SUPPLY CLASSIFICATION: A WRONG TURN?

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What's the issue? The Court of Appeal has held in *HMRC v Gray & Farrar International LLP* [2023] EWCA Civ 121 that a matchmaking agency was not providing services of consultants because the "predominant element" of its supply was the making of introductions.

What does it mean for me? As well as the potential impact on the consultancy profession more generally, the Court of Appeal approved the Upper Tribunal's formulation of a "hierarchy" of tests for supply classification, identifying a "predominant element" test as the main one.

What can I take away? Recent CJEU case law refuting the existence of a "predominant element" test was not brought to the Court's attention, so the judgment may well be wrong. If there is no appeal to the Supreme Court, advisers must consider carefully how best to engage with HMRC on supply classification until the position is resolved in a future case.

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1. The Court of Appeal ("**CA**") judgment in *HMRC v Gray & Farrar International LLP* [2023] EWCA Civ 121 may seem inconsequential – a case about a niche sector, apparently answered by Clause 1 of the contract. In fact, the case raises two important points - the first about the scope of consultants 'services; the second – and more fundamental – about the very method of supply classification for VAT. This article explores whether the domestic courts have taken a wrong turn.

The case

2. The case concerns Gray & Farrar's ("**G&F**") VAT liability on its matchmaking service for clients outside the UK and EU. Under art.59(c) of Council Directive 2006/112/EC (the "**PVD**"), the place of supply of "*the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information*" to a non-taxable person is the place where that person is established or resides. This has been transposed into UK law by section 7(5) and schedule 4A, para.16(2)(d) of the Value Added Tax Act 1994.

3. CA [13] sets out the facts. In essence, G&F agreed to provide clients with a minimum of 8 carefully curated "introductions" to potential matches over a 12-month period, having discussed, verified and considered their clients 'characteristics, suitability and requirements.

4. Clause 1 of G&F's contract sets out its obligation to "*...provide you, within 12 months of your becoming our client, with a minimum of 8 introductions that we consider suitable for your requirements."* An "introduction" was an exchange of telephone numbers.

The decisions below

5. The First-tier Tribunal ("**FtT**") decided that providing contact details where a person had been verified by G&F and was considered compatible fell within paragraph (c) because it was the provision of information and advice (FtT [73]). However, the

presiding judge concluded that "post-introduction" services of G&F's liaison team went beyond this and involved material support in developing a relationship which fell outside the paragraph. He exercised his casting vote and dismissed the appeal (FtT [90]).

6. The Upper Tribunal ("**UT**") held that the FtT had erred in its approach to supply classification. It considered that the CJEU's judgment in *Město Žamberk v Finanční ředitelství* (Case C-18/12) [2014] STC 1703 ("***Mesto***")[1] set out the primary test for characterising a supply – a "predominant element" test (UT [72]) (more on this later). Since the FtT failed to apply this test (UT [83], [86]) the UT considered it could remake the decision (UT [87]). The UT held that "*the qualitatively most important element to the typical consumer was the provision of the introduction to a prospective partner*" which incorporated the provision of both information and advice about the potential match (UT [90]) and the supply therefore fell within paragraph (c). "Post-introduction" services were not reflected in G&F's contract and were insufficient to disturb that conclusion (UT [93]).

The CA's judgment

7. In the CA, the parties agreed that services of consultants involved giving "*advice based on a high degree of expertise*" (CA [37]). Since Clause 1 of the contract established that clients paid not for advice but instead for 8 introductions (CA [59]), the CA purported to apply *Mesto* and concluded that the "predominant element" of G&F's supply was the provision of introductions. The judges held that dissecting this introduction service further into its constituent elements of advice and information, as the UT had done, was artificial. Since an introduction service was not a service habitually supplied by consultants or consultancy firms (CA [65]), the CA allowed HMRC's appeal.

8. But is it correct to limit the services of consultants in this way? Even more fundamentally, was the CA right about *Mesto* and this notion of a "predominant element" test for supply classification? These two questions have far-reaching consequences.

