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VAT liability for online consumer credit brokers used by pay day lender

*Dollar Financial UK Limited v. The Commissioners for Her
Majesty's Revenue and Customs
[2016] UKFTT 598 (TC)*

Article by David Bowden

Dollar Financial UK Limited v. HMRC - [2016] UKFTT 598 (TC)
VAT liability for on-line consumer credit brokers used by pay day lender

Judge Barbara Mosedale sitting in the First Tier Tribunal in a complex case has had to decide whether services provided to a pay day lender by a financial technology company and lead generators were exempt from VAT or not. To decide this point the FTT had to examine the exemption in the VAT Directive where supplies in relation to the granting and the negotiation of credit can be zero rated. Where a lender has merely outsourced a back office function and is charged for this service, then this is a taxable supply. Before the hearing HMRC conceded that where loans were made to existing customers or the pay day lender treated a loan as a pre repayment, then the charges made to it by the outsourcer were exempt from VAT. The FTT ruled that the provision of prospect data to the pay day lender by lead generators was enough to amount to the negotiation of credit to be exempt from VAT. However the FTT ruled that charges made to the lender by the outsourcer in relation to following up unsigned loan agreements or conversations with prospects on its web-enabled LiveChat system were not exempt and attracted VAT at the standard rate.

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[2016] UKFTT 598 (TC) 19 August 2016
First Tier Tribunal, Tax Chamber (Tribunal Judge Barbara Mosedale)

How was Dollar's business structured?

Within Dollar's VAT group were 2 companies which made supplies. The 1st company was MEM Consumer Finance Limited which traded as 'Month End Money' or MEM. The 2nd company was Express Finance (Bromley) Limited which traded as 'Payday Express' or PEX.

There was also a financial technology company called Allsec Technologies Limited ('Allsec') which was not an affiliate of Dollar. There was a contract between Dollar and Allsec under which Allsec provided back office services such as customer services and collections. Allsec also provided Dollar with a 'Livechat' service where prospects on its website could ask questions and then be directed to the most appropriate hand off point.

What are the facts?

Dollar Financial UK Limited ('Dollar') trades in the UK as 'The Money Shop', 'Payday UK' and 'Ladder Loans'. Dollar is a pay day lender. It offers short term loans of small amounts at a high rate of interest. The Money Shop advertises its representative APR on its website as 709%.

Lead generators operate websites which were aimed at people who were looking for these sorts of loans. The lead generators got prospects to fill in an online application form. Based on that information, lead generators would rapidly process the data and then submit a prospect's data to pay day lenders on their 'ping tree'. The lead generators would refer prospects to lenders which paid the highest referral fee. Where prospects were referred to Dollar, it would validate that data and decide whether the prospect met their lending criteria and make an electronic offer of a pay day loan.

Allsec invoiced Dollar separately for the services it provided to it. By the time of the hearing, HMRC accepted that where Allsec was dealing with new loans to existing customers or pre repayments, that Allsec was making an exempt supply to Dollar so that no VAT was due on these services. What remained in dispute between Dollar and HMRC was whether when Allsec provided either a conversion service or its LifeChat service whether those too were exempt supplies or whether those services attracted VAT at the standard rate of 20%.

What criteria did Dollar specify to obtain a pay day loan?

Dollar would grant a pay day loan to applicants who met the following criteria:

- was over 18 years of age,
- was UK resident and entitled to work in the UK,
- had a monthly net income of at least £900,
- had a UK current bank account with an associated debit card, and
- had a valid mobile phone number and email address.

What does the EU VAT directive say about exempt supplies?

The EU VAT Directive 2006/112/EC provides as follows:

'Article 135 Exemptions for other activities

1. Member States shall exempt the following transactions:

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- (a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;
(b) the granting and the negotiation of credit and the management of credit by the person granting it'

What does the Value Added Taxes Act 1984 say about this?

The EU framework is broadly mirrored in the VATA 1984 which provides for this in Schedule 9:

'Group 5 – finance

Item No

....

2. the making of any advance or the granting of any credit...
5. the provision of intermediary services in relation to any transaction comprised in item...2....(whether or not any such transaction is finally concluded) by a person acting in an intermediary capacity.'

Note (5) defines 'intermediary services' as:

'...bringing together, with a view to the provision of financial services

(a) persons who are or may be seeking to receive financial services, and

(b) persons who provide financial services,

Together with ...the performance of work preparatory to the conclusion of contracts for the provision of those financial services, but do not include the supply of any market research, advertising, promotional or similar services or the collection, collation and provision of information in connection with such activities.'

What did the HMRC say initially about the VAT liability?

