[2016] UKFTT 598 (TC)

TC05334

Appeal number: TC/2015/00612

VAT – finance exemption – whether web-based intermediaries who assessed would-be borrowers on simple criteria and then sold their information to highest bidding lender were making exempt supplies of negotiation of credit – yes – whether certain tasks undertaken by outsourcer were exempt supplies of negotiation of credit – no – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

DOLLAR FINANCIAL UK LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE BARBARA MOSEDALE

Sitting in public at the Royal Courts of Justice, London on 25 July 2016

Mr D Scorey QC, instructed by PWC Legal LLP, for the Appellant

Mr J Puzey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2016

DECISION

Introduction

1. The appellant's business, and that of companies in its group, is the making of small, short-term loans to private individuals, often referred to as pay-day loans, as its normal customer is looking for a loan to tide him or her over until the next pay-day. At the period in issue the typical loan made by the appellant was a few hundred pounds for up to 30 days. Its business was accepted as being exempt from VAT. The issue between the parties was the VAT status of certain supplies made to the appellant by overseas suppliers on which the appellant had accounted for VAT under the reverse charge. In 2013, it sought to recover VAT on the supplies made 2010-2013 on the basis that they were properly exempt. HMRC refused the claim. Ultimately that decision led to this appeal.

2. While nothing turns on this, the supplies in issue were actually made to two companies which are now (although they were not at the time) members of the appellant's VAT group, MEM Consumer Finance Limited ('MEM') and Express Finance (Bromley) Ltd ('PEX') (MEM was short for 'Month End Money' and 'Payday Express' was the trading name of PEX). I will refer to the appellant interchangeably as the appellant or MEM/PEX or just MEM.

3. Two supplies were in dispute:

(1) Supplies by 'leadgens' to MEM/PEX; and

(2) Certain supplies by Allsec Technologies Limited ('Allsec') to MEM/PEX.

Originally, within group (2) there were four types of supplies which were in dispute. However, HMRC accepted before the appeal came on for hearing that two of these supplies were exempt. I explain them in more detail below at §35-36.

The facts on the leadgens' supplies

The evidence

4. The only witness was Mr Richard Sharp. At the time of making the witness statement, Mr Sharp was head of consumer lending at the appellant (although by the time of the hearing he had changed employer). His background was in lending in the financial services market. He had been employed by the appellant since 2008 as a sales manager, rising through various promotions to his role at the time of his recent resignation.

5. Virtually all of the documentary evidence before the Tribunal (eg screenshots of websites and contracts) dated to a period after the time in issue. Mr Sharp's evidence, which I accept, was that this was largely because contemporaneous documentation could not be located. Mr Sharp outlined the extent to which the documentation at the time in issue would have differed from that in evidence. For instance, loan criteria increased in response to regulatory changes in 2013 but after the period in issue.

6. While his evidence was challenged on a few points, I accepted it as reliable as I found it consistent internally and with the documents, and it made sense. He was also criticised for omitting from his witness statement the fact that leadgens might buy in the leads that they sold to the appellant and other lenders. However, I accept his explanation that he had not included this in his witness statement as he did not see it as relevant to the case. I agree with him that it is not relevant (see §§11-12) and I do not consider the criticism of him justified.

Findings of fact – leadgens

7. The collective name given by the parties in the skeletons and at the hearing to the various companies which made the first type of supply in issue was 'leadgens' which, I understand, was a corruption of the phrase 'lead generators'. I read nothing into the use of this term, one way or the other. It was merely convenient to have a shorthand term by which to refer to them.

8. I shall refer to a person looking for a pay-day loan by the shorthand 'borrower' for convenience but of course such a person would not be a borrower at the time they were searching for a loan and might never become one. In outline, a borrower using a leadgen's website would be asked by the website to complete an online application form if s/he wanted to apply for a pay day loan. When the form was completed, the borrower was asked to hit the 'submit' button. When s/he did so, the leadgen would electronically and normally in a matter of seconds if not less, pass on the application form to one of its customers, one of which was the appellant. The borrower would see a 'searching' symbol on the website and would not know what was going on behind the scene.

9. If the application form was passed to the appellant, and if the appellant chose to accept and pay for the lead, which decision it would also make electronically in a matter of seconds, the borrower would then be presented with a page of the appellant's website offering the loan including the terms of the loan. The borrower could accept the loan by hitting a button 'accept', and then electronically signing the loan documentation, following which, in a short space of time, the loan would be deposited in the borrower's bank account.

10. I move on to consider the process in more detail.

11. How did a borrower reach a leadgen's website? There was some dispute as to how a would-be borrower ended up on a leadgen's website. It was possible that the borrower, looking for a pay day loan, would search the internet for something like 'pay day loan' and the internet search engine's results would include the leadgen's website. This was the process described in Mr Sharp's witness statement. But, as Mr Sharp accepted in cross examination, there were other ways a borrower would arrive on the leadgen's website. In particular, the borrower might have been funnelled there from other websites, websites perhaps advertising the leadgen's websites, and the leadgen may have paid a fee for the referral.

12. How the borrower arrived at the leadgen's website did not seem significant to me, although HMRC sought to suggest it was. The question was the nature of the service supplied by the leadgen to the appellant and it did not seem significant to me whether the borrower was induced to complete the leadgen's application form after a search of the internet led him to the leadgen's site or whether it was after the leadgen paid a third party for the borrower to be directed to its website.

13. How did the leadgen decide to which of its customers it would refer the borrower? When a borrower completed the leadgen's online application form and hit 'submit', the leadgen would, as I have said, electronically send the application form to one of its customers, of which the appellant was one. The leadgen would (electronically) make this decision on the basis of

> (a) Identifying all of its customers for whom the borrower met their varying basic loan criteria and for which the borrower's desired loan was no more than the maximum which the customer was prepared to lend; and, if it had more than one customer whose basic lending criteria the borrower met and whose maximum loan limit was more than or equal to the amount of loan the borrower sought, then from that shortlist of customers,
>
> (b) the leadgen would refer the borrower to the customer that would pay it the highest referral fee.

14. When the appellant received a loan application from a borrower via a leadgen, it would (electronically and in a matter of seconds) make a decision whether or not to accept the referral and offer the borrower the requested loan. As I have said, if it decided to accept the referral it became liable to pay the leadgen, and the borrower would be transferred to the appellant's website and would be shown the terms and conditions of the loan which the appellant was prepared to offer.

15. If the appellant decided against accepting the referral, then the leadgen would be informed (electronically) and the leadgen would then pass the borrower's application form on to its next customer for whom the borrower met the criteria and which would pay it the next highest referral fee and so on. In the jargon, this was referred to as a 'ping tree'. The leadgen would keep offering the borrower's application to its customers on its ping tree until the referral was accepted and a loan offer was made or until it exhausted its list of customers (in which case the borrower would not get a loan offer but might be offered some other kind of financial service). The appellant might be anywhere on the ping tree and would not necessary be the first lender to whom a leadgen offered a lead which met the appellant's basic lending criteria: that would depend on whether another lender was prepared to offer the leadgen more for the lead.

16. What were the appellant's criteria and did they differ from other lenders' criteria? HMRC appeared to be of the opinion that the basic lending criteria applied by the appellant were so general that the ping tree amounted to no more than the leadgen selling the lead to the highest bidding of its customers.

17. However, I find on the basis of the evidence, that the appellant only entered into contracts with leadgens on whom they had carried out satisfactory due diligence, which met the necessary regulatory conditions, and whose online application forms asked the questions to which the appellant required answers. Those questions were:

5 (a) Whether the applicant was over 18 years of age;

(b) Whether the applicant was UK resident and entitled to work in UK;

(c) Whether the applicant had a monthly net income of at least £900;

10 (d) Whether the applicant had a UK current bank account with associated debit card.

(e) A valid mobile phone and email address.

18. I note that Mr Sharp's witness statement only listed the first four of these criteria and did not list a valid mobile phone and email address as criteria but in his 15 oral evidence it was clear that these were additional criteria the appellant applied because, he explained, the appellant would not lend to someone without a valid mobile phone number and email address, as these were the appellant's methods of contacting their borrowers. But other lenders might not require a valid mobile phone number and/or email address. The validity of the number and email address would be 20 checked electronically.

