TC04051

Appeal number: TC/2010/05014

VAT - claim to recover input tax incurred by bank in providing deposit accounts - deposit accounts provided 'free of charge' to bank's customers - whether supply for consideration – yes – whether consideration capable of valuation – yes - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ING INTERMEDIATE HOLDINGS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at Bedford Square, London on 16-19 June 2014

K Prosser QC and Mr J Rivett, Counsel, instructed by PricewaterhouseCoopers LLP for the Appellant

K Beal QC and Mr P Mantel, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The appellant ("ING") is a UK registered company and the representative member of a VAT group which included the two companies which made the supplies at issue in this appeal, ING Direct (UK) NV and ING Direct NV, both Dutch companies.

2. It made various voluntary disclosures (the first in 2006 and the last in 2011) that it had failed to deduct input tax amounting to £6,032,280 in the periods 10/02 to 03/11. The claims were rejected by HMRC in decision letters issued in 2010 and 2011. The appellant lodged various appeals against these decisions which were consolidated into one.

3. The trade was carried on by ING Direct (UK) NV up until 31 December 2003, when it was transferred to ING Direct NV as part of a statutory merger under Dutch law. The making and rejection of the claim does not depend on which company made the supply so (save where specifically stated in this decision notice) I do not draw a distinction between the two companies but will refer to them both as the supplier or by the name IDUK (which was the acronym used in the hearing).

4. The business of IDUK was sold to Barclays with effect from 2 February 2013 and was thereafter run under the business name of 'Barclays Direct.'

Facts

The evidence

5. I had witness evidence from two witnesses on behalf of the appellant. Mr Feike Brouwers was Chief Financial Officer ('CFO') of IDUK from October 2007: he joined the finance department at ING NV (head office) in Amsterdam in 1997, became CFO at head office in 2000, moved to the French branch in 2006 before joining, as I have said, the UK branch as CFO in 2007. In summary, he explained the two sides of IDUK's business: investing deposited funds on the one hand and attracting the deposits on the other.

6. Mr Desmond McDaid was Savings Director at IDUK until 5 March 2013. His responsibility was to generate and retain savings deposits from private individuals in the UK. In summary, he explained how IDUK came to spend very significant sums in attracting and retaining its customers so that it was successful in obtaining about £24 billion on deposit. It was inherent in his evidence that attracting and retaining such large amounts in deposit was crucial to IDUK's business model: without the deposits it would not have the funds to make any investments.

7. I accepted the evidence of both witnesses as reliable, apart from the caveat about opinions set out in §26, and also with the very minor caveat with respect to Mr Brouwers that, as he accepted, his memory was at fault over the matter of whether customers could pay in cheques from third parties after the accounts were opened as

set out in §24. I also had various documents in front of me, which, where relevant, I refer to below. And from all this evidence I make the following findings of fact.

Overview

8. IDUK carried on a retail banking trade in the UK from about May 2003 and was regulated to do so by the Dutch Central Bank and the FSA. IDUK took cash deposits from private individuals in the UK. It used the money received to make investments. Depositors were protected by the Dutch deposit protection scheme.

9. Its profit was the margin between what it paid to receive deposits and what it gained in interest on its investments. In this it conducted its business like any ordinary retail bank in securing deposits and investing them, with the intention of making a profit. IDUK, in common with most banks, took deposits on 'short notice' (in other words, depositors could withdraw without notice) and invested the money in long term bonds and securities. The expectation was that the bank would earn more on its long term investments than it would have to pay out in interest on, and expenses in attracting, the deposits.

10. In other words, the business model comprised two parts. One half was the generation and retention of deposits by private individuals with the bank; the other half was investing virtually all of the deposited money on long term investments. Nevertheless, the costs of the business model did not split neatly in half: the costs of attracting and retaining deposits were very high. Many of these costs were subject to VAT. In relative terms, very little expenditure (and certainly very little expenditure subject to VAT) was incurred in making the investments (apart from the cost of the investments themselves). The appeal was concerned solely with the VAT which the appellant incurred on attracting and retaining deposits; while there was some VAT incurred on the investment side of the business model, the appellant did not seek to make out a case that this was recoverable as it considered the sums involved to be too small.

The investments

11. Up to 31 December 2003 ING Direct (UK) NV would loan the vast majority of the cash it received from depositors to the Spanish branch of its parent company. The Spanish branch was referred to by the acronym "EICC" which stood for European Investment Coordination Centre. I will use the same acronym. EICC invested the funds with EU and non-EU debtor institutions on its own account.

12. From 1 January 2004, as I have said in §3 above, the retail banking business was transferred to the UK branch of the parent company, ING Direct NV. While EICC continued to execute the investments made with the deposits received, it now did so on behalf of the UK branch. As before, the issuers of some of the financial instruments were based outside the EU.

13. The investments made by (or via the agency of) EICC were in low risk, fixed term bonds and securities, either by way of subscription (the majority) or purchased

on a secondary market. Normally IDUK would retain the securities until maturity. A small percentage of the funds were invested in short term deposits so IDUK could always meet its liquidity needs.

Additions to business after 2006

14. IDUK became an insurance intermediary for AXA after October 2006, arranging insurance on behalf of its customers and earning commission. This is not relevant to the appeal and I do not mention it again.

15. It started to offer private mortgages in October 2006, and actually made its first loans secured by mortgages in December 2006. Obviously, to the extent that its funds were used to make mortgage lending, these funds were no longer available to be invested via EICC in other long term investments. Similarly, this fact has no real impact on the appeal (apart from quantum). It was merely a different way of investing the deposits in long-term securities.

The investment strategy

16. ING Direct NV, based in Amsterdam, had an 'investment committee' which met quarterly and took strategic decisions on the investment strategies of the entire group and not just the UK operation.

17. IDUK had a committee called by the acronym 'ALCO' (asset liability committee) whose membership included (from IDUK) Mr Brouwers (or his predecessor), when appointed in 2008 IDUK's new portfolio manager, and the chief risk officer, but also included representatives from EICC and ING head office. It met once a month to discuss at high level IDUK's investment strategy.

18. Lastly, IDUK had 'INCOM' which was a weekly meeting between the portfolio manager and representatives from EICC and took operational decisions.

19. Day to day there would be phone contact by IDUK with the EICC, which involved Mr Browers, and then after his appointment in 2008 the portfolio manager for IDUK, giving instructions to EICC on which investments to make.

20. There was a dispute, which proved irrelevant to the legal case, between the parties on the extent to which IDUK controlled the investment strategy of its own portfolio and to what extent this was dictated by either or both ING head office or EICC. I find, based on the witness evidence, the evidence of the agreements and the lack of a portfolio manager at IDUK until 2008, that at the start on 1 January 2004 (when IDUK ceased to loan the money to EICC) the investment strategy was largely controlled by ING head office and EICC, but over time IDUK gained more control. The agreements were changed to reflect this in 2006 and IDUK appointed a portfolio manager in 2008. I find that by 2006, while EICC provided investment advice, IDUK made the final decisions on which investments were made, leaving it to EICC merely to execute IDUK's decisions.

The retail banking business

21. In summary, I find it fair to summarise IDUK's retail banking business model as offering a normal retail banking service but with the following distinctions:

- It only offered deposit accounts;
- It did not provide walk-in branches or have any other 'high street' or physical premises at which customers could attend.

It attracted customers by the following means:

- It charged its customers no fees or penalties. It was a core element of its strategy that no charges or penalties were levied on depositors for using their accounts. This was exemplified by its marketing catchphrase: "no fees, no exceptions". Having said that, there was an exception on one type of fixed rate account on which the customer would lose the right to 90 days interest if he made a withdrawal without notice.
- It offered its customers an interest rate higher than most or all competitors;
- It offered a 24 hour efficient telephone and internet based banking service.

22. Depositors could only make transactions on their accounts over the internet or by telephone. The witnesses accepted that this method of business reduced the bank's overhead costs and was linked with and facilitated its objective of attracting large numbers of customers with a higher rate of interest than most competitors offered.

23. IDUK offered a number of different savings accounts. As I have said, it did not offer current accounts. The savings accounts differed in the rate of interest offered to depositors, but save with the one exception already mentioned in §5, no fees or charges were levied on any of the accounts. It was accepted by the witnesses that there was one account in which the depositor would forfeit some interest if they withdraw funds early. Other than that, I find no fees or charges or penalties were levied.

24. IDUK did not offer its depositors many facilities. The depositors were not given cheque books, credit cards, debit cards or overdraft facilities. They were unable to make payments from their IDUK accounts to third parties. All that depositors were able to do was to pay in money by means of a cheque (drawn by anyone, not just the depositor) or by a transfer of money from another bank account (with any bank). Money could only be withdrawn by means of a transfer into a linked account, which might be with a different bank, but had to be in the name of the depositor.

The expenses

25. In order to operate its retail bank and in order to attract depositors, since late 2002, IDUK incurred heavy expenses many of which carried VAT. It is that VAT it seeks to recover in this appeal. The services included matters such as:

- Advertising to attract new depositors. Mr Brouwers said ING adopted a 'fairly scientific' approach to marketing and advertising expenditure by which he meant that they measured the success of campaigns in terms of how many more deposits were received;

- Construction of a head office and two call centres in 2003 and 2004 (to handle the calls from depositors making transactions by telephone);

- IT services (to provide, amongst other things, the computer hardware and software to run an efficient and reliable internet banking platform);

- Employing about 660 staff, about half of which worked in the call centres, and many of the others were engaged operating the internet banking platform ('web-based customer interface').

