

24 April 2013

VAT: Credit and Debit Card Charges

Introduction

The purpose of this guidance note is to update Members on the VAT treatment of charges made to customers who pay for products by credit or debit card. Currently, there is confusion around these charges. We have been and will continue in discussions with HMRC to get a better understanding of the charges and establish a clear position for our Members. We will communicate any further developments of those discussions.

We are also aware that many Members have been contacted by HMRC as part of a travel agent compliance programme and that some Members have been assessed for VAT on credit/debit card charges. We have been discussing this with HMRC and will continue to do so and will bring you any further updates when we can, along with the implications of any relevant Tribunal cases.

We should also bear in mind that in April 2013, a new law came into force that card charges must not be higher than the cost to the trader of accepting the payment ([see separate Guidance Note](#)). This however does not change the VAT position.

Background

The Member guidance published in 1998 set out the circumstances in which credit and debit card charges could be exempt from VAT. In 2006, however, HMRC announced that many credit/debit card charges which had previously been exempt should be subject to VAT. This followed court decisions involving Bookit Ltd and Scottish Exhibition Centre Ltd (SEC).

More recently, there have been further cases, notably the AXA and Everything Everywhere decisions, which have affected the wider industry.

Details of all cases are outlined below.

The current position is that HMRC expects Members to account for VAT on “stand alone” charges (see below). Any Member not accounting for VAT in the circumstances in which HMRC believes VAT is due, faces being assessed for underpaid VAT. Subject to time limits and the possible need to submit an appeal, such businesses would be entitled to a refund of that VAT (plus interest) should there be a successful challenge on this issue. Likewise, a business declaring VAT as due may be entitled to a refund, should anyone successfully challenge the HMRC position.

In practice, the current position can be summarised as follows:

1. Where the charge is made in relation to a supply for which the Member is acting as principal the charge is part of the value of that supply. Often that requires the inclusion of the charge in the Member's TOMS calculation;
2. Where the charge is made in conjunction with a transaction for which the Member acts as agent and the charge is the only charge made by the agent for its own account to the customer, i.e. it is a standalone charge, HMRC believes the charge is standard-rated, whilst we believe it is exempt;
3. As 2 above, but where the charge is made in conjunction with another agency fee charged for the account of the agent, the card fee takes the same treatment as the first fee.

ABTA disagrees with HMRC about the treatment of stand-alone fees i.e. category 2 above, but there is no disagreement about 1 and 3. We have considered the technical arguments below.

Further examples are included in an FAQ section at the end of this guidance.

Finally, it is important to appreciate that the value of the card charge is not relevant. Even if you charge less than the cost incurred, this makes no difference to the VAT position.

Case studies: Everything Everywhere (formerly T-Mobile) and AXA/Denplan, 2010

The AXA UK PLC case concerns the services of a group company (Denplan) which collects monies on behalf of dentists under patient payment plans. The court held that charges made by Denplan to the dentists were not exempt as financial services. Central to the decision was the finding by the court that these services are capable of falling within the definition of factoring or debt collection, such services being specifically excluded from exemption. Whether the amount in question is overdue or not doesn't matter.

Arguably, this decision should not affect services supplied by travel agents, because they "affect the legal and financial situation between the parties" and therefore fall within the exemption.

T-Mobile provides standard rated telecommunication services. Customers can choose from a variety of payment options – if the direct debit or BACS method is chosen, no extra charge is made. However, if customers pay via credit/debit card, cheque or in branch, a separate payment handling charge is made. T-Mobile argued that this was exempt from VAT, as financial intermediation.

The court ruled that such charges are not exempt from VAT, as they are not a supply in their own right i.e. the customer intends to purchase telecommunication services only and the payment handling charge is not distinct or independent. Instead, it is an opportunity for customers to pay using the method which is most convenient. Relating this to the travel industry, this decision supports the treatment of non-stand-alone charges and those levied by a principal as described above.

HMRC Brief 54/10

In January 2011, HMRC issued a Business Brief to explain their interpretation of the AXA/Denplan decision. The brief suggests that such credit/debit card charges (and indeed all other services which are concerned with collecting payment from the person who owes it, for the benefit of whomever it is due to) should be subject to VAT as consideration for debt collection services. The collection by an agent of amounts due to a principal should be classified as debt collection even where the amount in question is not overdue.