19. I find other customers of the leadgen might well apply criteria different to those applied by the appellant when assessing whether to make an offer of a loan to a borrower. So the leadgens' application forms asked more questions than the five required by the appellant and indeed the application form exhibited to Mr Sharp's 25 witness statement did ask more questions. Mr Puzey suggested in cross examination that the application form annexed to his witness statement asked more extensive questions simply because it originated later in time than the period at issue in the appeal, but I accept Mr Sharp's evidence, as it made sense, that different lenders had different critieria and the leadgens' application forms had to reflect all the different 30 criteria. For instance, some lenders might not require a mobile phone number and email address, they might have a higher or lower minimum monthly income than the appellant's, they might have a higher or lower maximum loan figure than the appellant's , they might not require a UK bank account and/or UK bank debit card to be held, and they might have additional criteria which the appellant did not.

35 20. For instance, possession of a UK debit card was crucially important to appellant as only if the borrower possessed this could it set up a continuous payment authority which was the means by which appellant insisted on being paid; other short term lenders may have had different means of repayment so may not have had possession of a UK debit card as a lending criterion.

Did the leadgens apply the appellant's criteria?

21. As I have said, it was HMRC's case that the leadgens were doing very little if anything more than simply selling a lead to the highest bidder, so another issue was whether the leadgens actually did filter the borrowers by the appellant's basic lending criteria and whether it mattered to the appellant whether or not they did.

22. Mr Sharp's evidence, which I accept, was that a team within the appellant had responsibility for checking that a new leadgen integrated the appellant's criteria into the leadgen's online application form (as well as vetting that the leadgen met the relevant regulatory rules and performing other due diligence on the leadgen, as mentioned above at §17).

23. Nevertheless, the appellant always duplicated the basic lending checks by checking the borrowers' online application forms in every case. Mr Sharp's explanation for this, which I accept, was that they did this to check that the leadgen had applied the criteria correctly as leadgens might make mistakes and/or be slow to update their systems when the appellant changed its criteria. The appellant did not wish to incur the cost of a credit check on a borrower who did not meet its lending criteria.

24. I accept that it was important to the appellant that the leadgen asked for the correct information from borrowers. This was demonstrated because the appellant's system created a daily report of exactly how many incorrect referrals had been made to them. A leadgen with a bad record would be asked to update their system with the appellant's criteria. If it did not do so, the appellant would terminate the relationship.

25. How did the appellant decide whether to accept the referral and make a loan offer? In order to decide whether to offer a loan to the borrower whose application form was passed to it electronically by a leadgen as described above, the appellant would:

(1) Check that its basic lending criteria (set out above at §17) were met;

(2) Carry out (electronic) credit checks on the borrower;

26. Only if the borrower passed these checks would the referral be accepted and the offer of a loan made to the borrower. The leadgens were paid commission by the appellant where the introduction led to a loan offer being made to the borrower.

27. If an offer of a loan was made, the borrower would automatically be taken to a page on the appellant's website which would set out the terms of the offered loan. If the borrower decided to accept the terms of the loan, s/he would click 'accept' and be taken to a page for electronically signing the loan agreement. Once signed, the appellant would deposit the amount of the loan in the borrower's bank account.

28. Slightly over half of the borrowers offered a loan in this manner would accept it. Mr Sharp's evidence, which I accept, was that leadgens were an important source of business to the appellant.

29. How many referrals did the appellant obtain from leadgens? However, very few borrowers arriving at any particular leadgen's website would ultimately, by this system, become customers of the appellant. This was because, firstly, the leadgen had other customers (one was known to Mr Sharp to have 50 customers), and the borrower would only be referred to one of them at a time. So another customer of the leadgen, higher up in the ping tree than the appellant, might make an offer of a loan to a borrower so that borrower would never be referred to the appellant.

30. And of the application forms actually offered to the appellant by the leadgen, only about 1% went on to be offered a loan by the appellant. This was because 99% of the applications made to the appellant from borrowers passed on to them by leadgens were rejected. The most significant reason for rejection (80-90% of all applications) was that the borrower was already known to the appellant. The appellant would not pay a leadgen for a referral where it had a pre-existing relationship with the borrower, even one which had already terminated. The rest of the rejections were because either the borrower failed the lending criteria checks or the credit checks. I accept Mr Sharp's evidence, which was unchallenged, that it only rejected a small number of borrowers for failing the duplicate lending criteria checks as referred to at §23.

The supplies by Allsec – the facts

The evidence

31. What I said above at §§4-6 in relation to the evidence in relation to the Leadgen's supplies applies here too.

The findings of fact

32. The contract between the appellant and Allsec together with its annexes evolved over time, and in particular more services were added. The contract indicated that Allsec provided four headline services for the appellant:

(a) Customer services

(b) Collections

(c) BPO/other

(d) Sales

33. However, these four were sub-divided in the statement of work annexes (which also evolved over time) but at some point in the period at issue, although not necessarily during the whole of the period at issue, Allsec provided four separately identified services the VAT status of which was in dispute:

(a) New loans to existing customers

(b) Pre repayments

(c) Conversions

(d) Livechat

34. I note that the documentary and oral evidence was somewhat at odds whether these four services were performed under the umbrella of 'customer services' or 'sales' but it does not matter. It was accepted by both parties that these were separate supplies. They were separately identified in the documents and separately charged and invoiced. Some were only added in to the statement of work at a later date. I agree that they ought to be treated as separate supplies.

35. HMRC accepted shortly before the hearing that items (a) and (b), new loans and pre-repayments, were exempt supplies. In the former case, Allsec acted as agent of the appellant in agreeing new loans with existing customers; in the latter case Allsec acted as agent for the appellant in effecting a deferral of repayment of an existing loan by creating a new loan on different terms. These supplies were therefore no longer in issue.

36. What remained in issue were 'conversions' and 'live chat'. Other services provided by Allsec, such as collections, where Allsec sought to collect on outstanding debts, were accepted by the appellant to be standard rated.

Conversions

37. Conversions was the name applied to the service whereby Allsec would ring a borrower who had been made an offer of a loan by the appellant but not accepted it (by 'signing' the online documentations). The object of the phone call was to get the borrower to enter into the loan contract. The conversions phone calls would be made by Allsec to any potential borrower to whom the appellant had made a loan offer, whether or not the borrower had come to the appellant via a leadgen or otherwise.

38. There were no doubt an infinite variety of reasons why a borrower offered a loan had not (yet) accepted it, but in general these conversion phone calls included some or all of the following:

(a) Answering queries

(b) Explaining how to electronically sign up to the loan

(c) Where the loan offer was conditional on further information being provided by the borrower, obtaining that information.

39. The ultimate object of the phone call was always to get the borrower to accept the loan on the appellant's terms. It was referred to as 'conversions' as the object was to convert a loan offer into an actual loan.

Live chat

40. The appellant's website had the ability to track persons looking at it; if a person stayed on the website for longer than a certain period, the website generated a 'pop up' asking the person if they needed further assistance and inviting that person to enter into an electronic communication with an agent of the appellant's. Allsec staff

would be the agents undertaking the 'live chat' with persons surfing the appellant's website.

41. The evidence of Mr Sharp, which I accept, was that these persons tended to be in one of three categories:

5

> (a) A borrower looking for a loan who wanted to know more information eg about the terms and conditions, or who needed help with completing the online application form;
>
> (b) An existing customer looking for information concerning their existing loan eg its repayment date, or looking to notify the appellant that they could not make the repayment on the due date; or
>
> (c) An existing customer in arrears looking to make a payment on account or trying to arrange a repayment plan.

10

15

42. One outcome of a conversation in Livechat, where an existing customer was notifying the appellant that they would not be able to make the repayment (see (b)), was that the Allsec agent could treat it as a pre-repayment task and negotiate and complete a new loan as set out at §35 above. An existing customer in (c) above would normally be transferred from the Live chat team to the collections team.

20

43. Allsec was paid by how much time was spent by its agents in Live Chat.

The appellant's rate of interest

44. HMRC drew my attention to the appellant's rate of interest and APR. The appellant's counsel complained that HMRC were disparaging the appellant and the nature of its business. The appellant, as it said, served a niche market, the subprime market. Its intended borrowers were persons with, for whatever reason, a credit rating below that at which a high-street bank would be prepared to offer a loan. As its loans were riskier due to its borrowers' low credit ratings, the appellant's rates of interest were higher than a bank would charge.

25

45. I agree with the appellant that this was irrelevant so far as this Tribunal was concerned. The question was whether the supplies in question were exempt: the terms of business on which the appellant made its (VAT-exempt) loans were not relevant.

30

The law

46. The Principle VAT Directive provides:

35

> **Exemptions for other activities**
>
> **Art 135**
>
> 1. Member States shall exempt the following transactions:

(a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents;

(b) the granting and the negotiation of credit and the management of credit by the person granting it;

47. Neither party suggested that the UK implementation of this was anything other than in accordance with it. the UK implementation provided, so far as relevant:

Value Added Tax Act 1994 Schedule 9

Group 5 – finance

Item No

1. ....

