TC03746

Appeal number: TC/2013/01519

VAT – Cost - saving group exemption – whether exact reimbursement of share of joint expenses – No – Article 132, Council Directive 2006/112/EC and Section 31, Schedule 9 (Group 16) VATA 1994 – Appeal refused.

FIRST-TIER TRIBUNAL
TAX CHAMBER

WEST OF SCOTLAND COLLEGES PARTNERSHIP **Appellant**

- and -

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

TRIBUNAL: JUDGE KENNETH MURE, QC
MR R L H CRAWFORD, BA, CA, CTA

Sitting in public at George House, Edinburgh on 20 and 21 May 2014

Mr W Saunders, Central VAT Consultants Ltd, for the Appellant

Mrs A Delibegovic-Broome, Advocate, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Preliminary

1. This is an appeal in respect of a repayment claim by the Appellant, the West of Scotland Colleges Partnership ("WOSCOP"), for VAT of £102,216.77 for the period from January 2008 to December 2011. The Appellant claims that this was incorrectly charged in respect of services rendered by it to the colleges of further and higher education which formed it. The work of the Appellant is accessing grant-funding from the EU and other sources. Rather than the individual colleges each providing this service internally (which would not represent a taxable supply) it is more practicable and economic that one external entity should provide this to members of the group. The Appellant, which is a company limited by guarantee, was set up for that purpose.

2. This service becomes VAT exempt if the criteria set out in Schedule 9, Group 16 VATA 1994 are met. In particular did each member make "exact reimbursement of [its] share of the joint expenses", and was there any likelihood of this causing "distortion of competition"? Both of these criteria were challenged by HMRC, but substantially the argument focussed on the former.

The Law

3. The Joint List of Authorities is set out as an appendix hereto. The provisions of Schedule 9, Group 16 VATA reflect the terms of Article 132 of Council Directive 2006/112/EC.

The evidence

4. The Appellant led two witnesses. Firstly **Mr Ian Graham**, who was Chairman of the Appellant's board from 1996 to 2000, and then at greater length Mrs Morag Keith, its current Chief Executive and who has been involved in its management since 2000.

5. Mr Graham explained that in the course of his career in educational administration, he had been involved in college funding. This had been affected by local government reorganisation, and in the west of Scotland particularly by the demise of Strathclyde Region in 1996. At that stage it became necessary for the various colleges, twenty two in number, to provide for themselves the service and expertise which Strathclyde Region had previously given in seeking sources of funds. There was a limited number of persons with the necessary expertise to render this service. The natural solution was for WOSCOP to be established as the colleges' collective representative in seeking funding from local and national government and from the EU. Those employees of Strathclyde Region engaged in this work transferred to WOSCOP.

6. Mr Graham explained that the revenue budget was divided by 22, the number of colleges involved. A reserve fund of about £152,000 was established, having been funded substantially by sums paid in reimbursement of pension liabilities for staff taken over by WOSCOP. With the end of Strathclyde Region the colleges had to adapt to a new funding "landscape". In addition support services for European audits were required. Budgets and finances generally were discussed at WOSCOP's AGMs. The principals of the various colleges served on its Board. WOSCOP would provide

additional support for its college members not simply in relation to funding matters but also in seeking replacement of key staff members.

7. Mr Graham confirmed and adopted the terms of his Witness Statement (Doc 3). On page 2 thereof it may be noted that each member was to pay an equal share of operational costs. However, this bears to be qualified in the conclusion where it is recorded that costs were to be shared on a "true and fair apportionment" of the benefits accruing and that with the members' agreement. Additional support would be charged individually. (It may be noted that the assessment under appeal relates to shared not individual services.)

8. Mr Graham was not cross-examined by Counsel for HMRC.

9. Next, **Mrs Morag Keith** gave evidence. She is presently Chief Executive of WOSCOP. She explained (in cross-examination) that she has a BA in Accounting and a Master's degree in European Funding. She has worked as an accountant in the private sector and latterly in the public sector as a finance officer in various educational colleges. She has specialised experience in European financial projects.

