



TC02407

Appeal number: TC/2011/03856

VAT – consideration for supply – Article 73 Principal VAT Directive – subsidies directly linked to the price of the supply – provision of free environmental consultancy services to businesses – funding from third party – whether payments amount to consideration – yes – appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

GROUNDWORK CHESHIRE

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S Respondents
REVENUE & CUSTOMS**

**TRIBUNAL: JUDGE JONATHAN CANNAN
MR PHILIP JOLLY**

Sitting in public at Manchester on 20 September 2012

Mr Glyn Everett CTA of County VAT Consultancy for the Appellant

Mr Richard Mansell of HM Revenue & Customs for the Respondents

DECISION

Background

1. The Appellant is a non-profit making groundwork trust and the representative
5 member of a VAT group. It owns a trading company called Groundwork
Environmental Services (Cheshire) Limited (“Groundwork”). This appeal is against a
decision of HMRC that certain services which Groundwork provides to businesses do
not amount to supplies for the purposes of VAT.

2. We set out the facts in more detail below. By way of introduction Groundwork
10 provides a range of services to businesses including health and safety management
and environmental consultancy. One particular service which it offers consists of
providing advice and support to businesses to help them improve environmental and
energy efficiency.

3. The arrangement between Groundwork and its clients is that clients are not
15 required to pay Groundwork for the services it provides. Instead Groundwork receives
funding through a programme called “Enworks”. The Enworks programme is itself
funded by the North West Regional Development Agency (“NWDA”) and the
European Regional Development Fund (“ERDF”).

4. The issue on this appeal is whether the sums received by Groundwork in
20 relation to these services are third party consideration for a supply of services or what
is known as a “block grant”. The appellant contends that sums received from Enworks
amount to third party consideration. As such they are consideration for a supply of
services and within the scope of VAT. The respondents contend that the sums
received amount to a block grant and are therefore outside the scope of VAT.

5. On 25 October 2010 an HMRC officer wrote to Groundwork’s representative
25 setting out his decision that the funds received by Groundwork from Enworks was
outside the scope of VAT. HMRC considered that the funds were not third party
consideration because they were in the nature of a grant. Mr Everett asked for a
review of that decision and by letter dated 21 April 2011 the decision was confirmed.

6. We are concerned in this appeal with the point of principle described above.
30 The significance for the appellant is that if the supplies are within the scope of VAT it
will be able to recover input tax on taxable supplies which it receives. We are
concerned with the point of principle on this appeal and not with an assessment by
HMRC or a refusal of a claim to input tax claim. We were also told that this decision
35 may have significance for other groundwork trusts.

The Law

7. There was no dispute between the parties as to the relevant legal principles
which we must apply in order to determine this appeal. The real issue between the
parties involves the application of the law to the particular facts of this case.

8. Section 4(1) of the Value Added Tax Act 1994 ("VATA 1994") provides:

“VAT shall be charged on any supply of goods or services made in the United Kingdom, where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.”

5 9. Section 5(2)(a) VATA 1994 provides:

“ ‘Supply’ in this Act includes all forms of supply; but not anything done otherwise than for a consideration.”

10. There is no definition of ‘consideration’ in VATA 1994, but Article 73 Principal VAT Directive (Directive 2006/112/EC) provides:

10 *“ In respect of the supply of goods or services, other than as referred to in Articles 74 to 77, 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.”*

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11. The ultimate question on this appeal is whether the payments received by Groundwork from Enworks are *“subsidies directly linked to the price of the supply”*. We were referred to various authorities as to the principles that are relevant to the application of this test.