26. The witnesses said they regarded the expenses incurred as overheads attributable to the making of the investments by IDUK, but it was clear that they meant this in the sense that the expenses at issue in the appeal were incurred in order to attract the deposits: without the deposits, IDUK could not make its investments. I do not find that they intending to make any statement of law in this matter and, even if they were, it would not amount to evidence. Nor do I accept it is right as a matter of fact other than in the sense the expenses were essential to attract the deposits and the deposits were essential to making the investments.

The terms and conditions

27. Two sets of terms and conditions were presented the tribunal, one dated 19 May 2011 which was just after the last period at issue in this appeal. The other set were from 2013 when the business had become 'Barclays Direct' and was no longer owned by IDUK.

28. In other words the Tribunal had no direct evidence of the terms and conditions which applied to the accounts which existed at the time of the periods at issue in this appeal. Mr Prosser pointed out that there was little change between the 2011 conditions and the 2013 conditions but that is of course not evidence of what the position was before the 2011 conditions came into force.

29. Having said that, neither party's case was that the terms and conditions operating in the periods at issue were materially different to those in front of me. Indeed Mr Prosser's position seemed to be that there was only one relevant written condition and that was that there would be no fees or charges levied by IDUK on its customers. I deal with this below.

30. As the witnesses did not consider the terms and conditions to have changed significantly, I find that so far as relevant that at the period in issue the conditions were:

- The customer had to be private individual aged 18 or over;
- The customer had to have a current account with a bank or building society in UK;
- Anything between £1 and several million could be deposited in an account with IDUK;
- The depositor could make up to 10 withdrawals in a day; he could withdraw any amount between £1 and the full amount in the account. Withdrawals did not require any notice.
- Statements were made available to customers online but (at the customer's request) would also be posted to them;
- IDUK had to give two months notice to close an account.

31. The terminology in the contract was one of service by IDUK. In virtually every clause there was a reference to the 'customer' by which term the depositors were designated. The contract referred to the 'service' the bank provided to its customers, such as:

> 'automated touchtone phone service…."
>
> "so that you can use our services securely, you must do all you reasonably can to keep your security details safe…."
>
> " we are committed to giving you a service of the highest standard"

32. The term which formed a significant part of Mr Prosser's case was:

> "There are currently no fees or charges for the ING Direct savings account. However, we may introduce or vary charges, in line with condition 16."

33. Mr Brouwers accepted that the terms of the agreement between the customer and IDUK were very different to the terms and conditions that would exist in a mere contract of lending. They were, I find, fairly typical of the sort of terms and conditions that one would expect to find in a retail banking contract albeit one which contained the less standard terms as outlined at §21 above.

The special method

34. The appellant operated a special method for input tax recovery ('the PESM'). This was agreed with HMRC on 17 June 2004 with effect from 1 April 2003. Appendix 7 of the PESM stated:

> "ING Direct NV Reading Branch

> Whilst NG Direct NV Reading Branch only generates exempt income, then no input tax can be recovered within this [income generating area]. Should this situation change, then HMC&E should be notified and a method of recovery shall be agreed before any input tax can be recovered."

The dispute

35. The appellant's case is that IDUK made specified supplies within the meaning of article 3(a) of the VAT (Input Tax) (Specified Supplies) Order 1999 when it made investments in non-EU issued financial instruments. HMRC accept that (after 1 January 2004) IDUK did make some investments in non-EU issued financial instruments but considered that these investments were not economic activities.

36. It is the appellant's case that the VAT on services purchased by IDUK to support its deposit taking activity in the UK (such as the marketing, administration, IT services and property costs referred to in §25) were business overheads and therefore under s 26(2)(c) Value Added Tax Act 1994 ("VATA") recoverable in part because IDUK made some specified supplies.

37. IDUK sees itself as (at least in so far as it made specified supplies) comparable to the hypothetical trader envisaged by the CJEU in *BLP* (see §45 below) which borrowed funds in order to carry out its taxable activities: the CJEU considered that in so far as the hypothetical, fully taxable, business incurred expenses in borrowing those funds, those expenses were attributable to its taxable business.

38. IDUK's case is that from 1 April 2004 its special method (§34) was inappropriate as IDUK ceased to make only exempt supplies and commenced making exempt and specified supplies to which its input tax was attributable. Its voluntary disclosures notified a proposed change to the special method, which would permit partial recovery of its input tax by IDUK.

39. HMRC do not agree that IDUK is entitled to recover any of its input tax or that its special method should be changed. They consider that the VAT on the costs which were incurred to support the deposit taking activity are attributable (in the VAT sense) to exempt supplies of banking services and therefore irrecoverable, irrespective of the question whether IDUK actually made any specified supplies with respect to its investments or whether making those investments amounted to an economic activity.

40. Finally, there is a subsidiary issue in that, prior to 1 January 2004, even on the appellant's case, it did not make specified supplies because it invested its money by loaning it to EICC. Nevertheless, it claimed that it was entitled to reclaim at least some of the pre 1 January 2004 input tax on the basis that there was a change of intention. This part of the claim relied on Regulation 109 of the VAT Regulations 1995/2518. I deal with this at §§177-182 below.

41. The question of to what supplies the input tax on the costs summarised at §25 was attributable underlies all issues in the appeal and I will deal with that first.

42. I note that the European law governing this appeal up to 31 December 2006 was contained in the Sixth VAT Directive ("6VD") but thereafter in the Principle VAT Directive ("PVD"). As there is no material difference between the two directives so far as the law at issue in this appeal is concerned, below I will only refer to the provisions of the PVD.

The law relating to attribution of input tax

43. The law governing attribution of input tax was not really in issue. Fundamentally, the dispute between the parties was whether IDUK made supplies for consideration to the depositors. It was assumed (rightly) that *if* IDUK made a supply of banking services to its depositors, then the costs IDUK incurred on its deposit taking activity had the most immediate and direct link to those banking services. Those banking services, if made, would be exempt and the attributable input tax irrecoverable.

44. The appellant considered that IDUK did *not* make a supply of banking services to its depositors and the input tax incurred in respect of its deposit taking activity was an overhead of its investment business, part of which included making specified supplies. It would therefore (on its case) be entitled to recover a proportion of the input tax. (HMRC's secondary case was that if IDUK was right to say it did not make a supply of banking services, then IDUK's investments did not amount to an economic activity and none of the VAT could be recovered in any event. I deal with this at §§168-176).

Is receiving a loan a supply?

45. The appellant's case is that receiving a loan is not a supply nor consideration for a supply. It points out that in *BLP Group PLC* C-4/94 [1995] STC 424 the Advocate General said:

> "[47] …. if a taxable person…takes up a loan, he does not himself thereby effect a transaction within the meaning of those rules. Instead he is the recipient of a service, which is the subject of a transaction by a third party. Under those circumstances the input tax charged on the advisory services supplied in connection with taking up the loan may be deducted if it is attributable to taxable transactions."

46. The CJEU appeared to agree with this as it said at §25:

> "It is true…if BLP had decided to take out a bank loan for the purpose of meeting the … requirements [of its taxable transactions], it would have been entitled to deduct the VAT on the accountants' services required for that purpose."

47. It was also the appellant's case that in taking deposits IDUK was acquiring the funds to use in its business and 'it is settled law that this is not a supply…" citing *Kaphag* C-442/01 [2005] STC 1500 and *Kretztechnik AG* C-465/03 [2005] STC 1118.

48. I agree that the mere receipt of a loan is not a supply by the borrower. But that does not resolve the dispute. Did the legal relationship between the bank and its customer involve something else, other than the receipt of the loan, that did amount to a supply by the bank to its customer?

The meaning of 'supply'

49. Art 24(1) of the PVD provides:

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

50. As Mr Prosser says, this does not mean that something which is not a supply of goods is therefore necessarily a supply of services. To be a supply of services it must amount to a *transaction* in the VAT sense. For instance, in *Landboden-Agrardiesnste* C-384/95 [1998] STC 171, farmers were paid in return for agreeing not to farm. The CJEU ruled that that was not a supply of services:

> "[23] A transaction such as that at issue in the main proceeding, namely the undertaking given by a farmer to reduce production, does not fall within the scope of that principle because it does not give rise to any consumption…the farmer does not provide services to an identifiable consumer or any benefit capable of being regarded as a cost component of the activity of another person in the commercial chain.
>
> [24]Since the undertaking given by a farmer to reduce production does not entail, either for the competent national authorities or for other identifiable persons, any benefit which would enable them to be considered to be consumers of a service, it cannot be classified as a supply of services..."

51. Mr Prosser agreed it was no part of his case that there was no identifiable consumer. So while I agree that not everything which amounts to contractual consideration is necessarily a VAT supply, the *Landboden* case is not otherwise relevant here. In this case, if the bank supplied a service, it was supplied to and consumed by its depositors.

