damages or compensation. These sums are claimed from members as a contractual debt, in full and without any deduction being made. The Appellant has a choice to treat the contract as having come to an end or to claim damages and to treat the contract as continuing.

22. The Respondents say that barring a member from using the facilities of the club is not the termination of the membership and further, it does not affect the link between the membership and the membership fee paid under the terms of the contract. The contract allows a member to be temporarily barred from using the facilities of the club until the fees in arrears have been paid or acceptable arrangements have been made for their payment. In such a situation, the membership continues. A defaulting member can resume using the facilities immediately upon paying the arrears, which is the case at all clubs. When this is done he does not have to pay an additional fee or make a further application to re-join the club. The Respondents say that this illustrates the on-going contractual relationship between the Appellant and defaulting member and the nature of the payment made by the member, whether in arrears or not as consideration for the supply of club membership.

Witness Statement of Mr Preedy

23. Mr Preedy, Head of Customer Services, Esporta Health and Fitness Group, provided a 14 page witness statement dated 10 June 2011. He also gave oral evidence and was questioned on his statement. The statement provided information on clubs, their operations and membership. The headings under which evidence was provided were –membership recruitment process, terms and conditions, membership options, benefits of membership, resignation of membership, payment of membership fees, debt collection process, referrals to ARC and payments received during the debtor process.

24. The evidence was a comprehensive account of the operation of the club, membership and debt collection. The evidence was explanatory in nature. He confirmed that the membership contracts were drafted by their in-house Head of Legal and the solicitors dealing with debt recovery were appointed by ARC. He also confirmed that tax matters were dealt with by their in-house tax advisor. He was given time by the Tribunal to review file correspondence on this matter and confirmed that the correspondence on the tax dispute and replies to the Inland Revenue were written by Nigel Dawes , the tax advisor. In reply to a specific question by Ms McCarthy over whether members were suspended from membership, he said defaulting members were not suspended, as defined in the contract. `

Discussion

25. The issue in this matter is a simple one. The basic question is whether the taxable services provided by Esporta are supplies of the membership of a gym or access to health and fitness facilities as well as activities. There is an attendant issue. That issue is whether the gym membership as represented in the contract between the members and the gym must be terminated formally before any sums recovered constitute compensation. There is no dispute on the facts between the parties though the parties have drawn different inferences from the facts.

26. The Appellant's basic position is that when a defaulting member is barred from access to the facilities and activities of the gym it brings an end to the supply of services. A defaulting member still retains their status as a member of the gym for the period of the contractual dispute so long as their membership payment remains in arrears. The Appellant says that the idea of membership is not a relevant consideration as such but rather it is the access to the facilities which the Tribunal must look at in determining whether there is a supply.

27. The Respondents say that the correct analysis is that there is a benefit to be gained by being a member. Members, even defaulting members, still have rights that non-members do not have. To all members, the club is required under the terms and conditions of the membership agreement to make available suitable facilities. Even though a defaulting member might be denied entry to the premises, there must still be premises and facilities, and these premises and facilities must be maintained to a reasonable standard. In doing so, Esporta is supplying a service, whether or not that individual has a right to enter the premises and use the facilities during his or her membership. They say that once the defaulting member has cleared the membership arrears they continue to have access to the club without having to re-apply or pay a further joining fee to the club and their existing contractual arrangements continue. They point to this as evidence that the individual retains their status as a member. In other words, the club holds the individual's place and its membership open for the entire period of the contract as long as the individual remains a member and the club chooses not to terminate that membership. Further, the club will accept a smaller sum in satisfaction of the outstanding arrears or enter into instalment arrangements to settle those arrears. In such circumstances, the Respondents say that payments made in order to procure altered contractual arrangements do not fall outside the scope of

VAT and are not compensation. In these circumstances, the payment had procured a service, namely Esporta's agreement to alter the contractual arrangements.
We now look at the contractual provisions:

Terms and Conditions

28. This appeal is only concerned with monthly memberships.

29. In looking at the first set of Terms and Conditions, the 2005 Terms, the key clauses are clauses 1.1, 2.1, 3.1 and 6.1.

Clause 1.1 provides as follows:

"**1. Membership**

1.1 Duration

When you join the Club you are agreeing to remain a member for a Commitment Period. For administrative reasons this period covers the rest of the calendar month in which you join (if you join after the first day of the month) and the following 12 full months.