2. the making of any advance or the granting of any credit.

.....

5. the provision of intermediary services in relation to any transaction comprised in item...2....(whether or not any such transaction is finally concluded) by a person acting in an intermediary capacity.

Note (5) defined 'intermediary services' as:

"...bringing together, with a view to the provision of financial services –

(a) persons who are or may be seeking to receive financial services, and

(b) persons who provide financial services,

Together with ...the performance of work preparatory to the conclusion of contracts for the provision of those financial services, but do not include the supply of any market research, advertising, promotional or similar services or the collection, collation and provision of information in connection with such activities."

Note (5A) defined 'acting in an intermediary capacity' as

"...acting as an intermediary, or one of the intermediaries, between-

(a) a person who provides financial services, and

(b) a person who is or may be seeking to receive financial services."

48. The UK exemption for insurance services was separate to the financial exemption: it was similar in that both the supply of insurance and the supply of intermediary services were exempt, but it was not identical. Nevertheless, the similarities between the two exemptions in both EU and UK legislation were such that it is appropriate, in my view, to draw some principles from insurance cases about intermediaries when looking at the finance intermediary exemption.

49. The relevant financial intermediaries' exemption even in UK legislation is brief; in the Directive it amounts to three words: 'negotiation of credit'. What this means

in practice has been considered in depth in the case law, and I turn to look at the case law and the principles which I consider should be derived from it.

(1) Exemptions should be interpreted strictly.

50. While it has been stated many times that exemptions, as an exception to the general rule that supplies are standard rated for VAT purposes, are to be interpreted strictly, that does not mean an exemption should be interpreted in the most narrow way possible. The Court of Appeal in *Expert Witness Institute* [2002] STC 42 said:

> [17]...A strict construction is not to be equated... with a restricted construction. The court must recognise that it is for a supplier, whose supplies would otherwise be taxable, to establish that it comes within the exemption, so that if the court is left in doubt whether a fair interpretation of the words of the exemption covers the supplies in question, the claim to the exemption must be rejected. But the court is not required to reject a claim which does come within a fair interpretation of the words of the exemption because there is another, more restricted, meaning of the words which would exclude the supplies in question.

The Court of Appeal later reiterated this view in *Insurancewide.com/Trader Media* [2010] STC 1572 at [83] specifically in relation to an exemption for intermediaries, although that case was concerned with insurance intermediaries rather than financial intermediaries.

(2) What matters is the nature of the supply and not identity of supplier.

51. It does not matter whether the person claiming the exemption is a broker or agent in the traditional meaning of the word: what matters is what they do. This is stated by the CJEU in *Sparakassernes Datacentre ('SDC')* (C-2/95) [1997] STC 932 at [30-38].

52. It is also clear from other cases such as *Insurancewide.com/Trader Media* where the appellants' business was entirely internet based and their websites disclaimed being an insurance broker. Nevertheless, both were held to be entitled to the exemption as negotiators of insurance. Another example of this is that the appellant in *Civil Service Motoring Association Ltd* [1998] STC 111 was found to be entitled to exemption for 'negotiation of credit' despite not being a traditional broker or agent but a non-profit making members' club.

(3) An intermediary can act entirely electronically

53. Similarly, the exemption can apply irrespective of the means by which the service is rendered. This is clear from case law such as *SDC*. SDC performed, electronically, a number of financial services for banks and their customers, such as the execution of transfers and management of deposits. The question was whether its services were exempt. The CJEU ruled that the means by which the supply was

carried out was irrelevant, so that a purely electronic supply could nevertheless be exempt: [30-38]:

> "[38]....the exemption is not subject to the condition that the transactions effected by a certain type of institution, by a certain type of legal person or wholly or partly by certain electronic means or manually."

Insurancewide.com/Trader Media is an application of this principle: the intermediaries in that case ran entirely web-based businesses but were held to be entitled to the insurance intermediaries' exemption.

(4) While the exemption is static, the services covered by it can evolve.

54. In other words, the question is the substance of what is undertaken. Even if it is a novel arrangement, it is the substance of what is done that matters. The world of finance and insurance is constantly evolving, new products are invented, new methods of selling and marketing them come into existence. Novelty does not prevent exemption.

55. I was referred to *Skandinaviska Enskilda Banken AB* (C-540/09) [2011] STC 1125 for this proposition, although the facts are not particularly relevant to this appeal. In that case, the Advocate General recognised that the financial services market was constantly evolving and said that the legislation had to be read as if drafted with this in mind: see his Opinion at §5 . But in any event the truth of this proposition in practice can be seen in cases such as *Insurancewide.com/ Trader Media* where the internet offered scope for the provision of services not really seen before and which were nevertheless held in substance to be within the scope of the exemption.

(5) An intermediary will be remunerated for intermediation but will not be a party to the contract between borrower and institution

56. This necessarily follows from the nature of the service of 'negotiation of credit'. Whether or not described as an agent or broker, the intermediary will not be a party to the financial or insurance contract the subject of the introduction and negotiations. It is also stated clearly in case law. The CJEU said in *CSC Financial Services Ltd* [2002] STC57:

> "[39]...it refers to the activity of an intermediary who does not occupy the position of any party to a contract relation to a financial product, and whose activity amounts to something other than the provision of contractual services typically undertaken by the parties to such contracts. Negotiation is a service rendered to, and remunerated by a contractual party as a distinct act of mediation. ...

57. In other words, the intermediary will have a legal relationship with, and be remunerated by, either borrower or lender for his intermediary services. In the normal situation, an intermediary is paid commission by the lender. But that will not necessarily be so in all cases. I discuss this further at §63 below.

(6) Negotiation can be exempt even if no contract results

58. This is recognised in the UK legislation where Note (5A) refers to the borrower as someone who 'may' be seeking to receive financial services; moreover, it has been implicitly recognised in many cases; eg in *Lloyds TSB Group Ltd* [1998] STC 528 (discussed below at §68) the taxpayer decided whether or not to grant the credit on behalf of the bank, so in some cases it refused the credit: there was no suggestion that this converted its supplies from exempt to taxable. The same is true in *Insurancewide.com/TraderMedia:* not all car owners went on to take up the offered insurance but that did not convert the taxpayers' supplies from exempt to taxable.

59. In *SDC* the CJEU said that the service concerned had to alter the legal and financial situation of the bank concerned: but that was clearly specific to the exemption at issue in that case which was the 'transactions concerning transfers' and not the 'negotiation of credit'. There is no requirement for an intermediary to alter the legal and/or financial position of the lender or borrower in order to obtain the benefit of the 'negotiation of credit' exemption.

(7) An intermediary does not have to undertake the entire mediation

60. To obtain the benefit of the exemption, it may be enough (depending on the facts) if the intermediary undertakes a part only of the negotiation of credit. While in *CSC* at [39] the CJEU said:

> "...the purpose of negotiation is therefore to do all that is necessary in order for two parties to enter into a contract, without the negotiator having any interest of his own in the terms of the contract."

this was said in the context of explaining why a negotiator would not be a party to the insurance/financial contract and was not intended to detract from what was said by them in the earlier case of *SDC* where, from the discussion at [60-68], it was clear that the negotiation exemption would be available to a person who did not carry out the entire 'negotiation' but merely a distinct and essential element. This proposition was also reflected in what the Court of Appeal said in *Insurancewide.com/Trader Media* although dealing with the insurance exemption -

> [87] ...It would ...be immaterial that neither [taxpayer] had anything to do with the negotiation of the terms of the insurance contract or its preparation or the collection of premiums or the handling of claims....
>
> (per Etherton LJ)

In other words, it is enough for the intermediary to undertake an introduction of borrower to lender, or to negotiate the terms of the loan contract: he did not have to do both to obtain exemption.

(8) An intermediary can be one in a chain of intermediaries

61. It really follows from the fact that an intermediary can be an exempt intermediary if providing only a distinct act of mediation, even if other persons can mediate on the same contract, that there can be a chain of intermediaries. This is

explicitly recognised in the UK legislation at Note (5A) where it defined 'acting in an intermediary capacity' as

> "...acting as an intermediary, <u>or one of the intermediaries</u>, between-
>
> (a) a person who provides financial services, and
>
> (b) a person who is or may be seeking to receive financial services."
>
> (my emphasis)

Neither side suggested this was inconsistent with EU law. I do not consider that it is, if the service is distinct and essential to the transaction.

62. The application of this proposition in case law can be seen in the case of *Insurancewide.com/Trader Media,* where the services of the taxpayers were found to be exempt even though they had no legal relationship with the borrower or insurer: they were intermediaries in a chain of intermediaries. Their relationship was with other brokers, who were the persons who paid their commission.