Beyond the "liberal professions"

9. Readers who are familiar with the place of supply provisions at issue here will know that HMRC have historically equated "services of consultants" with those of the "liberal professions". This term originated from the French: *les professions libérales*. It is perhaps a more relevant and familiar descriptor on the Continent than it is in the UK. For example, in Germany different tax rules apply to the liberal professions than to other self-employed businesspeople. Broadly speaking, liberal professions cover the independent provision of intellectual or conceptual services to clients or to the

[1]The domestic courts refer to this case as "***Mesto***", notwithstanding that Mesto just means town or municipality; Žamberk is the name of the town. For consistency, I adopt the *Mesto* labelling here, but the reason for pointing this out is that the CJEU case law just refers to the case as "***Žamberk***" in its subsequent decisions.

public at large, requiring a high level of education or professional training. They are usually regulated by the government or professional bodies.[2]

10. The FtT and UT disagreed with HMRC. While the CA did not address the issue (CA [37]), it seems to me that the tribunals below were right. In *Maatschap M J M Linthorst, K G P Pouwels and J Scheres cs v Inspecteur der Belastingdienst/Ondernemingen Roermond* (Case C-167/95) [1997] STC 1287 ("***Linthorst***"), the CJEU considered whether veterinary surgeons provided *"services of consultants… and other similar activities*". The CJEU observed (CJEU [20]) that the only common feature of the disparate paragraph (c) activities was that they all came under the heading of liberal professions. However, it was not the case that paragraph (c) must therefore encompass all liberal professions and the CJEU ruled that the surgeons 'services were excluded. That is not of course the same as saying that paragraph (c) necessarily extends beyond the liberal professions, however Advocate General Fennelly was more definitive, opining (AGO [21]):

> *"I do not think that the legislator, by that indent, intended to enumerate a catalogue or establish a genus or class of activities corresponding to those of the traditional notion of liberal professions. An interpretation which seeks to compare the myriad of possible forms of modern consultancy work with the social and intellectual prestige — based generally on high standards of educational attainment and strict regulation of ethical and professional behaviour — of the traditional liberal professions would strain considerably the language of the indent."*

11. In other words, "*services of consultants… consultancy firms*" should be given an everyday meaning.

What is advice based on expertise?

12. In allowing HMRC's appeal, the CA limited the "*services of consultants*" to giving advice (CA [37]) which it in turn distinguished from an introduction service. Hence the supply fell outside paragraph (c) (CA [65]).

13. The CA's analysis seems unduly restrictive, both in relation to paragraph (c), and to G&F's services. It also has the potential for unexpected consequences. The most obvious is the treatment of recruitment consultants paid to match candidates to suitable jobs. Bearing in mind that Article 59 includes the supply of staff at paragraph (f), it would be an odd result if the place of a supply of *staff* was the place

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[2]CJEU Christine Adams Case C-267/99, para.3 of the ruling: the liberal professions include activities "*which, inter alia, are of a marked intellectual character, require a high-level qualification and are usually subject to clear and strict professional regulation. In the exercise of such an activity, the personal element is of special importance and such exercise always involves a large measure of independence in the accomplishment of the professional activities.*"

The Directive on the recognition of professional qualifications 2005/36/EC also contains, in its revised version of 20 November 2014, a definition of the Liberal Profession, to be found in Recital 43. Here liberal professions are defined as such activities "*practised on the basis of relevant professional qualifications in a personal, responsible and professionally independent capacity by those providing intellectual and conceptual services in the interest of the client and the public.*"

of the customer, likewise in the case of pure recruitment *advice* – but the matching of candidates to roles now fell outside paragraph (c), notwithstanding that it is a professional service somewhere between providing staff on the one hand and mere advice on the other in terms of the degree to which a business helps a client fill a vacancy.

14. What about consultants hired not just to advise but also to implement projects? Implementation is a common feature of "*modern consultancy work*" (to borrow the AG's language from *Linthorst*). Again, it seems counterintuitive for advisory services to be supplied where the customer is based, but for the implementation of a project on a client site to be supplied where the supplier is established.