20 12. In *Office des produits wallons ASBL v Belgium [2003] STC 1100* (“Wallons”) the ECJ considered the equivalent provision to article 73 in the 6th Directive. The case concerned a non-profit making association which advertised and sold agricultural and horticultural products from a particular region in Belgium and received a subsidy from that region. The ECJ noted at [11] that operating subsidies which cover a part of running costs *“nearly always affect the cost price of the goods and services supplied by the subsidised body”*. The ECJ then set out the following approach to be adopted in determining the issue:

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30 *“12. However, the mere fact that a subsidy may affect the price of the goods or services supplied by the subsidised body is not enough to make that subsidy taxable. For the subsidy to be directly linked to the price of such supplies, within the meaning of Article 11A of the Sixth Directive, it is also necessary, as the Commission has rightly pointed out, that it be paid specifically to the subsidised body to enable it to provide particular goods or services. Only in that case can the subsidy be regarded as consideration for the supply of goods or services, and therefore be taxable.”*

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40 *13. In order to establish whether the subsidy constitutes such consideration, it should be noted that the price of the goods or services must, in principle, be determined not later than the time of the triggering event. It should also be noted that the undertaking to pay the subsidy made by the person who grants it has as its corollary the right of the*

beneficiary to receive it, since a taxable supply has been made by the latter. That link between the subsidy and the price must appear unequivocally following a case by case analysis of the circumstances underlying the payment of that consideration. On the other hand, it is not necessary for the price of the goods or services - or a part of the price - to be ascertained. It is sufficient for it to be ascertainable.

14. It is therefore for the referring court to establish the existence of a direct link between the subsidy and the goods or services at issue. That makes it necessary to verify at an early stage that the purchasers of the goods or services benefit from the subsidy granted to the beneficiary. The price payable by the purchaser must be fixed in such a way that it diminishes in proportion to the subsidy granted to the seller or supplier of the goods or services, which therefore constitutes an element in determining the price demanded by the latter. The court must examine, objectively, whether the fact that a subsidy is paid to the seller or supplier allows the latter to sell the goods or supply the services at a price lower than he would have to demand in the absence of subsidy.

15. In the main proceedings and in view of the fact that, according to the framework agreement, OPW carries out a number of activities, the referring court must verify whether each activity gives rise to a specific and identifiable payment or whether the subsidy is paid globally in order to cover the whole of OPW's running costs. In any event, it is only the part of the subsidy identifiable as being the consideration for a taxable supply that may, in appropriate cases, be subject to VAT.

16. ...

17. Moreover, in order to determine whether the consideration represented by the subsidy is identifiable, the national court may either compare the price at which the goods are sold in relation to their normal cost price, or examine whether the amount of the subsidy has been reduced once those goods are no longer produced. If the factors examined are significant, it must be concluded that the part of the subsidy allocated to the production and sale of the goods in question constitutes a subsidy directly linked to the price. In that regard, it is not necessary for the subsidy to correspond exactly to the diminution in the price of the goods supplied, it being sufficient if the relationship between the diminution in price and the subsidy, which may be at a flat rate, is significant.”

13. We take the reference to a “triggering event” at [13] to be the date of payment of the subsidy. In other words, it refers to the event which triggers the issue and the price of the goods or services must be determined or determinable at that time. Having said that, there is no timing issue on the facts of this appeal and it is not necessary for us to explore this matter further.

14. We were referred to a number of cases in which the principles described in *Wallons* have been applied. These included a decision of the ECJ in *Keeping Newcastle Warm Ltd v Commissioners of Customs & Excise Case C-353/00* and a recent decision of the First-tier Tribunal in *Hope in the Community Limited [2012] UKFTT 498 (TC)*. These cases do not really add anything to the approach set out in *Wallons*. It is however worth noting that the ECJ has on a number of occasions stressed the importance of a direct link between the consideration and the service provided. We were referred to the following cases by way of example: *Staatsecretaris Van Financien v Co-operatieve Aardappelenbewaarplaats GA Case C-154/80 at [12]*, *Staatsecretaris Van Financien v Hong Kong Trade Development Council Case C-89/81 at [10]*, *Apple and Pear Development Council v Customs & Excise Commissioners Case Case C-102/86 at [12] and [13]*, and *Tolsma v Inspecteur der Omzetbelasting Leeuwarden Case C-16/93 at [13]*.

15. We were also referred to the HMRC manual at V1-3 and 1-6 which considers the question of supply and consideration for VAT purposes. The manual does not have the force of law and whilst it includes a useful background discussion in relation to groundwork trusts generally it is not necessary for us to refer to it for the purposes of this decision.