The Commitment Period is a core term of membership necessary to allow us, as a private club, to commit to the level of investment required in providing equipment and facilities to the standard expected by our members.

If you choose to pay your membership fee monthly your Club membership will continue automatically after the Commitment period. If you choose to join the Club by paying your Commitment period membership fee in advance your club membership will terminate automatically on expiry of that Commitment Period."

30. Under this Clause the member is contractually obliged to make monthly payments for the duration of the Commitment Period, a minimum period of twelve months. The Commitment Period is described as a "core term" of membership which allows the club to "commit to the level of investment required in producing equipment and facilities to the standard expected by our members".

31. When a member signs a monthly membership contract, fees are payable on the first day of each month by direct debit. If the club has not received a member's fee by the fifth day of any given month, the member is barred from entering the club and efforts are made to recover the unpaid membership fee. The club tries to collect this fee for thirty days after which a reference is made to a debt collection agency and thereafter to a small claims court.

32. On joining, the member receives a membership card. That is personal to the member and must be presented at the club's reception to gain access to the facilities.

It is possible to use that card under special arrangement, to access other Esporta clubs. It is this swipe card which is "turned off" through the club's central data system (Centrica) where a member has failed to make payments, five days after the direct debits request has failed.

33. It should be noted that, though the member has a contractual obligation to pay monthly fees for the entire Commitment Period, the club stops access to its facilities during that time if there has been a non-payment of fees. There is a clear link between access to the club and its facilities and payment of the monthly membership fees.

Clause 2.1
This clause provides:

"**2 The facilities**
2.1 You will only be permitted to use the Club facilities provided your membership is current and fully paid up or you have made payment arrangements acceptable to the Club."

34. This clause allows the club to restrict access if a member defaults on payment. A member who has paid their monthly fees will be allowed access to the club in the normal way. A defaulting member remains contractually obliged to make advance monthly payments for the duration of the Commitment Period. The difference between a member gaining access and one not having access is the payment of the monthly fees.

35. The next relevant clause is Clause 3.1 which relates to fees.

36. This clause provides:

"3. Fees

3.1 The Membership Application forms set out the joining fee and membership fee payable on joining. If you pay membership fees monthly, they are payable in advance by direct debit.
3.3 If your bank fails to make a due direct debit payment from your account, we (or our processing agent) will write a letter to advise you of this. We (or our processing agent) may continue to apply to your bank for payment by direct debit for up to two times and we (or our processing agent) reserve the right to refer any missed due payments to a debt collection agency. We may charge a fee for failed direct debit payments and/or letters sent to you in respect of unpaid amounts."

37. If a defaulting member does not pay the membership fee then for the first month the club encourages the member to make payment by making reminder phone calls and writing letters. As explained earlier, the matter is then passed to a debt collection agency (ARC) who tries to collect the debt for a further period of 90 days.

If they fail to collect the debt, then it is passed to another collection agency (Scotcall) which has a further 90 days to collect the debt. Failing this, the debt is passed back to Esporta. The debt collection agencies also deal with the small claims court recovery or recovery by litigation.

38. Under this clause, the club gives the member a right to cancel the membership if there is "a significant change to the opening hours and/or facilities available". The clause states that there could be a termination of the agreement, at the option of the member, if the facilities offered are significantly altered.

Clause 6.1 relates to termination.

This clause provides:

"6. Termination
6.1 Termination by the Club

We may terminate your membership immediately if:-

- you commit a serious or repeated breach of these terms or the Club's rules (in particular, if you do not adhere to the safe and proper use of the Club's equipment or facilities as instructed by your staff or in Club notices);
- any part of your membership fee remains unpaid 30 days after its due date;
- you provide us with false details when applying for membership or
- you misuse your Esporta Club membership card.

If we terminate your membership for any of these reasons (or you terminate without giving the due notice period) you will remain liable to pay the membership fee for the due notice period and if applicable, the remainder of any unexpired Commitment Period.

The only exceptions to this are that the Club will allow a reduction for any operating costs saved through your not using the club (though such savings are likely to be minimal) or for any membership fees recovered from a replacement member (but only if the Club has a waiting list for membership)."

39. This clause gives the club different reasons to terminate a membership and to recover unpaid fees prior to termination.

40. The club gives credit for any mitigation in their costs, for example, if a new member is found to take the place of the defaulting member or there is a reduction in operating costs. The clause is akin to a liquidated damages clause in that it seeks to arrive at a reasonable sum for compensation.

