Following Brexit, the United Kingdom (UK) legislature is in principle free to amend UK Value Added Tax (VAT) law as it deems appropriate, without having to have regard to European Union (EU) Directives. Using the ‘debt collection’ carveout of the VAT exemption for financial services as an example, the author explores whether there is a case for Post-Brexit ‘VAT Quick Fixes’ in the UK.

1 INTRODUCTION

To a considerable extent, one of the promoted effects of Brexit was the ability of the United Kingdom (‘UK’) to depart from European Union (‘EU’) law. Irrespective of the political opinion one might have about Brexit, it is, from a legal perspective, largely true that the UK leaving the EU resulted in increased opportunities for the UK legislature to amend domestic acts and regulations.

In the context of Value Added Tax (‘VAT’), this is of particular significance: Being one of the most harmonized fields of EU law, especially as far as taxation is concerned, the gap between the UK’s pre- and post-Brexit freedom to amend relevant legislation is much wider than in other areas of law.

Against this background, it is worth asking whether the UK might want to consider departing from retained EU VAT law with regard to the debt collection carveout for the VAT exemption on financial services. The incentive for targeting in particular financial services emerges from a combination of two factors: On the one hand, even in the EU itself, the current status quo is often perceived as complex and controversial. Various attempts on a European level to review the VAT rules in this area have been made, but mostly stalled. On the other hand, financial services constitute an industry of particular significance to the UK economy, with the sector accounting for roughly one tenth of the total economic output (the third largest share amongst all countries in the Organization for Economic Co-operation and Development).

In that regard, research and academic contributions targeting the viability of the exemption as such and developing potential alternatives have been plentiful. Without doubt, whether the exemption is to be abolished or replaced in a post-Brexit UK is an issue with significant social and economic consequences which must be evaluated in the light of further studies and consultations. That being the case, it is also clear that significant reforms striking at the heart of the exemption would need enough time for the democratic process to unfold.

In the author’s view however, the foregoing considerations do not mean that nothing at all needs to happen in the interim. After all, the exact scope of the exemption has, in many fields, often been blurry and largely a result of the interpretation in the course of case law from the Court of Justice of the European Union (‘CJEU’). Apart from some critical voices of practitioners in the UK, only a very limited number of contributions however exists which question that case law and whether the result is the optimal one in the light of fundamental legal principles such as certainty and neutrality.

Under those circumstances, the present article uses the debt collection carveout as one example where, for reasons which will follow, the legal status quo is not perfectly aligned with the aforementioned principles. It will furthermore demonstrate how relatively simple legislative changes could be enacted to fix identified issues such as the one targeted by the present article. Amendments of that kind can be regarded, in essence, as...
‘Financial Services VAT Quick Fixes’ – reforms to rapidly improve the status quo from a legal perspective, while conversations on wider reforms around the social and economic feasibility of the financial services exemption as such might be held.

2 WHAT IS THE LEGAL STATUS QUO?

Under Article 135(1)(d) of the retained EU VAT Directive, it is crystal clear that ‘debt collection’ is not within the scope of the VAT exemption for financial services. The corresponding domestic legislation in the UK is missing equivalent wording, but nevertheless, considering the supremacy of (retained) EU law, there can be no doubt that the exclusion applies likewise for UK VAT purposes. For a long time, no case had been brought to a court or tribunal which would have asked for a specific definition of that term. In spite of the absence of any explicit authority, it appears however that there had been a common understanding that ‘debt collection’ would refer to overdue debt, i.e., a service that one might casually describe as ‘chasing a reluctant debtor’.

Albeit so, in AXA UK, when the question ended up in Luxembourg, the CJEU somewhat uncalled for, and all the more surprisingly, expressed a different attitude: According to the court, ‘debt collection’, as an exception to the exemption, must be interpreted widely and shall hence include the collection of any payment as soon as it becomes payable (as opposed to overdue). Technically, the relevant paragraphs and the CJEU’s inherent refusal to distinguish properly between due and overdue could be read as if the intention was to deprive of the VAT exemption virtually any (payment) service provided in the context of payable monies. Taking into account that payments frequently will not be made earlier than immediately after becoming due, one cannot help but wonder if much would be left in terms of the VAT exemption concerning the transfer of money.

Notwithstanding such headaches, the VAT Manual VATFIN 3225 of His Majesty’s Revenue and Customs (‘HMRC’) plainly delimits ‘debt collection’ as including ‘(all) services principally concerned with collecting payments from the person owing them’. Arguably, while appearing strict at first glance, HMRC’s policy should be more lenient in practice when read in conjunction with Brief 54/10, in which the authorities tried to limit the scope of AXA UK by implicitly suggesting that debt collection is not a special form of any exempt service (which would presumably be the transfer of money), but rather a separate service altogether. Such reasoning might be slightly artificial and does not reconcile easily with the wording of Article 135(1)(d) of the EU VAT Directive (‘excluding debt collection’): Had the drafters not considered debt collection to be in principle covered by Article 135(1)(d), such an addition would have been obsolete. Nevertheless, HMRC’s Brief might help to prevent the worst excesses AXA UK otherwise could have.