20 *Findings of Fact*

16. We received evidence in the form of a witness statement from Mr Michael Benson, a partner in the appellant's accountants, Murray Smith LLP. His evidence was not disputed. We heard oral evidence from Mr Greville Kelly who is a director of Groundwork. He had produced a witness statement and was cross-examined. We were also provided with a statement of agreed facts which we have incorporated into the following findings of fact in so far as it is relevant.

17. Enworks is a partnership between a number of organisations. It was established in 2001 and one of its purposes is to co-ordinate environmental advice, training and support to businesses throughout the North West of England. It works with local organisations including groundwork trusts. Groundwork trusts were set up as a result of government policy towards promoting urban and post industrial renewal. Enworks' is supported by NWDA and ERDF.

18. Groundwork markets an Enworks programme which offers an "Environmental Action Plan" to businesses in Cheshire. The programme is aimed at identifying the cost and resource savings businesses can achieve through increased resource efficiency. It is marketed as being supported by Enworks, amongst others, and is expressed to be "*available FREE of charge*".

19. On 17 November 2008 Enworks wrote to Groundwork setting out a "Service Level Agreement" for the period October 2008 to March 2010. The document was also on its face described as a "Grant Offer Letter". This was an extension to a previous agreement. The letter stated:

“The offer consists of a maximum grant of £769,419 (‘the Grant’) towards the eligible costs of the Project.

The grant is made up of the following:

5

North West Regional Development Agency (NWDA) £ 502,224
Single Programme

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European Regional Development Fund (ERDF) £ 267,195”

15 20. The grant was expressly subject to Groundwork delivering the project, ie the Enworks programme, in line with its business plan, achieving various targets and complying with various other conditions. Those conditions included:

- (1) Groundwork has to submit monthly claims,
(2) claims must be submitted on an appropriate claim form,
(3) claims must be accompanied by an invoice containing a detailed breakdown of grant being claimed from the two funding streams, namely
20 NWDA and ERDF,
(4) all project claims must be based on actual expenditure and not budgeted figures,
(5) all activity, expenditure, income, outputs and outcomes reported must be supported by adequate auditable evidence and made available to Enworks on
25 request.
(6) all businesses receiving support from the Enworks programme must be informed in writing, at least on an annual basis, of the value of the support they have received in order that they can make informed declarations on the receipt of state aid.
30 (7) documentation must be retained to demonstrate the causal link between funding and outputs/outcomes.

35 21. By letter dated 14 April 2010 Enworks offered Groundwork a further service level agreement and grant offer for the period 1 April 2010 to 31 March 2013. It was subject to similar terms as the previous offer. The “*maximum grant*” for the period was £1,190,158.

22. We have been asked on the grounds of confidentiality not to identify the specific clients of Groundwork in this decision. In fact there is no real reason for us to identify specific clients.

40 23. When Groundwork receives an enquiry from a potential client a consultant will identify the scope of support that can be provided. The aim is to spend the bulk of the grant monies where the best return can be achieved in terms of resource efficiency and energy savings. Tier 3 clients as they are called are generally smaller business,

and receive a basic level of generic advice. Support is based on a telephone interview. Time spent by consultants is recorded against that client's name and the grant will be drawn down as set out below.

24. Tier 2 clients are offered an initial resource efficiency audit. A consultant will visit the business spending between 1 and 4 hours identifying the scope of any opportunities. They receive an audit report describing those opportunities. Certain businesses are identified as justifying longer term support and a more bespoke service.

25. Whatever the level of service provided, Groundwork records the time spent by each member of staff with each client and any disbursements. Members of staff are required to complete project-coded time sheets. Groundwork also records outputs and outcomes achieved through delivery of the service. Outputs and outcomes include for example the number of businesses assisted to improve performance, jobs created, sales increased and CO₂ reductions. The causal link between funding and outputs/outcomes is documented.

26. Following a client visit and audit, Groundwork produce a report for the client. The report identifies and discusses recommended actions together with the potential savings including resource and energy savings as well as cost savings associated with each action. Further advice and support may be available to the business, although this does not extend to support for capital expenditure.

