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COMPOSITE SUPPLIES AFTER *FDR*

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Suppose a business would make both exempt and non-exempt supplies if its various activities were considered separately. The business would make a composite supply if its activities form a single supply that has its own tax treatment regardless of what the tax treatment of each activity would be if considered on its own. In contrast, the business would make multiple supplies of exempt and non-exempt supplies if its activities do not form a single supply. Taxpayers can therefore use the concept of composite supplies to their advantage by arguing that a collection of exempt and non-exempt supplies form a single exempt supply. Similarly, a taxpayer might argue that a collection of zero-rated and non-rated supplies forms a single zero-rated supply. The test for a composite supply was laid down by the Court of Justice in *Card Protection Plan Ltd v Customs and Excise Commissioners*:[2]

> "There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal services. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied."

The Court of Justice is envisaging a composite supply in which one element is ancillary or subordinate to a principal element. In *Customs and Excise Commissioners v FDR Ltd*[3] the Court of Appeal considered the meaning of 'transfer' in Article 13B(d)(3) of the Sixth Directive and invented another type of composite supply. This article highlights what extra arguments this development gives the taxpayer but argues that the Court of Appeal has extended the law too far.

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2 Case C-349/96 [1999] STC 270 at 293 para. 30.

3 [2000] STC 672.

FDR

FDR provided credit card services to banks. The legal structure behind a credit card transaction is as follows. Credit cards are issued to the public by banks called Issuer banks. A shop which agrees to accept credit cards has a contract with an Acquirer bank under which the Acquirer agrees to pay the shop for any goods bought by the cardholder. Acquirer banks have contracts with Issuer banks under which the Acquirer recovers the price of the goods from the Issuer. The Issuer bank then recovers the price of the goods from the cardholder. FDR provides credit card services to both Issuer and Acquirer banks. When goods are bought by a cardholder the shop notifies FDR which debits the Acquirer's account and credits the shop's account. Sometimes Issuers have claims against Acquirers. At the end of each day, FDR calculates the net position of each Issuer and Acquirer. FDR pays net claimant banks from its own funds and receives a corresponding payment from net debtor bank. FDR then debits the cardholder's account. FDR effects the credits and debits electronically.

The Commissioners assessed FDR on the basis that the credit card services it supplied were taxable at the standard rate. FDR argued that its supplies of credit card services were exempt under Article 13B(d)(3) which provides for the exemption of:

> "transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection and factoring"

In particular, FDR argued that it principally provided the exempt service of processing credit card transactions and settling the claims of the Issuers and Acquirers. The Commissioners argued that FDR provided the principal supply of book-keeping to which settling the claims of the Issuers and Acquirers was ancillary. Consequently, there were two questions for the Court of Appeal. First, did FDR make any exempt transfers within Article 13B(d)(3)? If not, the Commissioners' appeal must succeed because there cannot be a principal exempt supply if none of FDR's activities are exempt supplies. Second, what is the principal supply made by FDR?

Did FDR Make Exempt Transfers Within Article 13B(d)(3)?

The only reasoned judgment was given by Laws LJ. His Lordship answered the question whether FDR made exempt transfers by applying the principles laid down

by the Court of Justice in *Sparekassernes Datacenter (SDC) v Skatteministeriet.*[4] SDC provided banks with data-handling services that were used by the bank's customers. The documentation produced by SDC was sent out in the bank's name and there was no legal obligation between the bank's customers and SDC. One of the questions was whether SDC made exempt transfers under Article 13B(d)(3) or whether it merely provided technical and electronic assistance to the person actually performing the transfer. The Court of Justice held that:[5]

> "... a transfer is a transaction consisting of the execution of an order for the transfer of a sum of money from one bank account to another. It is characterised in particular by the fact that it involves a change in the legal and financial situation existing between the person giving the order and the recipient and between those parties and their respective banks ... Thus, a transfer being only a means of transmitting funds, the functional aspects are decisive for the purpose of determining whether a transaction constitutes a transfer for the Sixth Directive."

Laws LJ then reviewed the domestic meaning of transfer and concluded that it coincided with that laid down by the Court of Justice in *SDC*: the crucial question is whether there is a change in the legal and financial situation consisting in a credit in the payee's account and a debit in the payor's account. Applying this test, Laws LJ decided that FDR made three sorts of exempt transfer: (i) the electronic transfer of funds between accounts held by the Issuer, Acquirer and the shop; (ii) the netting-off procedure; and (iii) the operation of the cardholder and merchant accounts.

What is the Principal Supply Made by FDR?

Not all of the services provided by FDR to the banks would be exempt if considered on their own; for example, posting statements to cardholders. However, the question arose whether the exempt and non-exempt services provided by FDR could be regarded as forming a composite exempt supply. As has been explained, the present test for a composite supply is laid down in *Card Protection Plan* and envisages an ancillary supply which is subsumed into a principal supply. However, Laws LJ distinguished between what is integral and what is ancillary. Consequently, his Lordship held that that a composite supply can be of two sorts.

First, a composite supply may be an exempt supply to which other non-exempt supplies are ancillary. Here the non-exempt ancillary supply is subordinate to the

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4 Case C-2/95 [1997] STC 932.