Clause 6.2 allows a member to terminate their membership due to the "unavailability of facilities" and this is available to both defaulting members and non-defaulting members unless the contract of a defaulting member has been terminated by the club.

41. One clause which should also be noted is Clause 8 which deals with suspension. This allows club membership to be suspended, as opposed to terminated, for a period when, for example, a member is ill or away from the country.

2009 Terms

42. The 2009 Terms are materially similar to the 2005 Terms. Clause 6.1 dealing with termination by the club has now become Clause 7.1. Clause 3 (ceased) has been amended and there is a new Clause 4 dealing with advance payment of full Commitment Period fees which allows a member to pay for their full Commitment Period in advance and guarantee that there will not be any increase in membership fees during that period.

2010 Terms

43. There are two sets of terms in 2010, the January 2010 Terms and the December 2010 Terms. The latter are in the same format and make minor changes to give transparency and clarity.

44. The layout has changed and the format and style is more in the nature of questions and answers.

45. The following are relevant questions and answers:

> "1 **When will my membership start?**
> Your membership will start on the date given on your membership agreement form.
>
> 2. **How long will my membership last?**
> You will be a member for at least the minimum term given on your membership agreement form.
>
> 3. **What do I need to know about paying my membership fee?**
> You need to pay all membership fees in advance.
>
> 3a. **Monthly membership**
> If you pay your membership fees monthly, they will automatically continue after your minimum term, unless you give us at least three full calendar months' written notice that you want to resign.
>
> 3c. **Paying by direct debit**
> If you pay your membership fee by direct debit, this will be taken from your account on or around the 1st working day of every month

…

3e. **What happens if I don't pay my membership fee on time?**
If you don't pay your membership fee on time you will not be able to use the club facilities until you have paid what you owe.

If you don't pay, we or our processing agent will write to tell you. We have the right to refer any missed payment to a debt collection agency.

16. **Our right to cancel your membership**
We may cancel your membership straightaway if you, or your guests, seriously or repeatedly:
a. break these terms or club rules;
b. risk the health or safety of our staff and other members;
c. let other people use your membership card to get into the club; or
d. engage in disruptive or violent behaviour
If we cancel your membership you still have to pay your membership fees for the notice period and, if it applies, the rest of any minimum term left.
We have the right to cancel any membership at any time."

Defaulting Members

46. A defaulting member is barred from all Esporta club facilities within five days of a due payment not being made. The Club starts to correspond with the member. If the payment is not received within 35 days of the due date, the contract is referred to an external debt collection agency. The defaulting member will owe all amounts due for a minimum period of twelve months. If the member cancels their direct debit mandate before the end of the minimum commitment period of twelve months, they would be in breach of the terms of their contract. Where there has been a breach of contract the innocent party (Esporta) has the option to elect to treat the contract as having ended or to affirm the contract and to seek damages such that they would be in the same position as if the contract had been performed. The parties accept that payment of compensation or damages is not consideration for supplies for VAT purposes. Such payment arises from a settlement arising from a breach of agreement or infringement of rights (rather than the provision of goods or services) and does not give rise to a supply. This is confirmed in the cases of *Financial and General Print Ltd (VTD 13795) and FMS Management Services* (VTD 10398).

47. The Appellant operates their own database (Clubcentric) which stores all information on members including details of non-payment .Once the defaulting member's swipe card is turned off all services and facilities will cease to be available. This includes access to the gym, fitness and dance classes, swimming facilities and sports facilities including sporting and tennis courts as well as family benefits, which are crèche facilities, day nurseries, children's sports classes and children's parties.

48. Esporta does not want to lose members and keeping members is critical to the company's cash flow and business, with defaulting members, the club embarks on a policy to encourage the member to retain their membership. However, this approach is not successful. In 99% of cases the defaulting member does not re-activate their membership. This results in a huge amount of debt recovery claim.

49. In order to retain its members, Esporta makes direct debit claims throughout the next two months. Where these prove unsuccessful for the third time the matter is referred to a debt collection agency, as explained earlier. It is these recovered sums which are the subject of this appeal.

50. It should be noted for clarity that Esporta accepts that VAT is payable for the period of time before access is barred. In this short period (normally five days) the member still enjoys access to the facilities and therefore a service continues to be supplied by Esporta. In the circumstances, a small proportion of the sums recovered are liable to VAT on a pro rata basis.