HMRC said that Allsec was making supplies to Dollar under its written contract that amounted to taxable supplies and attracted VAT at the standard rate. HMRC also said that the lead generators were in effect not doing anything other than referring prospects through to financiers which paid them the greatest commission. HMRC said the lead generators were accordingly mere conduits and the supplies they made to Dollar could not be exempt supplies.

What were the issues before the First Tier Tribunal?

By the hearing HMRC had conceded 2 points and the FTT had to determine if the following 3 services were exempt from VAT or not:

- Payment to lead generators for the provision of prospect data to Dollar,
- Payment to Allsec where it had rang up prospects on Dollar's behalf who had not signed and returned the on-line pay day loan documentation ('conversions'), and
- Payment to Allsec for its LiveChat service and whether this was a 'negotiation of credit' service or an outsourced back office function of Dollar's.

What grounds did the taxpayer advance before the Tribunal?

Dollar submitted that the prospect data sold to it by lead generators was on all fours with *Smarter Money* and *Friendly Loans*. Dollar said the lead generators were an intermediary in the negotiation of a financial contract because they introduced suitable borrowers to it. Dollar said they were doing much more than merely advertising or acting as a conduit because they applied a simple filter to prospects for loans and only introduced those that met Dollar's basic lending criteria.

Dollar submitted that the LiveChat work undertaken by Allsec was exempt so that Livechat should be seen as one exempt whole. Dollar submitted that prospects introduced to it by Allsec following a LiveChat conversation that then converted to becoming a Dollar customer, that Allsec had provided a credit intermediary service to Dollar which was VAT exempt. Finally Dollar submitted that the pre repayment task that Allsec undertook for it in LiveChat was also covered by the 'negotiation of credit' VAT exemption.

What did the HMRC submit in response?

HMRC said lead generators simply sold prospect data to the highest bidder and were accordingly a mere conduit and what they did was insufficient to be covered by the 'negotiation of credit' exemption. As to LiveChat, HMRC said that Allsec was carrying out an outsourced back-office function for Dollar and that this too meant that this was outside the 'negotiation of credit' VAT exemption.

Are there any other prior domestic UK authorities of relevance?

There are 3 such authorities from the FTT of which 2 are favourable to the taxpayer. These cases are:

Smarter Money v. HMRC [2006] VTD 19,632 (First Tier Tribunal, Edinburgh – Tribunal Judges Gordon Coutts QC and Mr K Pritchard OBE)

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The taxpayer used the internet to attract prospective borrowers looking for a mortgage. The taxpayer required borrowers to provide information: their location, credit history, size and type of mortgage required. The taxpayer had a relationship with mortgage brokers and knew what information they were looking for. The taxpayer ran a bidding system whereby brokers could bid for each customer and the broker making the highest bid would be introduced to the borrower. Whether or not a broker bid, and how much they bid, would be influenced by the information the appellant had obtained from the borrower. If a borrower went on to apply for a mortgage via the introduced broker, the information gathered by the taxpayer could be used by the broker to complete the application form. The FTT ruled that the taxpayer's supply for which it was remunerated by the brokers' bid was exempt from VAT.

LeadX v. HMRC [2008] VTD 20,904 (First Tier Tribunal, Manchester - Tribunal Judge Michael Tildesley OBE)

The taxpayer operated an internet based bidding system on which brokers could buy and sell leads for insurance or lending contracts. The taxpayer offered to transfer the borrower to another broker who might be able to help and, if the borrower agreed to the transfer, could then transfer the borrower via the taxpayer's electronic bidding system to the broker who was prepared to pay the most for the lead. The selling broker had to provide the taxpayer with information about the lead so that the taxpayer could match the lead to those brokers prepared to buy leads which met particular criteria. Brokers had to pay for the leads they purchased irrespective of whether they were later able to negotiate contracts for them. The taxpayer made its money by charging commission to both the selling and buying brokers. The FTT decided that the taxpayer's supplies were not exempt. This was on the basis that the purpose of seeking information about the prospect's requirements was to enable the lead to be sold rather than to negotiate a deal for the borrower.

Friendly Loans Ltd v. HMRC [2009] UKFTT 247 (TC) (First Tier Tribunal, Manchester - Tribunal Judge Michael Tildesley OBE)

The taxpayer's main business was brokering loans in the sub-prime market. Some borrowers did not meet the criteria to secure a loan and, if the borrower agreed, the taxpayer would transfer the borrower to an associated company (GP) whose main business was negotiating debt repayment plans. GP was exempt from VAT. The FTT had to determine if the referral fee GP paid was exempt from VAT. The FTT held that the taxpayer was an intermediary in providing debt negotiation. It distinguished *LeadX* on the basis that the taxpayer here screened its callers to identify suitable customers for GP and then added value to the process by completing the application form for GP.

