

Supplying the answer: when are state-funded services “supply of services for consideration” for VAT purposes?

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Melanie Hall QC and Elizabeth Kelsey acted for Colchester Institute Corporation (appellant), instructed by VATangles Consultancy.

Peter Mantle acted for HMRC (respondents), instructed by the General Counsel and Solicitor to HMRC.

In this case note, [Jack Williams](#) of Monckton Chambers analyses the recent decision of the Upper Tribunal in *Colchester Institute Corporation v HMRC* [2020] UKUT 0368 (“**Colchester**”). In summary, in overturning the First Tier Tribunal’s decision, the Upper Tribunal held that state-funding *did* have a sufficient link to the provision of education and vocational training provided by a college to constitute supply of services for consideration and economic activity. Nevertheless, HMRC was entitled to set-off input tax to reduce the taxpayer’s repayment claim. The implications of the case are likely to be profound: many businesses – educational and otherwise – supplying services that are funded by state agencies are now likely to argue that their provision of services does, in fact, constitute the supply of services for consideration and economic activity. That being so, there would be no need to account for output tax on those services and any accounted for with HMRC may be recoverable.

State-funded education is a supply for consideration

In *Colchester*, the college had deducted input VAT on building costs under the *Lennartz* mechanism (which, in brief, permits businesses to recover input tax in full upfront and account for deemed output tax on future non-business use). At the time, it was thought that the provision of education and vocational services amounted to such non-business supplies, so the college and HMRC accounted for deemed output tax. Having done so, the college argued that it had, in fact, overdeclared output tax on the basis that the provision of education and vocational training to students was, after all, a business activity. That being so, there was no need to have accounted for deemed output tax on non-business

supplies. The college thus sought to reclaim those payments which were still in time.

The First Tier Tribunal ([\[2018\] UKFTT 0479 \(TC\)](#)) held that funded education and vocational training provided by a college was not a supply of services for consideration or economic activity, such that output tax must be accounted for because the college had deducted input VAT on work on buildings used for non-business activities. The Tribunal's core reasoning for this conclusion was threefold ([127]). **First**, there was an insufficiently direct link between the provision of education to the students and the funding provided because the funding by the two government agencies (which met the course costs for the students) was not "negotiated consideration paid for services, but rather a block grant provided subject to conditions". **Second**, lump sum payments calculated by reference to a formula could only be consideration for VAT purposes where there was a supply of services permanently available and the fee is paid for the right of access to services (so-called "*Kennemer supplies*"). **Third**, there was no consideration as there was no link between the amount paid by the funding agencies and the actual cost of the provision of any particular course to any particular student.

The Upper Tribunal overturned that decision. In short, the Upper Tribunal disagreed with the First Tier Tribunal's conclusion that there was insufficiently direct link between the education provided by the college and the funding. The college was making supplies of education services, which were at all material times exempt from VAT. The First Tier Tribunal had erred in each of its three core reasons. **First**, the First Tier Tribunal had erred in dismissing the significance of the agreements between the funding agencies and the college as that funding was restricted to certain specified courses, was determined using a formula specific to the taxpayer's outputs and was subject to clawback, and the taxpayer was required to provide the agencies with detailed information on use of the funds. There thus was a sufficiently direct link between the funding and the courses provided by the college to the students for free ([75] – [81]). **Second**, lump sum payments calculated using a formula can be consideration for VAT: that is not limited to situations of *Kennemer supplies* ([67] – [74]). The First Tier Tribunal had erred in otherwise limiting *C-151/13 Le Rayon d'Or SARL v Ministre de l'Économie et des Finances* EU:C:2014:185. **Third**, contrary to the First Tier Tribunal's approach, the cost of supplies is irrelevant to the question of whether a transaction is to be regarded as for consideration ([87]).

When is supply a “supply of services for consideration”?

Colchester is now the touchstone case for advisers in the determination of whether a supply is, for VAT purposes, a “supply of services for consideration” pursuant to sections 4(1) and 5 of the Value Added Tax Act 1994 (implementing Article 2 of the Principal VAT Directive). In short, the decision supplies all the

answers. It is therefore instructive to deconstruct the decision for the essential propositions of law found within it. These are as follows.