63. I note that in *CSC* the CJEU said that:

> [39] ....Negotiation is a service rendered to, and remunerated by a contractual party as a distinct act of mediation. ...

but the CJEU were not there considering an intermediary in a chain of intermediaries and cannot be taken to be laying down a proposition that only an intermediary with a direct contractual relationship with either borrower or lender was entitled to exemption. It is clear from *Insurancewide.com/Trader Media* that that is not the case. The point which the CJEU was making in *CSC* was that an intermediary is providing intermediation, and will therefore be paid for by someone with an interest in the contract mediated. In *Insurancewide.com/Trader Media* the taxpayer's legal relationship was with a broker who was paid commission by the insurance company on the successful conclusion of an insurance contract: the taxpayer was therefore paid by someone with an interest in the contract being mediated although someone who was not actually a party to it. That was sufficient.

(9) Intermediation does not include the carrying out of back office functions

64. The question of what exactly amounts to 'negotiation of credit' has given rise to a significant amount of case law and I consider the cases in some detail. It is clear that 'negotiation of credit' has limits. Firstly, as a general rule, the CJEU in *SDC* said at §65 that as exemptions...

> "...must be interpreted strictly, the mere fact that a constituent element is essential for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt."

65. UK legislation expressly states that certain activities do not amount to negotiation: Note (5) says intermediary services does not include

> "...the supply of any market research, advertising, promotional or similar services or the collection, collation and provision of information in connection with such activities."

66. This does not reflect specific wording in the much briefer EU exemption but again neither party suggested that UK law was in any way inconsistent with EU on this point. Indeed, the CJEU in *SDC* stated that negotiation did not include:

> "[66]...a mere physical or technical supply, such as making a data-handling system available to a bank...."

And in *CSC* the CJEU said:

> [40] ... it is not negotiation where one of the parties entrusts to a sub-contractor some of the clerical formalities related to the contract, such as providing information to the other party and receiving and processing applications for subscription to the securities which form the subject matter of the contract...."

67. CSC provided a call centre for various financial institutions; it dealt with all queries by potential purchases of a particular financial product and processed the application form. It did not actually issue the financial product; the issue was carried out by the financial institution. CSC's services were held by the CJEU not to be exempt as the negotiation of a financial product because they were no more than the provision of information and clerical formalities: the financial institution had merely outsourced to CSC some of its back office functions.

68. However, in the earlier UK case of *Lloyds TSB* mentioned above, the High Court ruled that the exemption applied where the outsourcer made a single supply to the lender of a service comprising receiving and processing applications for credit, dealing with enquiries, obtaining credit checks, deciding whether or not to make the grant of credit, concluding the contract, making the loan, and dealing with early repayments and bad debts. This case preceded *CSC* but neither party suggested it was wrongly decided. While the facts seem very similar to those in *CSC*, the crucial distinction was that in *Lloyds TSB* the outsourcer was a true agent for the lender as it used its own discretion to decide whether or not to grant the credit, and then was able to commit its client to the loan contract. It was an archetypal intermediary as it was an agent in the legal sense and not merely someone to whom back-office functions were delegated.

(10) Intermediation does not include advertising

69. UK legislation clearly states that advertising is not negotiation, and neither party suggested this was wrong. The object of advertising is normally to create awareness of a product and to generate a demand for it where there was none before: while its purpose ultimately is to encourage persons seeking the financial product to contact the provider of the product or someone on his behalf, advertising does not aim to introduce any particular person to the product provider and certainly does not undertake any assessment of a borrower's suitability for credit, or of the lender's suitability to offer the borrower credit.

70. In *Insurancewide.com and Trader Media,* it was assumed that there was no exemption for a 'mere' click through service, in other words, where a website advertises the availability of something by enabling reader to click a button to access another website, even if the service was charged on the basis of the number of persons clicking on the button. Exemption was achieved by the traders in that case because they went further: the persons they brought to the insurers' websites were known to them in the sense that the intermediaries had obtained information from them about their needs and insurance history and had used that information to identify suitable insurers.

71. In the much earlier case of *Civil Service Motoring Association Ltd* [1998] STC 111 (CA), the taxpayer promoted to its members an affinity credit card issued by a bank in return for commission. Its supply to the bank was found to be the exempt negotiation of credit. Although this case preceded the CJEU decision in *CSC,* there was no suggestion it was wrongly decided. It seems to me the reason what the taxpayer did was not pure advertising was that it had negotiated the terms of the credit card with the bank prior to promoting it to its members. Its services were exempt, not because it introduced borrower to lender, but because it had negotiated the terms of the deal.

(11) An intermediary is someone who introduces two parties, one looking for a financial product and a person providing it; or is someone who negotiates the terms of such products as between the borrower and lender; or is someone who concludes a contract on behalf of one or other parties;

72. In *CSC* the CJEU gave a list of the sort of things that a financial intermediary might do, and the list was one of alternatives. To gain exemption, the intermediary did not have to undertake *all* the activities in the list:

> "[39]...[Negotiation] may consist, amongst other things, in pointing out suitable opportunities for the conclusion of such a contract, making contact with another party, ***or*** negotiating, in the name of and on behalf of a client, the detail of the payments to be made by either side. ...
>
> (my emphasis)

So the intermediaries' exemption can be obtained where an intermediary does any one of the following:

> (a) Concludes the contract as agent of one or other party (*Lloyds TSB);*
>
> (b) Negotiating the terms of the contract (*Civil Service Motoring Association* and 'negotiating...the detail' from *CSC)*
>
> (c) Assessing potential lenders and introducing the borrower to those offering the best deal (the reference to 'pointing out suitable opportunities' in *CSC* and the case of *Insurancewide.com/Trader Media* – see below*)*

> (d) Putting a borrower and lender in contact ('making contact with another party' as per *CSC*)

There may be other activities which amount to 'negotiation of credit', the list in *CSC* was stated not to be exhaustive, but none others were suggested to me or apparent from caselaw and I do not attempt to speculate what they might be.

73. The dispute in this case centred on (d) which was the only potentially relevant activity undertaken by the appellant. It did not do any of (a)-(c).

74. *Introductory services do not necessarily have to include an assessment of the service provider:* HMRC's proposition was that *unless* the intermediary carried out some kind of assessment of the suitability of the lenders to which it introduced borrowers, then its services were not exempt. In other words, HMRC did not accept that category (d) even existed, although that necessarily ignored what the CJEU had said in *CSC*, where the CJEU distinguished between introduction and assessment.

75. For their proposition that mere introduction was insufficient for the 'negotiation of credit' exemption, HMRC relied on *Insuarancewide.com/Trader Media.* Trader Media's basic business was advertising, including online advertising. It ran a website on which adverts for the sale of cars could be displayed; one section of this website enabled users to obtain quotes for car insurance from a selected panel of insurance brokers, and Trader Media earned commission if a car insurance contract was entered into off the back of its website. The other appellant ran a similar website. HMRC considered the services to be standard rated.

76. The Court held that it was not necessary for the intermediary to be in a legal relationship with either borrower or insurer; nor did they have to do all that an insurance broker would do; it was enough to do a part of the intermediation if vital. All this is clear from propositions I have already covered. However, the Court went on to say that 'a mere conduit' would not be entitled to exemption:

> [86] ...HMRC's case is that the relevant functions performed by [the taxpayers] were nothing more than the provision of a 'click through' facility to a broker, agent or insurer, it is plain that both taxpayers were doing much more than that. They identified, and provided those looking for insurance with access to, insurers who provided a range of competitive insurance products. In both cases the evidence indicated that the insurers were appraised and selected bearing in mind the competitiveness of their pricing and product and their level of consumer service. ....Neither of them were...a mere 'conduit'. Their relevant activities can fairly be described as the business of bringing together insurers and those seeking insurance .....
>
> [87] ...It would ...be immaterial that neither [taxpayer] had anything to do with the negotiation of the terms of the insurance contract or its preparation or the collection of premiums or the handling of claims....
>
> (per Etherton LJ)

77. While the taxpayers in that case clearly did undertake an assessment of the insurance provider to whom the borrower was introduced, the Court of Appeal did not

say it was essential for an intermediary claiming exemption on the basis of introductory services to do so. Moreover, as I have said, to consider that as an essential requirement would overlook what the CJEU said in *CSC*. There is therefore no authority for HMRC's proposition that to be exempt the service of introduction must include an assessment of the lender. There are first instance decisions, discussed below, where exemption for the service of introduction was found to be exempt in circumstances where there was no assessment of the suitability of the financial services provider to whom the borrower was introduced: *Smarter Money* and *Friendly Loans.* On the contrary, in the former case, the borrower was introduced to the lender who would pay most for the introduction, and in the second case, the intermediary always introduced the borrower to the same service provider, with whom it was in joint ownership.