Are there any other prior CJEU authorities of relevance?

There are 2 CJEU cases of relevance too:

Sparekassernes Datacenter v. Skatteministeriet [1997] STC 932, C2-95

The financial services VAT exemption was not limited to banks. It could apply to electronic transactions. It was capable of applying to chains of transactions that had the effect of making payment from one person to another. It does not matter whether the person claiming the exemption is a broker or agent in the traditional meaning of the word - what matters is what they do. Negotiation did not include a mere physical or technical supply, such as making a data handling system available to a bank.

CSC Financial Services Limited v. Customs & Excise Commissioners [2002] STC 57, C-235/00 (5th Chamber – Judges Jann, La Pergola, Sevón, Wathelet & Timmermans and Advocate-General Ruiz-Jarabo Colomer)

CSC provided a call centre for various financial institutions. CSC dealt with all queries by potential purchasers of a particular financial product and processed the application form. It did not actually issue the financial product – this was issued by the financial institution. CSC's services were held not to be VAT exempt as the negotiation of a financial product because they were no more than the provision of information and clerical formalities. The financial institution had merely outsourced to CSC some of its back office functions. The purpose of negotiation is to do all that is necessary in order for two parties to enter into a contract, without the negotiator having any interest of his own in the terms of the contract. Negotiation is a service rendered to, and remunerated by a contractual party as a distinct act of mediation. An intermediary is providing intermediation, and will therefore be paid for by someone with an interest in the contract mediated. It is not negotiation where one of the parties entrusts to a subcontractor some of the clerical formalities related to the contract, such as providing information to the other party and receiving and processing applications for subscription to the securities which form the subject matter of the contract.

What principles did the First Tier Tribunal apply in coming to its ruling?

Tribunal Judge Mosedale said she had to apply these 12 principles and that to be within the 'negotiation of credit' exemption the legislation and case law shows that:

- Exemptions should be interpreted strictly,
- What matters is the nature of the supply and not identity of supplier,
- An intermediary can act entirely electronically,

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- While the exemption is static, the services covered by it can evolve,
- An intermediary will be remunerated for intermediation but will not be a party to the contract between borrower and institution,
- Negotiation can be exempt even if no contract results,
- An intermediary does not have to undertake the entire mediation,
- An intermediary can be one in a chain of intermediaries,
- Intermediation does not include the carrying out of back office functions
- Intermediation does not include advertising or acting as a mere conduit.
- An intermediary is someone who:
 - introduces two parties, one looking for a financial product and a person providing it, or
 - is someone who negotiates the terms of such products as between the borrower and lender, or
 - is someone who concludes a contract on behalf of one or other parties,
- An intermediary who carries out introductory services must do more than merely advertising or acting as a mere conduit - that is not within the exemption. That extra could be assessing the suitability of the service provider to provide the loan or the suitability of the borrower to receive the loan.

What ruling did the First Tier Tribunal give on Lead Generators?

The Tribunal Judge held that prospect data provided to Dollar from lead generators could only fall within the introduction exemption and not either of the negotiation or conclusion exemptions. She had to decide whether the lead generators had made a *'real assessment'* or not. On this she said that Dollar's *'criteria were simple but they were not the same as all other lenders and I do not consider that they were so simple that no real filtering took place'*. She said that the lead generators *'applied all the criteria necessary'* for it *'to determine whether to offer a loan bar the credit checks which for regulatory reasons'* Dollar had to do itself. She ruled that *'such partial assessment'* was *'sufficient'* and that the lead generators had done *'enough to cross the line from being a mere conduit or advertiser into being intermediaries introducing the sort of person to whom the appellant might lend the sort of credit s/he was looking for.'*

What ruling did the First Tier Tribunal give on conversions?

The Tribunal Judge ruled that what Allsec did for Dollar here did not fall within the *'negotiation of credit'* VAT exemption because it was not an *'introduction'* of credit. The tribunal judge said that *'the evidence was that the service did not comprise actual negotiation of terms of the loan'* and that whilst *'Allsec operatives were expected to explain the benefits of the loan to the borrower, there was no evidence whatsoever that they had power to alter the terms of the loan or accept a borrower who did not quite meet the appellant's lending criteria'*. Whilst *'Allsec agents did have delegated agency powers to conclude loan contracts ...there was no evidence that these powers were used in conversions'*. She said that it was clear to her *'that the carrying out of back office-type functions, which the lender could do itself but has chosen to outsource, is not exempt intermediation'*. She said conversions merely amounted to *'chasing up a borrower to whom a loan offer was made with a view to the borrower taking up the loan'*. She ruled that there *'was no introduction and no negotiation of terms'* by Allsec and not it did it act as Dollar's agent.

