

# AVOIDING VAT LIABILITY ON FACE VALUE VOUCHERS

**S**urprisingly little High Court case law exists on the circumstances in which a taxpayer can avoid paying VAT where a right to receive goods or services for an amount stated on any token, stamp or voucher has been granted for consideration under VATA 1994, paragraph 5, Schedule 6. As a result, a number of outstanding issues have yet to be fully resolved by the courts and tribunals.

In June of this year, HM Customs & Excise published its eagerly awaited consultation document on modernising the VAT treatment of face value vouchers.<sup>2</sup> The proposed changes focus on two specific areas:

- The perception by the Commissioners that the *Argos* case<sup>3</sup> has led to tax leakage of an estimated £120 million per year caused by 'abusive tax avoidance' (an expression which itself gives rise to numerous and complex issues of Community law). In *Argos*, the ECJ held that, when a supplier sold a voucher to a buyer at a discount and promised subsequently to accept that voucher at its face value in full or part payment of the price of goods purchased by a customer who was not the buyer of the voucher, the consideration represented by the voucher was the sum actually received by the supplier on the sale of the voucher. The scope for tax leakage arises in cases where an intermediary purchases vouchers from issuers at a discount and then sells them on to the customer at the full price. In such a situation, there is no obligation to account for VAT on the mark-up.

*Melanie Hall QC and Ian Hutton, Barrister, Monckton Chambers, examine the legislation and case law concerning the VAT liability on the face value of vouchers, and highlight some of the grey areas!*

- The legislation also proposes to focus on vouchers which can only be used to purchase zero-rated or exempt goods or services.

It is clear from the consultation document that most of the issues raised

The material legislation is in deceptively clear and simple terms: Under VATA 1994, s 19 the value of any supply of goods or services shall, except as otherwise provided by or under the Act, be determined in accordance with that

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in this article are unlikely to be directly addressed by the proposed changes to the legislation. Judgment must be reserved on those changes until the Government comes up with a workable alternative statutory scheme.

section and Schedule 6 of the Act. Paragraph 5 of Schedule 6 provides as follows:

'Where a right to receive goods or services for an amount stated on any token, stamp or voucher is granted for a

consideration, the consideration shall be disregarded for the purposes of this Act except to the extent (if any) that it exceeds that amount.<sup>4</sup>

It would therefore appear that an issuer of vouchers need only demonstrate the following if the consideration he receives for those vouchers is to be disregarded for the purposes of the Act:

- that he has granted a right to receive goods or services for an amount stated on the voucher;
- that the right has been granted for consideration; and
- that the consideration which he claims should be disregarded for the purposes of the Act is no more than the amount stated on the voucher.

<sup>4</sup> However, paragraph 5 of Schedule 6 cannot be read in isolation from the Schedule as a whole or from the Sixth Directive. In the light of current case law, it would clearly not be advisable to set up a face value voucher scheme by reference to a purely linguistic analysis of that provision.

As its heading suggests (*Valuation: Special Cases*), Schedule 6 is designed

In cases where a customer pays for the right to receive a discount on goods and services, there would be no such double taxation. On the contrary, the supplier of the goods and services would only be liable to account for VAT on the discounted price, whereas the issuer of the voucher would escape accounting for VAT altogether. It was for that principal reason that the taxpayers in *Commissioners v Granton Marketing* [1996] STC 1049 (a restaurant vouchers case), failed to persuade the Court of Appeal that they should not pay VAT on vouchers they had issued. In that case, the customers' entitlement was limited to the right to a reduction in price if and when he ordered a meal of an appropriate size.

In rejecting the taxpayers' case in *Granton*, the Court left unanswered a number of fundamental questions: In what circumstances does a customer acquire the right to receive goods or services for an amount stated on the voucher? The Court of Appeal suggested in *Granton* that a taxpayer must establish his right merely by virtue of ownership

of legislation (because it would rarely, if ever, bite), neither the statutory language nor its clear purpose justify such a construction. Paragraph 5 speaks merely of '... a right to receive goods or services'. In the real world of commercial transactions, a customer rarely buys an absolute right to receive anything.<sup>7</sup>

Although *Granton* does not appear to have been argued on either basis, the better rationale for the result (which was clearly correct) is as follows.

- If viewed as a whole, the commercial essence of a transaction is that the customer has paid for the right to receive a discount, paragraph 5 does not bite. Having established a quite separate regime for the taxation of discounts, Parliament cannot have intended paragraph 5 to apply to discount vouchers.