51. The Tribunal would like it to be noted that the County Court claims for recovery of money are undertaken by the solicitors Trevor Munn on a bulk basis. In the claim form it is stated that the claim relates to "the balance of consideration outstanding … in respect of services rendered".

52. The Tribunal accepts that these claim forms are not properly drafted and on the evidence of Mr Preedy, agree that the claim forms are not shown or agreed with anyone at Esporta. The solicitors, Trevor Munn, are appointed by ARC. The contract between ARC is with Esporta Management Services Ltd. The claimant on the claim form is New Esporta Holding Ltd, the holding company. The claim form may have different claimants since different companies run different clubs and the claimant may depend on the company with whom the contract has been entered.

Membership

53. A prospective member receives a Welcome Pack which includes a membership, membership agreement, terms and conditions and other member information. The tribunal was provided with a copy of the application form. The Welcome Pack provides a summary of the important points relating to membership. In its executive summary it provides as follows:

> "Your Esporta Club endeavours to provide superior facilities and excellent levels of service in a safe and enjoyable environment. As a private club we are dependent on the fee income from our members to finance the high cost of investing in equipment facilities and health and safety to the standard expected by our members."

This is a sort of mission statement by the club. Members are members of a particular club but can pay extra to have use of the facilities at a variety of clubs. Membership

itself can be provided on a peak or off-peak basis. This means that different members have different periods when the gym can be used.

54. Members may also join different gyms which have different facilities. Some clubs are health and fitness only and some are health and fitness and racket clubs which means that rackets sports are available. The gym facilities also differ. Some gyms have a swimming pool as well as a gym but may have limited restaurant and food facilities. Some of the premier clubs have full facilities with better equipment and offer a range of tennis courts, private lessons, massage, hot meals and a greater choices of facilities. Membership fees differ depending on the club and range from £45 to £199 a month.

55. The Respondents say that membership, on its own, carries benefits. These benefits include accepting smaller settlement sums as payment from defaulting members and altering contractual obligations in cases of default. The Respondents also say that membership allows facilities to be available and this continues to be available under the subsisting terms and conditions of the membership agreement even to defaulting members. The premises are maintained to a reasonable standard as required in the mission statement of the club.

56. The Appellant believes that membership carries no additional benefit. The critical benefit is the access it provides. It gives a member the right of access to classes, the gym and other facilities offered by the particular club and it seems to provide a collateral benefit in having the facilities available for use to the member. If one looks at the legal relationship between the gym and the person receiving the supplies from the gym and asks the customer "what are you receiving?", they would answer that it is the access to the gym and use of facilities offered by the club.

57. Facilities on their own denote something physical such as the playing fields, gym equipment, pool etc, which are provided as part of the infrastructure. It is the means or resources provided by the gym to the members. It is the plant in the form of permanent or semi-permanent structures built, established, or installed for the performance of one or more specific activities or functions. The club must have this infrastructure in order to allow access to members and to market itself to the public. It is not enough to have the facilities. When a person pays a membership they are paying to make use of and to enter the facilities. This creates a relationship between the gym and the individual member and links the member to the gym. While the contract does speak of making facilities available to the member , what the customer would be paying for, in his or her mind, would be the services offered by those facilities. Membership is not a separate and distinct supply from access to services; the facilities are made available to members, who have paid their subscription. The payment creates a link between the club and member since the member is paying to obtain the right to use the facilities. It is the use of the facilities which is primary to the member. A member may choose not to use the club's facilities but only if they have paid their subscriptions. If they have not paid, they have no right to use the facilities or to gain access to the club.

58. Let us turn to two cases *RCI Europe v Revenue and Customs Commissioners* (Case C-37/07) [2009] STC 2407 ("RCI Europe") and *MacDonald Resorts Ltd v HMRC* (Case C-270) [2011] STC 412 (MacDonald Resorts"), which are helpful cases on the question of membership.

59. The Appellant relies on these two cases to say there is no need for the underlying membership agreement to be terminated because there is no benefit in mere membership and membership as such is not a service for the purposes of VAT.