The position of travel agents is not dealt with expressly, but it seems clear that HMRC expect charges to be subject to VAT, unless an individual taxpayer has previously received a contrary ruling from HMRC.

However, we think that there's still scope for Members to demonstrate that their circumstances are distinctly differently from those of AXA/Denplan and to apply the exemption.

Case examples: Bookit and SEC, 2006

Bookit is a subsidiary of The Odeon and it takes bookings on behalf of The Odeon mainly by telephone. Bookit accepts payment by credit and debit card and levies a charge to cinema goers for the use of their card. HMRC argued that Bookit's services should be subject to VAT but Bookit counter-argued that it was providing a financial service and should be exempt. Bookit succeeded at the Court of Appeal but, as is explained in detail below, HMRC interpreted the decision as requiring a specific set of circumstances to be satisfied before exemption can be applied.

In the later case of SEC, the Scottish Court of Session agreed with SEC that its own charges for the use of credit/debit cards at its booking office should be exempt.

On 30 October 2006, HMRC issued a Business Brief containing their response to the Bookit and SEC decisions. The Business Brief detailed the four activities which the Court of Appeal concluded that Bookit was performing.

1. Obtaining the card information with the necessary security information from the customer.
2. Transmitting that information to the card issuers.
3. Receiving the authorisation codes from the card issuers.
4. Transmitting the card information with the necessary security information and the card issuers' authorisation codes to Girobank (Bookit's merchant acquirer).

It was clear from the Business Brief, and from our discussions with HMRC, that HMRC attached particular importance to the fourth activity above.

The Business Brief suggests that exemption could continue to apply in many circumstances but, in practice, it appears that HMRC was proposing a restrictive interpretation with which we believe our Members would be unable to comply. This more onerous restriction appeared to require retailers to undertake more than point four above, and to have a relationship directly with the card issuers.

We did not accept that this narrow, restrictive view was a true interpretation of the Bookit and SEC decisions and in practice were concerned that few, if any, retailers (in any sector) could satisfy this, and "have a relationship directly with the card issuer". Our understanding was that it is simply not normal practice for retailers to have a direct relationship with a card issuer, and that the transactions in question are routed via a

merchant acquirer which, we understand, wasn't sufficient in HMRC's view to support exemption. The use of a merchant acquirer meant that (according to HMRC) the conditions for exemption could not be satisfied and on this basis most, if not all, retailers fail to be exempt.

Accordingly, we took advice from leading tax counsel who supported our interpretation.

ABTA's position in this, therefore, was quite clear: the decisions in the Bookit and SEC cases demonstrated that exemption should be applied to credit/debit card charges where the supply for VAT purposes is of acceptance of payment by card and the activity of the merchant gives rise to a transfer of funds. We don't believe that HMRC's restrictive interpretations of the circumstances of Bookit and, to a lesser extent, SEC, were a proper reflection of those decisions. We still hold that view; what needs to be considered is the effect of the AXA/Denplan case.

The interaction of the 2006 cases and AXA/Denplan

The questions asked of the European court concerned whether the operations of AXA/Denplan affected the legal and financial relationship between the parties. The court concluded that they did but this was not enough to obtain exemption: the exemption for such services was negated by the court's conclusion that the service was of debt collection. This conclusion has now been accepted by the UK Court of Appeal.

In a sense, therefore, the outcome can be read as support for our argument that exemption should apply. The problem that needs to be overcome is the conclusion that Denplan was performing a debt collection service, and HMRC's interpretation of this aspect of the decision.

In Brief 54/10, HMRC describes debt collection as "all services principally concerned with collecting payments from the person owing them for the benefit of the entity to which those payments are owed". The brief goes on to say that it does not matter whether the payments are made before, on or after their due date. However, the crucial aspect here would appear to be HMRC's acceptance that the person paying the amount must owe it before the collection. This would suggest that there must be an amount owed before the transaction in question is created. This is borne out, to a degree, by the circumstances of Denplan, which involved an annual payment plan. Amounts due for dental cover were agreed at the start of a year and the patient agreed to pay that premium in 12 equal monthly instalments. It can be seen in that case, therefore, that there was an "amount owed" before the collection of the amount due each month. We would suggest that the circumstances in the typical agency booking of a flight, hotel or holiday, etc, are very different in this sense.