- **Consideration is a broad concept.** See Article 73 of the Principal VAT Directive: “In respect of the supply of goods or services ... the taxable amount shall include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply.”
- **There must be a direct link between the service provided and the consideration received.** See, for example, Case C-16/93 *R J Tolma v Inspecteur der Omzetbelasting Leeuwarden* [1994] STC 509 at [13].
- **Consideration can be made by a third party i.e. paid by a person who is not the recipient of the supply.** See, for example, Case C-353/00 *Keeping Newcastle Warm v CEC* [2002] STC 943 at [26] and *Revenue and Customs Commissioners v Airtours Holidays Transport Ltd* [2016] UKSC 21 at [55]. It is not therefore necessary that the recipient of the service is legally responsible to the supplier for payment of the remuneration to the supplier for payment of the remuneration.
- **Third party consideration can be in the form of subsidy paid from public funds, so long as the subsidy bears a direct link with the goods or services at issue.** See, for example, Case C-184/00 *Office des Produits Wallons ASBL v Belgium* [2003] STC 1100 at [14].
- **The fact that payments are from public funds or that the services are provided pursuant to statutory obligations is not determinative.** See, for example, Case C-263/15 *Lajvér Meliorációs Nonprofit Kft v Southern Transdanubia Regional Tax Directorate, Hungary* at [38]-[43]. Thus, a supply analysis “remains possible even where the payments are made pursuant to statute”: *Colchester* at [75].
- **In order to establish a direct link between the service and consideration received from a third party, it is not necessary to establish that a payment relates to a personalised supply, at a specific time, or that the recipient of the services is aware of the price of the services.** See, for example, C-151/13 *Le Rayon d’Or SARL v Ministre de l’Économie et des Finances* EU:C:2014:185 at [29] – [38] (where healthcare lump sum was consideration for the care provided by the residential care home to its residents).
- **Lump sum payments calculated by reference to a formula can be consideration for VAT purposes outside of Kennemer supply**

situations (i.e. beyond those situations where there was a supply of services permanently available and the fee is paid for the right of access to services). See ([67] – [74]) of *Colchester* and Case C-174/14 *Saudaçor – Sociedade Gestora de Recursos e Equipamentos da Saúde dos Açores SA v Fazenda Pública* [2016] STC 681. Rules for identifying what is, or is not, consideration for VAT supply “are generic” ([72] of *Colchester*).

- **The “key” determining factor of whether supply is for consideration in funding scenarios is the content of any funding agreements** (*Colchester* at [76]). Factors that are likely to mean that the supply is for consideration include: (i) where there are restrictions in what the funding can be used for i.e. only the provision of the services ([77]); (ii) whilst the use of a formula is “not itself a basis for concluding that the payments are not for consideration”, where a formula is used, it is highly specific to the outputs (e.g. number of students, type of students, number of course and type of courses) that points towards the funding payments being for consideration ([78]); (iii) where the provider would have to pay back any part of the funding which was not used for supplying the courses as anticipated (i.e. clawback arrangements) ([79]); and (iv) where the funding agency is given full sight of the activities for example detailed information on how the funds are being spent in order to ensure the payments can be adjusted and that the funding agency can see how the grant has been spent ([80]).
- **The concept of “direct link” does not require a high degree of specificity.** For example, it was not determinative in *Colchester* that the funding was not specific to any particular course or courses, that it did not reflect the specific costs of any particular course, or that it did not identify the particular students who would take the course ([81] and [86]). Moreover, it does not matter that there is little precision at the point of payment about what exactly would be provided in exchange ([83]).
- **The cost of supplies is irrelevant to the question of whether a transaction is to be regarded as for consideration** (see Case C-520/14 *Gemeente Borsele v Staatssecretaris van Financiën* [2016] STC at [26]).
- **The description about the cost or funding of the supply to any recipient is “of little relevance” to the analysis of the transaction between funding agencies and the provider for VAT purposes** ([88]).
- **It is important to take a common sense approach by assessing the “wider canvass” of the nature of the services’ provision in reality.** In *Colchester*, for example, the Upper Tribunal noted ([82]) that the experience for the funded students was identical to that of non-funded students such that “to conclude that all students were in receipt of supplies by the college,

the consideration for those supplies coming from different sources, meets with common sense". Otherwise, "within the same classroom [the college] could be making business and non-business supplies".

Set-off: a sting in the tail?

The consequence of allowing the college's appeal in *Colchester* was that the supplies of education were exempt supplies of education and not supplies which fell outside the scope of VAT. No deemed output tax was ever properly due on those supplies, hence the college's claim for repayment of overpaid VAT. HMRC, however, claimed that, despite the passing of time, section 81(3A) of the Value Added Tax Act 1994 permitted them to bring into account against the college's claim all the *Lennartz* input tax which had previously been discredited to the college on the grounds of mistake. This would have the effect of extinguishing the claim.

The Upper Tribunal accepted this submission on behalf of HMRC on the basis of *Birmingham Hippodrome Theatre Trust* [2014] EWCA Civ 684. HMRC mistakenly thought that the college was entitled to input tax under the *Lennartz* mechanism which was, in turn, based on HMRC's mistaken view that the college's grant-funded supplies were not within the scope of VAT ([132] – [133]). No deemed output tax was ever due and no *Lennartz* input tax deduction could arise. Therefore, the four-year limitation period under section 80(4) of VATA 1994 was disapplied and HMRC could bring into account against the taxpayer's claim all the *Lennartz* input tax previously credited to the taxpayer. This sting in the tail means that advisers will have to carefully consider the extent to which HMRC's right to set-off input tax reduces or even extinguishes any taxpayer's repayment claim. Nevertheless *Colchester* still represents a significant victory for education – and other state funded – service providers.

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.