ING Intermediate Holdings Limited v HMRC

[2017] EWCA Civ 2111

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The Court of Appeal's decision in this case, handed down on 13 December 2017, deals with fundamental concepts of VAT, namely whether there was a supply of services, and if so, whether it was 'for consideration', and if so, whether the consideration could be expressed in monetary form. The case concerns deposit accounts provided by two members of the appellant's VAT group referred to as "**IDUK**" and the ability of the group to recover input tax.

The Court of Appeal, with Lady Justice Arden giving the lead judgement, upheld the decisions of the First Tier Tribunal ("**FTT**") and the Upper Tribunal ("**UT**") that IDUK provided exempt banking services and consequently was not entitled to recover input tax. IDUK had argued that it was acting as a mere deposit taker and banking services were not provided through the deposit accounts. The case is another which tests whether contracts entered into by the parties reflected economic reality and how economic reality is identified.

The Salient Facts

IDUK carried on a retail banking trade. The trade comprised taking cash deposits from private individuals, which were used to acquire bonds and securities. The FTT found that the retail banking operations were 'normal retail banking services' with two distinctions. Firstly, IDUK only offered deposit accounts. Secondly, IDUK had no walk-in branches, but customers were offered 24-hour telephone and internet banking services. The account holders could withdraw their deposits without notice. And they were protected by the Dutch deposit guarantee scheme.

Customers were attracted by being offered higher interest rates than those offered by most of IDUK's competitors and by its catchphrase 'no fees, no exceptions'.

Customers could open accounts and make deposits by cheque, but otherwise they could only undertake transactions on their accounts by telephone or on the internet. They did not receive a cheque book, debit or credit card or overdraft facilities. Customers could not make payments from the deposit accounts to third parties. Withdrawals from the account could only be made via a transfer to another IDUK account or to a linked account held by the customer with another bank.

IDUK initially used the deposits to make loans to the Spanish branch of its parent company ING Direct NV, which invested the funds. The investment operations were essentially merged into the same legal entity, with IDUK increasingly controlling the investment strategy. The investments were made in low risk fixed-term securities. A small percentage funds were held on short-term deposits to meet liquidity needs. Some issuers of the securities were based outside the EU, which IDUK maintained involved 'specified supplies'. Later additional business lines were developed. IDUK became an insurance intermediary and additionally used deposits to make loans secured by mortgages.

IDUK had incurred significant expenses in connection with its deposit taking activities. They included expenses of advertising, construction of a head office and two call centres, IT systems and staff and recruitment costs.

Terms and conditions applying to the deposit accounts

The deposit account was described as an easy-access variable rate savings account. The terms and conditions provided for how deposits and withdrawals could be made into and out of the deposit account. A provision for withdrawals from the account stated that:

> *"withdrawals can only be made by electronically transferring money from an account by using the ING website, by calling ING'S customer service number, or by using ING's Interactive Telephone Banking Service."*

The terms contained provisions for how ING would deal with instructions given over the telephone or on the internet. If ING failed to carry out any instructions, the terms provided for the customer to be informed and given reasons and guidance on correcting factual errors which led to the refusal or delay. ING agreed to take instructions from holders of powers of attorney in some cases.

The terms specified that the accounts could be accessed through the ING website. ING could be contacted by phone for information on the account. A summary of all electronic transactions was made available on the ING website.

There was a specific term stating that there were currently no fees for the account but that ING may introduce or vary any charges imposed.

Provision was made for interest to be paid gross once the customer had registered for receiving gross interest. Customers were given an additional right to close their account upon being given advance notice of a change in the interest payable on their deposits.

The salient terms and conditions are set out in Appendix 2 to the Court of Appeal's decision. They give rise to questions over what services IDUK was

providing and whether they reveal the economic reality of IDUK's activities.

Issue 1: Was there any supply of services?

IDUK's central case was that it was merely taking deposits and it was not providing any primary supplies to the depositors. Before the FTT and the UT, IDUK had argued that its arrangements with the customers were lending arrangements, with IDUK being the borrower. IDUK had also argued that any banking service was ancillary to the lending by the customer and that the ancillary supply was not an end in itself but merely a means of better enjoying IDUK's holding of deposits. IDUK argued that the UT had erred in law by failing to apply the principle adopted in *MBNA Europe Bank Ltd v Revenue and Customs Commissioners* [2006] STC 2089 ("***MBNA***"), namely that it was necessary to understand the commercial purpose of the various steps in the relevant transactions, which would have revealed that there was no supply made by IDUK.

Judge Mosedale in the FTT made clear findings that IDUK provided banking services and that they were not peripheral to the deposit taking business. The electronic and telephonic platform created by IDUK was a different means of delivering the banking services, which did not alter the legal analysis of the facility provided by the bank to its customers. Although there were restrictions on how the deposit account operated, nevertheless it was recognised by the parties as a bank account and it operated as such. IDUK provided statements and facilities for allowing access to the funds on deposit. Those facilities were services provided by the bank to its customers which went beyond a relationship of borrower and lender.

The UT concluded that although there was borrowing and lending between the customers and IDUK, IDUK was providing bank accounts which were qualitatively different to mere borrowing and lending transactions. IDUK was obliged to accept deposits a customer wished to make, a matter which was in the control of the customer as lender. That was a key feature of a bank account. All activities, namely deposits and withdrawals, were at the customer's instigation. The arrangement had features of a bank account rather than a 'revolving loan agreement' which would have given the borrower control over activities. IDUK had set all the terms and conditions, including the interest rates, yet given the customers key elements of control referred to above.