52. The question is whether there was a 'transaction' by IDUK. Did IDUK do something for consideration?

53. In its skeleton, the appellant characterised its UK banking activities as a 'deposit taking activity' and merely borrowing funds at interest. IDUK viewed itself as *receiving* the service of the loan of money from its depositors: it did not (in its original case at least) view itself as supplying anything to its depositors.

54. The appellant denied was that accepting the deposits was a service. The appellant's case was that all IDUK did was to accept deposits on terms that IDUK would pay interest. The transactions with depositors were, in the view of the appellant, 'straightforward loans of money at interest' *to* IDUK, rather than a supply *by* IDUK.

55. Obviously the bank promises to repay the monies deposited with it (often with interest). But any debtor does the same. It is the nature of the grant of credit that money is loaned for a period of time (whether finite or indefinite) on terms that it must be repaid: I agree with the appellant that the promise to repay is not 'doing something' in VAT terms. In the same way, the loaning of an object (eg a car) is a service by car hire company to the car renter: the promise by the renter to return the car is not a service to the car hire company. That leads me to consideration of the *MNBA* case.

MBNA case

56. The appellant relied on the cases of *MBNA Europe Bank Ltd* [2006] STC 2089 per Briggs J at §22 for the proposition that it is wrong in principle to see the borrower of money as providing a service to the lender:

> "[22]…when a bank lends money to a customer, the bank makes a supply of credit (ie the use of the money lent) rather than the supply of the money itself. The consideration is therefore the interest (and any relevant charges) payable by the borrower, rather than the aggregate of the interest, the charges and the value of the promise to repay the principle. If the customer provides security for the loan, that is not a supply to the bank. It is merely the performance of a condition of the loan agreement…..
>
> [23] That is not to say that there cannot be mutual supplies arising from the same transaction. The best example consists of a barter of goods for goods. Whether that is the correct VAT analysis of any particular transaction will depend on an economic analysis of its essential nature set against the nature and purpose of VAT as a form of taxation."

57. In other words, the promise by a borrower to repay its lender is not a supply in meaning of the PVD. The question is whether the contract between IDUK and its customers contained *other* conditions which amounted to a supply within the meaning of the PVD. What Briggs J here said does not support the appellant's case that the borrower of money cannot also provide a service to the lender. On the contrary, Briggs J recognised the possibility of barter transactions. The question is whether something was provided by IDUK to its customers ***additionally*** to its promises to pay interest and repay the principle sum.

58. So the question is whether IDUK did more than merely promise to pay interest and promise to repay the capital: did it do something that amounted to a supply to the depositor (the lender) and thus create a barter transaction, where both parties made supplies to the other?

Bank of Scotland case

59. HMRC considers that the Tribunal decision in *Bank of Scotland* [1995] VTD 13854 shows that a banking contract involves the provision by the bank (the borrower) of more than just the promise to repay the capital and to pay interest, and

that a banking contract does involve a supply by the borrower (the bank) to the lender (the customer).

60. The appellant considers that the VAT Tribunal wrongly decided the case. It says that the Tribunal incorrectly relied on the domestic contract law concept of consideration and based its decision on the incorrect legal view that anything done for contractual consideration was a supply of services. More specifically, Mr Prosser's view was that the Tribunal (Sir Stephen Oliver) was wrong because he regarded (contrary to what Briggs later said in *MBNA)* the mere acceptance of a deposit by the bank as consideration. The agreement to repay a deposit is contractual consideration: but it is not a supply for VAT purposes for the reasons set out at §55 above.

61. I consider, however, that that is not what Sir Stephen Oliver actually meant. He said:

> "[19] Anything done for a consideration which is not a supply of goods is a supply of services; see Value Added Tax Act 1983 section 3(2)(b) (VAT Act 1990 section 5(2)(b)). What then, in the context of current account and deposit account facilities, does the Bank do for a consideration? Taking current accounts first, I understand that the Bank and the customer have a contractual relationship covering the setting up and maintenance of the facility. The Bank agrees to open the account in the name of the customer, to accept deposits of cash, to repay to the customer any monies deposited to act as agent of the customer to pay sums of money to others, to issue cheque books and cards as appropriate etc. The customer agrees to abide by the terms governing the setting up of and maintenance of the facility and to pay such charges, if any, as the Bank may impose. Once the account is in credit (or debit) the legal relationship becomes that of debtor and creditor; and unless anything is agreed to the contrary the Bank, in common with bankers generally, has a general lien over securities etc. deposited by the customer. The provision of the "free" banking facility cannot, in my view, be severed from the debtor and creditor relationship that subsists when the facility, eg the current account, is in operation. Whether one looks at the agreement for the current account facility or at the debtor and creditor relationship once the facility is used by the customer or at both there is a bilateral legal relationship under which both sides give consideration.
>
> "[20] …. The payment of bank charges, if demanded, is not the only ingredient in the consideration given by the customer under the legal relationship covering the current account facility. The customer gives non-monetary consideration by complying with the rules governing the current account and by, for example, handling the cheque book and bank card as directed. The customer gives monetary consideration when the current account facility is activated and cash is deposited…I conclude that the Bank does supply services for a consideration so far as current accounts are concerned….
>
> [21] With deposit account facilities the conclusion must, in my view, be the same. There may be no cheque books and bank cards, but the

> agreement governing the opening of the deposit account facility is bilateral and the customer provides monetary consideration as soon as the deposit account is put in funds by him."

62. Did Sir Stephen fall into the trap of deciding that the terms on which the money was lent were a supply in their own right?

63. In §19 he asks what the bank does. His answer is that the bank accepts deposits of money, it pays out money on behalf of its customers, it issues cheque books and debit cards. Clearly paying out money to third parties on the customer's instructions and the issue of cheque books and debit cards are not ordinary terms of a contract of lending, although they are clearly ordinary terms of retail banking contracts. They are supplies in their own right. The supply is of a bank account facility.

64. The mere acceptance of a loan, however, is simply an incident of being a counterparty to a contract of lending, and, I agree with Mr Prosser, is not a supply in its own right. What I think Sir Stephen probably meant here, where he says the bank 'accept deposits of cash', was not the mere acceptance of a loan but the facility of the customer's right to pay in money whenever he chose. It does not matter, however, whether providing facilities to accept deposits is simply seen as a term of a contract of lending or a supply of a service in its own right, as it is clear that some of what the bank does in making available a current account is a supply in its own right.

65. I accept that the analysis given by Sir Stephen in §20 of what the depositor did in return might be also be open to criticism on the basis outlined at §55 above. Complying with the rules and handling the cheque book as directed are clearly simply terms on which the bank made its supply of its services of bank accounts: they are not services in themselves. Moreover, the deposit of cash is not *monetary* consideration. It is a loan of money on terms including a term for repayment. So while a cash sum is obviously involved in a loan, the loan is nevertheless non-monetary consideration: see [22] of *MNBA* at §56 above.

66. But putting aside these quibbles, in essence what Sir Stephen said here was right. The customer gives consideration for the bank's services by depositing money in his account. In other words, the consideration for the provision of the bank account by the bank, is the loan of the deposited monies to the bank by the depositor. I accept Mr Prosser's point that the loan is not monetary consideration: but I accept HMRC's point that it is *non*-monetary consideration.

67. Sir Stephen's view was that this was as much true of deposit accounts as of current accounts, although he gives no detailed explanation for this view at [21]. Mr Prosser does not agree with him. I consider this point at §§89-104 below.

68. In any event, the decision is not binding on me: I agree with Mr Prosser that the normal terms a borrower promises to its lender (such as to pay interest and repay capital) are not 'supplies' within the PVD. That does not mean that a banking contract is nothing more than a normal contract of lending: the contract has to be

considered to see if the bank does more than merely promise to repay the principle and pay interest.

69. I will look at the terms of the contract shortly but first mention a few other arguments by HMRC which are relevant to the question of whether IDUK made supplies to its depositors.

Retail banking exemption

70. HMRC point out that there is a specific exemption in the PVD for retail banking:

> "**Art 135**
>
> 1. Member States shall exempt the following transactions:
>
> …..
>
> (d) transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection;
>
> (e) …."

71. HMRC's case is that the existence of the exemption implies that there the thing exempted would otherwise amount to a taxable supply (or there would be no point in the existence of the exemption) and, therefore, must be a supply.

72. However, I agree with the appellant that the fact that retail banking transactions are stated to be exempt does not imply that all retail banking activities are necessarily transactions within the meaning of the PVD. This exemption is repeated in the UK provisions enacting the PVD (Item 8 of Sch 9 VATA) but again the existence of the exemption does not prejudge whether any particular banking activity amounts to a transaction.

73. HMRC's view seemed to be the mirror image of the appellant's, in other words that the transaction between the bank and any individual customer was merely a supply by the bank to the customer, not recognising any supply by the customer to the bank. HMRC point out that Art 135 draws a distinction between the provision of credit and (on the other hand) 'transactions …concerning deposit…accounts' on the other, implying (say HMRC) that they are not the same. HMRC also pointed out that depositors are not authorised credit institutions, implying, says HMRC, that they are not providing credit.