What ruling did the First Tier Tribunal give on LiveChat?

As to LiveChat, the Tribunal Judge ruled that it was a single supply and expressly rejected HMRC's submission to the contrary. She noted that Allsec's contract *'did not provide for the appellant to choose aspects of Livechat which it could drop from the agreement'* and that *'aspects of Livechat were not invoiced separately'*. Rather sensibly she noted that *'it was not really possible to split Livechat prospectively as Allsec would not know until it was conversing with the borrower what the borrower's query was'*. For this reason she concluded that Dollar *'has not satisfied me that Livechat comprised multiple supplies: on the contrary it comprised a single supply and that supply was either exempt or standard rated: it could not be apportioned'*.

However she went on to rule that Dollar *'has not proved that the supply seen as a whole was exempt as mainly comprising exempt activities'*. Although the tribunal judge ruled that whilst *'one aspect of what Allsec did in Livechat (the pre repayment part) would be exempt if an isolated supply, it was not proved to me that it was the dominant part of the actual supply made, that supply being Livechat.'* She ruled that none of the categories of borrowers in Livechat had been *'introduced by Allsec'* to Dollar but rather they were *'either existing customers or had independently found their way to'* Dollar's website. Further she ruled that none of the Livechat tasks amounted to *'any negotiation of the terms*

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of loans'. For this reason she concluded that *'I find that Livechat was not the exempt negotiation of credit but standard rated supply of principally back-office functions'*.

Will there be an appeal to the Upper Tribunal?

The decision of the FTT is dated 19 August 2016. If HMRC remain dissatisfied with any aspect of it, then it has 56 days taking it to 14 October 2016 to ask the FTT for permission to appeal to the Upper Tribunal on this. As Dollar won on 3 issues but lost on 2 issues, it too could try and appeal the issues it lost to the Upper Tribunal. The FTT judgement is lengthy but the analysis is clear. It is difficult to fault the reasoning of the FTT and it also leaves open to determine in future cases where the line is to be drawn on crossing the line on being a mere conduit and an introducing intermediary.

HMRC will be licking its wounds to some extent as some of its tactics in the FTT backfired on it quite badly. The FTT said HMRC's attempts to introduce Dollar's consumer interest rates to try and blacken it in the Tribunal's eyes were not only misplaced but also entirely irrelevant to determining the VAT issue. Dollar put in sufficiently detailed evidence in its witness statement and its witness also amplified on this at the hearing. Again, the HMRC's attempts to try and trip up Dollar's witness not only failed but also annoyed the judge. If HMRC does want to take a case to the Upper Tribunal on mere conduits then it must be able to find a better case than this one.

What action should consumer finance businesses take in the light of this ruling?

The Tribunal Judge adopted a pragmatic approach in this case and noted that Dollar's contract with Allsec *'together with its annexes evolved over time, and in particular more services were added'*. This is the nature of the way many outsourcing arrangements develop. That being said in relation to the services that Allsec provided to Dollar only services in relation to new loans to existing customers and pre repayments were found to be exempt from VAT. Allsec's services in relation to conversions and Livechat were held to be an outsourced back office function and were not covered by the VAT exemption but attracted VAT at the standard rate of 20%.

Outsourced contracts that consumer finance or insurance businesses have should be checked carefully in the light of this ruling to ensure that those services which genuinely relate to either the granting or negotiation of credit or the management of credit are invoiced separately. If they are then they are exempt from VAT. Similarly outsourced services in relation to insurance and reinsurance transactions are exempt from VAT. Where an outsourcer provides services beyond the scope of the VAT exemption – for example back office services relating to Livechat – then those services need to be invoiced separately and to include VAT on them at the standard rate of 20%.

Dollar also established before the FTT that the services that lead generators provided to it were exempt from VAT. It is clear from the way HMRC fought this case, that it is sceptical that lead generators were doing enough to fall within the credit negotiation exemption. HMRC's view is that lead generators were simply selling prospect data to the highest bidder and this represented being a mere conduit so that the VAT exemption did not apply. At the moment we have a FTT decision which VAT inspectors will have to follow but will be merely persuasive for other judges hearing similar cases in the First Tier Tribunal. The activities of the lead generators here were put under the microscope and examined in great detail. What other lead generators do may be different. The FTT decision here on lead generators is vulnerable to a challenge in another case and indeed HMRC may decide to appeal this point to the Upper Tribunal. Consumer finance and insurance businesses should seek to cover themselves in the meantime by having an appropriate indemnity in any contract with a lead generator in case HMRC succeeds in establishing that fees charged by lead generators do indeed attract VAT at the standard rate either on appeal in this case or in another case.

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