27. The various costs incurred by Groundwork are claimed from Enworks. There are agreed methods in place for the recovery of costs. For example, staff costs are recovered by reference to productive hours recorded on time sheets and an appropriate charge out rate according to the particular member of staff. Staff members do not spend all of their time on the Enworks programme and Groundwork offers other areas of consultancy services. Office rental costs are recovered by reference to a space/time apportionment method. NWDA and ERDF have different rules as to what costs can be recovered via the Enworks programme.

28. A detailed "Monthly Progress Report and Grant Claim" is submitted by Groundwork to Enworks. The front summary page splits the claim between NWDA funding and ERDF funding. Apart from having different rules as to cost recovery, the two funders have different rules as to the businesses which can be funded. For example ERDF will only fund small and medium sized enterprises under the Enworks programme whereas NWDA will also fund larger businesses. There are no circumstances in which Groundwork will work for clients who do not qualify for funding.

29. Each client is provided with an annual statement indicating the value of the support it has received from Groundwork. By way of example such statements are in the following terms:

40 *"In the last 12 months Groundwork Cheshire has provided your company with support to improve its resource efficiency or standards of corporate*

responsibility. This work was funded by the European Regional Development Fund and the Northwest Regional Development Agency.

... The level of support for your business for the past year (2010) is as follows:

5 £ 10,195.93

... If you wish to access further support please contact your adviser ... ”

30. The information used to produce these statements is derived from a database. All time spent and support given is recorded against the client’s name. This mainly comprises time spent by consultants employed by Groundwork but can also include
10 sums spent on obtaining third party consultancy services on behalf of the client. The figure for support given to an individual business does not include any apportionment of overheads. Overheads are not apportioned to particular businesses. However the overheads recovered in any particular month are those directly attributable to the work done for businesses pursuant to the Enworks programme in that month.

15 31. The business plan produced by Groundwork as a condition of the grant offer includes details of employees of Groundwork who will be working on the Enworks funded programme. Employees are categorised between direct delivery staff, direct support staff and indirect support staff. Direct delivery staff includes the consultants who deliver advice to clients. Direct support staff includes administrators who co-
20 ordinate and market the Enworks programme. Indirect support staff includes general office managers and assistants.

32. The business plan also shows the anticipated amount of time each member of staff will spend on the Enworks programme, split between NWDA funded activity and ERDF/NWDA co-funded activity. The reason for identifying the source of
25 funding is because ERDF has certain restrictions on what it will fund which do not apply to NWDA. Time spent by certain indirect support staff such as finance and office staff, is not recoverable via ERDF funding. The cost of senior management is not recoverable at all under the Enworks programme.

33. Mr Kelly described the grant funding from Enworks as being subject to “*a
30 fundamental principle that the grant money can only be claimed retrospectively, for costs, which it can be demonstrated were incurred in delivery of specific activities within the Enworks contract*”. We accept that is a fair description of the circumstances. He also said that “*... funding is only payable for specific work undertaken*”. That is part of the issue we have to determine and which we consider in
35 our decision below.

Summary of the Parties’ Submissions

34. The grounds of appeal succinctly summarise the issue, asserting that the payments received from Enworks are properly to be treated as third party consideration on the basis of the ECJ decision in *Wallons*.

35. Mr Everett on behalf of the appellant essentially submitted that the payments received from Enworks are a subsidy for the work done by Groundwork on behalf of clients. The subsidy is directly linked to the price of the supply. It covers the whole of the price but no more. The fact that it is payable by reference to a single maximum amount does not cause the sums paid to be a global grant. He accepted that the fact that certain overheads are recovered from Enworks but not apportioned to clients does at least support the respondents' case but it was not determinative of the issue. His principal submission was that the grant is not a fixed sum. If the services were not delivered to specific businesses then Enworks would not make any grant payment to Groundwork.

36. Mr Mansell on behalf of the respondents submitted that the necessary direct link between the service and the grant funding was not present on the facts of the case. He noted that Enworks cannot identify from the claim forms what proportion of each monthly payment relates to which business. The absence of any allocation of overheads indicates that there is no direct link between the payment and the service. The condition of funding requiring Groundwork to retain auditable evidence and documentation demonstrating a causal link between funding and outputs/outcomes is simply a matter of good housekeeping and financial control. In reality Groundwork is claiming all its costs incurred in relation to the programme from Enworks.