74. But I do not agree. Private customers depositing money with a bank are not authorised credit institutions and they are not depositing the money by way of business, but the reality is that they do give credit to the bank. It makes no difference to that analysis that they are not (and presumably are not required to be) regulated for the purpose; nor even that they understand that that is the effect of what they are doing. The separate exemptions in Art 135 imply nothing: there is a supply of credit by customer to bank; there may in addition be a supply by the bank to the customer.

The supplies are different so it is no surprise that they are exempted by different provisions.

75. So I do not agree with HMRC that a banking contract does not involve a supply from depositor to bank; such a supply is however, outside the scope of VAT at least where private customers are concerned as the deposit is not made in the course of economic activity. But while it is true that the depositors provide credit to the bank, that does not answer the question whether the bank provides a service to depositors. A banking contract may amount to a barter of services.

The deposit guarantee scheme

76. The Appellant accepted that the deposits made by its customers with IDUK were covered by the Dutch deposit guarantee scheme. HMRC pointed out that the Deposit-Guarantee Scheme Directive provided at Art 1(4) the definition of a credit institution as:

> "'credit institution' shall mean an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account."

77. HMRC says that the acceptance by IDUK that it is a credit institution negates its case. I cannot agree. IDUK does not deny that its business is the receipt of deposits from the public and the granting of credits on its own account: it merely says that the receipt of deposits does not involve a supply of services by it, or at least it does not involve a supply of services for consideration. That the bank is defined as a credit institution does not answer the question of whether it made supplies of services to its depositors.

Barter?

78. I agree with the appellant that it is wrong in principle to see the person who accepts a service provided to them and who pays consideration for it as itself making a supply of accepting a service. But that situation must be distinguished from one of barter, where both sides provide a service to the other. Mr Prosser relied on footnote (19) to Advocate General Mr Jacobs' Opinion in *Kreztechnik* C-465/03 where he said:

> "In the case of a barter transaction there are, of course, two supplies and two acquisitions."

79. This is self-evidently right. But Mr Prosser's point is that even with a barter transaction only the supply is a transaction; the acquisition (or receipt) of a supply is not. And that is true too; but the supply by one party to a barter is in whole or part the consideration for the supply by the other party. Each party makes a supply to the other; and the supply received by one is the consideration for its own supply to the other.

80. The appellant actually accepted during the course of the hearing that IDUK provided a few, what it described as peripheral, services to its depositors. In particular, contrary to what it said in its skeleton, it accepted, on reading the terms and

conditions, that there was an element of service provided by IDUK in that it would accept cheques issued to a depositor by third parties, and credit them to the depositor's account, it would provide statements, and easy access by the depositor to his money. It still did not see these as altering its analysis of the situation that fundamentally the supply was customer to bank and not bank to customer.

Contractual terms

81. Both parties considered that the answer was in the contractual terms and criticised the other for not giving weight to them. I agree that the contractual conditions should be given proper weight in this case where there is no suggestion that the terms do not reflect the economic reality. I was referred to what the CJEU said in *Newey* [2013] C-653/11 [2013] STC 2432:

> "[43] Given that the contractual position normally reflects the economic and commercial reality of the transactions and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' transaction within the meaning of Articles 2(1) and 6(1) have to be identified.
>
> [44] It may, however, become apparent that, sometimes, certain contractual terms do not wholly reflect the economic and commercial reality of the transactions.
>
> [45] That is the case in particular if it becomes apparent that those contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transactions."

82. Subsequent to and applying this decision the Supreme Court (Lord Neuberger giving the court's unanimous decision) said in *Secret Hotels 2 Ltd* [2014] UKSC 16:

> "[31] Where parties have entered into a written agreement which appears on its face to be intended to govern the relationship between them, then, in order to determine the legal and commercial nature of that relationship, it is necessary to interpret the agreement in order to identify the parties' respective rights and obligations, unless it is established that it constitutes a sham.
>
> [32] When interpreting an agreement, the court must have regard to the words used, to the provisions of the agreement as whole, to the surrounding circumstances in so far as they were known to both parties, and to commercial common sense. When deciding on the categorisation of a relationship governed by a written agreement, the label or labels which the parties may have used to describe their relationship cannot be conclusive, and may often be of little weight…."

Here there was no suggestion that IDUK's contractual terms failed to reflect economic and commercial reality or that they were a sham. It was therefore the appellant's position that I was bound to take the 'no fees' clause (§32) at face value and that resolved the appeal in the appellant's favour.

83. 'No fees, no exceptions': As mentioned, IDUK's advertising slogan was 'no fees, no exceptions' and (see §32) the later contract provided that no fees were charged. While I did not have the written contract from the relevant period, HMRC accept that no fees were charged (with one exception – see §23). The appellant's position was that there was no suggestion that the written contractual terms were a sham or in some other way failed to represent the agreement between the bank and the customer, and so the Tribunal must accept that, as the contract provided that there was no fee, that that resolved the matter in favour of the appellant because, even if banking services were provided, they were provided without consideration and were therefore, says Mr Prosser, not supplies within the meaning of the PVD.

84. I will address below the question of whether there was consideration after considering whether services were provided by the bank to the customers. But I am unable to accept that the 'no fees' clause was the only relevant term and I go on to consider all terms relevant to the question of whether services were provided by the bank.

85. I note in passing that in the 'no fees' clause (see §32), the bank *reserved* the right to charge fees: this is consistent with a service being provided rather than the reverse. If the bank did not provide a service, for what was it reserving the right to charge fees?

86. Relevance of other terms: I agree with what Sir Stephen Oliver said in *Bank of Scotland* at §22 that the legal essentials of bank accounts are public knowledge. Nevertheless, as I have said, in this case I did have the benefit of at least some written, albeit rather too young, contracts. And as Mr Beal said, and I find, they evidenced a normal customer-bank relationship.

87. A service of safekeeping? The nature of a deposit of money is that the depositor exchanges cash for the promise by the bank to repay an equivalent amount (often plus interest). Putting money in a bank might be seen as a safer option than retaining a large sum as cash ('putting it under the mattress' as it was referred to in the hearing) or than investing it in stocks and shares. Is there therefore a service of safekeeping provided by a bank when accepting deposits? I agree with Mr Prosser that there is no such service. The 'safekeeping' is merely a reflection of the creditworthiness of the bank: what the depositor gets is the bank's promise to repay. That is all any lender gets. Some borrowers are clearly more creditworthy than others, but the promise to repay by itself, as I have already said at §55, is not a service. That does not alter merely because the institution promising to repay is a bank. There is therefore no supply of keeping the money safe.

88. Secure interaction with bank? HMRC also suggested that IDUK provided a service because it ensured that its internet platform and phone service were very secure, to prevent unauthorised transactions on a depositor's account. For much the same reasons as in the previous paragraph, I am not satisfied that there is any element of service in a borrower taking steps to ensure that it correctly identifies and only repays the lender. A liability to repay the right person (the lender) is merely an incident of borrowing money.

Conclusion on whether bank provided a service

89. The parties appeared agreed that providing a current account, even one that was constantly in credit, would involve a supply of a service by the bank to the depositor because of the extent of the facilities provided, such as debit cards and cheque books, 'holes in the wall' (ATMs) and so on. And I think that this is right. The provision of a current account is the provision of a banking service by a bank even if the current account is always in credit.

90. The appellant's position was that its deposit accounts were very different. The methods of withdrawing money were very restricted and there were no walk-in branches, credit or debit cards, cheque books, or ATMs.

91. I do not think the lack of walk-in branches is of any significance to the analysis of whether a service was provided. Branches are provided so that depositors can give instructions to the bank, normally as to paying money in or taking money out. IDUK provided its depositors with facilities to give it instructions but depositors could only access these facilities via the internet or the telephone. The method of delivery of the service (electronic and telephonic rather than face-to-face through a walk-in branch or ATMs) makes no difference to the legal analysis of the facility. In other words, if the provision of walk-in branches is a service bank to customer, then the provision by IDUK of its telephone and internet interface would also be a service.

92. The methods of withdrawing money from the IDUK accounts were restricted, and more restricted than with 'high street' deposit accounts, from which cash could normally be withdrawn. With IDUK the depositor could only withdraw by transferring funds to another ING account or to transferring to a nominated linked account (an account with another bank but in the depositor's name.)

93. The methods of paying in were slightly less restricted. As I have said, see §24, IDUK would not only accept transfers from accounts with other banks, but would accept any cheques drawn in favour of the depositor. (These would have to be posted to the bank).

94. IDUK provided statements. These could be accessed on line or (at the request of the depositor) sent by post: §30.

95. There were no restrictions on the depositor's access to his funds. While one account involved a penalty in the sense of reduced interest if money was withdrawn without notice, the terms of all accounts were that a depositor could withdraw all his money without notice: §30.

96. In conclusion, I find depositors could (subject to doing so in the right form) deposit and withdraw money at will; they were provided with an interface to give the bank instructions on withdrawals and deposits and could check their balance when they chose. Statements were provided.

97. I consider that these facilities were valued by depositors. Not only does it stand to reason that a failure to offer such facilities would make the bank's offering

extremely unattractive, Mr McDaid's evidence was that the bank spent a very great deal of money in ensuring that its phone and internet platforms were efficient and reliably available to depositors around the clock, reflecting the bank's understanding of the importance to its customers of the facilities it was providing them and that it would not receive the deposits unless it provided these facilities.

