

VAT, DUTIES AND INDIRECT TAX

COMPOSITE SUPPLIES AT SEPARATE RATES: COLAINGROVE LTD v HMRC

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In the 1990's VAT practitioners learned that multiple elements of a supply could be taxed as one composite supply; all that was required was that the principal supply be for the better use and enjoyment of the principal supply. Then, in the first decade of this millennium we learned that a composite supply could exist without principal and ancillary elements: they could be "economically indivisible". Then, last year, in its Judgment in *Deutsche Bank* the ECJ identified a new sub-category of composite supply: one where the elements are economically indivisible but where there is no predominant element. So, it seems until recently there were three different types of composite supply: the *CPP* composite supply; the *Levob* composite supply and the *Deutsche Bank* composite supply. In *Colaingrove Ltd v HMRC* [2013] UKFTT 116 (TC) the Tribunal did not identify a new category of composite supply but it did redefine what it means to be a composite supply.

It would be fair I believe to describe the consequences of a finding of a composite supply that the supply is to be treated not as the supply of several elements which comprise the thing supplied but the supply of one thing. This carries with it several consequences, the first is that the rate of VAT applicable is that applicable to the single composite supply and not its individual elements and, second, the place of supply rules will apply to that single composite supply and not its various elements.

In *Colaingrove* the first tier tax tribunal concluded that – in very limited circumstances – a composite supply can be liable to VAT at two separate rates. Before considering the decision it is necessary to consider the two pillars on which it was constructed: *Talacre Beach Caravan Sales v C&E* (Case C-251/05) [2006] STC 1671 and the *French Undertakers Case*.

Talacre v HMRC

In *Talacre*, we saw the first hint that it might be possible to have a composite supply liable at two rates. In that case, it was accepted by HMRC that, in selling caravans, Talacre made composite supplies of the caravan and its contents. However, HMRC argued that, notwithstanding the existence of the composite supply the contents of the caravan were

liable to VAT at the standard rate. This argument arose, and was successful, because the UK provisions which zero-rated caravans specifically excluded removable contents but, more importantly the legislation had excluded removable contents from the zero-rating since before 1 January 1991. Because of this, and because the zero-rating was one which was 'grandfathered-in' pursuant to Article 28(2)(a) of the Sixth Directive HMRC argued that it was simply impermissible for the contents to be liable at the zero-rate. According to the ECJ if the contents were to be liable at the zero-rate as a consequence of the existence of a composite supply this would serve to extend the scope of the zero-rating laid down for the supply of the caravans themselves.

The Court concluded that its jurisprudence on composite supplies:

"does not preclude some elements of that supply from being taxed separately where only such taxation complies with the conditions imposed by Article 28(2)(a) of the Sixth Directive on the application of exemptions with refund of the tax paid"

Therefore, it was not the mere fact that the UK legislation excluded the contents which rendered them liable at a separate rate; it was the fact that by dint of their exclusion prior to 1991 the State was now precluded from applying the zero-rate. In my view *Talacre* must be read in light of the fact that the contents were expressly excluded from zero-rating prior to 1991, otherwise a zero-rate could never extend to cover an entire composite supply (unless all of the elements were themselves zero-rated) since it would by definition be extending the zero-rate to items which could not themselves be zero-rated pursuant to Article 28(2)(a). Because of this, *Talacre* has for some time being regarded as having been decided on unique facts.

Commission v France

In *Commission v France* (Case C-94/09) (hereinafter the "*French Undertakers Case*") the ECJ brought the *Talacre* analysis one step further. In that case the ECJ considered whether French legislation was compatible with the VAT Directive. Article 98 of the VAT Directive entitles, but does not oblige, member states to apply up to two reduced rates on certain supplies which are listed in Annex III. Amongst those supplies is "the supply of services by undertakers and cremation services, and the supply of goods related thereto." The French Republic had decided to apply the zero-rate only to the transportation of the deceased. The Commission challenged this position on the basis that it resulted in the French Republic applying two different rates to "*two components of a supply which must be regarded as a composite supply*".