- Paragraph 5 must be construed by presuming that Parliament used language which was intended to implement the provisions of the Sixth Directive and in order to achieve a result which is consistent with its purpose.<sup>8</sup> Its construction must also accord with the interpretation of the Sixth Directive as laid down by the European Court of Justice, if that can be done without distorting the meaning of the domestic legislation.<sup>9</sup> A construction of paragraph 5 which results in a supply of goods or services affected for consideration upon which VAT is not payable in full is not a result which accords with the Sixth Directive or the case law of the ECJ. It is not therefore a result which Parliament can be presumed to have intended, regardless of the literal meaning of the words used.

Although paragraph 5 has been part of domestic law since the introduction of VAT by the Finance Act 1972, its Community Law vires is not immediately apparent.<sup>10</sup> It has not been addressed directly by the ECJ<sup>11</sup> and the UK courts have yet to form a definitive view as to which part of the Sixth Directive Parliament intended to implement. In *F&I Services Ltd v Customs and Excise*<sup>12</sup> the Court of Appeal rightly rejected the taxpayer's submission in that case that the source of paragraph 5 was the financial services exemption in Article 13B(d) of the Sixth Directive. Paragraph 5 is concerned with disregarding consideration for the purposes of the VAT Act, except to the extent that the consideration exceeds the amount stated on the voucher. Article 13 has a quite different purpose, namely exempting certain supplies of goods and services from the obligation to account for VAT altogether, regardless of the amount of consideration.

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to avoid potential distortions and anomalies which might otherwise arise from transactions with unusual features.<sup>5</sup> It accordingly deals with the valuation of, for example, supplies made between connected parties for a consideration in money which is less than the open market value and supplies where a discount is given for prompt payment.

Paragraph 5 is designed to deal with cases where payment for the voucher is in reality merely a pre-payment for the goods or services supplied on its redemption. In those circumstances, the pre-payment and the subsequent supply of goods and services are treated as one transaction, despite the fact that many months may have elapsed between the pre-payment and the supply. Viewed as such, charging VAT on the supply of the voucher and the subsequent supply of goods or services would therefore amount to double taxation.<sup>6</sup>

of the voucher. It would therefore follow that in a case where a supplier refused to or was unable to supply the goods or services in question, a paragraph 5 right could not be established. However, if that is the test, no face value voucher scheme would ever come within paragraph 5. No voucher will evidence an absolute right to receive goods or services. Express or implied conditions will always be attached. To take the example of restaurant vouchers: the restaurant must be a participant in the voucher scheme; there must be an available table; the restaurant must be open; the restaurant must comply with the conditions attached to its liquor licence etc. Despite the Court of Appeal's ruling to the contrary, the existence of such conditions cannot justify taking away a paragraph 5 right that would otherwise exist. Quite apart from rendering paragraph 5 a barren piece

What then is the vires for paragraph 5? The third and fifth recitals to the First Directive (67/227/EEC) make it clear that one of the principal aims in harmonising the system of VAT was to achieve the highest degree of simplicity and of neutrality when the tax is levied. It is also clear that the tax is to be levied in as general a manner as possible and that all factors which may distort conditions of competition, whether at a national or at a Community level, are to be eliminated.

Although identification of a precise vires for paragraph 5 may be difficult, it is entirely consistent with the Sixth Directive. By way of illustration: Taxpayer A supplies a meal in a restaurant which is paid for by his customer immediately after consumption. Taxpayer B supplies a meal in a restaurant for which his customer has paid two months earlier. The VAT analysis is the same in each case. There has been a supply of services for consideration. It is clear from Article 11A1(a) that the question whether payment was made before or after the supply is immaterial to the basic VAT analysis.<sup>13</sup> The mere fact that the customer has been issued with a voucher as evidence of his pre-payment cannot change that analysis. In commercial terms, there has only been one transaction, the supply of the restaurant meal. The sale of the voucher is merely treated as a stage in that transaction.<sup>14</sup> To apply different VAT analyses to taxpayers A and B, by obliging taxpayer B to account for VAT on the issue of the voucher, would not only distort competition between them; it would unnecessarily complicate the administration of VAT and perhaps most importantly, would subject taxpayer B's customer to double taxation.

A complication may arise when there are more than two parties to the transaction. Typically, there is a party issuing the voucher, a customer and a retailer. In what circumstances can the issuer of the voucher avoid paying VAT on the basis that the customer's payment for the voucher was in truth a pre-payment for goods or services to be supplied by a third party retailer?