15. There could also be said to be a parallel between G&F's services and those in *Levob Verzekeringen BV and OV Bank NV v Staatssecretaris van Financiën* (Case C-41/04) [2006] STC 766 ("***Levob***") – where basic software (goods) had been customised (services), the customisation service prevailed. In G&F, however, the CA focused on the fact of a basic introduction rather than the application of expertise that went into it – customisation, if you will.

16. In G&F's case, introductions were not just names plucked from the phone book. G&F considered a client's brief, undertook necessary research and applied their specialist expertise to make tailored recommendations. Isn't making a recommendation in these circumstances the giving of advice based on a high degree of expertise? Or on any view, the implementation of such advice? Aren't these the hallmarks of "*modern consultancy work*"? Bearing in mind G&F's fees range from £15,000 from £140,000, it seems tolerably clear that clients are really paying for the application of G&F's specialist expertise, as a matter of economic reality.

The "*predominant element*" test: a wrong turn?

17. Turning to the matter of supply classification, the CA approved a "*hierarchy of tests*" to be applied in characterising a single supply for VAT purposes (see at [49]-[50]). This hierarchy was first identified by the UT in *HMRC v Metropolitan International Schools Ltd* [2017] UKUT 431 (TCC), [2017] STC 2523 ("***MIS***") (CA [49]):

> *"(1) The Mesto predominance test should be the primary test to be applied in characterising a supply for VAT purposes.*
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> *(2) The principal/ancillary test is an available, though not the primary, test. It is only capable of being applied in cases where it is possible to identify a principal element to which all the other elements are minor or ancillary. In cases where it can apply, it is likely to yield the same result as the predominance test.*
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> *(3) The "overarching" test is not clearly established in the ECJ jurisprudence, but as a consideration the point should at least be taken into account in deciding averments of predominance in relation to individual elements, and may well be a useful test in its own right."*

18. The "*overarching*" test at (3) comes from *HMRC v College of Estate Management* [2005] UKHL 62; [2005] 1 WLR 3351 ("***College of Estate Management***") at [12]

where the House of Lords held that distance learning courses were educational services, not supplies of books. It has been neatly explained by the High Court in *Byrom, Kane & Kane (t/a Salon 24) v Revenue & Customs* [2006] EWHC 111 ("***Byrom***") at [43]:

> *"43. Lord Rodger, in College of Estate Management, used the phrase an "over-arching single supply" to describe the single supply resulting from several elements. Those words suggest that there may (and indeed I think often will) be a generic description of the supply which is distinct from the individual elements. In many cases the tax treatment of that over-arching single supply according to that description will be self-evident."*

19. Readers may also recall Laws LJ's "apex" versus "table-top" analysis in Customs & Excise v FDR [2000] EWCA Civ 216. Having identified a principal/ancillary situation (the "apex") as one case where multiple supplies fall properly to be treated as a single supply for VAT purposes, Laws LJ continued at [53]:

> *"53. ... but there may be others where the single supply that is arrived at for VAT purposes consists, not in one supply to which others are ancillary, but in a bundle of supplies none of which predominates over the others; the single supply may, as it were, be an apex or a table-top. There is thus a difference between what is "ancillary" and what is "integral": several supplies may be "integral" to one another, with none predominating - the table-top - and this I think is the situation contemplated by the phrase "physically and economically dissociable", quoted by Lord Millett and appearing in some of the Court of Justice jurisprudence, and by Lord Nolan's expression "the true and substantial nature of the consideration given for the payment". The services of a hotelier (compare the facts of the Madgett case) are perhaps an example. ..."*

20. In contrast, the "predominance test" at (1) is said to emanate from *Mesto*, a case about entry fees to an aquatic park which contained a variety of sporting and leisure facilities. To date, it has been interpreted by the domestic tribunals and courts as involving the weighing up of the individual elements of a supply to determine what the typical consumer would regard as qualitatively the most important one. At CA [41], the CA quoted CJEU [29] - [30] of *Mesto*. Having considered the competing domestic and EU authorities which had been identified by the parties, the CA held (at CA [47]):

> "*47. The question remains whether Mesto goes further than the earlier cases referred to, and has established a principle of EU law that the predominant element test is the primary test to be applied in characterising a supply for VAT purposes. I have concluded that it has. In Mesto the CJEU gave authoritative guidance on the test for deciding how a single complex supply must be categorised for VAT purposes. The language used by the CJEU in setting out this test is mandatory. Where it is possible to do so, the predominant element must be determined. This is the primary test to be applied for this purpose."*

21. This is a surprising conclusion, not least because the CJEU in *Mesto* decided to proceed to judgment without an AG Opinion. In other words, the CJEU thought the case raised no new point of law (see Article 20(5) of the CJEU Statute). This is a clear indication the CJEU was not seeking to go further than its previous case law, far less to mandate a new primary test.