98. I find that the provision of these facilities was a service provided by the bank to its depositors. The facilities go beyond what a mere borrower of money would provide to a mere lender. The bank provided more than a promise to repay the lender. It provided the facility of easy access deposit accounts. Depositors were able to (within generous restrictions) pay in and take out money at will, and check their balance and obtain statements. Via its online and telephone interface the bank facilitated this easy access. This was more than a mere receipt of loaned money by IDUK. Fundamentally, while the account could not be operated in exactly the same way as a deposit account with a 'high street' bank, it was very similar in essentials.

99. While I had no evidence from a depositor, the bank's own evidence of the importance it placed on a reliable, efficient and fast internet and telephone interface with its customers, and common sense, all indicate that the provision of this interface and the easy access to their money was crucial to and valued by the customers. It is relevant but not conclusive that the terms of the later written contracts, which all parties assumed were very similar to the ones in force at the relevant time, were ones of 'service' provided by the bank to its customers and the depositors were referred to as the bank's customers (§31). The contract assumed that the bank provided a service to its customers.

100. At the conclusion of the hearing the appellant accepted that the bank did provide services to its depositors, although it may not have accepted the extent to which it did provide facilities. Its position became that no consideration was provided for what it saw as peripheral services.

101. I do not find the services to be peripheral. I do accept that the facilities provided were less valuable than the service which the depositor provided to the bank, which was the service of the loan of money. This follows logically because the bank not only provided the banking facilities to its depositors, it paid interest on the money deposited too.

102. But the services were not peripheral. There was no suggestion, and indeed it would defy logic to suggest that, depositors would have been prepared to deposit their money with IDUK unless given the facility of an easy-access deposit account. To the extent that there was evidence, the evidence was that IDUK's strategy was to poach depositors from other banks by attracting them with a higher rate of interest. There was absolutely no suggestion that the many 1,000s of depositors who became IDUK's customers would have been prepared to move for any fewer facilities than IDUK provided. While they were clearly prepared to give up the right to a walk-in branch, instead the bank gave them a 'virtual' 24 hours bank via the internet and telephone. The appellant did not even seek, and certainly did not succeed, in any kind of a case that these services were 'peripheral' or of less than central importance to the depositor

when depositing funds with a bank. Logic dictates that its customers were very unlikely to accept anything less. Mr McDaid's evidence emphasised the importance to the bank of providing very good facilities to its customers and the clear implication that it feared it would lose its customers if it provided less. I find the services provided by the bank were central to the customers' decision to deposit the monies with IDUK.

103. It was not entirely clear whether the appellant's case was that its particular deposit accounts did not involve a supply (or only involved peripheral supplies) by the bank or whether it was its case that no deposit accounts involved supplies by any bank. This does not matter: the Tribunal can only decide on the basis of the facts in front of it. Nevertheless, fundamentally, I did not consider the lack of walk-in branches (the main distinguishing feature with other deposit accounts) as relevant to the question of whether the bank provided a service, as it was clear in this case that alternative methods of access to the depositor's money were provided.

104. I find that the bank provided a valuable service to its customers of an easy access deposit account, with around the clock ability to pay in or withdraw from the account via the internet or telephone and to obtain balances and statements. It follows that I agree with the decision of Sir Stephen Oliver in *Bank of Scotland* that the provision by a bank of a deposit account is a service as well as the provison of a current account (although I do not entirely agree with all Sir Stephen's reasons given in support, as explained at §§63-65 above).

A supply for consideration?

105. The appellant's case was that even if it was making a supply when taking the deposits, it did not do so for consideration. Its slogan was "no fees, no exceptions". Its contractual terms were that no fees were payable: and HMRC accept that no fees were charged apart from the one exception already mentioned.

106. Mr Prosser referred me to the re-statement of the principle that a VAT supply must be for consideration as set out by the CJEU in *MacDonald Resorts Ltd* C-270/09:

> "[16] It should be recalled that, under Art 2(1) 6VD, 'the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such' is to be subject to VAT. In that regard, the Court has already held that a supply of services is effected 'for consideration', within the meaning of that provision, and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient…[citing *Tolsma* C-16/93, *FNCB (below), Kennemer Golf* C-174/00]"

107. Mr Prosser relied on what was said by Briggs J at [22] in *MNBA* (at §56 above) for the proposition that the promise to repay a debt is not consideration for the loan. I accept that this is quite correct as a matter of law for the reasons explained above

(§55). But he then goes on to say that unless there is a charge for something the borrower (ie the bank) does, then there is no consideration because the lending by the borrower is not consideration.

108. This argument is logically flawed. While the *borrowing* by the bank is not a service, the *lending* by the depositor is a service (albeit not one subject to VAT as it is not made in the course of business (see §74 above)). The *lending* by the depositor can most certainly be consideration. Indeed, it is obviously the consideration. The bank provides the deposit account facilities because the customer deposits money with it; the customer deposits his money with the bank because the bank provides him with the deposit account facilities. This is a contract of barter.

109. A service can be exchanged in barter. Lending is a service. It can be bartered for other services. I find it was bartered for deposit account services where a depositor deposited his cash with IDUK.

110. The appellant's case seemed to be that somehow the Tribunal was precluded from a finding that there was ***non***-monetary consideration for the bank's services because the contractual terms were that there were no fees or charges. Mr Prosser said that because the contract said there were no fees the Tribunal had to be 'very careful' before concluding that there was consideration, apparently suggesting that I had to conclude that the written terms were a sham (as per *Secret Hotels2* – see §82*)* before I could make such a finding. HMRC, of course, had not suggested that the contractual terms were a sham: there were no grounds on which to do so.

111. But Mr Prosser is mis-reading the contract. The contract merely said that there were no fees or charges for the bank's services: it did not say that there was no consideration at all. I accept that there were no fees or charges (other than in that one case mentioned before). But the contract did not say there was no consideration so I do not have to be 'very careful' nor do I have to conclude the contract was a sham, before deciding that there was ***non***-monetary consideration.

112. I make the point that a loan of money is non-monetary consideration because the loan has to be repaid (see §65). A loan is a service, not a provision of a sum of money with no ties attached. A loan has to be repaid. It is therefore (if in return for a different supply) to be classed as non-monetary consideration.

113. Even if the contract had purported to say that there was no consideration whatsoever, that term would be so clearly be at odds with the actual agreement between the parties, that under *Newey* and *SecretHotels,* I would be right to disregard it. But the contract did not purport to do so. Far from it, the contract presupposed that the customer would make a deposit with the bank. Had the contract actually said the deposit making customer gave no consideration for the facilities provided, that term would have contradicted the most fundamental part of the banking contract, the making of the deposit. The 'no fee' clause did not purport to do so: all it did was reassure the depositors that they would not be required to pay a cash charge for the facilities the contract gave them.

114. In conclusion, the actual agreement was that deposit account services (and payment of interest) were provided in return for the deposit of money with the bank. The deposit of money is a loan to the bank. That loan was clearly (on the evidence) of very real value to the bank. Its entire business rationale depended on deposits of money so that it could make investments.

115. The only express agreement on consideration for the bank's services was that no *cash* consideration in the form of fees or charges would be paid for the bank's services. But as I have said, it is clear that *non-cash* consideration was given for the bank's services, in the form of the deposits, so the question is whether this consideration can be valued and how.

Was the loan 'for' the banking services?

116. The appellant does not agree. Mr Prosser relied on §27-30 of the CJEU's decision in *Kuwait Petroleum (GB) Ltd* C-48/97 [1999] STC 488 for his proposition that I must not go beyond the statement in the contract that there were no fees nor charges. It denied that the situation was one of barter. It says that there is no barter because this is a straightforward loan, and by their own dealings the parties have recognised that the loan was given in return for the interest and not the banking services.

117. In *Kuwait Petroleum* there was a contract under which Kuwait (or an independent petrol supplier) was liable to supply both petrol and 'Q8' vouchers in return for payment, and later to redeem the Q8 vouchers for 'free' gifts. The CJEU said:

> "[26] Goods are supplied 'for consideration' … only if there is a legal relationship between the supplier and the purchaser entailing reciprocal performance, the price received by the supplier constituting the value actually given in return for the goods supplied….."

118. The CJEU went on to say that the national court had to determine:

> "whether, at the time of purchasing the fuel, the customers and Kuwait Petroleum had agreed….that part of the price paid for the fuel, whether identifiable or not, would constitute the value given in return for the Q8 vouchers or the redemption goods….."

119. The CJEU indicated that (a) because the redemption goods were described as free in the contract and (b) because the price of the fuel was not discounted when a person did not take the Q8 vouchers, the national court was likely to conclude as a matter of fact that the price was only paid for the fuel and not for the vouchers/free gifts as well.