On a different note, it is not clear whether debt collection also encompasses services provided to the debtor themselves instead of the creditor. Herbain suggests that this should be the case and might insofar find an ally in the CJEU and its judgment MKG, where it was held that the recipient of a service under Article 135 shall not influence the (non-)applicability of the exemption. In two decisions, Barclays v. HMRC and Paymex v. HMRC, the UK Tribunals disagreed and argued that services are necessarily of a different character when provided to the debtor. The Tribunals’ view seems preferable when considering that the opposite opinion cannot be separated from the irritating logical consequence of the debtor paying for the collection of their own debt. Nevertheless, with a resulting stretch of neutrality as per MKG being the inevitable consequence, doubts remain.

In any case, it cannot be denied that AXA UK leads to a legal situation where any payment or transfer of money which is provided after the due date faces concerns, at least a priori, that the application of the VAT exemption is precluded due to the service being regarded as debt collection.
3 WHY IS THE LEGAL STATUS QUO UNSATISFACTORY?

Of course, any exemption from VAT, or, as in the case of debt collection, any exception from the exemption, requires a line to be drawn between services that are covered and those which are not.

When facing exactly this task in AXA UK, the CJEU, in the author’s view, unfortunately made the wrong decision, resulting in the contemporary legal status quo being in conflict with the principle of neutrality. As has been explained, what matters in the eyes of the CJEU is merely that a payment is due. In turn, whether it is due or overdue seems to lack further relevance.

In order for this distinction to be compatible with neutrality, it would be required for the point in time when a payment becomes payable to constitute a crucial event for the average consumer in the sense that a financial service provided shortly after the ‘due point’ is suddenly substantially different than shortly before.[24]

A brief example shall illustrate why this is obviously not the case: If a person went to a café and ordered a drink to sit in, the payment would become due at the latest once the waiter delivers the bill. As a matter of fact, if subsequently a payment is actually made (by any means but cash), the resulting service from the payment processor is the transfer of money with a view to executing a payment that is already due. Had the coffee however been purchased at a coffee vending machine, again by any means but cash, making the payment would presumably be a preliminary step before the machine would start to distribute the coffee. Since in this case only the payment constitutes the acceptance of the offer by the buyer and gives rise to the contractual relationship between seller and customer, the payment is not due (and hence not in settlement of debt) when it is made. Without prejudice to the different experience coffee-wise, in both cases the service from the payment processor of course serves exactly the same aim for the customer, with that aim being the transfer of money in order to ensure that the consideration for the coffee reaches its destined recipient. Under AXA UK in its strictest reading however, in the first case the payment service would be taxable debt collection, while qualifying as a VAT exempt money transfer in the second case.[25] It emerges with a certain inevitability that the definition of ‘debt collection’ as per AXA UK is incompatible with the principle of neutrality.

The concerns are aggravated by the fact that AXA UK results in the need of having to reconcile the CJEU’s definition of ‘debt collection’ with neutrality between services provided to the debtor versus those provided to the creditor. If debt collection is limited to services provided to the creditor, as suggested in Barclays and Paymex, one would have to explain why a payment service is different depending on whether it is provided to the seller or the buyer in a regular commercial transaction. For payments not having to be enforced as overdue, but which are just regularly due, this is a Sisyphean task since, in the case of the latter, creditor and debtor equally share the goal of the payment taking place and, by extension, have the same aim towards a service from a payment provider. Consequently, the debtor/creditor question makes a further violation of the neutrality principle resulting from AXA UK inevitable.

For the sake of completeness, it shall be noted that for many services, ironically including those provided in AXA UK, this might not be too problematic in practice since they would, after DPAS, no longer be considered within the scope of Article 135(1)(d) anyway and hence already fail to meet the first hurdle for qualifying as VAT exempt.[26] However, if the UK Parliament or the courts were to overturn that case law (for the latter an opportunity may arise in the near future)[27], the problem would become once again more widespread. In any event, the contemporary definition of ‘debt collection’ is in need of reform: Currently, at best it aligns uncomfortably with administrative practice and undermines certainty, at worst it violates neutrality by covering services executing a transfer of money after due date.

4 HOW CAN THE LAW BE REFORMED?

Having explained why the current VAT treatment of ‘debt collection’ should not be maintained in a post-Brexit UK due to concerns about certainty and neutrality, it might be justified to ask if there is any point in maintaining
the exclusion of debt collection services or if it would not be easier to abolish the exception from the exemption altogether.

Whether such a step might be feasible from a policy standpoint can be discussed, but, from the legal perspective to unsatisfactory law which this article aims to apply, it would go beyond what is necessary to solve the current issues: The trouble around neutrality can likewise be tackled by means of developing a new definition of the term ‘debt collection’ for implementation into the UK’s Value Added Tax Act 1994, schedule 9, group 5 (which contains all VAT exemptions for financial services).