60. In the case of *MacDonald Resorts* the ECJ had to consider whether certain timeshare arrangements should be characterised as membership of a club, the leasing or letting of immoveable property or as something else. HMRC had taken the view that the payments made to MacDonald Resorts were consideration for taxable supplies of club membership benefits. This argument was rejected by the ECJ. The Court followed the approach in the *RCI Europe* case and agreed that the relevant question was "what was the customer's intention when they paid for the service?" The court took the view that what the customer wanted was to obtain timeshare holiday accommodation at some time in the future. The obtaining of points, which they received in exchange for their existing timeshare rights, had no value until they were exchanged for holiday accommodation. They were not simply paying to be members of a time share club. The service being provided was therefore one which was connected with immoveable property and therefore fell under Article 9(2) (a) of the Sixth Directive. This meant that the place of supply was where the property was situated.

61. The Court said, in effect, that the members' trading in of points represented a right to book a future holiday accommodation rather than some sort of supply of membership. The Court said the following:

> "**(d) Service not classifiable as membership of a club**
>
> 90. I do not, however, share the view taken by the Government of the United Kingdom that the relevant supply must be classified as membership of a club and that Article 9(1) of the Sixth Directive must apply.
>
> 91. As the Commission rightly states, **the customer in the main proceedings is not paying to be a member of a club. The payments he makes are not**, for example, regular membership fees paid in fixed amounts **in exchange for a multitude of services.** Unlike in *Kennemer Golf* (Case C-174/00 [2002] ECR I-3293), which did concern such a situation, the payments in question in the main proceedings can indeed be attributed to individual supplies. This notwithstanding, a classification such as that carried out by the Government of the United Kingdom seems to be legally untenable since *RCI Europe*. In that case, which concerned the assessment for VAT purposes of a business concept similar to membership of a club,

> the Court was able, on the basis of a careful examination of all the facts, to establish a synallagmatic relationship between the individual types of contribution and the corresponding services provided by the association (*RCI Europe* (Case C-37/08 [2009] ECR I-00000 paragraphs [34]-[35]).
>
> 92. Article 9(2)(a) was applicable in that case because the Court went on to find that access to an exchange pool for timeshare usage rights was only ancillary to the actual aim, the exchange or the possibility of participating in such an exchange (paragraph [35]). In view of the fact that the Court held timeshare usage rights to be rights in immoveable property and their transfer in exchange for the enjoyment of similar rights to be a transaction connected with immoveable property (paragraph [37]) the application of that provision in that case appears to be conclusive.
>
> 93. It is not therefore possible in the dispute in the main proceedings to rely on Article 9(1) of the Sixth Directive by arguing that the service in question is to be classified as membership of a club."

62. The Court clearly rejected the argument that the supply was one of membership. The point is that the Court did not see the member as paying to become part of a club but rather as having obtained the right to use the properties which were part of the timeshare arrangements. The Court clearly looked at the substance of the transaction from the point of view of the consumer.

63. The Court took a similar view in the *RCI Europe* case, also a case involving the exchange of timeshare usage rights and concluded that the membership of such a scheme "would be pointless "if there was no underlying intention of exchanging their right for those of other members. The customer was not paying to be a member of a club but rather to obtain the right to use the timeshare properties on an annual basis.

64. The Appellant is of the view that membership does not carry any particular separate or distinct rights or services and to be a member does not alter the commercial, financial or legal reality with which we are dealing. That reality is that access to the gym is based on the contractual arrangements and payment is required to satisfy the member's part of the bargain. There is no distinct consideration being provided for membership. Mr Scorey explained it more simply when he said , "it is not as if one is paying to be a member of the Garrick Club", a private members club in Central London , having its roots in the literary world.

65. The Respondents say that nothing turns on the membership fee collected from defaulting members. Ms McCarthy for the Respondents drew the distinction between the *MacDonald Resorts* and *RCI Europe* cases and said that the members of the timeshare option scheme were not supplied with any service unless and until the points which they had acquired were converted into property rights. In other words, no chargeable event occurred until the moment of that conversion when the customer

received the consideration for their initial payment. In our case Esporta is under a continuing obligation to make its facilities available to members, whether they are allowed access to them or not.