78. Moreover, HMRC's suggested proposition would seem to me to remove exemption from persons who have always clearly been seen as financial and/or insurance brokers in the original meaning of the word. It is well-known, not to say notorious, that historically some brokers have selected as the service provider to recommend to the borrower the one paying them the best rate of commission. That is one of the reasons why there has been regulation of brokers and a requirement for transparency about rates of commission earned. But it seems to me that that is a matter for regulation and not for VAT law: if brokers who make recommendations to borrowers based on the broker's self-interest were intended to be liable to charge VAT on their commission I would expect the Directive to have said so. It does not do so nor does the case law. I conclude that it is *not* essential for a broker introducing a borrower to a lender to carry out an assessment of the suitability of various lenders before making the introduction. I do not consider *Smarter Money* or *Friendly Loans* wrongly decided.

79. *Introductory services do include the making of some kind of assessment:* as the intermediary does not have to assess the suitability of the lender, what amounts to the exempt 'making contact with another party'? It is clear that mere advertising is not an exempt activity (see §§69-71) nor is being a 'mere conduit' exempt intermediation (see *Insurancewide.com/Trader Media* cited at §76 above).

80. So what distinguishes exempt introduction from the mere standard rated advertising or acting as a mere conduit? I consider this question in the context of the three first instance decisions to which I was referred (*LeadX* (2008) VTD 20904 , *Smarter Money* (2006) VTD 19632 and *Friendly Loans Ltd* [2009] UKFTT 247 (TC)). These are neither binding nor authoritative but they are relevant to analysing the nature of the exemption for finance negotiation as they are much closer to the facts of this case than the binding and authoritative decisions I have referred to above. I consider them in chronological order.

81. *Smarter Money Ltd:* The appellant used the internet to attract borrowers looking for a mortgage. The appellant required borrowers to provide certain information, such as their location, their credit history and what size and type of mortgage they required. The appellant had a relationship with mortgage brokers and knew what information

they were looking for and that influenced what information it requested from borrowers.

82. The appellant ran a bidding system whereby brokers could bid for each customer and the broker making the highest bid would be introduced to the borrower. Whether or not a broker bid, and how much they bid, would be influenced by the information the appellant had obtained from the borrower. If the borrower went on to apply for a mortgage via the broker to whom the appellant introduced him/her, the information gathered by the appellant could be used by the broker to complete the application form.

83. The Tribunal ruled that the appellant's supply for which it was remunerated by the brokers' bid was exempt, although the decision recording this is not particularly detailed: the conclusion was that:

> "...All [the taxpayer's] activities were conducted 'with a view to' the provision of credit. Whether the [taxpayer] is paid or receives remuneration irrespective of the conclusion of a contract is neither here nor there. The service provided is the introduction of one party to another with a view to the provision of credit."

84. *LeadX:* This case was two years later and had the *Smarter Money* decision cited to it. In this case, the taxpayer operated an internet based bidding system on which brokers could buy and sell 'leads' for insurance and lending contracts. It seems the opportunity to sell leads arose where one broker was in contact with a borrower whom he was unable to help. He would then offer to transfer the borrower to another broker who might be able to help and, if the borrower agreed to the transfer, could then transfer the borrower via the taxpayer's electronic bidding system to the broker who was prepared to pay the most for the lead. One presumes that the borrower had no idea that his interest in entering into a lending/insurance contract was being electronically bid on and sold between brokers, but that was quite irrelevant to the tax question which was whether the commission earned by the taxpayer operating the bidding system was exempt from VAT.

85. The selling broker had to provide the taxpayer with information about the lead so that the taxpayer could match the lead to those brokers prepared to buy leads which met particular criteria. In some cases, the taxpayer approached the borrowers direct for more information in order to match their criteria with brokers looking to buy leads. Brokers had to pay for the leads they purchased irrespective of whether they were later able to negotiate contracts for them. The appellant made its money by charging commission to both the selling and buying brokers.

86. The Tribunal decided that the taxpayer's supplies were not exempt. This was on the basis, it seems, that the purpose of seeking information about the would-be borrower/insured's requirements was to enable the lead to be sold rather than to negotiate a deal for the borrower.

87. *Friendly Loans:* a year later the same tribunal as in *LeadX* determined this case, in which the taxpayer's main business was brokering loans in the sub-prime market.

Some borrowers did not meet the criteria to secure a loan and, if the borrower agreed, the taxpayer would transfer the borrower to an associated company ('GP'), whose main business was negotiating debt repayment plans. That business was exempt for VAT purposes: the question for the tribunal was whether the referral fee paid by GP to the taxpayer was exempt from VAT.

88. The Tribunal held that the taxpayer was an intermediary in providing debt negotiation. The Tribunal distinguished its earlier decision in *LeadX* on the basis that the taxpayer here screened its callers to identify suitable customers for GP and then added value to the process by completing the application form for GP.

89. *Use of bidding system:* HMRC tried to persuade me that where the intermediary sold the lead via a bidding system it was no more than a mere conduit. They sought to distinguish *LeadX* and *Friendly Loans* because the sale of the lead was via a bidding system in the former but not latter case. This distinction overlooked the fact that the sale of the lead in *Smarter Money* was also by a bidding system yet the Tribunal found that supply to be exempt.

90. As I have said, the failure to carry out an assessment of the lender to whom the borrower was introduced and to select the most appropriate lender for the borrower is not a bar to the exemption (§§74-78). Therefore, it is not a bar per se to exemption if the lead is sold via a bidding system. I do not think *Smarter Money* was wrongly decided on this.

91. The real distinction between *LeadX* and the other two cases was the very different nature of what the intermediary did in *LeadX*. Conceptually, it was wholly different to both *Smarter Money* and *Friendly Loans* although a bidding system was involved. While all three cases involved a broker selling a lead either to another broker (*Smarter Money* and *LeadX)* or direct to a provider of a financial service (*Friendly Loans),* the taxpayer seeking exemption <u>*was*</u> the broker selling the lead in *Smarter Money* and *Friendly Loans* but that was not so in *LeadX*. In that case, the taxpayer was not a broker between a person looking for finance and an entity providing it, it was a broker between such brokers. It brokered the deal by which the lead was sold. That is simply too remote to be within the finance exemption. The exemption is limited to the providers of financial services, and those negotiating financial services. The taxpayer in *LeadX* did neither. It did not negotiate between borrower and institution. It was not even a broker in a chain of brokers (see §61) because it did not introduce a borrower to a broker. It merely negotiated the sale of a lead between two brokers. It was broker to brokers, an intermediary to intermediaries. As the Tribunal itself said, it:

> 'brought together brokers for the purpose of marketing leads about potential customers.'

92. Even if the sale of a lead which LeadX negotiated, from one broker to another, was exempt as the 'negotiation of credit', brokering the sale of that lead was no more than an intermediary service to an intermediary service. It was intermediation in the negotiation of credit and therefore not itself the negotiation of credit. It was outside the exemption for that reason.

93. As the Tribunal in *LeadX* did not, and did not need to, address the question of whether the sale of the lead by a broker (in a deal brokered by the taxpayer) was the exempt negotiation of credit, the case is of no relevance to this appeal.

94. *Level of detail in information provided:* HMRC tried to persuade me that *LeadX* and *Friendly Loans* should also be distinguished because the level of detail obtained from the borrower was greater (they said) in the later than former case. I have already explained why the taxpayer in *LeadX* could never have achieved exemption no matter how much detail it obtained from the borrower because it was not in a chain between borrower and lender. And in any event, I don't actually agree that there was less information about the borrower in *LeadX* than *Friendly Loans.* Certainly, details were obtained in *LeadX* and where they were insufficient, the taxpayer made contact with the borrower to obtain further details. I do not think that the cases can be distinguished on the level of detail obtained: in all cases sufficient details were obtained in order for the second broker or financial product provider to decide whether it was worthwhile to bid on the lead. There is no reason to suppose (although it does not appear to have been discussed) that the actual sale of the lead by broker 1 to broker 2 in *LeadX* was, or should have been, standard rated.

95. *There must be some assessment?* Just what does the intermediary have to do to be exempt? Is it enough to gather information on the borrower and if so, how much information? In *Smarter Money* the information gathered was useful to complete the lender's application form: the implication is that the broker assessed the borrower's personal information in some way and only bid on those it thought likely it could obtain loan offers for (and therefore earn commission) but that was not expressly the basis of the Tribunal's decision, which is set out at §83 above. In *Friendly Loans* the suitability of the borrower for GP's services was assessed before the introduction was made.