This issue arose for consideration in the *F & I Services* case and in *Hartwell v Customs & Excise*.<sup>15</sup> What is clear from both cases is that the issuer can only avoid accounting for VAT if the retailer receives consideration for his supplies to the customer. There must be symmetry between, on the one hand, the payment made by the customer for the voucher and on the other, the payment received by the

retailer for the goods or services supplied on redemption. In each case, there must be reciprocity between the payment and what is given in exchange.<sup>16</sup> A difficulty may often arise in identifying the consideration between the retailer and the issuer or between the retailer and any other participant in the scheme.

In the *F & I* case, the retailers were not paid for the goods and services supplied on redemption of the vouchers. However, the retailers were aware that in return for agreeing to be named on the vouchers, they would receive a benefit from the dissemination of the vouchers in the form of advertising services and additional business revenue. The taxpayers therefore argued that this was sufficient to demonstrate the existence of non-monetary consideration. The argument failed. There was an insufficiently direct link between the general benefit to the retailers and the goods and services supplied.

It would therefore appear that on the present state of the case law, mere participation in a voucher scheme, and with it the hope and expectation of

principle from the High Court. However, given the size of the taxpayer, it would come as no surprise if this case continued higher up the appellate chain.

It is in the nature of voucher schemes that at least part of the consideration will be non-monetary. There is a great deal of case law on non-monetary consideration. Space does not permit a comprehensive review of that case law. However, in headline form, the following principles have emerged so far.

- Whether the consideration is monetary, non-monetary or a combination of the two, a direct link must exist between the goods or services supplied and the consideration received.<sup>19</sup>
- The consideration must be capable of being expressed in money or a monetary equivalent.<sup>20</sup>
- The basis of assessment must be the consideration actually received and not a value estimated according to objective criteria (such as market value).<sup>21</sup>
- The objective is to ascertain the monetary value which the parties to the contract attributed to the goods or services, so that the monetary equivalent

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increased business, is insufficient for the purposes of generating the required degree of reciprocity. Something with a more intimate connection to the supply of goods and services is required.

The case of *Tesco plc v Commissioners of Customs & Excise* was recently heard in the High Court. One of the key issues to be determined is whether vouchers and/or various points issued under Tesco's 'Clubcard' scheme were issued free of charge or for a consideration.<sup>17</sup> A substantial part of the argument focused on the question whether the inability of the customer to elect to forego the vouchers and thereby pay less, was fatal to the argument that the vouchers had been given for a consideration.<sup>18</sup> Judgment is unlikely to be delivered before October 2002. Whatever the outcome, we can expect some helpful guidance and statements of

of the non-monetary element of the consideration can be ascertained.<sup>22</sup>

- In cases where the parties have, between themselves, put a value upon the non-monetary element, the monetary equivalent is to be taken as that value.<sup>23</sup>
- Where there is no consensus as to the monetary equivalent of the non-monetary element, the monetary equivalent must be ascertained in another way. The objective is to identify the value which the recipient of the goods or services attributes to those goods or services. On the current state of ECJ case law, that amount must correspond to the amount which he is prepared to spend for that purpose.<sup>24</sup>

The Court of Appeal has recently heard the case of *Commissioners of Customs and Excise v Ping (Europe) Ltd* where the parties had not reached any consensus on value. The judgment (which is expected before September) will determine whether

the valuation should be calculated by reference to 'intrinsic worth', cost price or opportunity cost, namely the price which the recipient of the non-monetary consideration would otherwise have obtained in the ordinary course of business.<sup>25</sup>

What is apparent from the case law is that the most effective route to obtaining symmetry between the consideration paid to the retailer and the face-value on the voucher, is for the parties to reach agreement as to the monetary value to be placed on any non-monetary consideration. As long as such an agreement is not a sham, it would be difficult on the current state of the law for the Commissioners, the tribunals or the courts to go behind it.

In my view it necessarily follows that if payment for a face value voucher is a pre-payment for a future supply, the Commissioners cannot legitimately complain about a low redemption rate.<sup>26</sup> The EC Commission may, however, have concerns about the difference in treatment between, on the one hand, those taxpayers who would ordinarily have an obligation

Appeal should resolve that issue by the end of this year. However, as the case law presently stands, it does not seem to matter whether a voucher is supplied as part of a wider transaction.

In general, the case law on paragraph 5 is still in its infancy. Not all of the issues to which it gives rise have been addressed in this article but we can expect the issues which have been addressed to occupy the courts for years to come, particularly the question of non-monetary consideration. What is clear is that the apparent simplicity of the provision<sup>28</sup> masks the issues which have pre-occupied the Commissioners, the taxpayers and the courts so far. It remains to be seen whether those issues will be addressed by the proposed amendments to the legislation.

## Notes

<sup>1</sup> An earlier and shorter version of this article appeared in the *VPG Bulletin* for June 2002.