66. The *Kennemer Golf* case (Case C-174/00) [2002] STC 502 is also relevant. The case concerned a VAT treatment of supplies made by a golf club, particularly in relation to the sporting exemption provided in Article 13A(1)(m) Sixth Directive. One issue was whether the annual membership fees paid by members to the golf club were "for" the services provided by the club to its members. While there was an obligation to pay the annual membership fees it had to be paid whether or not the member used or regularly used the club during the period of their membership. The case highlighted the nexus between the supply, the facilities, and the consideration which was paid, the annual fee. If the fee was payable irrespective of whether there was actual use then there was no reciprocity and consequently there was no relationship between what was being paid and what was being supplied. The Advocate General and the Court recognised that the services provided by the club were making available the facilities and not particular services provided at the member's request. In that sense, there was a direct link between the annual subscription fees paid by members and the services it provided. The relevant point, for our purposes, is that there must be a "direct link" between the payment and the service provided .The court said:

> "40. The services provided by the association are constituted by the making available to its members, on a permanent basis, of sports facilities and the associated advantages and not by particular services at the members' request. There is therefore a direct link between the annual subscription fees paid by members of a sports association such as that concerned in the main proceedings and the services which it provides."

67. This case certainly highlights the two different aspects of the submissions before the Tribunal. On the one hand the Respondents say that the service is available regardless of if the member uses the services. The Appellant says that having the facilities available is a prerequisite for making a service. The supply of the services is one part of the equation and the payment the other; what the tribunal must establish is a link between the two.

68. It seems if one looks at the case of *Customs and Excise Commissioners v Redrow Group plc* [1999] STC 161 the House of Lords was more willing to say that the service is whatever is done in return for the consideration. In this sense, if one identifies the consideration there must be a relationship of reciprocity where something is done for the consideration. This reciprocal relationship creates the supply. The Tribunal respectfully submits that the better view is to first identify the supply which is being made and then identify the consideration which is paid for that supply and then establish a link between the two. This is because the supply being made must directly relate to the payment made, in other words the payment must be "for" the supply.

69. The Tribunal believes that members are paying their membership fees in order to gain access to the gym. It is correct to say that the club expends money on the construction of swimming pools, gym equipment and other such capital expenditures and in maintaining those to a high standard. This is the provision of facilities for playing of sport or undertaking exercise but it is the use of or access to those facilities that gives rise to a supply for VAT purposes since the payment is made by the member for the actual use of those facilities. A member may choose not to use the facilities but has to still make the payment. Using the facilities, once payment has been made, is a matter of personal choice.

70. In the case of *Apple and Pear Development Council v Customs and Excise Commissioners* [1988] STC 221, the Court held that the concept of the supply of services effected for consideration within the meaning of Article 2(1) of the Sixth Directive pre-supposes the existence of a direct link between the service provided and the consideration received. The link requires that a specific service is paid for directly and so a tax liability arises. The VAT charges are raised by reason of this link. This is the reasoning in the case of *TOLSMA v Inspecteur der Omzetbelasting Leeuwarden* (Case C-16/93) [1994] STC 509 which explains the link by stating that a supply of services is within the scope of VAT only if, as between the provider and the recipient, there exists a legal relationship in which there is a reciprocal performance.

71. What seems to evolve from the law is that there must be three parts to the transaction for a liability to arise. These are: a supply, consideration and reciprocity in the relationship. The provider and recipient must have a legal relationship which makes the transaction taxable. Thus reciprocity underpins the relationship.

What of the Link?

72. For a supply to be taxable there must be a link between the supply of the goods or services and the consideration which is paid. The link is determined by reference to the contractual arrangements between the parties. It is possible for payment to be made between parties, which are not subject to VAT. This would be the case, for example, where compensation is paid in reparation or restitution for loss or damages. A payment may be made for breach of contract but it will not give rise to a VAT charge. In such case there is no taxable supply.

73. The tribunal must look at the transaction from the customer's point of view. The question which must be asked is "what is being paid for?" The simple answer is that members are paying for the use and access to the Esporta gym facilities. The intention in making the payment is determinative. If no subscription payment is made by the member then they are denied access to the gym. Their membership is not automatically terminated. The membership which is retained allows there to be an on-going contractual relationship between the parties. The defaulting member can resume their membership on paying the outstanding arrears with no need to reapply for membership and pay a further joining fee. The Respondents say that this is a benefit of membership. It is difficult to see, on the facts, how membership alone can

constitute a supply. The member has no right to be re-admitted as a member. The club can refuse or deny access to a defaulting member or choose to re-admit that member. If they choose to readmit the member who pays up their arrears, they are choosing not to terminate the contract. They can make such an election since there is no obligation in law for them to terminate the contract. The reason they elect to affirm the contract is that they do not wish to lose members. It is commercially preferable to encourage members to return to active membership and not to lose those members. It is for the innocent party, Esporta, to decide whether to accept repudiation or to ignore it and keep the contract in being. The case of *White and Carter (Councils) Ltd v McGreg*or(1962) AC 413 (HL) support this view. Lord Reid said that the contract survives "save so far as the innocent party's right to perform the contract is concerned". If Esporta affirmed the contract and continued to provide services to defaulting members, then the compensation recovered would be standard rated. In the case of Esporta, they denied access to the defaulting members and so sums recovered by the third party debt agencies would be free of VAT.

