HMRC v SAE Education Ltd

[2016] UKUT 193 (TCC)

Tarlochan Lall, Monckton Chambers

The Upper Tribunal ("UT") overturned the First-Tier Tribunal's ("FtT") decision that SAE Education Ltd ("SEL") was an eligible body for the purposes of Note(1)(b) to Item 1 of Group 6 of Schedule 9 to the Value Added Tax Act 1994 ("VATA"). In my view, it is strongly arguable that the UT erred in doing so. The UT construed Note (1)(b) strictly. That provision should have been construed purposively, as SEL argued.

The Facts

SEL belongs to the SAE corporate group. "SAE" is the acronym for School of Audio Engineering. The dispute concerned the issue of whether SEL was a "college… of…a university". The university in question was Middlesex University ("MU"). In essence, the UT held that the 'association' SEL had with MU was insufficient for SEL to be an eligible because SEL was not sufficiently integrated into MU.

There was no dispute that SEL provided education. SEL's difficulty lay in the form of its association with MU. Both tribunals had to consider a number of agreements on which the 'association' was founded. The following facts gave rise to divergent conclusions on the relationship between MU and SEL in the FtT and the UT.

- The SAE group traded worldwide as the "SAE Institute". Initially the UK activities were undertaken by SAE Education Trust Ltd ("SETL"). SETL got into financial difficulties. Its business was overtaken by SEL. However, it emerged before the FtT that MU did not know about that succession.

- The relationship between the SAE group and MU "developed incrementally" over a number of years and had been documented in a number of agreements. The SAE group's relationship with the MU was exclusive in that SEL did not have any similar arrangements with other universities in the UK.

- In 2002, there had been a meeting between representatives of the SAE Institute and MU in Sydney when it was recommended that the SAE Institute should be granted "associate college status". Despite the incremental development of relations between the SAE Institute and MU, such status was not granted until 2010 when a Special Associate College Agreement (SACA) was entered into. The SACA had not been professionally drafted. There was confusion over which SAE entity was party to it. It contained a provision the

> FtT found to be of great significance, that the partnership "builds upon the existing status of SAE-UK as a Middlesex University Associate College". The SACA also recited that the agreement was "to further strengthen the degree of collaboration and interdependency in the United Kingdom, and to designate [sic] a higher level of integration of SAE-UK operations with those of Middlesex University."

There were a number of detailed facts. Here I raise the question whether such detail really matters given key findings made by both tribunals and referred to below. In this context it is necessary to refer to the EU law.

EU Law

Article 132.1 of the Principal VAT Directive 206/112/EC ("PVD"), so far as relevant, provides that:

> "Member States shall exempt the following transactions: ...
>
> (i) the provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the Member State concerned as having similar objects ..." (emphasis in italics added).

The UK recognises eligible bodies as described at the outset. The italicised words emphasised in article 132.1 provide the vires for that provision in the VATA.

Arden LJ's description in *Finance & Business Training Ltd v Revenue and Customs Commissioners ("FBT")* [2016] EWCA Civ 7 of the construction of this EU law as derived from , the Court of Justice of the European Union in *Minister Finansów v MDDP sp z oo Akademia Biznesu, sp komandytowa* (Case C-319/12) [2014] STC 699 (*"MDDP"*) was quoted in the UT. *MDDP* concerned Polish law, which gave a general exemption from all supplies of education. The reference to the CJEU on the relevant question was whether a commercial body (which did not wish to benefit from the education exemption) was required to be excluded from the education exemption if it was profit-making. Arden LJ summarised the findings in *MDDP* as follows

> "[5] Any exemption had to be construed strictly. It had also to comply with the doctrine of neutrality: [25].
>
> [6] **The purpose of the exemption was to facilitate access to educational services:** [26].

[7] A profit-making **enterprise** could still meet the conditions for the exemption, unless the member state had chosen to use the option in Article 133 to exclude profit-making entities: [27] - [29].