<sup>2</sup> See <http://www.hmce.gov.uk/business/consultations/vat-face-value.pdf>.

<sup>3</sup> [1996] STC 1359.

*Internacional de Alimentacion SA* (Case 106/89) [1990] ECR I-4135 at page I-4159 and Lord Keith in *Webb v Erno Air Cargo Ltd* [1993] 1 WLR 49 at 59 E-G.  
<sup>10</sup> See Schedule 3, paragraph 5 of that Act and Schedule 4, paragraph 6 of the 1983 Act.

<sup>11</sup> It was referred to in the opinion of the Advocate General in *Argos Distributors Ltd v Commissioners of Customs & Excise* [1996] STC 1359 at 1362, paragraph 6 but not by the Court.

<sup>12</sup> [2001] STC 939.

<sup>13</sup> Article 11A1(a) refers to '... consideration which has been or is to be obtained by the supplier from the purchaser, the customer or a third party ...'.

<sup>14</sup> See Carnworth J's summary in *F and I Services* at page 956 c-d.

<sup>15</sup> *F and I Services v Customs & Excise Commissioners* [2001] STC 939.

*Hartwell v Customs & Excise Commissioners* [2002] STC 22. *Hartwell* is under appeal and should be heard by the Court of Appeal before the end of the year.

<sup>16</sup> See *Naturally Yours Cosmetics* [1988] STC 879 at 894, paragraphs 11 to 17.

<sup>17</sup> Apart from the issue of consideration, there is an issue as to whether issuing points, as opposed to vouchers meant that the points scheme was not within paragraph 5.

<sup>18</sup> See *Kuwait Petroleum (GB) Ltd v CCE* [1999] STC 488, paragraph 31 and *CCE v Primback* [2001] STC 803, paragraphs 40-43 and 47.

<sup>19</sup> *Naturally Yours Cosmetics*.

<sup>20</sup> *Dutch Potatoes* [1981] ECR 445.

<sup>21</sup> *Dutch Potatoes*.

<sup>22</sup> *Naturally Yours Cosmetics*.

<sup>23</sup> *Commissioners of Customs & Excise v Littlewoods and others* [2000] STC 1568.

<sup>24</sup> See the *Littlewoods* case.

<sup>25</sup> For the High Court decision see [2001] STC 1144.

<sup>26</sup> In the *Tesco* case the Tribunal sought to distinguish the *Kuwait* case on the basis that the take up rate was substantially higher in *Tesco* than it was in *Kuwait*. [See paragraph 58 of the decision]. However, in my view the Tribunal was wrong to do so on that basis. The fact that one voucher scheme proves to be more or less successful than another and/or more or less successful than originally anticipated, should not affect the VAT analysis at the point of sale.

<sup>27</sup> [2002] STC 22.

<sup>28</sup> Which is reflected in the Commissioners' brief Notice – see 700/7/94, which does not address recent developments in the case law.

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to account for tax on the supply of a contractual right (regardless of whether or not the right is exercised) and, on the other, those taxpayers who issue face value vouchers and thereby benefit from the following two advantages:

- in the case of redeemed vouchers, a cash flow advantage which lasts for as long as it takes for the customer to redeem them; and
- in the case of vouchers that are never redeemed, the permanent exclusion of their face value from the issuers' daily gross takings.

A further issue which is yet to be resolved by the courts is the extent to which it is appropriate to consider whether the supply of a voucher is an ancillary element in another supply or whether it is a single free-standing supply. In the case of *Hartwell*<sup>27</sup> the High Court took the view that paragraph 5 was purely a valuation provision and that it would be inappropriate to analyse voucher transactions in that way. The Court of

<sup>4</sup> Although paragraph 5 refers to tokens, stamps or vouchers, this article will simply refer to vouchers for ease of reading. However, the principles discussed apply equally to tokens and stamps.

<sup>5</sup> See *Customs & Excise Commissioners v Granton Marketing; Customs & Excise Commissioners v Wentwalk Ltd* [1996] STC 1049.

<sup>6</sup> See the *Granton Marketing* case.

<sup>7</sup> In *F&I Services Ltd v Customs and Excise* [2001] 939, at page 954 c-d a differently constituted Court of Appeal thought there was considerable force in the submission made by the taxpayer in that case that the Court of Appeal went further than it should have gone in that part of its reasoning.

<sup>8</sup> See *Litster v Forth Dry Dock & Engineering Co Ltd* [1990] 1 AC 546 per Lord Keith at 554, Lord Templeman at 558 and Lord Oliver at 576-577.

<sup>9</sup> See Paragraph 8 of the Judgment in *Marleasing SA v La Comercial*