Decision

37. Both parties agreed that the approach we should take in considering the facts of the present case is to be derived from *Wallons*. We must consider whether the payments received by Groundwork from Enworks are directly linked to the price of the services provided. This involves consideration of the following matters:

- (1) Do the payments from Enworks affect the price charged by Groundwork to its clients?
- (2) If so, are payments made to Groundwork specifically for it to provide particular services to its clients?
- (3) The link between the subsidy and the price must appear unequivocally from the circumstances in which the payment is made.
- (4) It is not necessary for the price of the services provided to be ascertained, it is sufficient that it should be ascertainable.
- (5) The price payable by the client must be fixed in such a way that it diminishes in proportion to the payment made by Enworks, such that the payment made by Enworks constitutes an element of the price charged by Groundwork to its clients.
- (6) We must consider whether each activity carried out by Groundwork gives rise to a specific and identifiable payment, or whether the payment is made globally to cover the whole of Groundwork's running costs.

(7) It is not necessary that the payment from Enworks corresponds exactly to the reduction in price to Groundwork's client. It is sufficient that the relationship between the two is significant. A flat rate subsidy may be significant.

5 38. It was not suggested to us that the principles to be applied are any different where there is a partial subsidy reducing the price paid by the customer, or where as here the subsidy effectively reduces the price paid by the client to nil. In the latter case no part of the price is charged to the client. It seems to us that the question remains whether the subsidy is directly linked to what would otherwise have been the price charged to the client for the supply.
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39. It is clear to us that the payments from Enworks to Groundwork do affect the price charged by Groundwork to its clients. They enable the service to be provided free of charge. As *Wallons* makes clear, subsidies will nearly always affect the cost price of goods or services supplied by a subsidised body.

15 40. It is also clear that payments made by Enworks to Groundwork are made specifically for Groundwork to provide particular services to its clients within the Enworks programme. The fact that Enworks does not know at the time the service is provided the identity of the client or the specific service within the Enworks programme which is being provided is not relevant.

20 41. In the light of our findings of fact set out above we are satisfied that the link between the subsidy and the price appears unequivocally from the circumstances in which the payment was made. In particular the grant is by reference to a maximum amount of funding and the funding is calculated each month by reference to specific services provided to specific businesses.

25 42. The fact that not all overheads are allocated to particular businesses is relevant to the existence of a direct link. However everything else points towards a direct link and overall we are satisfied that there is a direct link. Indeed we consider the fact that not all overheads are allocated to particular businesses simply indicates that the price of the services to those businesses has not been fully ascertained. However it is ascertainable because there is no reason in principle why the overheads incurred each month could not be allocated.
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43. No price is payable by clients to Groundwork. It is therefore artificial to consider whether the price is fixed in such a way that it diminishes in proportion to the payment made by Enworks, or that the subsidy constitutes an element of the price charged to clients. Looked at overall the price that would be payable by clients is clearly related to the payment made by Enworks. It is that payment which enables Groundwork to provide a free service. For the same reason the payment made by Enworks can be said to constitute an element of the price that would be charged by Groundwork to its clients.
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40 44. We consider that each activity carried out by Groundwork gives rise to a specific and identifiable payment. Work done for a client pursuant to the Enworks programme can be traced directly to a monthly payment made by Enworks. The more

work done for clients, the greater that payment will be. The relationship between the work done and the payment made is clearly identifiable. Again, whilst overheads which are recovered from Enworks are not allocated to clients, they could easily be allocated. As such the payment made in relation to each client is identifiable. The relationship between the payment from Enworks and the provision of a free service to clients is significant. The payment is not made globally to cover the whole of Groundwork's running costs.

45. On the basis of the above analysis we consider that that there is a direct link between the services provided to clients and the funding received from Enworks. The payments from Enworks amount to consideration for the services supplied to clients. For all the reasons given above we allow the appeal.

46. There was some discussion during the course of Mr Kelly's evidence as to how in practical terms, if the supplies to clients are within the scope of VAT, Groundwork would charge VAT to clients when what was offered was a free service. That is beyond the scope of the issue we have to decide and we say no more about it.

47. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 6 December 2012

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