Termination

74. The Respondents say the contract is not terminated but rather Esporta continues to make supplies under the contract. There are continuing obligations to make its facilities available to members whether they are allowed access or not. They say that Esporta chooses not to terminate the contract, in which case they would be entitled only to fees after mitigating their loss. This may not have been recovery of full membership fees for the entire Commitment Period but Esporta continued the members' membership for the duration of the Commitment Period.

75. The Respondents say that the contract clearly contemplates termination in particular circumstances. Denial of access is not one of the circumstances. Rather, termination would arise if the facilities are not available if, for example, the building housing the health club had caught fire and burnt down. In such a case, the facilities would not be available. The member pays for facilities, whether or not they use them. The club has an obligation to maintain the facilities to a high standard.

76. In further support of their argument that the facilities are what is being paid for, the Respondents say that the quality of facilities determines the membership charges, premium or basic. Given that defaulting members are still obliged to pay their fees even though they are barred from entry to the premises supports the view that they are paying for the availability and upkeep of facilities. The contractual arrangements reflect the fact that members are allowed access on a month by month basis but nothing turns on the membership fee collected from defaulting members. Rather, the VAT liability arises on the supplies even if those supplies are received as at a later date as would be the case where defaulting members pay their outstanding fees in arrears some time later. It may be paid later, for example, where it is collected by a debt collection agency. The wording of the Welcome Pack states that the facilities are what are promised to the prospective member.

77. The Respondents say that the contract draws a distinction between termination and suspension. The contract states that being time barred or suspended does not constitute a termination of the contract. It is a restriction on access. A termination only arises where there is a significant change in the facilities which are made available to the members.

78. In support of their argument that the contract has not been terminated, they refer to Clause 6.1 which allows the Appellant to recover damages if the contract is terminated. Such damages will have to be mitigated in accordance with normal commercial principles and the clause provides a mechanism for such mitigation. The Appellant has a choice to rescind the contract and claim damages under Clause 6.1 or to treat the contract as continuing and to require the defaulting member to make the monthly membership payments under Clause 3.1 until the end of the contract. The Respondents say that the Appellant has elected the latter option and so the payments are consideration for the on-going supply of club membership. The Respondents draw on the case of *White and Carter v House of Lords Association* [1962] A.C. 413 where the House of Lords decided that the appellants were entitled to carry out the contract and claim the full contract price, and were not obliged to accept repudiation and sue for damages.

79. The Respondents say that the contracts are valid in law. They point out that the terms and conditions in the membership contracts are fair and reasonable and would not fall foul of the provisions of the Unfair Terms in Consumer Contracts Regulations 1999. They say that under the terms of the contract, a standard form agreement, where a member agrees to join the gym for a minimum period and agrees to pay a monthly membership fee in advance, they become liable to pay for the whole contractual period but on a monthly basis. The Respondents have used the consumer law to make a point regarding the contract in dispute and to say that it is a perfectly acceptable way for a gym membership to be offered and conducted and termination is only allowed if there is good cause. The good cause in their view is where facilities are not available since the facilities are what are being provided.

80. The Respondents draw a distinction with the case of *Hometex Trading Ltd* (MAN/94/742), a case referred to by the Appellant to show that damages for non-performance do not attract VAT. In the *Hometex* case, the company was the wholesaler of carpets and floorings. The company's order for a quantity of yarn was cancelled. The supplier of the yarn resold the yarn elsewhere for less than the order price. The supplier obtained judgment against the company in respect of the cancellation of the contract. Before the tribunal it was found that the yarn had not been supplied to the company and so the tax point occasioned by the issue of an invoice did not bring a supply into existence since the contract to which it related was not in fact performed. The goods were not supplied and the tribunal concluded that the judgment was for an amount by way of compensation for damages which was outside the scope of VAT. The Respondents draw a distinction with this case. They say that there was a supply, the supply of facilities, and to that extent the contract was performed. This was not a case where, according to the contract, the facilities were no longer available.