10. Mrs Keith explained that financial matters were subject to regular review by the Board. At the AGM these were reviewed and proposed budgets and contributions by members considered. The core service provided by the Appellant was the strategic overview of funding for the sector. The receipt of European funds depends on having the competence to manage these successfully.

11. She confirmed that the service provided by WOSCOP would have been too expensive for the colleges to provide individually. WOSCOP had benefited from acquiring staff with an historical legacy of knowledge. It did not engage in commercial contracts: its work was confined to benefitting its members.

12. Mrs Keith then addressed the financing of WOSCOP. It relied on its members to pay costs. Contributions were made equally. Its costs were reviewed at Board meetings and at the AGM. If a member left WOSCOP she would check on what was its fair share of costs. Reserves would be reviewed annually and costs would be determined when its budget was fixed. Reserves had to cover the potential costs of winding-up. There were delays in obtaining official funding. Two contracts relating to adult education (the "Grundvig" contracts) had complicated the management of the reserves. Mrs Keith explained that new members contributed only to those costs arising from when they became members. Liabilities, she claimed, were shared fairly by old and new members.

13. Mrs Keith approved and adopted the terms of her Witness Statement (Doc 4). It may be noted that at page 3 (para 1) that she claims that members' shares of costs directly corresponded with the benefits received. Most services were generic, however, of a representative nature, benefitting each member equally, she asserts.

14. In cross-examination Mrs Keith insisted that in the relevant period, viz 2008 to 2011, the VAT reclaim was in respect of "core" services, being of value to all the colleges. Where the Appellant provided individual services, eg one college seeking staff replacement, that would be paid for by the individual college. Most services provided, she explained, were "generic". While a service might have been sought by a particular college, and pursued on its behalf, the process would be likely to yield

benefit for the others by in particular providing an information base for general reference. Thus, she argued, the cost would be shared.

15. Mrs Keith was pressed by Counsel for HMRC about the lack of documentary records and the need for an "audit trail" noted in paras 30 and 46 of HMRC's guidance (Doc 19) in respect of such services. Mrs Keith insisted that such single services were of benefit to all the members.

16. Mrs Keith accepted that no invoices in respect of the Appellant's services had been produced. She was then invited to comment on certain of the productions. Counsel for HMRC noted paras c and i on page 3 of Mr Saunders' letter of 14 November 2012 (Doc 13). Mrs Keith explained that excess income earned would be used to avoid further requests for payment by the members. Where a member left, then its costs and its share in reserves would be taken into account. The reserves, Mrs Keith explained, were at a level sufficient to fund the winding-up of the company. In the documentation appended to Mr Saunders' letter of 29 October 2013 to the OAG (Doc 24), Counsel queried the final paragraph of the section entitled "16 Budget Setting for 2011/12" that reserves set aside for one purpose had been diverted to cover losses of three departing colleges. Mrs Keith acknowledged that the reserves had been used to avoid seeking extra sums from the members.

17. In terms of the Memorandum of the Appellant Mrs Keith acknowledged that para 4 precluded income and profit passing to its members. She accepted too the terms of the last paragraph on page 4 of Mr Saunders letter (Doc 13) that exact reimbursement of costs was not shown satisfactorily in the annual accounts. Mrs Keith accepted that an accounting exercise to show this had not been undertaken, although costs and value had been considered. This was in the context of pages 1 and 2 of Mr Saunders' letter of 29 October 2013 (Doc 24).

18. Towards the end of cross-examination Mrs Keith stated that as far as members were concerned, they received the same service. The members told her how to share costs. (These remarks were confirmed in these terms in response to the Tribunal's questioning.)

19. Mrs Keith was not re-examined. However, in the course of Submissions the Tribunal considered that some further limited evidence should be taken from her in relation to Doc 36, which sets out member colleges' subscriptions over an extended period. In her replies to the Tribunal Mrs Keith explained that in the initial Year subscriptions were equal. In the next year an increase was tapered in relation to the size of the particular college. She explained that the subscription from the City of Glasgow College had increased substantially when it amalgamated with other member colleges.