96. I have already explained that to gain the exemption the intermediary does not necessarily have to assess the lender's suitability to offer the loan (§§74-78): but to be an exempt intermediary it may be that some assessment must be carried out. In other words, it may not be enough simply to gather information on a borrower, the intermediary may need to assess the information and in particular form a view on the borrower's suitability for the loan on offer from the lender. However, what is clear to me that if the intermediary does assess the suitability for either the borrower or lender for the lending then it is within the exemption: a mere introduction is not enough but it is not necessary that the intermediary assesses both borrower and lender. Therefore, it logically follows that it is enough to be within (d) 'making contact with another party' as per *CSC* (see §72) if the intermediary, when making the introduction, assesses the suitability of the lender offering the loan *or* the suitability of the borrower seeking the loan.

97. To summarise my findings of law, to be within 'negotiation of credit' legislation and case law shows that there are the following rules:

(1) Exemptions should be interpreted strictly.

(2) What matters is the nature of the supply and not identity of supplier.

(3) An intermediary can act entirely electronically

(4) While the exemption is static, the services covered by it can evolve.

(5) An intermediary will be remunerated for intermediation but will not be a party to the contract between borrower and institution

(6) Negotiation can be exempt even if no contract results

(7) An intermediary does not have to undertake the entire mediation

(8) An intermediary can be one in a chain of intermediaries

(9) Intermediation does not include the carrying out of back office functions

(10) Intermediation does not include advertising or acting as a mere conduit.

(11) An intermediary is someone who (a) introduces two parties, one looking for a financial product and a person providing it; (b) or is someone who negotiates the terms of such products as between the borrower and lender; or (c) is someone who concludes a contract on behalf of one or other parties;

(12) An intermediary who carries out introductory services (11)(a) must do more than merely advertising or acting as a mere conduit as (per (10)) that is not within the exemption: that extra could be assessing the suitability of the service provider to provide the loan or the suitability of the borrower to receive the loan.

I do not refer to (1) expressly again: it seems to me that the criteria (2)-(12) are applications of the principle that exemptions should be interpreted strictly but not restrictedly. The exemption is interpreted in a practical fashion to apply to those who, whatever called and whatever means employed, are making what the drafters of the Directive envisaged would be an exempt supply.

Application of law to facts on leadgens' supplies

98. Looking at these criteria for 'negotiation of credit', much of the dispute centred on issues covered in (12) and whether the leadgen was a mere conduit. In particular:

(2) HMRC rightly did not take issue with the fact that the leadgens were not traditional brokers: the question is what they did and not who they were;

(3) HMRC did not suggest (at least not directly) that leadgens could not offer exempt services because their entire service was carried out electronically;

(4) Nor did I really understand HMRC to be suggesting that because the type of service offered by leadgens would not have existed at the time, say, the Sixth VAT Directive was enacted, that their services could not be exempt;

(5) Nor was there any issue over the fact that the leadgen was not a party to the lending contract;

(6) Nor did I understand that it was HMRC's case that negotiation could not be exempt if no contract resulted: their case did in part, however, revolve around the very low success rate of 1% mentioned above at §30. I consider this below.

(9) I did not understand HMRC to be suggesting that the leadgens carried on a back-office function.

However, to a greater or lesser degree the remaining criteria were in issue and I address these issues below. In particular, I address the remaining issues in the following sections:

(7) An intermediary does not have to undertake the entire mediation: §106

(8) An intermediary can be one in a chain of intermediaries: see §106.

(10) Intermediation does not include advertising or acting as a mere conduit: see §§112-113.

(11) An intermediary is someone who (1) introduces two parties, one looking for a financial product and a person providing it; (2) or is someone who negotiates the terms of such products as between the borrower and lender; or (3) is someone who concludes a contract on behalf of one or other parties: see §§102-105, 107-108, 132-133.

(12) An intermediary who carries out introductory services must do more than merely advertising or acting as a mere conduit: that extra could be assessing the suitability of the service provider to provide the loan or the suitability of the borrower to receive the loan: see 109-111, 124, 125-130.

99. The appellant's case was that the leadgens sold leads just as the taxpayers in *Smarter Money* and *Friendly Loans* did (and like the brokers, but not taxpayer, in *LeadX)*. By doing so they were an intermediary in the negotiation of a financial contract: they introduced suitable borrowers to the appellant. They were doing much more than merely advertising or acting as a conduit because they applied a simple filter to would-be applicants for loans and only introduced those that met the appellant's basic lending criteria.

100. HMRC does not agree that the leadgen's suppliers were exempt. It says the supplies were not exempt for a number of reasons which I summarise as follows:

(a) There was no legal relationship between borrower and leadgen;

(b) The lead is sold for to the highest bidder and there is no attempt by leadgen to obtain best deal for the borrower.

(c) There is no 'real' assessment of the potential lead, and the leadgen determines in a 'millisecond' whether the customer fits the appellant's (and other financial institutions') criteria;

(d) There is only a 1% chance that a lead offered to the appellant will be purchased by the appellant.

(e) The appellant duplicates the checks undertaken by the leadgen in any event.

5 (f) HMRC's case was that the economic reality is that the appellant undertakes a broad filter of potential loan customers, though which it is straightforward to pass;

(g) The appellant's criteria are not complex nor require exercise of any judgment or discretion by Leadgen.

10 101. I do not consider that any of these grounds are reasons to deny exemption to the leadgen's supplies to the appellant and I explain why below.

(a) No legal relationship between borrower and leadgen

102. There is no legal relationship between the borrower and leadgen. The borrower does not pay the leadgen even if a loan offer is made to him and accepted by him. So 15 there is no consideration. Moreover, the leadgen acts as if there is no legal relationship. He introduces the borrower to the lender that will pay the leadgen the most: he does not act in the interests of the borrower by introducing him to the lender offering the best deal to borrowers.

103. But does this matter from the point of view of the leadgen's entitlement to the 20 VAT exemption?

104. I do not see that it makes any difference. As I said at §57, the case law, and *CSC* in particular is clear is that the legal relationship is sufficient for the exemption if the intermediary has a legal relationship with <u>either</u> borrower or lender (or indeed, as I say at §63, with another broker in the chain). It ought to go without saying that an 25 intermediary cannot (or ought not to) be in a legal relationship with *both* borrower and lender as there would be a conflict of interest. So one or other is sufficient.

105. In all cases here, where the lead was sold by the leadgen to the appellant, the leadgen's legal relationship was with the appellant. The appellant was liable to pay the leadgen. That is obviously sufficient for the exemption.

30 106. Moreover, an intermediary can be an intermediary in a chain of intermediaries (§61), and in such a situation the intermediary's legal relationship might be with another broker in the chain (as it was in *Insurancewide.com/Trader Media)* rather than with the borrower or product provider. In this case, in some instances the leadgen was the only intermediary; in others it appears it would have been one in a 35 line of intermediaries (§11-12) as it may have purchased the lead from another intermediary. But that is immaterial to this issue, as in all cases in this appeal, it had a legal relationship which was with the appellant in respect of the lead sold, even if it had another legal relationship with another intermediary who sold the lead to the leadgen.

(b) Introduction sold to highest bidder without assessment of lenders

107. It was true that the borrower was introduced by the leadgen to the highest bidder without any assessment of whether that lender was offering the best deal. But it was also a finding of fact that the leadgen was obliged under the contract with the appellant to, and did (although not always completely successfully), filter the borrowers so that the introduction was only offered to those lenders whose criteria the borrowers met, in other words to lenders who might offer them a loan. This was no doubt also self-serving on the part of the leadgens in that if the borrowers were not filtered, the lenders were less likely to bid, or would bid lower amounts, for the introduction, as it was less likely to be useful to their business.

108. I have found that as a matter of law, and for the reasons already given at §§74-78, that it is not essential for an intermediary to undertake an assessment of both borrower and service provider: it is enough to undertake an assessment of one or other. So the fact that the (filtered) lead was sold to the highest bidder, without any assessment of whether that lender was offering a good deal to borrowers, does not of itself prevent the leadgen's services being exempt.

(c) Electronic assessment in milleseconds: no real assessment of borrowers

109. HMRC do not accept that the leadgens undertook any real assessment of the borrowers. While it is undoubtedly the case that the leadgens had application forms which the borrowers had to complete with relatively basic information, HMRC's position is that it was very simple for the leadgen to assess whether or not the borrower met the appellant's criteria and indeed it was done electronically in a matter of seconds or less.