[8] The PVD did not permit member states to give a general exemption for all supplies of educational services without regard to the objects pursued by the non-public organisation providing the service: [35], [39]. To qualify for the exemption, the body in question needed to be recognised by the member state as a body having objects which were similar to those of a body governed by public law having such as their aim (see Article 132.1(i)): [35]. (The word 'such' refers back to 'the provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto'). I will call this 'the PVD supplier condition'.

[9] Each member state had to lay down conditions for this purpose, to the extent that the conditions were not specified in Article 133.1(i). However, member states had a discretion as to what those conditions were (citing C- 498/03 *Kingscrest Associates Ltd v Customs and Excise Commissioners* [2005] STC 1547 at [49] and [51], and C-174/11 *Steglitz v Zimmerman* at [26]): [37].

[10] National courts had to determine whether national law imposed EU law-compliant conditions (*Kingscrest* at [52]). The conditions had to comply with EU law principles, including the principle of fiscal neutrality: [38]. The national courts have to compare the activities of the person whose entitlement to the exemption is in issue with those of bodies who (1) are of the member state, (2) are governed by its public law and (3) provide educational services (see [54]).” (Emphasis in bold added.)

The text highlighted in bold identifies (a) the purpose of the exemption and (b) that profit making “enterprises” can qualify for the exemption. Although words used in decisions of courts should not be treated in the same way as statutory provisions, it is reasonably clear from the above that 'partnerships' and 'associations' can qualify for the exemption. Although Member States have discretion over determining the conditions for extending the exemption to bodies not governed by public law, the principles of fiscal neutrality and equal treatment must nevertheless be observed.

Principles derived from previous cases

The question whether an “Associate College” described by the University of Lincolnshire and Humberside was a college of the University arose in *Customs and Excise Commissioners v School of Finance and Management (London) Ltd* [2001] STC 1690 (“SFM”). The college taught the University's degree

courses and degrees were awarded to successful students by the University. SFM identified 15 factors which can be adopted in testing whether an entity is a college of a university. Those 15 SFM factors achieved a measure of acceptance as a helpful guide by being implicitly approved by the Court of Appeal in *FBT* at [57].

There must be mutual understanding between the entity claiming to be a college and the university. In *London College of Computing Ltd v HM Revenue and Customs Commissioners* [2013] UKUT 404 (TCC), [2014] STC 404 Judge Bishopp said, at [92], that

> "There should also, one might think, be some evidence of the recognition by the university of the other institution as a college of itself. I do not see how it can plausibly be argued that an institution such as LCC is, or is to be regarded as, a college of a university which does not acknowledge it as such."

Objective evidence of such mutual understanding should suffice.

Perhaps most significantly, Arden LJ in FBT said

> "[21] Even though it is supplying educational services, FBT fails to meet the EU law-compliant supplier condition for the education exemption. FBT has fundamentally misunderstood the statutory scheme which in brief is that, in the case of university education, the UK has exercised a member state option to recognise non-public law bodies carrying on qualifying educational activities to a *small group consisting of college and halls of universities which are integrated into the university's activities.* (Emphasis in italics added).

The UT noted at [100] *"The most important findings of fact were that the provision of university education represented only a minor part of FBT's activities."* This finding is considered to be vitally important. It forms a basis on which *FBT* can be distinguished. Consequently, that should allow for arguments to be raised on the binding force of FBT.

The Upper Tribunal' approach

The UT adopted the following a multi-step evaluation exercise to test the relationship between SEL and MU. It decided that:

1. the first step is to ascertain whether the university and the college had a common understanding of their relationship. If they did not, the enquiry is likely to end there;

2. the common understanding must be that they are in a relationship of university and college, and not some different relationship, such as partnership;

3. it is necessary to examine whether the relationship is sufficiently close that the college is a college "of" the university. At this point "most, though not all" of the *SFM* factors become relevant;

4. finally it is necessary to consider whether the college satisfies the requirement that it supplies education. The entity must have "similar objects" to those of the university; absent similar objects it would not satisfy the supply test. The UT went on to add that the "similar objects" requirement is met only if the "fundamental purpose" of the college is to supply university-level education" and noted that this was not in issue in this case. The UT cautioned that *"if it is right, as Arden LJ said in FBT at [33], that an institution may be a college of a university without making exclusively exempt supplies "fundamental purpose" may overstate what must be shown."*

The UT held that the FtT fell into error because they did not undertake steps 1 and 2. However, it appears that the UT unduly focused on step 1 and itself failed to give sufficient consideration to step 2.