The starting point for the ECJ's analysis was that there was nothing in the text of Article 98 which required that it be interpreted as meaning that the reduced rate could be charged only if it is applied to all aspects of a category of supply covered by Annex III. Accordingly a selective application of the reduced rate was permissible provided that no risk of distortion of competition resulted. The Court expressed it thus:

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“subject to compliance with the principle of fiscal neutrality inherent in the common system of VAT, Member States may apply a reduced rate of VAT to concrete and specific aspects of a category of supply covered by Annex [VIII] to the [VAT] Directive”.

As we will see shortly these “concrete and specific aspects” comprised a major element of the taxpayer’s submissions in *Colaingrove*. The Court held that if a member state chose to apply the reduced rate in an *à la carte* fashion it must nevertheless comply with the principle of fiscal neutrality. So, two conditions existed and the Commission argued, in effect, that there was also a third condition, namely that the zero-rating could not be applied to elements only of a composite supply. The ECJ disagreed and held that the principles governing composite and multiple supplies:

“may be applied on a case-by-case basis, in order to prevent, inter alia, the contractual structure put in place by the taxable person and the consumer from leading to an artificial splitting into a number of fiscal transactions of a transaction which, from an economic point of view, must be regarded as a single transaction, [but] they cannot be regarded as decisive for the purpose of the exercise by the Member States of the discretion left to them by Directive 2006/112 as regards the application of the reduced rate of VAT.”

So, where a member state has been given the power to apply a reduced rate to particular supplies listed in Annex III it may choose to only apply the reduced rate to elements of those supplies provided that they are doing so in respect of “concrete and specific aspects” and doing so does not result in a breach of fiscal neutrality.

The *French Undertakers* case is not authority for the fact that any composite supply which contains a reduced rate element is liable to VAT at two different rates, though the implication of the Judgment does appear to be that in France a composite supply of undertaker’s services is liable to VAT at two different rates because the State has expressly – and legitimately – decreed that it should be so (though this is not 100% clear from the Court’s judgment).

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The Appellant is a member of the Bourne Leisure Group and owns, amongst others, “Haven” and “Butlins”. It provides accommodation at its holiday parks in the form of static caravans, chalets and pitches for caravans owned by holiday-makers. One of its business lines is the offer “Sun Holidays”. These are cut-price holidays offered in static caravans or chalets to the readers of *The Sun* newspaper. One of the features of the offer is that the customers must pay a separate charge for the electricity that will be supplied to the caravan or chalet. As it is not practical to engage in meter reading for each holiday maker, a set charge of £12 per day is payable at least 56 days in advance of the commencement of the holiday.

It was accepted by HMRC that electricity supplied at pitch-sites to those who own their own caravans was liable to VAT at the reduced rate. Similarly it was accepted that if the supply of electricity was done on a metered basis it would constitute a separate element of the supply and would also be liable at the reduced rate. It was alleged however that because a flat-fee was payable which did not relate to the amount of power consumed by any particular customer the supply was a composite supply liable to VAT at the standard rate applicable to the supply of holiday accommodation. Ultimately the Tribunal agreed with HMRC that, following *Weight Watchers (UK) Ltd* and *David Baxendale*, the typical Sun Holiday customer was purchasing a composite supply. However, this conclusion was only reached after the Tribunal had first considered the taxpayer's principal argument, namely that irrespective of the existence of a composite supply, two separate rates applied.

The Tribunal analysed *Talacre* and the *French Undertaker's* case in some detail and concluded that the latter:

"Is authority for the entitlement of a Member State to legislate that a reduced rate of VAT will apply to a supply of goods or services in relation to which a reduced rate is authorised under the relevant European Union Legislation notwithstanding that the application of the CPP jurisprudence would lead to the conclusion that such supply was merely an element in a larger single complex supply which receives the tax treatment appropriate to the nature of the larger single complex supply taken as a whole."