120. Mr Prosser also relied on *Lex Services plc* [2004] STC 73 at §§18-19 per Lord Walker, who, when discussing non-monetary consideration, said:

> "[17] …First, there must be a direct link between the service provided and the consideration received; secondly, the consideration must be capable of being expressed in money; and thirdly-
>
> '…that such consideration is a subjective value since the basis of assessment for the provision of services is the consideration actually received and not a value assessed according to objective criteria.'
>
> [18] …So far from introducing an element of vagueness or obscurity, the concept of subjective value (correctly understood) achieves legal certainty and ease of administration of the VAT system….
>
> [19] Subjective value is therefore, in a straightforward case, the value which the parties to the contract have themselves recognised in the course of their dealings, and have in that way attributed to goods or services which amount to non-monetary consideration…"

121. What Mr Prosser appears to construct from this is a proposition that the scenario in this case is similar to *Kuwait* in that the bank contractually provides 'A + B' to its customers. In *Kuwait* the 'A + B' was the petrol plus vouchers; in this case the 'A + B' is the interest plus banking services. The distinction with *Kuwait* is that the customer in that case gave cash consideration; in this case the customer gives non-monetary consideration (the loan effected by the deposit of money). But that should not alter the principle explained by the CJEU in that case.

122. The contract in *Kuwait* can be rendered diagrammatically as:

> Cash *for* A + B
>
> where A = petrol and B = vouchers for free gifts.

123. The contract in this case can be rendered diagrammatically, very similarly, as:

> Non-cash (loan) *for* A + B
>
> where A = interest and B = banking services

124. The judgment in *Kuwait* makes it clear that it is wrong, says Mr Prosser, to say that because contractually the supplier is bound to provide A + B in return for the consideration (whether cash or non-monetary), the consideration is necessarily 'for' both A + B in the VAT sense.

125. I agree that the CJEU judgment in *Kuwait* makes it clear that the contractual position is not determinative. The CJEU clearly indicated that (depending on the fact finding by the referring court) the court might conclude that the cash was only paid 'for' A (the petrol) even though contractually the supplier had to provide 'B' (the vouchers) as well.

126. Mr Prosser's case is that the loan by the depositor was similarly only made in return for the interest. The loan was not, he says, given in return for the banking services, which, as they were described in the contract as attracting no fees or charges, should be compared to the free gifts in *Kuwait.*

127. Is Mr Prosser right? The CJEU in *Kuwait* did not actually decide whether the price was paid 'for' both A + B or just A, because that was a question of fact, which it could not determine. It did indicate, of course, the description that something was 'free' was relevant to, if not conclusive of, this question. It also indicated other factors were relevant and in particular it was relevant that the price paid did not alter whether the customer took the vouchers or not.

128. So it is a question of fact whether the banking services were provided, together with the interest, in consideration for the loan of the monies deposited by the bank's customers.

129. To resolve this question of fact, I note that, contrary to the position with *Kuwait*, this case involves a barter. The only consideration provided in *Kuwait* was cash; so when the contract said the vouchers were 'free' it meant that no consideration was provided for them.

130. On the contrary here, the consideration provided by the customer was non-monetary (the loan). The contract described the bank's services has having no charges; it did not say they were free or for no consideration. Its meaning was clearly that no *money* would be paid for them. It said no fees; it meant no fees. It did not even purport to say that the banking services were provided without consideration. This is a very significant distinction factually from *Kuwait*.

131. The appellant's case seems to be that there is no such distinction because (the appellant says) the parties expressly agreed that there would be no consideration. This is wrong factually. The agreement is set out at §32. The parties did not agree that there would be no consideration: they simply agreed that the customers would not pay a fee or charge. This is not the same thing. Consideration does not have to be monetary.

132. So the fact that there was a term that no fees were to be paid for the services is no help in resolving the question whether the non-monetary consideration (the loan) was given in return just for the interest, or for both the interest and the banking services.

133. Taking into account the evidence, and common sense, I consider it extremely unlikely indeed that any person would have been prepared to deposit money with the bank without, in addition to the interest, receiving the banking service which IDUK provided. Indeed Mr McDaid's evidence was very clear that the bank understood the importance of providing an excellent banking interface in order to attract depositors. It was not all about providing a competitive rate of interest. The bank attracted deposits with a competitive rate of interest *and* its banking services. It seems obvious to me that the deposits were made in return for both the payment of interest and the banking services. The bank had no expectation that members of the public would deposit monies with it unless it provided good banking services and that it why it spent such large sums on its telephone call centres and web-based interface. They were vital to its business.

134. I accept that the customers (with the exception mentioned at §23) paid no fees or charges on the accounts they held with IDUK.

135. But I find that there was non-monetary consideration. To me this was obvious. As soon as it is a finding (as it is) that the bank made a supply to its customers, then the question is what did the bank get in return? In return the bank got a loan of the monies deposited with it from time to time by its customers. This was clearly valuable (if non-monetary) consideration to the bank. And the loan was 'for' the banking services in as much as the services were provided 'for' the loan; that interest in addition to the banking services was provided 'for' the loan was a reflection of the value to the bank of the deposits. As a matter of fact, it was clear that the deposit was made in return for ***both*** the interest and the banking services. I find the banking services were provided for consideration.

Value of the consideration

136. Related to the above argument, the appellant's case was also that as (citing *Naturally Yours Cosmetics* C-230/87) consideration is valued subjectively, the consideration was valued by the parties at nil as the contract said that there were no fees, and the Tribunal must respect that.

137. *Naturally Yours Cosmetics* is the case where the CJEU ruled that, where the parties have subjectively attributed a cash value to the supply, that is the value of the supply. In that case, a wholesaler supplied to the retailer a pot of cream for a reduced price in return for the retailer's promotional services. In other words, the wholesaler sold a pot of cream at a reduced price and received in return from the retailer cash plus services. Only the wholesaler's supplies were subject to VAT as the retailers were unregistered, and the question was the amount of VAT it had to account for on the supply of the pot of cream. It had received both cash and services for the pot of cream; the court had to resolve how to value the services element of the consideration.

138. The parties were found to have subjectively valued the services at the amount by which the wholesaler was prepared to discount the pot of cream in return for them. So the wholesaler was in effect liable to pay VAT on the normal selling price of the cream even though the cash it received was less than this.

139. The basic principle that the value of consideration is the value which the parties subjectively attribute to it has since been applied in a legion of cases. It applies here. But applying that principle does not lead to the result Mr Prosser seeks. As I have already said, the fact that the parties agreed that no fees or charges would be paid by the customer, was not an agreement that the bank's services were subjectively of no value for the reasons explained at §§129-135. On the contrary, it is clear that the services were of value.

140. I reject the appellant's case for all the reasons given at §§129-135 that subjectively the parties valued the bank's services at nil. It was merely a case that the value given was non-monetary (the loan).

Can the consideration be valued?

141. Separately to its above contention, it was the appellant's contention that even if it was providing a service for consideration, the consideration cannot be valued and must therefore be ignored.

142. HMRC's contention is that I do not have to value the consideration because there is no question of the bank being liable to account for VAT on its services to its depositors as the supply is clearly exempt. Nevertheless, I accept the appellant's point that the consideration has to be capable of being valued.

143. The failure by the parties to attribute a monetary value to consideration does not mean that the consideration has no subjective value: *Empire Stores* C-33/93. In that case the catalogue retailer, in receipt of a promotional service from its customer, paid in kind. This was a barter situation. Goods were supplied in return for services. The supply of the goods was subject to VAT. But, unlike with *Naturally Yours Cosmetics,* neither the goods nor the services had a value attributed to them by the parties because the goods supplied were not out of the Empire Stores catalogue. If X was the supply and Y was the consideration, it was a case of 'X = Y' where the value of both X and Y were unknown.

144. However, the catalogue retailer had to purchase the goods which it supplied to its customer-cum-service provider. The CJEU ruled that the value of the goods (the supply) was the value of the services (the consideration); and the value of the services was what the recipient of them (the supplier) was prepared to spend to receive them. That was the cost to the catalogue retailer of the goods it bartered with its customers for their services:

> "[19] Where that value is not a sum of money agreed between the parties, it must, in order to be subjective, be the value which the recipient of the services constituting the consideration for the supply of goods attributes to the services which he is seeking to obtain and must correspond to the amount which he is prepared to spend for that purpose. Where, as here, the supply of goods is involved, that value can only be the price which the supplier has paid for the article which he is supplying without extra charge in consideration of the services in question."

145. HMRC also relied on the case of *First National Bank of Chicago* (C-172/96) ("*FNCB")* for the proposition that barter transactions where no monetary value is attributed by the parties does not prevent valuation of the consideration.

146. In *FNBC* the bank entered into foreign exchange currency swaps. It would deliver an amount of one currency to its customer in exchange for the receipt of an amount of a different currency from that customer. It charged no fees. The CJEU analysed the position as one of barter:

> "[26] With regard, second, to the question whether services are supplied for consideration, the Court has already held that a supply of services is effected 'for consideration' within the meaning of Article 2(1) of the Sixth Directive, and is therefore taxable, only if there is a

> legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient (Case C-16/93 *Tolsma v Inspecteur der Omzetbelasting* [1994] ECR I-743, paragraph 14).
>
> [27] Only where a person's activity consists exclusively in providing services for no direct consideration is there no basis of assessment and the services are therefore not subject to VAT (*Tolsma*, cited above, paragraph 12).
>
> [28] In the present case, it cannot be disputed that a bilateral legal relationship exists between the Bank and its counterparty under which the two parties to the transaction give reciprocal undertakings to transfer amounts in a given currency and to receive the countervalue in another currency.