81. It seems to the Tribunal that what we have here is simply a breach for non-payment of sums due under the contract. The monies recovered, as arrears due under the contractual document, represent damages and/or compensation for non-performance of the primary obligation to make monthly payments. The question which one has to ask is whether a formal termination of the contract is required. The short answer is "no". A formal termination of the contract is not required in deciding whether a supply is subject to VAT. The relevant question is whether the payments which are being made arise because there has been a supply and there is a relationship of reciprocity between the supply and the payment. The payment must relate directly to the supply. It must be remembered that the supply must be made "for" consideration, there must be a clear link between the two - the payment and the supply. In our case the supply, which is the use of facilities, is not made. Each monthly payment is made for a supply, namely the use of and access to the club's facilities. Where compensation has been recovered for any one month where access has been denied to a member then those sums are not related to a supply of services and therefore no VAT is chargeable. There is no requirement for the contractual relationship relating to the supply to be terminated. The tribunal does not interpret the contract as providing for a monthly fee which represents instalments by way of payment for a 12 month supply of "membership" at the time the contract was made. The services are dependent on payment and, for our purpose, that payment is linked to the supply, which is access to the facilities. It is quite clear that the service has ceased (subject to the short period of approximately four to five days when a member may have cancelled the direct debit but it would not have showed up at the club and so in principle services are still available to the member). This is clear from clause 2.1 of the 2005 Terms and the 2009 Terms.

82. The Respondents rely on the case of *Finance and General Print Ltd v HMRC* (1995 VTD 13795) in support of the contention that termination is necessary. They draw reference to a statement by Sir Stephen Oliver QC who, while recognising that a payment in compensation for early termination of a lease was outside the scope of VAT, said:

> "Here the service may be terminated by a lessor on an event of default; it is because it is terminated that the compensation becomes payable".

In this case, it was required that an act of termination take place since there was the lease of equipment and if no action was taken the supply of the possession of equipment would have continued. The act of termination caused the supply to cease. In this case, the cessation of the supply is done by the exclusion of the defaulting member from the club's premises. Where a payment is made and it does not relate directly to the supply of goods and services it will be outside the scope of VAT. In such a case the payment is compensatory. The taxability of the payment does not depend on the status of the contract as such but rather whether a supply is made. This view is supported by the case of *Holiday Inns (UK) Ltd* (1993 VTD 10609).

83. The Tribunal finds that, where there is a settlement between the parties when the member pays the outstanding arrears, Esporta forgo their right to sue and the money is paid in settlement of the claim. It is not paid for a variation of the contract. Since the member does not have access in the period when monthly payments have not been made, there is clearly no benefit conferred on the member and there is no link between the provision of a service and the payment of the money.

Conclusion

84. Since there is no direct and immediate link between the payment and any services provided by the Appellant, no output tax is due. The simple fact is that access to the gym is denied and no payment means that there is no service. The payments which are made are compensatory in nature. The Tribunal does not accept the Respondents' argument that there is a supply of facilities and membership, regardless of whether those facilities are used. The fact that the member can resume use of the facilities upon payment of the arrears and does not need to re-apply for membership are not convincing arguments to show that membership itself constitutes a separate and distinct service above and beyond access to the facilities. The tribunal cannot identify any direct connection between payment and the provision of "membership". The club chooses not to terminate the contract, which is an election an innocent party to a breach can elect to make. Rather the supply is the actual use of the facilities and the consideration is the monthly fee.

85. The Tribunal also finds that it is not required that the contract be terminated formally in order for the payment to be outside the scope of VAT. There is a breach not a suspension of the contract. It is the breach which gives rise to the barring of the member by stopping access to the facilities. This operates to break the link between the supply and payment. The Tribunal finds no merit in the Respondent's argument that the payment made by the member is to procure an alteration in the contract.

86. The Tribunal notes that an adjustment to the output tax calculation is required to take account of the 5 day period before the club is aware. This is referred to earlier. Accordingly, the appeal is allowed and it is ordered that the £1,319,461.73 overpaid as output VAT for the vat periods 05/06 to 12/09 be repaid after deducting the adjustment for the 5 day period.

87. The parties may apply separately on matters of costs.

88. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR K KHAN
TRIBUNAL JUDGE

RELEASE DATE: 28 September 2011