22. With respect to the CA, this is also a misreading of *Mesto* itself. This becomes apparent when:

    a. CJEU [29]-[30] of *Mesto* are read together with CJEU [28] (which the CA excluded from its quotation at CA [41]); and

    b. One reviews the paragraphs from previous CJEU judgments cited in CJEU [28]-[30] of *Mesto*.

23. CJEU [28]-[30] of *Mesto* read:

> "*28. There is a single supply where two or more elements or acts supplied by the taxable person to the customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split (Levob Verzekeringen and OV Bank, paragraph 22; Case C-425/06 Part Service [2008] ECR I-897, paragraph 53; and Bog and Others, paragraph 53). There is also a single supply where one or more elements are to be regarded as constituting the principal supply, while other elements are to be regarded, by contrast, as one or more ancillary supplies which share the tax treatment of the principal supply (see, in particular, CPP, paragraph 30; Levob Verzekeringen and OV Bank, paragraph 21; and Bog and Others, paragraph 54 and case-law cited).*
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> *29. In order to determine whether a single complex supply must be categorised as a supply closely linked to sport within the meaning of art 132(1)(m) of the VAT Directive although that supply also includes elements not having such a link, all the circumstances in which the transaction takes place must be taken into account in order to ascertain its characteristic elements and its predominant elements must be identified (see, to that effect, in particular, Faaborg-Gelting Linien A/S v Finanzamt Flensburg (Case C-231/94) [1996] STC 774, [1996] ECR I-2395, paras 12 and 14; Levob Verzekeringen and OV Bank, para 27; and Bog, para 61).*
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> *30. It follows from the case law of the court that the predominant element must be determined from the point of view of the typical consumer (see, to that effect, in particular, Levob Verzekeringen and OV Bank, para 22, and Everything Everywhere Ltd (formerly T-Mobile (UK) Ltd) v Revenue and Customs Comrs (Case C-276/09) [2011] STC 316, [2010] ECR 1-12359, para 26) and having regard, in an overall assessment, to the qualitative and not merely quantitative importance of the elements falling within the exemption provided for under art 132(1)(m) of the VAT Directive in relation to those not falling within that exemption (see, to that effect, Bog, para 62)."*

24. When these paragraphs are considered together, it is clear that:

a. CJEU [28] of *Mesto* is concerned with identifying the two situations in which there will be a single supply (as opposed to multiple supplies). The first is where there is a "*single, indivisible economic supply, which would be artificial to split*"; the second is where there is a principal supply with ancillary supplies which share the tax treatment of the principal supply (a principal/ancillary case). These two situations are exceptions to the general rule that for VAT purposes, every supply must normally be regarded as distinct and independent. Moreover, they are mutually exclusive – one does not rank above the other.

b. In a principal/ancillary case, no further analysis is needed to determine the tax treatment of the supply. By definition, it is that of the principal supply.

c. On the other hand, in a "*single, indivisible economic supply*" situation, a further stage is needed to determine classification and CJEU [29]-[30] goes on to explain how to do this:

    i. The reference to a "*single complex supply*" in CJEU [29] is to the "*single, indivisible economic supply*" exception referred to in CJEU [28]. In this situation, all the circumstances must be considered to ascertain the characteristic / predominant element**s** (**plural**) of this single supply (and the paragraphs cited in *Faaborg, Levob* and *Bog* all refer to "element**s**" plural).