110. The fact that the assessment was purely electronic is irrelevant as the case-law at §53 makes clear; the fact that the assessment was done very quickly might have been indicative that there was no real assessment if carried out by a human being as human beings could scarcely have read the application form, let alone assessed its contents in the time frame in which the leadgens operated, thus indicating that they were doing no such thing. But it is well-known computers can undertake very complex processes very fast and so I find, as the assessment was electronic, the speed of it is not an indication by itself that the assessment was not a real assessment.

111. The real question to me is whether the assessment of the criteria, irrespective of the method or speed of it, was sufficient to cross the line from being a mere conduit of borrowers to undertaking negotiation of credit. I deal with that issue in below §§131-133.

(d) Few successful leads

112. HMRC's case is that the leadgens were not intermediaries as only about 1% of leads offered to the appellant were purchased by the appellant. As I understand the point, it is that the leadgens offered the appellant a great many more leads than the appellant considered worth its while to buy. Is this evidence that it was the appellant and not the leadgen who identified whether the borrower was a suitable candidate for

a loan offer, so all the leadgen was supplying to lenders was indiscriminate offers of introductions to borrowers, in other words acting as an advertiser or mere conduit?

113. I find that when deciding whether to purchase a lead, the appellant had two different types of criteria. One set of criteria was to identify whether the borrower was the sort of person to whom they would make a loan (these were the basic lending criteria and credit checks referred to above at §25 and elsewhere). The other criterion was that it was an introduction to a new borrower: the appellant would not pay for an introduction where they had a pre-existing relationship with the borrower (§30). That did not mean that those borrowers did not meet its loan criteria, it was just that the appellant already had a dialogue with those borrowers and did not need to be introduced to them.

114. So the fact that of the rejected offers, 80-90% were rejected, not because they did not meet the lending criteria, but for a different reason, detracts from HMRC's case that the leadgens were offering their customers indiscriminate introductions to borrowers.

115. It remains the case that some offers of introductions made to the appellant were rejected because the borrower did not meet the appellant's lending criteria, either because they failed the credit check or because they did not meet the appellant's basic lending criteria. In figures, it seems something like 1% of introductions were accepted and paid for while some 10 to 20 times that number were rejected because the borrowers failed the basic lending criteria or credit check.

116. Does that mean that what the leadgens did was offer the appellant indiscriminate introductions to borrowers, because, looked at like this, the evidence is that 10 to 20 times the number accepted as fulfilling the appellant's lending criteria were rejected for failing the criteria? What is the answer to the question of whether the leadgen was selling a carefully selected introduction to a borrower who met the appellant's lending criteria, or whether it was offering an indiscriminate choice of borrowers which the appellant was then having to screen?

117. I think the answer to this is the same as with HMRC's next issue which was that the appellant duplicated the checks undertaken by leadgens and I give my conclusion at §121-122.

(e) Duplicated checks

118. Another reason put forward by HMRC for its position that the leadgens were offering indiscriminate leads for sale was that the appellant double checked that each borrower met its basic lending criteria. `What I understood them to mean is that it made no difference to the lender whether or not the leadgens filtered the borrowers, because the appellant would carry out the filtering itself anyway.

119. I do not accept that the leadgens' filtering of borrowers was irrelevant to the appellant. On the contrary, the evidence, which I accept, was that the appellant checked that the leadgen would apply the appellant's basic lending criteria before

entering into a contract with the leadgen and then would terminate the contract if the the leadgen regularly introduced borrowers who did not meet its criteria. That clearly indicates that it was important to the appellant that only filtered borrowers were introduced to it. Moreover, it stands to reason that the leadgen was fulfilling a useful task to the appellant: unless the application form which the leadgen required the borrowers to complete contained the questions to which the appellant wanted answers, the appellant would be unable to merely check that the borrower met its basic lending criteria. It would have had to ask the borrower the questions direct itself, which it did not do. On the contrary the evidence, which was unchallenged and I accept, was that the appellant's check was done by computer very quickly indeed: two seconds including the credit check.

120. I also accept Mr Sharp's evidence that the reason for the duplication of the checks was that sometimes the leadgen failed to update its application form at the same time as the appellant revised its criteria and sometimes the leadgen simply made mistakes and the number of borrowers rejected by the appellant for failing the duplicate test was small. In other words, the filtering by the leadgens was largely effective. And as I have already said, it was clearly useful to the appellant.

121. In conclusion, I do not think that the fact that the appellant checked in every case whether the leadgen had correctly applied the filter means, and that it rejected 99% of all offered introductions, means that the leadgens' suppliers were not 'negotiation of credit'. The question remains whether the checks that the leadgens carried out were sufficient to make their supply one of the negotiation of credit.

122. It might also be significant, it seems to me, is if the actual sales of leads to the appellant rarely led to the grant of a loan. If that were the factual picture, then it might mean that what was going on was the indiscriminate sale of introductions without any effective filtering to identify those borrowers to whom the appellant would chose to make a loan offer, with the filtering being left to the appellant.

123. But that is not the fact pattern. Of the leads which the appellant purchased, it seems loan offers were made to all the borrowers, and half or slightly more of these offers resulted in loans. Mr Sharp's evidence, which I accept, was that leadgens were an important source of new business to the appellant. In other words, the filtering undertaken by the leadgen, together with the checks undertaken by the appellant, meant that the appellant was not indiscriminately buying up leads, hoping that some of the borrowers might meet its criteria, it was only buying leads where the borrowers actually did meet its criteria.

(f) Economic reality

124. HMRC did not really press this point in the hearing, although it was a part of their skeleton argument. The Tribunal must consider the economic reality; but the economic reality is what I have found above and largely was not in dispute which was that the leadgens applied a simple and broad filter of applicants and introduced them to the lender who would pay them the most for the introduction. Referring to 'economic reality' amounted to no more than saying that what the leadgens did was so

simple and fast that it did not cross the line from a mere conduit into being ‘negotiation of credit’ And I consider that below at §§131-133.

(g) The appellant’s criteria are not complex nor required exercise of any judgment or discretion by Leadgen.

125. *Complexity:* Dealing with the issue of complexity first, I agree that there might be a dividing line in that a filter could be so basic (eg what is the borrower’s name?) that it is not a filter at all. A leadgen asking only for that information from a borrower before offering the lead to a lender would be doing no more than acting as a mere conduit, selling leads indiscriminately, and not undertaking the negotiation of credit.

126. But how complex does the filter have to be to amount to the negotiation of credit? I think the appellant is right to suggest that can depend on the nature of the product. A simple filter applied by an intermediary where the criteria to be satisfied to be eligible for the offer of the financial product concerned are very complex might mean the intermediary is not entitled to exemption.

127. But I accept the appellant’s case that the financial product here was simple: a loan of a few hundred pounds for a month. The appellant’s criteria for making such a loan were correspondingly simple. But the criteria applied by the leadgen were sufficient (bar the credit check) for the appellant to decide whether or not to make the offer of the loan.

128. If it is possible to envisage a financial product such that the provider of it was prepared to sell it to virtually anyone, then I accept that an intermediary introducing borrowers to the product provider would be unable to filter leads and could only be a mere conduit and unable to obtain exemption. But that is not, I find, what happened here. While the appellant was prepared to loan in the sub-prime market, it was not the case that it would lend money to anyone. It had real, if simple, criteria (eg minimum monthly income of £900 and a UK debit card).

129. *Judgement/discretion:* Dealing with the point on judgement and discretion, there is no suggestion that an intermediary to be an exempt intermediary must be able to exercise judgment or discretion on behalf of its client. A typical old-fashioned broker brokering loans or insurance policies would not normally have discretion to forego some of the financial institutions’ lending criteria. The intermediaries in *Insurancewide.com/Trader Media* were not reported to have such discretion and their supply was found to be exempt: the Court of Appeal did not state that discretion was a necessary thing for exemption to be obtained.

130. *Partial Filter:* it is clear that the leadgens were only a partial filter in that, while they checked that the borrowers met the appellant’s basic lending criteria, they did not carry out the credit check. I do not consider that the intermediary has to carry out the complete assessment of suitability of the borrower for the introduction to be exempt negotiation of credit: some discretion can be left to the lender. This is point (7) in the list at §97. Exactly where the dividing line between being a mere conduit and an exempt intermediary is not clear from case law, but I do consider that an

intermediary is not outside the exemption where it undertakes every check of the borrower's suitability for the loan except a check (such as the credit check in this case) which the lender has to do for regulatory reasons.