It is also important to recognise that AXA/Denplan made its charges to the dentist, ie, the person to whom the amount was owed. Indeed, in this context it is worth quoting from the decision: "Denplan is, in return for remuneration, responsible for the recovery of debts and provides a service of managing these debts *for the account of those entitled to them*" (our emphasis added). However, a Member's credit/debit card charge is made not to the principal supplier of the services but rather to the customer. Unlike Denplan therefore, the agent's supply is made to the debtor, not to the creditor, and this is an important distinction: is it appropriate to treat the agent as providing a debt collection service to the debtor?

There are, therefore, reasons to believe that agents' standalone charges can be distinguished from the AXA/Denplan circumstances. However, any Member wishing to treat its charges as exempt must be able to prove that:

1. AXA/Denplan does not apply to the charges in the Member's individual case, based on the potential differences set out above.

2. The Bookit principals do apply, so that the four activities listed above are present in the transaction;
OR
3. A successful challenge is made that demonstrates the HMRC interpretation of the Bookit case to be too restrictive.

HMRC's compliance programme

We are aware that many Members have been contacted by HMRC to discuss the treatment of card fees. A number of these discussions have already concluded in the issue of an assessment by HMRC.

We met with a team from HMRC to discuss this area and we can confirm a number of the matters agreed:

1. A concern for many Members has been the difficulty in obtaining accurate information for HMRC and the length of time required to carry out this exercise. We have agreed with HMRC that a simplified procedure will often be acceptable. It is a matter for each Member to agree with HMRC that a simplified approach can be adopted but HMRC have indicated that they will look upon such requests favourably. Often the difficulty faced by Members is the way in which records have been kept and the difficulty of identifying standalone and non-stand-alone charges. One approach which Members may care to propose to HMRC is to select a representative quarter and identify the circumstances of each card charge made in that quarter. From this, the Member can identify how much VAT is payable on charges made in the quarter. This VAT due figure could then be expressed as a percentage of turnover in the same period and this result can be applied to turnover in other periods to estimate the level of VAT payable in the full period under review.
2. The letter received by many Members requests information for the period from 1 June 2007. VAT assessments are limited to errors in the four years preceding the issue of the assessment and we were concerned, therefore, as to why HMRC were requesting information covering longer periods. HMRC have confirmed that the maximum period covered is indeed four years and they have no intention of raising assessments for tax underpaid going back as far as June 2007. Information for such older periods is being requested merely for statistical purposes.
3. Discussions with a number of Members have demonstrated that HMRC have sometimes incorrectly raised assessments on all card fees and have not taken account of the distinctions summarised in points 1, 2 and 3 in the Background section. Members should therefore be aware that any assessment must be calculated in line with the different approaches described in this guidance note and that when providing information to HMRC the nature of different values should be made clear. Any member receiving an assessment which has been wrongly calculated should contact the assessing officer with a request that the erroneous assessment be replaced.

Challenging HMRC's position

We are aware that taxpayers in other sectors have challenged the HMRC position in what we believe to be very similar circumstances (see below). We have set out below options available to those members who wish to challenge the HMRC position where an assessment has been issued by HMRC to recover the VAT which they consider to have been underpaid.

1. Request an independent review of the decision. The taxpayer can ask for an HMRC officer independent of those responsible for the initial decision to reconsider the initial decision.

2. If the review does not over-turn the decision, the Member can appeal to the VAT Tribunal. (Note: it is possible to omit the review stage and appeal direct to the Tribunal). The Tribunal is independent of HMRC and represents a relatively informal way in which HMRC's decisions can be challenged in court. The letter from HMRC to uphold its decision on review will detail the process for the taxpayer's right to appeal to the Tribunal. The process is straightforward, and the submission of an appeal does not commit the taxpayer to attend a hearing. A condition of the appeal will be that the VAT in dispute is paid unless hardship is demonstrated
3. Another dispute that is relevant to Member's cases is that being taken by the National Exhibition Centre. We understand that the arguments put forward by the NEC challenge the position adopted by HMRC in their dealings with Members in a similar way. The NEC case was heard in 2012, and a decision is expected soon. Members can seek acceptance from HMRC that their appeal be stood behind this case. The effect of this allows the dispute to be left open for a potentially longer time without the need to attend court or incur costs, pending the outcome of the NEC case. The outcome of Member's appeal will therefore be dependent on the outcome of this case, and therefore if successful extends the time period for any re-claim of potentially over-paid VAT.