20. Mrs Keith agreed that costs of providing particular courses varied and that these were "weighted" appropriately. However, so far as WOSCOP's service was concerned, she considered that there was no correlation between that and the amount of funding obtained. (This was in the context of possible relative values being derived by individual colleges from funding exercises.) Further, she insisted that it was impractical to apportion time to particular aspects of work. Work for one college, she believed, would always be for the benefit of other colleges additionally.

21. The Tribunal then asked her to comment on para 47 of HMRC's Guidance (Doc 19) and the requirement of "exact reimbursement". She responded that the company's accounts were its "audit trail". While it was a cost-sharing service, revenue had to cover costs. There had been an exception in relation to two high education contracts (the Gruntvig contracts). Budgets had to be fixed to meet cash-flow requirements and other financial responsibilities.

22. In further cross-examination by Counsel for HMRC Mrs Keith acknowledged that in 2008/09 a flat-rate return of £2,000 had been made to each of the colleges without any differentiation. Counsel invited Mrs Keith to comment also on why, if Kilmarnock College had rejoined WOSCOP in 2009 (page 5 of Doc 24) it had not apparently been charged a subscription in 2009/10.

23. Much of the evidence of Mr Graham and Mrs Keith was matter-of-fact and unchallenged. The controversy which emerged from it was the basis for and extent of the colleges' agreement as to the sharing of expenditure. WOSCOP was not a commercial concern, serving independent third parties. Where one member college instructed a particular task for its own needs, it bore all the relative expenditure. The VAT assessment, however, is in respect of generic services, ie where the service is prompted by the needs of one member but arguably a shared benefit accrues for all or other members indirectly. The extent and nature of any agreement in respect of generic services is addressed in the concluding section of the Decision.

Submissions

24. On behalf of the Appellant Mr Saunders submitted that the necessary conditions in terms of Schedule 9 (Group 16) VATA for a cost-sharing group had been satisfied. The dispute related to the recovery of VAT only where the activities were for the benefit of all members. The challenge was, of course, in relation to only two aspects, viz whether there had been *exact reimbursement* by members of their shares of joint expenditure, and whether competition was affected. There was no UK tax law on the subject but Mr Saunders noted para 8 of HMRC's Guidance (Doc 19), which included Education Institutions.

25. WOSCOP, Mr Saunders continued, qualified as a cost sharing group. HMRC were enforcing the rules too rigidly, he complained. They sought detailed records. These were unnecessary, as WOSCOP's activities benefitted all its members. It provided the same service for each member. Time spent on one member's remit always benefitted all members. There was no direct correlation between costs and benefits. The Board of WOSCOP, Mr Saunders insisted, was conscious of both costs and benefits. It consulted its members about the proportion of benefits enjoyed.

26. Mr Graham, in his evidence as Mr Saunders has noted, indicated that members had to be satisfied that they were paying only their own shares of costs incurred. Mrs Keith had said that all services were for the joint benefit of all members, he continued. She confirmed, he said, that members were consulted about their contributions representing their shares of expenditure incurred. WOSCOP was a "not for profit" body. There were no mark-ups or margins yielded from its activities.

27. A cost accounting approach was necessary only where different services were provided, Mr Saunders stated. Here, by contrast, all services benefitted all members.

28. Mr Saunders then considered the reserve fund. It should not be included in the test of reimbursement. It became the property of all members. All assets were for the joint and equal benefit of the members. He also noted the matter of profits. WOSCOP's other activities were not commercial activities. These were split equally between members.

29. Finally, Mr Saunders submitted that there was no distortion of capital arising from the Appellant's activities. It did not compete in a market. It had no competitors, he said. Accordingly Mr Saunders invited us to allow the appeal.