147. It went on to consider how to value the services given in barter. It said:

> [29] Apart from the actual exchange transaction, the service provided by the Bank is characterised by the Bank's preparedness to conclude such transactions in the currencies in which it specialises.
>
> [30] From the mere fact that no fees or commission are charged by the Bank upon a specific foreign exchange transaction it does not follow that no consideration is given.
>
> [31] Moreover, any technical difficulties which exist in determining the amount of consideration cannot by themselves justify the conclusion that no consideration exists.
>
> [32] In addition, it is apparent from the case-file that the rates at which the Bank is prepared to sell or purchase currencies are different and are separated by a spread. The conclusion must therefore be that, in return for the service which it provides, the Bank takes for itself a consideration which it includes in the calculation of those rates.
>
> [33] To hold that currency transactions are taxable only when effected in return for payment of a commission or specific fees, which would thus allow a trader to avoid taxation if he sought to be remunerated for his services by providing for a spread between the proposed transaction rates rather than by charging such sums, would be a solution incompatible with the system put in place by the Sixth Directive and would be liable to place traders on an unequal footing for purposes of taxation.
>
> [34] It must therefore be held that foreign exchange transactions, performed even without commission or direct fees, are supplies of services provided in return for consideration, that is to say supplies of services effected for consideration within the meaning of Article 2(1) of the Sixth Directive."

148. As Mr Beal pointed out, the CJEU in that case said it is no objection to valuing consideration that it can not be valued at the time of the transaction. The CJEU also said in *Argos Distributors* C-288/94:

> "[49] ….it does not matter that when the transaction is concluded the parties do not known the basis on which VAT will be charged and that it remains unknown, even afterwards, to the recipient of the service."

149. In other words, it does not prevent a supply being for consideration where the consideration cannot be valued at the time and that valuation might forever remain unknown to the counterparty. It is clear that the CJEU considers a valuation can be achieved even when the barter is of currency.

150. The appellant considers, however, that the consideration in this case is not capable of being valued. It points to HMRC's statement of case where it was suggested that the value of the bank's services was the money the bank was prepared to expend to acquire the deposits, which of course includes the interest the bank paid. The appellant rightly criticises this because it makes the interest consideration for the depositor's supply of the loan to the bank *and* the consideration for the bank's supply of services to the depositor.

151. Mathematically the position could be represented like this:

> X= Y + I.
>
> X represents the value (not amount) of the loan; Y represents the value of the bank's services. I represents the interest, the value of which is known.
>
> Y + I represent the consideration for X.
>
> But both X and Y unknown. 'I' cannot determine the value of X or Y unless the value of one of them is known.

152. The appellant's position is that the payment of interest is simply a term of the loan and that therefore the bank gives no value for the loan. That is clearly wrong too. While the payment of interest is simply a term of the loan and not a supply in itself, the bank does give value for the loan. The interest is part of the value given. It is part of the consideration. The point is that it is not the *whole* of the consideration because the bank supplied services to the depositor as well as paying interest.

153. It is clear that the interest is not the measure of value of the bank's services because it is the interest *plus* its services which the bank provides to the customer in return for the loan of money deposited. There is no reason at all to suppose that the amount of the interest bears any relationship to the value of the bank's services. The only relationship is that (subjectively to the parties) the combined value of the interest and bank's services equals the value of the loan.

154. HMRC's statement of case suggested an alternative method of valuation. That was that the value of its services should be meansured, similarly to the *FNBC* case, as the value of IDUK's profits. In other words, HMRC suggested the value of the bank's services was the difference between the cost to IDUK of obtaining the deposits and the return on its investments made with those deposits.

155. The appellant said that that profits were an inappropriate measure as this case was 'miles away' from the sort of 'esoteric' transaction in the *FNBC* case.

156. I agree that it is not obvious why the bank's profit should be the value of the service it supplies. Profit is normally the difference between the value of the service (measured as consideration received for it) and the cost of providing it. The profit is usually rather less than the value.

Conclusions on valuation

157. The *FNBC* case does show that difficulties with valuation do not necessarily prevent valuation and that where there are such difficulties it may be right to use profit as a measure of value. But in my view, valuation in this case is much more straightforward and is merely an extension of the principles in the case of *Empire Stores.* The CJEU said, in effect, as reported above, that the value of the supply is the value of the consideration received, which, subjectively is

> "the value which the recipient of the services constituting the consideration for the supply …. attributes to the services which he is seeking to obtain and must correspond to the amount which he is prepared to spend for that purpose."

158. This case differs from *Empire Stores* because two things (interest and banking services) were given in exchange for the consideration (the deposits). I need to value the banking services, but IDUK was prepared to spend *both* the cost of the banking services and the interest payments in order to obtain the deposits. So the value of the deposits was *more than* the amount the bank spent on its banking services. So unlike *Empire Stores,* the value of the consideration (in this case the deposits) is not equal to the value of the service provided in return.

159. This is why it was erroneous for HMRC to suggest, as I mentioned at §§150-153 that the value of the banking services was the entire value of the loan, as the value of the loan was both the value of the interest and the value of the banking services.

160. In other words, the value of the consideration (the deposits) exceeded the value of the banking services by an amount equal to the value of the interest. So, as the value of the consideration (the deposits) was *both* what the bank was prepared to spend in interest and what it was prepared to spend in providing banking services, the value of the deposits *less* the value of the interest was equal to what the bank was prepared to spend on its banking services; so the value of the banking services is what the bank was prepared to spend on providing them.

161. Shortly put, a simple application of *Empire* Stores is that the value of the supply of the bank's services is calculated by what the bank was prepared to expend on making those services. This is because, together with the interest, that is what it was prepared to spend in order to get the consideration (the deposits) which was given in return for both the interest and banking services.

162. The amounts the bank spent on providing its banking services are amounts which can be ascertained by the bank, albeit in global terms. The bank will be able to calculate how much it spent in providing the banking services. This would include not only the costs on which it pays VAT and which are the subject of this hearing, but

also the costs on which it does not pay VAT, such as the wages of the staff in the call centre.

163. The calculation in *Empire Stores* was not a global calculation. The supplier knew the cost to it of each pot of cream. But *FNCB* shows that global calculations can be used to calculate the value of consideration, so this is no objection to valuing the banking services by the global cost to the bank of providing them. If it was necessary to divide the value between each individual customer, this could simply be done on a pro rata basis.

164. Therefore, in summary, I reject the appellant's proposition that it is not possible to value the service it provides to its customers. It is perfectly possible to value them. *Empire Stores* shows how the CJEU would value the bank's services. The subjective value of consideration given for the provision of banking services is the amount which the bank was prepared to spend in order to provide the banking services. I do not have the full evidence of the bank's costs to make that valuation, but I do not need to have it. The question was whether the service could be valued: not what the value actually was.

165. That conclusion ends this appeal against the appellant.

166. I have found that it did supply its banking services in return for the supply to it of the loans made by the depositors. The consideration for that supply by the bank was capable of valuation (applying *Empire Stores)*. The supply was exempt. As both parties accepted, it inevitably follows from that finding that the input tax at issue in this appeal, which was incurred in making the supplies of banking services, had a direct and immediate link to those banking services. It was attributable to those exempt banking services and is irrecoverable.

167. So far from being in a comparable position to the hypothetical trader in *BLP* (mentioned at §37 and §§45-46), taking up a loan to fund its overall business, IDUK is in a comparable position to the actual trader in *BLP* who was unable to recover its input tax incurred in raising funds for its overall business. This is because IDUK's input tax, even though incurred with an eye to IDUK's overall business, had a direct and immediate link to the exempt supply by it of banking services.

Economic activity issue

168. I do not need to go on to deal with the economic activity issue but I set it out in case this appeal goes higher.

169. If my conclusion summarised at §§166-167 above is wrong, and the provision of banking services was not a supply by IDUK, then the appellant's position is that the VAT on the costs incurred in providing banking to its depositors is overhead VAT. HMRC say that it would, on the contrary, be attributable to its investment activities.

170. Either way makes no difference, as the only 'supplies' (if any) that IDUK made, if the provision of its banking services was not a supply, were its investments in bonds in both EU and outside EU, and, post 2006, exempt supplies of mortgages and insurance agency services.

171. The investments, says HMRC, are not economic activities. The appellant does not agree. It relies on the undisputed fact its investment activities were treated as a trade in its accounts and corporation tax returns. It also relied on *Wellcome Trust* (C-155/94):

> "[35]It is true that, by virtue of Article 13B(d)(5) of the Directive, transactions in shares, interests in companies or associations, debentures and other securities may fall within the scope of VAT. This will be the case, in particular, where such transactions are effected as part of a commercial share-dealing activity or in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired *(Polysar Investments* …). However, as is clear from the order for reference, the Trust is forbidden to engage in precisely such activities, being required to make all reasonable efforts to avoid engaging in trade when exercising its powers and being precluded from taking majority holdings in other companies.
>
> [36] Consequently, and irrespective whether the activities in question are similar to those of an investment trust or a pension fund, the conclusion must be that a trust which is in a position such as that described by the referring tribunal must, in the light of Article 4 of the Directive, be regarded as confining its activities to managing an investment portfolio in the same way as a private investor."

