

VAT- Bad news for third party payments

In two joined cases, “Baxi” (a boiler manufacturer that runs an incentive scheme) and “LMUK” (the company that runs the well-known Nectar reward scheme) the European Court of Justice (the ECJ) has considered the situation where one party receives a good or a service but another pays for it.

The Court has ruled that Baxi, LMUK and potentially, many other affected businesses cannot recover VAT on large payments they have made. The judgement appears to conflict with earlier decisions of the UK Courts, in particular the House of Lords decision in Redrow Group Plc.

Redrow case

Redrow was a house builder who paid the estate agency fees of house buyers who were selling their existing houses so they could buy a new Redrow house. Redrow was permitted to recover VAT on the estate agent’s bills because the parties entered into a tri-partite contract. In effect, Redrow was paying for the right to instruct the estate agents to sell the customer’s house.

The Baxi case

The Baxi group supplies many of its products to installers. It ran a promotion scheme to encourage installers to buy Baxi boilers, and commissioned a third party to run the scheme. Rewards were supplied directly to the installers, for which the third party charged Baxi.

The Court held that Baxi couldn’t recover VAT on the cost of the goods, but potentially part of the overall charge was a marketing service on which it could recover VAT. Since the third party buys below the recommended retail price (RRP) and makes its money by charging RRP, presumably the value of the marketing service is its profit on the goods.

The LMUK case

‘Sponsors’ pay LMUK for the right to issue Nectar points to ‘collectors’ and LMUK pays other businesses (‘redeemers’) for the goods/services (“rewards”) that retail customers receive when redeeming their points.

LMUK argued that although it clearly did not receive the rewards itself, it did receive a service (a ‘redemption service’) and, therefore, again following the Redrow principle, it was entitled to recover the VAT it paid.

The ECJ sent the case back to the UK courts to decide whether **part** of the money LMUK paid was for a service to it, as in Baxi. If so, LMUK will be able to recover part of the VAT charged by redeemers; if not, it can recover none of the VAT.

What does this mean?

A payment by party A for the provision by B of goods or services to C doesn't allow A to recover input VAT on the payment; unless A receives something over and above what C does.

Many businesses have relied on the "Redrow Principle" to recover VAT where they have paid to have goods or services delivered to a third party. These arrangements need to be revisited.

It will also affect situations where say a bank commissions an advisor to undertake a report on a company seeking finance, but at the latter's expense. Banks typically enjoy a low VAT recovery, and following these cases the company seeking finance is not entitled to recover the VAT on the advisor's services either. It would be better, if possible, for the company to commission the report from the advisor.

For more information on this or other aspects of VAT consultancy, please contact Steve Chamberlain on 01865 261100 or email schamberlain@critchleys.co.uk

Notes

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