30. In reply Counsel for HMRC submitted that one issue emerged from the evidence viz were all services made equally to all members? While certain services were for individual members, these were charged separately and were not the subject of the assessment under appeal. Exact reimbursement was crucial. She stressed three main points, viz the Appellant had failed to provide relevant evidence in support of its assertion that it charges its members on the basis of exact reimbursement of their share of expenses, and its accounting methods were inadequate; the matter of cross-funding arose; and there were other services from which the Appellant made profit. This shaded into questions of transparency and the possible distorted effect on competition.

31. Counsel then referred to the statutory provisions contained in VATA 1994, Schedule 9 (Group 16). These reflected the terms of Article 132 of Council Directive 2006/112/EC. She founded particularly on the Opinion of AG Sharpston in *Stichting Centraal* which stressed the stringency of the test of *exact reimbursement*. In para 18 of her Opinion the use of sophisticated cost accounting methods was recommended and approved (para 18). However, the exemptions should not be so interpreted that their terms became almost inapplicable in practice. The interpretation had to be "tempered according to the nature of the exemption concerned" (paras 13 and 14).

32. Counsel complained that there was inadequate information before the Tribunal about services which cross-subsidised the members. This was relevant to questions of competition. Further, in the Schedule which set out members subscriptions at doc 36, there was a variation in contributions which had not been satisfactorily explained. (Hence, the Tribunal's decision to recall Mrs Keith.)

33. Essentially, in Counsel's view, the Appellant's case seemed to be that the member colleges "had agreed". That, she submitted, was inadequate to meet the interpretation of the strict rule applicable. *Exact reimbursement* must be given effect to.

34. Realistically, Counsel continued, there had to be "a clear audit trail" as suggested in HMRC's Guidance (Doc 19). No invoices had been produced. No documentation had been produced to explain the nature of the services provided to individual colleges. There were no examples of proposals put to the Board for consideration of the benefits to all the member colleges produced.

35. When members left, *exact reimbursement* had not been applied. A full reconciliation would be required to satisfy this test. Even if the members considered the arrangements fair, that fell short of *exact reimbursement*. It was reasonable to seek adequate information to support the Appellant's contentions.

36. We were referred to para 4 of the Memorandum of Association (appended to Doc 24) which precluded the payment or transfer of the income and property of the Appellant to its members. Counsel suggested that it might not have been properly considered in relation to the cross-financing of activities.

37. There remained the matter of whether the grant of the exemption would distort competition. There was a dearth of information here, she submitted. However, if it could be established that there had been *exact reimbursement* then the matter of "distortion of competition" probably did not arise (see para 51 of the Guidance at Doc 19).

38. The level of service and reimbursement had not been adequately established on the evidence, only asserted. The statutory wording required exact reimbursement. If the Appellant's arguments failed to meet that test, there was no need to consider the matter of distortion of competition.

39. For these reasons Counsel for HMRC invited us to refuse the appeal.

40. In his concluding reply Mr Saunders stressed that HMRC's Guidance encouraged a degree of flexibility. Such an approach should be adopted in the present case, he urged. Surpluses were kept for contingencies rather than distributed. There had been full disclosure of information on behalf of WOSCOP in the exchange of correspondence with HMRC. Where staff replacements were sought, this was billed to the particular college. There was no profit or cross-subsidy resulting. Article 4 of the Memorandum had not been contravened. There had been no distributions of profits. Rather, costs had been reduced.

41. Finally, competition considerations did not arise in Mr Saunders' view. WOSCOP did not operate in any market. Granting the exemption in the present case simply enabled the services to be VAT free just as if provided "in house".

Decision

42. We consider that the test which the Appellant requires to meet is a high one. *Exact reimbursement* denotes a measure of precision. The word *exact* obviously has to be given its meaning. The term appears both in Article 132 and the UK legislation. There is possibly a greater emphasis in Article 132(f) where it is stated that the cost-saving groups "… merely claim from their members exact reimbursement". "Merely" bears to add to the stringency of the test in our view. Useful guidance is given by the Advocate General in *Stichting Centraal*. Clearly some precision is required, with some effort at distinguishing the individual interests of the members of the cost-saving group (para 18). However, she (the A-G) "tempers" that interpretation earlier in paras 13, 14 and 17. The nature of the exemption and its practical application have to be considered and allowed for. She warns against an interpretation which "… would place an unwarranted and artificial restriction on the scope of the exemption".