5 Above, at 954 para. 53.

principal exempt supply. Laws LJ described this as the apex case because the single exempt supply predominates over the non-exempt supplies. His Lordship acknowledged that the correct test for identifying a composite supply in the apex case is the test laid down by the Court of Justice in *Card Protection Plan*.

The second type of composite supply consists in several different elements that are integral to each other. In contrast to the apex case, none of the different elements predominates because each is integral to the other. His Lordship described this as the table-top case. If the composite supply is made up entirely of exempt elements, the composite supply is itself exempt. However, if the composite supply is made up of both exempt and non-exempt elements, then the composite supply is exempt if the core elements in the composite supply are exempt. If no core elements are discernible, then the composite supply is exempt if there are more exempt elements than non-exempt elements.

Laws LJ held that FDR provided a composite service consisting in processing credit card transactions and settling the liabilities and claims arising under them. All of FDR's activities were integral to each other in performing this service. Consequently, FDR's composite supply was a table-top, not an apex. The core elements of FDR's composite supply was making exempt transfers; so the composite supply was itself exempt.

The question arises what is the test for a composite supply in the table-top case. This is an important question. As Laws LJ pointed out, it is conceptually possible for a table-top composite supply and an apex composite supply to arise on the same set of facts. In other words, it is possible for a particular supply to be a better means of enjoying a table top composite supply. Moreover, the test for a table-top composite supply must always be applied first. This follows because the test for an ancillary supply cannot be applied until the principal (potential table-top composite) supply has been properly characterized: the test for an apex composite supply is whether the ancillary supply is a better means of enjoying the principal supply but this question cannot be answered until the nature of the principal (potentially table-top composite) supply is established.

Laws LJ indicated that the Tribunal's decision was reasonable without saying why he agreed that FDR's activities constituted a table-top composite supply. However, in his review of the authorities Laws LJ suggested the following guideline:[6]

> "With respect I apprehend (but I by no means propose to lay down any rule) that where this sort of issue arises, the first question to be asked may be couched as Lord Nolan put it: what is the 'true and substantial nature of the

6 *Customs and Excise Commissioners for FDR Ltd* [2000] STC 676 at 693b-d.

consideration given for the payment'. This will identify the apex or the table-top. The second question will be whether there are other supplies which are ancillary to the core".

Was the Court of Appeal Right to Extend the Concept of A Composite Supply to Include Table Top Cases?

In my opinion, there are two grounds for questioning whether Laws LJ was right to extend the concept of a composite supply to include table-top cases.

First, the Court of Appeal has introduced a new concept that requires advisers to take a novel analytical step without laying down a clear test for table top composite supplies. Laws LJ merely referred to the importance of identifying the true and substantial nature of the consideration. All would accept this test is uncertain. Moreover, this test was one of those used for identifying apex composite supplies before the Court of Justice gave its definitive ruling in *Card Protection Plan*. This is all the worse because the question whether there is table-top composite supply is logically prior to the question whether there is an apex composite supply. The test for an apex composite supply in *Card Protection Plan* is tolerably certain; however, the Court of Appeal has undermined this certainty by introducing the logically prior concept of a table-top composite supply but without saying how it should be identified.

The second objection to extending the concept of a composite supply to the table top case is that the extension breaches the well-settled principle that exemptions should be construed strictly. Suppose that a business would make exempt and non-exempt supplies if its activities were considered in isolation from each other. In the table top case none of the activities predominate but all are integral to each other. However, the fact that none of them predominates over the other makes it difficult to see how all the activities can be exempt. The best that can be said is that the composite supply is made up of some supplies that are exempt and some supplies that are non-exempt. But, if exemptions are to be construed strictly, the exemption should not apply unless all the supplies that make up the principal supply are non-exempt. But this, it will be said that in the table top case the supplies in question are *integral* to each other. However, in my opinion, this cannot make a difference in establishing the tax treatment of the composite supply. As Laws LJ recognizes, the only way in which the tax treatment of the composite supply can be established is 'to look again at the elements which comprise the core, and arrive at a decision on the facts whether, numerically if nothing else, the taxable or exempt supplies predominate'.[7] In other words, the question is whether a composite supply made up of exempt and

[7] Above, at 693c

non-exempt constituents is exempt. But once again, to say that the composite supply is exempt is contrary to the rule that exemptions should be construed strictly. By contrast, in the apex case there is no breach of the rule because the non-exempt elements in the composite supply are subsumed into an exempt supply. Laws LJ attempted to support the extension of the concept of composite supplies to the table top case by reference to the authorities which held that there is a composite supply when two elements in the activities of a business are physically and economically dissociable. However, this is based on a misunderstanding. This is an old test for an apex composite supply: it was satisfied if a subordinate element was physically and economically dissociable from a predominant element – the test was not satisfied when the elements were physically and economically dissociable from each other, as envisaged by Laws LJ.

Thus, in my opinion, the Court of Appeal's extension of the law in *FDR* goes too far. Nevertheless, it is an extension that will benefit the taxpayer. The practical upshot of *FDR* is that taxpayers whose activities would consist in exempt and non-exempt supplies if considered in isolation now have two arguments that all their supplies should be characterized as exempt. First, that the supplies are so integral to each other that they form a table-top composite supply whose core elements are exempt. Second, that any remaining non-exempt supplies are ancillary to the principal supply.