MBNA, relied on by IDUK, concerned the securitisation of customers' debts. MBNA could not directly borrow money on the security of the debts. It entered into complex arrangements which involved the assignment of debts to a bare trustee special purpose vehicle ("**the SPV**"). The SPV borrowed funds in the market using the assigned debts as security. The SPV paid various amounts back to MBNA. On their face, the assignments appeared to be for consideration.

Briggs J held that although they were capable of being supplies for VAT purposes, the assignments did not give rise to a supply for VAT purposes because

> *"… they were no more than the necessary pre-condition to the supply of a securitisation service to the banks, by the SPVs set up to operate that service, they are thereby deprived of the character of a supply by the banks. They therefore constitute an addition to the exceptional class of transactions which look prima facie like a supply, but which lose that character when viewed in their context. Other examples are the sale of currency to a forex dealer to obtain an exchange service, the assignment of debts to a factor to obtain a factoring service, and the assignment of property to a lender as security for (ie to obtain) a loan."*

In each case, there is a transfer from A to B, but there is no directly linked reciprocal performance which perfects a supply from A to B for VAT purposes. As such, the transfer from A to B may be said to be a mere transfer which does not give rise to an economic transaction, although it may have economic effect. In each case there are or may be related services provided by B to A or possibly a third person, which is often the cause of complication in the VAT analysis. Briggs J had recognised a "…*critical difference between an assignment by way of security and an assignment of property to another so that that other can use it as security"*. The difference is that the former assignment allows security to be perfected, whereas the latter does not create any security by way of the assignment, but it is difficult to see any difference in the VAT analysis given that security is mentioned in the quote above as one of the exceptional events which does not involve a supply for VAT purposes.

The conclusions in MBNA were underpinned by examining the economic purpose of the contracts, namely "t*he precise way in which performance satisfies the interests of the parties*" or the "*cause of the contract and understand as the economic purpose, calculated to realise the parties' respected interests, lying at the heart of the contract*". That purpose is determined objectively, so it is the same for all the parties to the contract, untainted by the subjective reasons which led the parties to enter into the contract. English trust law perhaps provides a clearer explanation of the economic reality of the arrangements adopted by MBNA, namely the SPVs acquired the debts as bare trustees and held and used them for MBNA, therefore, no economic transaction for VAT purposes had taken place on their assignment, even though the assignment had the economic effect of allowing the SPVs to use the debts to borrow funds. VAT, being founded on EU law, essentially precluded reliance on English trust law for an explanation of the economic reality.

IDUK could not demonstrate that it merely took deposits without providing reciprocal banking services. IDUK did not contest that it had entered into

lending arrangements. However unlike MBNA, IDUK could not demonstrate that the impugned transactions could be ignored for VAT purposes.

IDUK was also saddled with its own terms and conditions, which were entirely in its control. They could not be disregarded on the basis of principles established in *Revenue and Customs Commissioners v Newey* [2013] STC 2432 and *Secret Hotels 2 v HMRC* [2014] STC 937. Although the court is not bound by the terms of a contract or labels the parties use, the starting point is that as the contract usually reflects the economic realities and the parties' rights and obligations, so the court must have due regard to them. The court will normally only look behind the terms of the contract where it does not reflect the realities of the relationship between the parties. IDUK's terms and conditions recognised that there was a provision of a banking service. That in itself did not bind the court. Nor did the use of the label 'account'. However, the circumstances examined by three courts were consistently found to have indicated that IDUK was providing banking services to its customers.

Issue 2: Was the supply of services for consideration?

IDUK's terms and conditions expressly stated that there was no fee charged for the account, although ING could introduce or vary any fee charged. The FTT had found that as a matter of fact, all the term specified by IDUK meant was that there was no express fee. The FTT had also found that the interest rate on the deposit account must have contained some deduction for the services provided by IDUK. IDUK had not provided any contrary evidence. The evidence indicated that IDUK had incurred substantial expenses in providing the facilities to the customers. The FTT had also found that there was barter transaction between IDUK and the customers. The FTT's fact findings had not been challenged before the UT, so they were not open to challenge before the Court of Appeal. In contrast to the terms reflecting that IDUK was providing banking services, on the matter of consideration, even if the reference to 'no fee' purported to say there was no consideration, that term could be ignored as it was "*so clearly at odds with the actual agreement between the parties*".

Issue 3: Could the consideration be expressed in monetary form?

IDUK argued that any consideration for banking services could not be expressed in a monetary form. The Court of Appeal rejected that argument. The UT had considered four methodologies for determining the consideration. The Court of Appeal found that the final choice of method would depend on the evidence available to the court and its findings.

VAT jurisprudence had dealt with the valuation of non-monetary consideration

in many cases; and cases such as *Naturally Yours Cosmetics limited v HMRC*

[1988] STC 879 and *Customs and Excise Commissioners v First National Bank of Chicago* [1998] STC 850 ("*FNBC*") were relevant. Even if establishing the consideration was difficult, it was not impossible. The Court of Appeal did not select any method put to it, but their Lordships were satisfied that an appropriate method could be found.

***Peter Mantle* acted for the Respondents, instructed by HMRC.**

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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