Conclusion

From 1 June 2007, HMRC has expected VAT to be charged on many credit/debit card fees.

However, we think there is still an argument whereby Members can seek to apply the exemption for these services. As advised by tax counsel, we believe that the Bookit decision can be used to support the exemption and, we anticipate that many Members can demonstrate that their services are different to those of AXA/Denplan.

For many Members faced with an HMRC assessment a suitable course of action may be to seek an independent review of the initial adverse decision, appeal to the VAT Tribunal and seek acceptance that the appeal should be stood behind another case such as the NEC case.

We hope that the above overview highlights the complexity of VAT issues, but also gives some explanation as to the complications surrounding VAT exemption. Members wishing to discuss the generalities of these rules, or how they apply to their business specifically, should speak to HMRC's National Advice Service on 0845 010 9000 or the ABTA VAT helpline operated on our behalf by Saffery Champness on 020 7841 4052.

FAQ

I am a travel agent selling package holidays on behalf of the tour operator, earning a commission from the tour operator. When a client pays by credit card I make a charge to cover my cost of that transaction.

The card fee is likely to be a stand-alone charge as it is the only amount which the agent is charging on its own account to the customer. HMRC believes such a fee to be subject to VAT, whilst ABTA believes there are good grounds to say that it is exempt.

I create a tailor-made package for a client. If the customer wants to pay by credit card I will charge a fee, but what is the treatment of that fee?

This depends on the capacity in which you are acting when creating the holiday. If the circumstances are such that the sale of the holiday is accounted for within TOMS, the card charge is part of the selling price of the holiday and the value must be included as turnover in the TOMS calculation. If, however, you act as agent for

each supplier of the component parts of the holiday, and earn a commission from each supplier, it is likely that the card fee should be treated as a stand-alone fee.

I sell a low-cost flight for which I am to receive no commission, but charge an agency fee to the customer. What happens if I also charge a card fee to that customer?

The fee charged for the booking of the flight is not subject to VAT as the service provided is the making of arrangements for the provision of passenger transport. The card fee is not a stand-alone fee because it is charged in conjunction with the booking fee. The card fee is part of the value of your service of making the flight booking, and the total value i.e. the two fees in aggregate is not subject to VAT.

I arrange a car rental booking and receive a commission from the rental company. The car is for use in Spain. I charge the customer a card fee – what is the treatment of this fee?

The card fee is the only amount that the agency is charging on its own account to the customer and, therefore, it is a stand-alone fee. As above, HMRC believe such a fee to be standard-rated, whilst we believe it is not.

I make a booking of a UK hotel for a customer who wishes to pay by card. I make a charge to cover the cost of that transaction – what is the treatment of that charge?

It is necessary to determine whether the card fee is a stand-alone charge or not. If, for example, you earn a commission from the hotel and do not charge a booking fee, or similar, to the customer, the card fee is standard-rated, according to HMRC, as it is a stand-alone fee. If, on the other hand, you are making a booking fee to the customer (regardless of whether you are also earning a commission from the hotel), the card fee is not a stand-alone fee. However, in such a situation, the booking fee is standard-rated as you are arranging a service which takes place in the UK and the card fee takes on the same treatment as the booking service itself. In this situation, therefore, both the booking fee and the card fee are standard-rated.

I take a booking for a Spanish hotel and make the reservation with a UK bed bank. The customer wishes to pay by card for which I am going to levy a charge, but what is the treatment of that charge?

This is a difficult one. In this situation you are making your own booking fee to the customer and, therefore, the card charge is not a stand-alone charge. Accordingly, it is necessary to treat the card charge as part of the value of your booking service. The liability of the booking service depends on the status of the bed bank: this is why it is very difficult for you to identify the correct treatment. If the bed bank is accounting for the sale of the hotel within a TOMS calculation, your booking fee, and by extension the card fee, are subject to VAT as you are arranging a supply that takes place in the UK i.e. the bed banks' TOMS supply. If, however, the bed bank is an agent, so that is not accounting for the sale within TOMS, you are now arranging the bed bank's agency supply which is made in Spain, given the location of the hotel. The bed bank's supply is, therefore, outside the scope of UK VAT and so is your supply to the customer. In such a situation, the booking fee and the card fee, accordingly, are not subject to VAT.

This document is intended as a guide only and cannot be a substitute for specific advice.