Conclusion on the Leadgen's supplies

5 131. The remaining criteria I indentified for the 'negotiation of credit', with which I have not already specifically dealt with in the context of this case, were (§97):

> (10) Intermediation does not include advertising or acting as a mere conduit.
>
> (11) An intermediary is someone who (a) introduces two parties, one
> 10 looking for a financial product and a person providing it; (b) or is someone who negotiates the terms of such products as between the borrower and lender; or (c) is someone who concludes a contract on behalf of one or other parties.
>
> (12) An intermediary who carries out introductory services must do more
> 15 than merely advertising or acting as a mere conduit: that extra could be assessing the suitability of the service provider to provide the loan <u>or</u> the suitability of the borrower to receive the loan.

132. If the leadgens were exempt at all it was because of their introductory service(11)(a): they did not negotiate (11)(b) nor did they have agency powers to
20 conclude a contract (11(c)). Introduction must be distinguished from advertising or acting as a mere conduit (12) and an assessment by the intermediary of the borrower's suitability for the loan is enough of a distinction.

133. But was there a real assessment in this case? For the reasons given at §§121-123 and §§125-130 I consider that there was. The appellant's criteria were simple but
25 they were not the same as all other lenders (§16) and I do not consider that they were so simple that no real filtering took place; the leadgen applied all the criteria necessary for the appellant to determine whether to offer a loan bar the credit checks which for regulatory reasons the appellant had to do for itself, and I consider such partial assessment sufficient. In conclusion, I consider that the leadgens did enough to
30 cross the line from being a mere conduit or advertiser into being intermediaries introducing the sort of person to whom the appellant might lend the sort of credit s/he was looking for. To my mind that is within the exemption of 'negotiation of credit' for the reasons given above and to that extent the appeal is allowed.

The supplies by Allsec – the law

35 134. The first thing to be considered with Allsec is whether what it did should be seen as a single supply or a collection of different supplies. The parties were agreed, as I have said, and as I have agreed was right, that Allsec made a collection of different supplies, two of which were 'conversions' and 'Livechat'.

135. However, it became the appellant's case in the hearing that at least some of the
40 work undertaken by Allsec under the banner of LiveChat was exempt so either

Livechat should be seen as one exempt whole, or should itself be apportioned between exempt and standard rated supplies. HMRC did not agree that Livechat by itself represented more than a single supply and so I have to decide the point. My decision is that Livechat was a single supply. The contract did not provide for the appellant to choose aspects of Livechat which it could drop from the agreement; aspects of Livechat were not invoiced separately. Moreover, while it would be possible to retrospectively split Livechat into component parts, recognising whether the conversation with the borrower had been about taking out a new loan or defaulting on an old loan, for instance, it was not really possible to split Livechat prospectively as Allsec would not know until it was conversing with the borrower what the borrower's query was. My conclusion is that the appellant has not satisfied me that Livechat comprised multiple supplies: on the contrary it comprised a single supply and that supply was either exempt or standard rated: it could not be apportioned.

136. So I go on to consider the two supplies, the VAT status of which was in dispute.

Conversions

137. I did not understand the appellant to suggest that 'conversions' comprised a number of single supplies. If it did, I do not consider it correct. For much the same reasons as with Livechat, conversions was a single supply.

138. The facts are summarised at §§37-39. Allsec would ring borrowers who had been offered but not accepted the loan with a view to getting the borrower to electronically sign up to the loan. They might answer the borrower's queries, explain the benefits of the loan, chase outstanding information, and take the borrower through the electronic signing process.

139. It was quite clear, however, that there was no element of introduction of the borrower to the appellant. On the contrary, the borrower in the 'conversions' supply was already known to the appellant, as the appellant had already made a loan offer to him/her and the appellant was instructing Allsec to try to close the deal on its behalf.

140. As I identified at (11), negotiation of credit comprises one of three tasks (or at least no others were suggested to me). 'Conversions' was not, as I have said, (11)(a) introduction. The evidence was that the service did not comprise actual negotiation of terms of the loan so it was not within (11)(b). And so far as (11)(c) was concerned, while the Allsec operatives were expected to explain the benefits of the loan to the borrower, there was no evidence whatsoever that they had power to alter the terms of finally the loan or accept a borrower who did not quite meet the appellant's lending criteria. Although, it was clear that for some of their services provided, in particular 'new loans to existing customers' and 'pre-repayments' Allsec agents did have delegated agency powers to conclude loan contracts (§35). However, there was no evidence that these powers were used in 'conversions' which did not concern new loans to existing customers or customers in default negotiating new loans.

141. As I have said at §97(11), an exempt intermediary will either act as agent of one or other of the parties, it will introduce one to the other (but act as more than a mere

conduit in doing so) and/or negotiate the terms of the deal. While I do not rule out the possibility there may be some other task of exempt intermediation not yet apparent in case law or to me, it is clear that the carrying out of back office-type functions, which the lender could do itself but has chosen to outsource, is not exempt intermediation.

5 142. And in my view, that was all the 'conversions' task amounted to. It was chasing up a borrower to whom a loan offer was made with a view to the borrower taking up the loan. There was no introduction and no negotiation of terms; nor did Allsec act as the appellant's agent. On the contrary, if the conversion was successful, the evidence was that the borrower signed up electronically on the appellant's 10 website.

143. Even if I am mistaken and there was some action within conversions where the Allsec agent did have power to enter into a loan on behalf of the appellant, the overall impression of the evidence is that it would have been a minor aspect of the 'conversions' task as a whole. As 'conversions' was a single supply, the answer 15 would be the same. Conversions was not within the negotiation of credit exemption. The appeal is dismissed in so far as it relates to the conversions supplies.

Livechat

144. The facts about Livechat are set out at §§40-43 above.

145. As Mr Scorey said, the evidence (which I accept) was that at least one of the 20 tasks undertaken by the Allsec agents within Livechat, if a separate supply, was exempt and that was the 'pre-repayment' task as it comprised the negotiation of new loans as agent of the appellant as described at §35. I agree that acting as agent in completing a loan agreement would put Allsec within the 'negotiation of credit' exemption.

25 146. However, I had no evidence on the relative percentage of tasks within Livechat which resulted in Allsec exercising its power to commit the appellant to a new loan compared with other tasks: the impression I had from the evidence is that the pre-repayment task was one of many possible outcomes and certainly the appellant has not proved that the supply seen as a whole was exempt as mainly comprising exempt 30 activities.

147. Would any of the other activities within Livechat be exempt if supplied by themselves?

148. Firstly, none of the categories of borrowers in Livechat identified by Mr Sharp were introduced by Allsec to the appellant. On the contrary, they were either existing 35 customers or had already independently found their way to the appellant's website. Even where Allsec contacted persons on the website who were not pre-existing customers, there was no evidence that they undertook any filtering of them so not only was there no introduction there was no assessment either so Allsec could never have been more than a mere conduit. So, as far as (§97)(11)(a) was concerned the 40 Livechat supplies were not within it.

149. Secondly, considering (11)(b), in none of the categories of borrowers in Livechat identified by Mr Sharp did Allsec undertake any negotiation of the terms of loans (other than, it seems in the pre-repayment task which I have already said would be exempt if supplied separately or if the dominant part of the Livechat supply).

150. So far as (11)(c) was concerned, the same was true. The pre-repayment task was within the exemption, but none of the other Livechat supplies involved Allsec acting as a true agent to the appellant in entering into a loan agreement.

151. In conclusion, while one aspect of what Allsec did in Livechat (the pre repayment part) would be exempt if an isolated supply, it was not proved to me that it was the dominant part of the actual supply made, that supply being 'Livechat'. The other aspects of Livechat did not involve the exempt negotiation of credit and the finding I make from the evidence I heard was that these more customer-service-type matters were the more significant part of the 'Livechat' supply.

152. I find that Livechat was not the exempt negotiation of credit but standard rated supply of principally back-office functions. The appeal is dismissed in so far as it relates to the Livechat supplies.

Costs

153. Both parties accepted that this was a complex appeal in which the appellant had not opted out of the costs regime. It asked for its costs in so far as they related to the two types of supply which HMRC accepted before the commencement of the appeal hearing were exempt but which were initially part of the appeal; they also sought their costs in relation to all matters in dispute if they won the appeal.

154. It seems appropriate for costs to follow the event and neither party suggested otherwise. The event, in this case, is that the appellant won on (a) leadgens, (b) new loans to existing customers and (c) pre repayments but lost on (a) conversions and (b) Livechat. I am not in a position to say whether the appellant has largely won or largely lost the appeal as I simply do not know the relative sums involved as the parties treated it as a hearing in principle.

155. In those circumstances, it seems to me that I should defer a decision on costs. HMRC is also at liberty to apply for costs, and I dispense with the need for either party to provide a schedule with their application. If the parties are unable to agree a suitable settlement on costs, they should notify the Tribunal and I will decide the matter.

156. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

5

RELEASE DATE: 19 AUGUST 2016