In accordance with the *French Undertakers* case, the Tribunal also held that the reduced rate element must comprise a "concrete and specific element" and it must not lead to a breach of fiscal neutrality.

The difficulty was that in the *French Undertakers* Case the member state had expressly chosen to exclude certain elements of a composite supply from the reduced rate which it implemented in its legislation with the result that it applied the reduced rate to only a portion of a composite supply. In *Colaingrove* there was no question of the legislature having chosen to apply a reduced rate to only part of an Annex III activity – it was simply alleged that the manner in which the reduced rate had been applied in the legislation made it clear that the reduced rate applied to electricity was intended to survive the incorporation of that supply into a standard-rated composite supply.

In my view, whatever the rights or wrongs of the Tribunal's decision, it is hard to see how this case falls squarely within the *French Undertaker's* Case. It may well constitute an appropriate extrapolation from the principles set down in that case but in the *French Undertakers* case Annex III permitted the application of a reduced rate to an identified composite supply. By electing to apply the reduced rate to only one element of that supply there was a clear intention to apply two different rates to the composite supply. In *Colaingrove* the challenge was proving a clear legislative intention to apply two rates to

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the composite supply of a caravan and electricity.

The taxpayer relied upon the fact that the reduced rate applied to the supply of electricity only when it was used for a "qualifying use". Note 3 of Group 1 Sch 7A, VATA defines such a use as including "domestic use" and Note 6 provided that if the electricity was supplied for use in, *inter alia*, "self-catering holiday accommodation" or "a caravan" it was liable to VAT at the reduced rate. This demonstrated, according to Roderick Cordara QC for the taxpayer:

"the intensity of the Parliamentary intent' that the electricity supplied to a caravan or self catering accommodation should attract the reduced rate."

The argument then was simply that having provided expressly for the application of a reduced rate to such supplies, the reduced rate remained applicable irrespective of whether the supply formed merely one element of a composite supply of standard-rated holiday accommodation.

On the other hand, of course, it might merely be indicative of a legislative intent that the reduced rate should apply "only" where there is a qualifying use as opposed to "always" where there is a qualifying use.

HMRC argued that this approach would:

"completely rob the CPP line of authority of its force and undermine the principle which lies behind the rule in CPP, which was there to prevent over-compliance of VAT and the need to separate out, in relation to every transaction, each concrete and specific element which could be identified in order to decide what rate of tax was applied to it"

The Tribunal concluded:

"It seems to us, that applying the French Undertakers in the way that we propose would not open the floodgates and wash away the CPP jurisprudence, because French Undertakers can, as we see it, only apply in the very limited class of case where a reduced rate of VAT is in issue and the domestic legislation imposing it indicates and intention that the CPP jurisprudence should not apply."

It is not clear to me why the Tribunal says that its decision will only apply in respect of the reduced rate. It is true that Article 98 and Annex III are permissive (providing that member states "may ...") but that would appear only to produce the result that, as in the *French Undertakers Case*, the member state could bifurcate a composite supply contained within Annex III when implementing its decisions on rating. On the other hand, the Judgment in *Colaingrove* would appear to apply in any circumstances where the legislature has indicated a clear intent to apply a particular rate of VAT to any element of a composite

supply. The Tribunal was clearly satisfied that this was not so but the basis for this satisfaction is not clear to me.

A further question arises regarding the place of supply. If there is a highly specific rule for the place of supply of a particular good or service in particular circumstances. Is that indicative of a legislative intent that the place of supply of that element will be immune from its inclusion in a particular supply? If so, one could end up with composite supplies with different rates and different places of supply.

One cannot help but admire the ingenuity of the taxpayer's argument in *Colaingrove* but HMRC's floodgate concerns would not appear to be unfounded. One would have thought that an appeal is almost inevitable and it will be very interesting to see whether the Upper Tribunal will agree that *Colaingrove* comes within the "very limited class of case" created by *Talacre* and the *French Undertakers* case.

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