The UT's analysis of step 1 may be described as a technicality which proved to be fatal to SEL. The UT held that although MU regarded SAE Institute as a body which was capable of providing university level education, it was clear that MU did not regard SAE Institute as a college of itself, and the nature of their relationship was such that it could not realistically have done so. The UT held that the SAE Institute could not have been a college of the MU because it was wholly independent; and when it entered into agreements similar to those it had with MU with other universities throughout the world it did so on its own behalf and not in common with MU. In other words, the UT attached importance to SAE Institute's worldwide activities and not just those in the UK. It will be necessary to revert to this when considering issues arising in respect of step 2. Essentially, although there was a form of association between the SAE Institute and MU, the UT considered this factor to be evidence of insufficient integration between the two. This led to a second difficulty, in that if the SAE Institute itself could not be a college of MU, neither could SEL within the UK. As the VAT liability concerned SEL, that was fatal. Those difficulties enabled the UT to conclude that the FtT's contrary finding was perverse, so the UT could interfere with the FtT's decision.

With regard to step 2 the UT held that

> "we have considerable doubt whether an informal regard by a university of another institution as an associated college could ever satisfy the statutory test. … the expression used is "college of a university"; it is in our view plain that something more than an informally recognised association is required."

When considering step 2, the UT focused only on the statutory language and did not refer to EU law, including the purpose of the exemption or the principle of fiscal neutrality. This indicates that the UT adopted a strict construction of the VATA and not a purposive construction as SEL argued it must. It is considered that a purposive construction would have allowed an association such as SEL to qualify as an eligible body. There was no dispute that it provided education. Although there was some confusion over numbers, the UT accepted that "a great majority" of SEL's students were undertaking courses which could lead to an MU degree. The FtT referred to 90%. The UT appears to have been influenced by the technical considerations of step 1 described above, in particular that the SAE Institute itself could not be a college because as a world wide body, it was not sufficiently integrated with MU. Given the UT's own observation that it was only the SEL's status that mattered for VAT purposes, arguably all the UT needed to do was focus on SEL.

Why It matters

A strict construction of VATA also led to the failure to explore whether a partnership could be excluded from qualifying as an eligible body. Section 45 VATA essentially treats a partnership as a single firm. The ordinary meaning of a partnership is 'an association of two or more people acting as partners'. Integral to the ordinary meaning of association is the need for a joint purpose. In this case, the undisputed joint purpose was to provide education. Treating a partnership differently from a single entity breaches the principle of fiscal neutrality. In the case of universities, it is particularly difficult to see how even a strict construction justifies the conclusion the UT reached. The UT at [108] quoted Arden LJ that there are *"many variations in the organisation of universities in the United Kingdom"*.That in itself indicates that 'associations' must be capable of being eligible bodies.

The UT's decision appears to be unduly harsh because SEL provided education, which is directly in the aim of the exemption. As a matter of economic reality, SEL appears to have met the core requirements: it provided education and its objects appeared to be sufficiently clearly similar to bodies governed by public law. Its exclusion on the basis of an imprecise test of integration arguably breaches the principle of fiscal neutrality. To the extent the UT felt constrained by the Court of Appeal's decision in *FBT* indicates that this case warrants being considered by the Court of Appeal.

Melanie Hall QC and Elizabeth Kelsey represented SAE Education Limited instructed by Gordon Dadds LLP.

The comments made in this case note are wholly personal and do not reflect the views of any other members of Monckton Chambers, its tenants or clients.

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