Helpful guidance can be found when looking beyond VAT, where one might observe that the common meaning of ‘debt collection’ is different than the one applied by the CJEU in AXA UK. According to the Cambridge Dictionary for example, debt collection is the collection of ‘payments from people who have failed to pay the money they owe.’ Economically, enforcing payments in these kinds of circumstances, i.e., where there is an actual risk of ultimate default, serves a vastly different aim than merely executing a payment which has become due. Ringfencing the former type of services and excluding them from the exemption would therefore not violate neutrality.

The suggested wording for the new definition, to be implemented into Note 6, which contains all definitions, is as follows:

(6) [For the purposes of this group], ‘debt collection’ shall mean services concerning the collection and enforcement of overdue debt.

It would be supplemented by the inclusion of the following Note 2B into Schedule 9 (which currently happens to be vacant):

(2B) This Group does not include debt collection.

Given that debt collection is not explicitly excluded from the exemption in the current version of the UK VAT Act, Note 2B above becomes necessary in order to give effect to the new definition drafted into Note 6. Therefore, stipulating that Group 5 ‘does not include debt collection’ is by no means introducing a new restriction to the VAT exemption, but merely codifies what is already the status quo as prescribed by Article 135(1)(d) of the retained EU VAT Directive.

Using the exact same term (‘debt collection’) is crucial to ensure that the proposed amendment unambiguously overrides Article 135(1)(d) to the extent that debt collection is concerned. By extension, AXA UK seizes to apply insofar and is replaced by the revised definition as suggested in the proposed addition for Note 6.

If the VAT Act was supplemented by the new definition, then, going forward, services of ‘debt collection’, would only qualify as such and hence not be VAT exempt if they concerned debt which has become overdue. Particularly the terminology ‘collection and enforcement’ is designed to target services where the primary aim for the creditor is the recovery of debt which might otherwise have to be written off. It follows axiomatically that the execution of the payment itself (i.e., the transfer of money) would normally be ancillary to such services. The definition hence should achieve exactly the intended outcome of separating real debt collection (taxable) from mere processing of due payments (VAT exempt).

One legitimate criticism of the suggested reform would be that it falls just short of solving the neutrality-problem because ‘debt collection’ is still prone to an overly wide interpretation owing to the new definition referring to ‘overdue debt’. Admittingly, the plain fact that a payment is overdue is insufficient to conclude that there is a risk
of ultimate non-payment. Instead of being reluctant to pay, a debtor in default might have merely forgotten that the payment became due. In such circumstances, a payment provider is still rather executing a transfer of money than engaging in true debt collection.

However, it shall be noted that the arguably somewhat weak reference to 'overdue debt' is supported by the expression 'enforcement' which, in itself, suggests some reluctance from the payor's side and hence ensures that not every transfer of money can no longer be exempt only because it might take place shortly after the corresponding debt became overdue.

Furthermore, alternatives to the term 'overdue', for example any reference to payments at risk of ultimate default, would be inherently subjective and hence at risk of disputes as well as subject to uncertainty.

Footnotes

* Fabian Barth, LLM Bournemouth University.


10 Case C-175/09 *Commissioners for Her Majesty’s Revenue and Customs v. AXA UK plc* [2010] EU:C:2010:646.


12 AXA UK (n. 10), paras 33 and 34.

13 *Collecting and Accounting for Money Via Direct Debit Not VAT Exempt*, 278 EU Focus 38 (2010).

14 See e.g., interpretation *Target Group Ltd v. HMRC* [2018] UKFTT 226 (TC) [103].


16 HMRC Manuals, *Credit, Debts and Related Services: Debts and Related Services: Debt Collection* (VATFIN 3255).
17 HMRC, Revenue and Customs Brief 54 (2010): The European Court of Justice (ECJ) Judgment in AXA UK plc, HMRC Position, last paragraph (2010).

18 Charlène A. Herbain, ECJ Confirms Function-Based Approach to the VAT Exemption of Transactions Concerning Payments and Transfers, 46 Intertax 930, 932 (2018).


20 [2008] UKVAT V20528 [16].

21 [2011] UKFTT 350 (TC) [142].

22 Edmund King, VAT Treatment of IVAs and Debt Collection, 1085 Tax J. 8 (2011).


24 An aspect arguably neglected by some comments, e.g., Marc Welby, Another One Bites the Dust, 174 De Voil ITI 19, 20 (2010).

25 The obvious caveat here being the assumption that the defective definition of ‘money transfer’ has been updated in accordance with the suggestion in the previous subchapter.

26 In contrast to what had originally been anticipated when the ruling was published: Valentina Sloane, Reviewing the AXA Ruling, 1053 Tax J. 7 (2010).

27 Pending case: Target Group Ltd v. HMRC UKSC 2021/0189.


29 Dailé Jimenez, Dirty Debts Sold Dirt Cheap, 52 Harv. J. Legis. 41, 94 (2015).

30 The reason why AXA UK ceases to have any effect in the UK after the implementation of the proposal is that the law would no longer be ‘unmodified’ in the sense of the European Union (Withdrawal) Act 2018, s. 6(3).