    ii. While CJEU [30] refers initially to "predominant elemen**t**" (**singular**), it is important to note that the corresponding citations (*Levob* para.22 and *Everything Everywhere* para.26) are not authority for a predominant element test – rather, they are authority solely for the proposition that the viewpoint of a typical consumer is the correct perspective from which to analyse the supply. In fact, neither citation mentions "predominant element" at all. In contrast, CJEU [30] refers to performing "*an overall assessment*".

    iii. While it is true that the CJEU in *Bog* refers to a predominant elemen**t** (**singular**) in places, *Bog* is not authority for a "predominant element" test either. It is a food versus restaurant services case, and the CJEU's ruling itself explains when it is that services collectively predominate over goods. This is clear from the more recent case of *Frenetikexito* (discussed further below).

25. For all these reasons, *Mesto* is not mandating a new approach. In particular, it is not saying that VAT treatment must primarily be determined by breaking down a single, indivisible economic supply into its individual elements, then weighing up which individual element is said to "predominate". Rather, it is saying that the classification of a single, indivisible supply must be determined by an overall, qualitative assessment of the supply, from a typical consumer's perspective. Properly understood, the "*predominant element*" refers to the overall nature of the supply ascertained by looking at it holistically (not by breaking it down into its component pieces). At its core, this is materially the same as the "*overarching*" approach historically applied by the UK courts.

26. Indeed, the "*overarching*" approach is supported by a recent judgment of the CJEU, *Frenetikexito – Unipessoal Lda* (Case C-581/19) ("***Frenetikexito***") (AGO 22 October 2020; CJEU 4 March 2021). At CJEU [39], the Court expressly approves paragraphs in the AG's Opinion in which Advocate General Kokott calls a predominant element approach "slightly misleading" and the weighing up individual elements "irrelevant" (AGO [27]-[28]). Unfortunately, this later case does not appear to have been brought to the CA's attention (see CA [18]).

***Frenetikexito* – important guidance**

27. *Frenetikexito* concerned a fitness studio that offered a fitness service and a nutrition advice service. The question was whether the studio made a single supply or multiple supplies. If the latter, was the nutrition advice service exempt medical care?

28. In contrast to *Mesto* (where the CJEU proceeded to Judgment without an Opinion), AGO [3] of *Frenetikexito* explains that the referring court (Portugal) could not identify clear criteria for assessing bundles of supplies from the CJEU's existing case law. The AG continues:

> "*3. …These proceedings therefore also give the Court an opportunity to clarify the criteria governing the VAT treatment of bundles of supplies. This could make it easier for specialised national courts to decide, with legal certainty and autonomy, whether there is a single complex supply, a dependent ancillary supply or two (principal) supplies that are to be treated differently.*"

29. The Opinion goes on to set out comprehensive guidance on supply classification which directly addresses and rationalises previous judgments of the Court at some length. The paragraphs of central relevance to this article (AGO [22]-[33]) were expressly approved by the CJEU at CJEU [39], underlining that the Opinion contains important clarification and analysis.

30. There is no substitute for reading both the Opinion and the Judgment in full. Not only do they identify the different situations in which a single supply exists, they also summarise the relevant indicia for differentiating between them. *Mesto* is directly referred to in AGO [29] and the corresponding footnotes (it is cited as *Žamberk* - see footnote 1 above), but only in relation to the limited and uncontroversial proposition that there is a single complex supply where the recipient cannot receive one element of the supply without another.

31. For present purposes, the salient points are:

    a. Every supply must normally be regarded as distinct and independent (AGO [16]).

    b. There are two exceptions arising from the CJEU's case law: (a) single complex supplies; and (b) dependent ancillary supplies (i.e. principal/ancillary cases) (AGO [21]).

    c. The AG is clear that where there is a single complex supply (i.e. where the first exception applies), the multiple elements of the supply form one *sui*

generis supply (AGO [22]). In other words, the individual elements merge into a new distinct supply such that there is only a single supply from the viewpoint of a typical consumer (AGO [25]). This is the same as the "*over-arching supply*" analysis – "*…a generic description of the supply which is distinct from the individual elements. In many cases the tax treatment of that over-arching single supply according to that description will be self-evident*" (*Byrom* at [43]).

