

Charity VAT newsflash - Direct mail VAT bombshell

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Graham Elliott

CONSULTANT | UK

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The Direct Marketing Association ('DMA') tells us that it has received a letter from HMRC in response to its query concerning the VAT treatment of supplies by direct mailing fulfilment houses ('fulfilment houses') to clients such as charities and financial service providers. This has brought the unwelcome news that HMRC thinks the service is fully standard rated, and that the assumption that the end-to-end service involving a zero rated 'package' is fully zero rated does not conform with their policy. The reasoning provided is described below:

Traditional approach

Charities wishing to send printed marketing/fund-raising materials to potential donors commonly ask a fulfilment house to design and produce a package which qualifies to be wholly zero rated on the basis of the contents being either wholly or predominantly zero rated. The fulfilment house is then asked to ensure that these packs are sent to selected recipients. It uses a delivery service provider to achieve this. The delivery service is subject to VAT, but the fulfilment house pays it to the delivery provider, reclaims the VAT, and sells a fully inclusive 'delivered goods' service to the charity, which it zero-rates. The reasoning is that the postal service is merely a means of ensuring that the zero rated package gets to the location which the charity requires. This means that there is no VAT on the underlying costs of the provision of this supply.

Whilst case law and the implication of the contents of HMRC's Notice seems to substantiate this traditional treatment, the DMA was concerned that the position was not spelt out explicitly enough. It therefore asked HMRC to confirm that this treatment was applicable, and commenced that enquiry in 2012 when VAT began regularly to be charged on the relevant postal services. After a long wait of two years, HMRC has written to the DMA confirming a totally different point of view.

HMRC's new interpretation

Whilst the DMA does not publish all of the HMRC letter, nor its original query, it appears from what they have told us that HMRC does not accept that the supply is one of 'delivered goods' such as can be zero rated. HMRC justifies this negative viewpoint by saying that 'the supply is not a composite supply of goods to your customer, but is a supply of services as the 'goods' are sent directly to the recipient rather than to your customer'. This appears to draw a distinction between the normal situation with 'delivered goods', where the customer himself receives the goods, and the situation where the customer directs that goods be sent to other parties. This seems to be irrelevant in light of HMRC's published policy that the position can be regarded in the same way, whether or not delivery is to the actual customer, and can be treated accordingly if delivered to the customer's customer. Whilst, in the case of recipients of advertising material, it is a moot point as to whether that person is a 'customer', this surely is an immaterial distinction and the important point is that the goods can be delivered anywhere at the behest of the true customer and still be 'delivered goods'.

HMRC goes on to say that: 'even if the supply consists of different elements such as printed material and postage, one element is not ancillary to another because they are both essential to the overall aim of the contract'. This appears to assert that the general zero rated nature of the products being delivered cannot determine the treatment of the postal element because the act of posting material to the recipient is (to use their own words) 'at least as important as the printed material element'. We find this a remarkable comment. The sole purpose of the delivery is to ensure that the printed material reaches the recipient. It is obvious, we think, that the postal service is entirely subservient to the goods being delivered, and does not have a free-standing purpose of its own.

All of this would be alarming enough if the analysis was that there were two separate supplies, one of zero rated printed material, and one of the delivery service which happens to be standard rated. But HMRC then comments (without the clarity one would wish) that: 'the nature of the supply has changed and so it cannot take the same VAT liability [as the printed material]. As this supply does not fall within the zero or reduced rate, the whole supply must be taxed at the standard rate of VAT'. That reference to 'the whole supply' seems to indicate that VAT applies also to the production of the zero rated printed material.

Our views on HMRC's approach

HMRC's approach would appear intended to levy VAT on a supply which has generally been treated, hitherto, as completely zero rated. It seems to us that this lacks any justification. As mentioned above, the delivery is subservient to the products which are being delivered. HMRC seeks to characterise this as a general marketing supply, whereas this fails to take into consideration the fact that the objective supply is one of materials to be delivered to the customer's contacts. Whilst the overarching purpose for the charity may be to advertise a fund-raising campaign, we think that this fails to deal sufficiently with the actual supply being delivered by the fulfilment house, and seeks to re-characterise it by reference to some overarching subjective purpose. It also appears to us to depart from the well known precedent set by *Plantiflor* (STC 1132) which

determined that a recharge of postal services for delivery of goods could not be a disbursement if the supplier was responsible for ensuring that the products were actually delivered to any given address, and that the supply was one of delivered goods.

Impact on Fulfilment House

The DMA, unsurprisingly, has warned its members that they may face difficulties. As HMRC has couched its views in terms of a clarification of its policy, it does not say that it will draw a line in regard to past transactions. In situations where a charity has entered into a contract which allows the fulfilment house to add VAT where applicable (which is likely to be the case), the fulfilment house can revert to the charity to make good the difference and potentially even to seek recompense for any penalties that may be levied.

Charities should resist the requirement to make good such liabilities on the basis that HMRC's opinion is challengeable. As to how that challenge will arise, this depends on whether a test case can be brought forward, either by a recipient of the service or, more likely, by a provider. It is to the benefit of both the charity and financial services sectors in particular (not to mention education, health, and care) that a unified opposition is made to HMRC and that the direct mailing industry is encouraged as far as possible to co-operate.

Charities may find that their contract does not allow the fulfilment house to add VAT, and they should take advice on all of their contracts to see if they can resist the imposition of VAT on a retrospective basis under the contract. Whilst this may seem unfair on the fulfilment house, a charity is obliged not to pay more for the service than it has contracted to do, and therefore ought not to take the view that it wishes to 'help out' a fulfilment house unless it has very good reasons based on its charitable purposes.

How we can help

As mentioned above, we can review contracts to see if a provider has the legal ability to transfer the liability to the charity. Further, we can consider the details of the contractual arrangements and the practical arrangements between the parties, to determine the strength of any opposition to HMRC's point of view. If there are aspects in the arrangements as currently configured which may be adjusted to improve the chances of success (from the date of adjustment onward), we will advise on how to achieve this. We encourage clients to deal with this proactively and not to delay until they face a dispute with a provider.

Authors

Graham Elliott

CONSULTANT | LONDON

International corporate tax

 +44 20 7597 6112

 graham.elliott@withersworldwide.com