172. As it did not hold the investments to secure a direct or indirect involvement with the management of a company, its case seems to be that its investments were a trading activity. However, the CJEU in *Wellcome Trust* did not, in my view, consider whether a taxpayer was trading, as a matter of accountancy or direct tax law, to be decisive of the question of whether an economic activity was being carried on. The CJEU referred to 'commercial share-dealing activity' which means they envisaged a party buying and selling shares with a view to making a profit on the sale price over the buy price. Here the bank bought investments with a view to holding them to maturity, earning interest. That is *not* a commercial share dealing activity. That merely holding investments to maturity is not, for VAT purposes, an economic activity was restated in *Harnas & Helm* C-80/95:

> "[18] … the activity of a bondholder may be defined as a form of investment which does not extend further than straightforward asset management. The income from the bonds derives from the mere fact of holding them, which entitles the holder to payments of interest. Such interest cannot, therefore, be regarded as a return on an economic activity or transaction carried out by the bondholder, since it derives from the mere ownership of the bonds.
>
> …

> [20] … mere acquisition of ownership in and the holding of bonds, activities which are not subservient to any other business activity, and the receipt of income therefrom are not to be regarded as economic activities conferring on the person concerned the status of a taxable person."

173. The fact that the IDUK's investment activity was on a vast scale (up to £24 billion at one point) does not alter the fundamental position that holding investments until maturity by itself does not amount to making VAT supplies, irrespective of whether it is classed as a trading activity for direct tax or accounting purposes.

174. HMRC do accept that the investment activity amounts to an economic activity if it is a 'direct, permanent and necessary' extension of another economic activity. In other words, they accept that if the bank made supplies of banking services, then the investment activity (investing the deposits received via the provision of banking services) is a direct, permanent and necessary extension of those banking supplies and therefore an economic activity under *Regie Dauphinoise* (C-306/94) and *Harnas & Helm.* I agree; but it is of no assistance to the appellant because the question of whether their investments amount to economic activities is only relevant if there is a finding (which there is not) that its banking activities were not supplies.

175. The argument is sterile as I have decided that the appellant's banking activities were the making of exempt supplies to which the input tax at stake was attributable. The appellant's activity in making investments via EICC was only an economic activity in so far as it was an extension of its deposit taking activity, which was itself an economic activity as it involved the bank making supplies of banking services for consideration.

176. While it was true that ultimately the provision of the banking services led to the deposit of the monies which the appellant used to make its investments, the services were most closely connected with the supplies which they enabled to be made. The direct and immediate link was therefore to the banking services. The services on which the input tax at stake was incurred were not overheads of the business as a whole. Following the CJEU decision in *BLP*, the services were used to make an immediate exempt supply even if the ultimate purpose of the expenditure was to support the business overall, and therefore the input tax incurred in making the exempt supply of services is irrecoverable.

The Regulation 109 issue

177. The appellant's point is that it considers that Reg 109 permits it to recover some of the VAT incurred before 1 January 2004. Before that date it accepts its investments were exempt supplies as all made to EICC in the EU. After that date it made some specified supplies (if the investments amounted to economic activities, as to which see above).

178. The point is otiose in view of my finding that the services in question had a direct and immediate link to the exempt supply of banking services by IDUK to its

customers; it is further otiose in view of my finding that if IDUK did not supply banking services, then its investment activities were not economic activities.

179. So I do not need to decide this point. Nevertheless, I note in passing that the appellant would have been in difficulties with this part of its case in any event. Regulation 109 only applies where the change in intention occurs *before* the goods or services are first used:

> **Regulation 109**
>
> (1) This regulation applies where taxable person has incurred an amount of input tax which has not been attributed to taxable supplies because he intended to use the goods or services in making either -
>
> (a) exempt supplies, or
>
> (b) both taxable and exempt supplies,
>
> And during a period of 6 years commencing on the first day of the prescribed accounting period in which the attribution was determined and before that intention is fulfilled, he uses or forms an intention to use the goods or services concerned in making taxable supplies or, in the case of an attribution within sub-paragraph (a) above, in making both taxable and exempt supplies.

180. Regulation 109 is not like the capital goods scheme which permits alterations in input tax recovery during the lifetime of use of a capital asset. The appellant wished to construe 'before that intention is fulfilled' as meaning that Regulation 109 was only inapplicable where the goods or services had been fully consumed. But my preliminary view is that is wrong. The 'intention' is the intention to 'use the goods or services' in making exempt or mixed supplies. That intention is fulfilled as soon as the goods or services are first used, even if they are not fully consumed.

181. Mr Prosser relied on the statement from Lord Hoffman in *Royal Sun Alliance Insurance Group plc* [2003] UKHL 29, a case about Regulation 109:

> "[47] …If there are still inputs around from the previous activity which can be used in the new taxable activity, like a building which has been constructed for exempt letting and is then used, after an election, for taxable letting, the taxpayer will be entitled to an adjustment…"

182. He said this at least implied that an adjustment under Regulation 109 could be made after the inputs had been partially consumed. However, I agree with Mr Beal that the case is no authority for that principle as that was not an issue in the case and Lord Hoffman was not intending to make any comment on it: it is clear that in *Royal Sun Alliance* the input tax at issue had been incurred on vacant buildings which were not being used for anything and the first 'use' of the costs were when the buildings were used for taxpayer's changed purpose.

Who can recover VAT on investments?

183. Another issue between the parties, now irrelevant in view of my finding at §§166-7, was the effect of *Credit Lyonnais* C-388/11 on the right to recover input tax partly attributable to the specified supplies. As I have ruled that the input tax in question was attributable to exempt supplies of banking services in the UK, this issue is irrelevant. However, I note in passing that I cannot agree with Mr Beal that the effect of *Credit Lyonnais* is that a fixed establishment, making supplies in one country (A) but incurring attributable input tax in another country (B) in which the same legal entity has another fixed establishment, has to recover its input tax arising in B from the tax authorities in A. That is clearly not right. The answer is that the fixed establishment in B, even if it is not the fixed establishment most closely associated with the supply, must reclaim the VAT arising in B on its VAT return given to the tax authorities in B. This is clear from *Credit Lyonnais:*

> "[33] ..the concept of 'place of establishment' covers not only the taxable person's principal establishment, but also the fixed establishments within the meaning of the [6VD] which that person may have in other Member States. Thus, a company which has its principal establishment in one Member State and a fixed establishment in another Member State must be considered, by virtue of that fact, as being established in the last-mentioned Member State for the activities carried out there and can no longer claim a refund of the VAT within the meaning of the [8th or 13th Directives] which is paid there. It is for that fixed establishment to seek, from the tax authorities of that State, deduction of VAT in respect of the acquisitions made there."

184. So, had I decided the other issues in favour of IDUK (which I have not), I would not see any bar to the VAT at issue being recovered from HMRC by IDUK, even if the place of supply of its investments was not the UK.

185. Mr Prosser objected to the Tribunal considering this point as it was not in HMRC's statement of case and HMRC had had 18 months since the release of the CJEU's decision to apply to amend it. My view is that the point is (a) otiose in view of my decision and (b) a bad one, but if this goes higher the appellant will clearly have time to respond to it.

Lack of evidence

186. Lastly, it was HMRC's case that, if the appellant had succeeded in the appeal in principle, the appellant had not proved its case as it has not provided HMRC or the Tribunal with documentary evidence of the supplies on which it seeks input tax recovery. Mr Beale points out that the voluntary disclosure was (as it must be) for a stated amount. It is for the appellant to prove that that claim is justified, not only in principle but in amount.

187. The appellant pointed out that the time estimate for the hearing was four days and that it would have estimated longer if it thought it had to prove quantum as well as principle. It also pointed out that a letter from its advisers to HMRC informed

HMRC that the invoices were available for inspection yet HMRC never asked to inspect them. They have not been included in the bundles.

188. The position is unsatisfactory. I agree with the appellant that this is the sort of case where a point of principle is at stake and quantum could sensibly be left to the parties to determine. Nevertheless, HMRC are right that this is the appellant's appeal and, unless the parties agreed or the Tribunal directed, that the decision would be on a point of principle only, then it is for the appellant to prove its case, including the quantum.

189. But the appellant has not sought to prove quantum. It has provided no evidence of quantum to HMRC or the Tribunal. It has assumed that HMRC's failure to ask for evidence on quantum was tacit agreement that the Tribunal was only deciding a point of principle. I do not find that it was. The appellant did not show me anything else which might have amounted to explicit or implicit acceptance by HMRC that the Tribunal would only decide a point of principle. Nor did the appellant approach the Tribunal at any stage for an order under Rule 5(3)(e).

190. I have the power to make an (effectively belated) direction that the hearing is only to determine the matter in principle. I do not need to do so because my decision on the point of principle is that the appellant's appeal fails, so the quantum of its claim is irrelevant. If quantum had been relevant, without any evidence that HMRC explicitly or implicitly accepted that this hearing, which was to determine the validity of the appellant's voluntary disclosures, was only on a point of principle, I would have been inclined to dismiss the appeal on the basis that the appellant had failed to prove the quantum of its claim or to agree with HMRC or, prior to the hearing, ask the Tribunal to direct, that this would be a hearing in principle only.

191. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 7 October 2014