43. We note also the Guidance issued by HMRC in VAT Information Sheet 07/12 (Doc 19). Para 46 emphasises the need for a "clear audit trail". Para 47 indicates that HMRC considers that the *exact reimbursement* rule may be met over a reasonable period of time, to be assessed according to the nature and context of the supplies being made. That might suggest that the test can be applied over a period extending beyond one year.

44. Notwithstanding, we consider having regard to the circumstances of this case that at least some effort or attempt has to be made to differentiate the interests of and benefits accruing to each of the members in assessing their shares of the joint expenses. Each of the Colleges is of a different size and offering a different variety of courses. Account, however, may be taken of fluctuating needs and benefits over an extended period (para 47 *supra*).

45. This complicates the assessment of the evidence. Quality and reliability are in issue, especially so since no written records supporting an exact or even an approximate calculation of *exact reimbursement* have been produced.

46. All this accentuates the evidential difficulty confronting the Appellant. The burden of proof rests, of course, on it and here to meet a high test. As Counsel for HMRC stressed, there is only limited documentary evidence available. This raises doubts in our view as to whether there were even detailed deliberations, far less a considered agreement as to the apportionment of expenditure. The oral evidence falls short of this: it tends to support simply some agreement as to sharing expenditure, perhaps reflecting largely a degree of goodwill. The evidence does not seem even to support an awareness at the material time of the true nature of the test.

47. Having regard to the schedule setting out the subscriptions for 1996/97 to 2008/09 (Doc 36) there was initially an annual charge levied equally. The "reserve" was held for equal benefit too. There was some variation subsequently. It was explained by Mrs Keith that an increment was sought at three levels depending on the size of the college. We note that the City of Glasgow College paid substantially more from 2011/12: that was because it represented then an amalgamation of several colleges. In cross-examination Mrs Keith acknowledged that the *exact reimbursement* of costs was not shown satisfactorily in the annual accounts (she was referred to Doc 13, the letter of Mr Saunders dated 14 November 2012, at page 4, final paragraph) and that an accounting exercise to show this had not been undertaken. In her evidence (as confirmed) she stated that the member colleges received the "same" service, and that the members "told her how to share costs". This in our view falls short of what the legislation requires. While she considered that work for one college would be for the benefit of others, this had not been quantified even on an approximate basis. Further, in 2008/09 when £2,000 had been returned to each college, no question as to a need to vary the repayment had arisen. Also, there is no explanation as to why Kilmarnock College did not contribute that Year although it had re-joined the Group.

48. Taking the evidence of Mrs Keith and Mr Graham at its highest, we consider that it falls short of satisfying the test of *exact reimbursement.* In respects their evidence is somewhat contradictory too. It confirms certainly an agreement, but on the face of it no more than a compromise without due regard being paid to the benefits accruing individually to each College.

49. For these reasons we dismiss the Appeal and confirm the assessment.

50. 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.

KENNETH MURE, QC
TRIBUNAL JUDGE

RELEASE DATE: 18 July 2014

Amended pursuant to Rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules on 27 September 2011.

APPENDIX

Legal Authorities

1. Council Directive 2006/112/EC, Preamble and Article 132
2. Value Added Tax Act 1994, section 31, Schedule 9(Group 16)
3. *Stichting Centraal v Staatssecretaris* [2009] STC 869
4. *Stichting Uitvoering Financiele Acties vStaatssecretaris van Financien* [1991] 2 CMLR429
5. Tolley's VAT Cases 2014, paras 13.2,22.305 -22.307,33.72
6. British Tax Guide: Value Added Tax 2013 -2014, para 14-900
7. Tolley's Practical VAT Service, para 20.5