32. AGO [27] and [28] are worth setting out in full:

> *"27. From the perspective of the typical consumer, where there is a single complex supply the individual elements lose their independence and become secondary to a new sui generis supply. The object to be examined is then only that single supply as a whole. Any weighting of the individual elements of the supply is rightly irrelevant. It is also to be determined solely according to the generally accepted view whether the single complex supply constitutes a supply of goods under Article 14(1) or a supply of services under Article 24(1) of the VAT Directive.*
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> *28. It is therefore slightly misleading when the Court sometimes states that the material factor in the assessment of a single supply is whether the elements of the supply of goods or of the supply of services 'predominate'. This wording suggests that the individual elements must be broken down and then weighed. In fact, this merely distinguishes between whether, in the generally accepted view, the complex (sui generis) supply is to be regarded as a supply of goods or a supply of services."*

33. The last sentence in AGO [28] identifies the analytical basis for the exercise that the CJEU carried out in *Mesto* at CJEU [33]. In the context of admission to an aquatic park, the CJEU did not separate out and weigh up individually the various different facilities on offer. Rather, the CJEU's approach was to ask whether what was being supplied overall was properly to be characterised as exempt services (sporting facilities) or as taxable services (rest and amusement). What the court was analysing was the "single complex supply" as a whole. It was not trying to assess whether the qualitatively most important element to the typical consumer was the swimming pool divided into lanes, the water slide or the lazy river.

Does this matter in practice?

34. Potentially, yes. Without the benefit of hindsight, if you were to apply a "predominant element" test to the supply of a meal in a restaurant (say) can you really say you wouldn't conclude that food was the most important individual element? It is only because you perform an overall assessment of the supply as a whole that you get to a different answer (i.e. restaurant services: *Faaborg-Gelting* and *Bog*). Moreover, how are you supposed to know at the outset that yours is not a "predominant element" case so that it's permissible to skip to test 3 in the hierarchy? *Byrom* is a good example of this - the UT noted that the supply of the room was the "*single most important element*" to the typical customer (*Byrom* UT [70]), yet somehow the CA accepted in *G&F* that the High Court arrived at the right answer and it was

permissible for it to have applied the overarching test (see CA [48], noting that the CA downplayed the actual finding in *Byrom* to merely "*an important element*").

35. The CA seems to accept that exceptions to the predominant element test might exist (CA [48]) – but given the imprecise nature of the test itself (something that is more than merely important or essential, but not dominant enough to be a principal supply) how is one supposed to know in practice that yours is one such exceptional case? Indeed, both *MIS* and *G&F* illustrate the difficulties of adopting "predominant element" as the primary test:

    a. In *MIS* (another distance learning case), the UT was unable to identify the predominant element of the supply, other than that it was not books (UT [109]). That was sufficient to dispose of *that case* – but had the UT needed to identify what the supply was (as opposed to what it was not), by its own admission the UT would have had to resort to the "overarching" approach to characterise the supply as that of educational services (UT [110]).

    b. In *G&F*, notwithstanding that both the UT and the CA purported to apply the same "predominant element" test, they reached opposing conclusions in effect because they disagreed on how far to break down the supply into individual elements in the first place.

36. While it is also analytically incorrect to suggest that a "predominant element" test takes precedence over the principal/ancillary analysis, this is unlikely to matter in practice. If you have what is in truth a principal/ancillary case, the "predominant element" on a *G&F* analysis should be the principal supply on any view.

Advising clients and corresponding with HMRC

37. If *G&F* is not overturned on appeal, subsequent tribunals may hold that the CA's "hierarchy of tests" is binding since *Frenetikexito* is a post-Brexit CJEU judgment.

38. Domestic case law may take another turn if and when the higher courts come to consider *Frenetikexito*. Pending any restatement, we are left with a disconnect between the approach of the UK courts on the one hand and the CJEU on the other. In dealing with HMRC and the tribunal, advisors should be careful not to be over-reliant on a "predominant element" test to the exclusion of all other analyses and should ensure that a client's facts, evidence and legal analysis can also be presented in such a way to meet the guidance in *Frenetikexito.*