

HIGH COURT SUPPORTS RETAIL VAT SCHEMES – HMCE APPEALS

A recent High Court judgment came down in support of retailers' VAT avoidance schemes, in which customers sign away 2.5% of the purchase price to a card services company. But what's the position in the emerging chip & PIN environment?

A few years ago, accountancy firms started selling a VAT reduction scheme to their retail industry clients. The amount of money saved appeared to be small – just 37p for every £100 of turnover – but this adds up to millions of pounds for each of the scores of retailers that have adopted the scheme.

Customs & Excise launched a legal challenge and were successful before the VAT tribunal. But earlier this year, the High Court overturned the decision and allowed so-called 'PITA plans'. This is how the scheme typically works:

- When a retailers' customers pay by credit or debit card and sign their receipt, small print at the bottom says that 2.5% of the value of the transaction is paid by the customer to a named card services subsidiary of the retailer.
- The fine print makes clear that the total purchase price is not affected, regardless how the customer pays.
- The 2.5% fee paid to the card services company is not vatable.
- In a normal sale of goods for £100, £85.11 would be retained by the retailer, and £14.89 would be collected as VAT and remitted to Customs & Excise.
- The VAT scheme splits the transaction into two parts: one for a sale of goods at £97.50; another for a card handling fee of £2.50.
- VAT payable on the sale of

goods at £97.50 is £14.52 – 37p less than for a normal transaction. The ex-VAT price is £82.98.

- The retailer keeps the ex-VAT price for the goods of £82.98, plus the credit card fee of £2.50, totalling £85.48: again, 37p more than for a normal transaction.

The Debenhams case

The High Court case involved legal action by Customs & Excise initiating proceedings against Debenhams Retail plc (DR). Its key subsidiary is Debenhams Card Handling Services Ltd (DCHS). (Debenhams' legal counsel were instructed by Ernst & Young.) The PITA plan has been running at Debenhams since December 2000.

A similar case had earlier been considered by the European Court of Justice in *Chaussures Bally v Belgian State*, in which the shoe retailer Bally tried to argue that the 5% fee it had to pay to a third party card handling company ought to reduce the VAT that Bally had to pay since it couldn't recover input tax on the card handling charges incurred. But Lindsay J said the ECJ ruled in part that there could be no reduction because the card service was provided to the retailer, not the purchasers, and that the purchasers had entered into just one contract; in other words, with the supplier – Bally.

Debenhams sought to get around these objections by various notices to customers that they were entering into two contracts: the notification on the till receipt, signs on the shop doors, and more signs around the till area alerted customers to the terms governing the use of certain credit and debit cards. Debenhams also used its

own in-house card handler to collect the handling fee payment from the customer, which presumably was then wholly or partly remitted to the company that provided the actual service to Debenhams – GE.

Refunds provoke an interesting point: if, legally, £2.50 is paid over by the customer to a card services subsidiary, then what happens if the customer wants to return the goods for a full refund? The customer has, in fact, agreed that only £97.50 is paid to the retailer for the goods. There appears to be no legal basis for a customer to demand a refund of anything more than £97.50 – just good customer and public relations.

Ticket cases and chip & PIN

Railways in the 19th century faced the potential problem of having thousands of customers every day; hence, thousands of individual contracts for carriage. The courts took a pragmatic view in what became known as the ticket cases, ruling that it wasn't necessary to determine whether a particular passenger had read, understood and agreed to standard terms of contract, but simply whether such terms had been adequately brought to the attention of the customer.

No specific mention is made in this judgment of the use of chip & PIN technology – by which the customer does not sign a receipt that might have special wording about there being two contracts but instead simply enters a four-digit code into a keypad. But it appears from the judgment that signage for the customer is more important than

a signature from the customer.

Economic secretary to the Treasury and Customs minister John Healey said in June 2003 on winning the case before the VAT tribunal: "This decision sends a clear message to all tax avoiders that we are determined to clamp down on their schemes. We will not allow taxpayers to be cheated in that way, and we will not allow small businesses who cannot afford to run these sorts of schemes to be undercut by the big retailers who can." After losing in the High Court, he said: "We will appeal this decision to the Court of Appeal, and we will work immediately with other Member States to amend EC VAT law to put this matter beyond doubt."

Sue Rathmell, VAT director at Deloitte, commented on Debenhams' victory: "The case may end up at the European Court of Justice. This is not the end of the dispute and retailers should prepare themselves for a long fight."

Andrew Sawers

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