



[2013] UKUT 0173 (TCC)
Appeal number FTC/12/2012

VAT –whether First-tier Tribunal erred in concluding that membership fees recovered after access to club's facilities had been denied due to non-payment were not consideration for a supply but compensation – held yes - appeal allowed

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Appellants

- and –

ESPORTA LIMITED

Respondent

**Tribunal: Judge Greg Sinfeld
Judge Edward Sadler**

Sitting in public in London on 13 – 14 December 2012

Hui Ling McCarthy, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

David Scorey, counsel, instructed by PwC Legal LLP, for the Respondent

DECISION

Introduction

5 1. The Appellants ("HMRC") appeal against the decision of the First-tier Tribunal (Dr K Khan and Mr Julian Stafford FCA) ("the FTT"), [2011] UKFTT 633 (TC) released on 28 September 2011. The FTT allowed the appeal by the Respondent ("Esporta") against HMRC's decision to refuse Esporta's claim for repayment of output tax of £1.3 million.

10 2. Esporta operates several health and fitness clubs with different membership schemes. The claim related to VAT that Esporta had accounted for on amounts recovered from members who had stopped making monthly payments of membership fees. Esporta did not terminate the membership agreements of the defaulting members but, under the terms of those agreements, denied such members access to
15 the facilities and services of the clubs until they had paid all arrears. The only issue in the appeal was whether Esporta made a supply for VAT purposes in return for the late paid fees. It was common ground that if Esporta made a supply, it was chargeable to VAT at the standard rate.

20 3. The FTT allowed Esporta's appeal holding that the late paid fees were not consideration for any supply by Esporta but were compensation. HMRC now appeals to the Upper Tribunal on the ground that the FTT misconstrued what the members were paying their membership fees for, ie what Esporta did in return for the payments.

25 4. For the reasons given below, we consider that the payments were consideration for supplies of services by Esporta, namely the grant of the right to enter the premises of the club and to use the facilities and services provided there, subject to availability. That analysis does not change where the right to enter the club and use its facilities is denied because the member has failed to pay part of the membership fee on time but such fees are paid later. Accordingly, we allow HMRC's appeal.

Facts

30 5. There is no dispute about the facts which are set out in the FTT's decision at [4]-[10] and [28]-[54]. For the purposes of this decision, the facts may be summarised as follows. Membership of Esporta gave members the right to have access to the club and to use facilities and services provided at the club to the extent they were available
35 at the time of the member's visit (and had not, for example, been pre-booked for use by other members). Members were required to join for a minimum period which was usually 12 months but could be up to 24 months (the "Commitment Period"). Some members paid their membership fee for the year in advance. Esporta accounted for output tax on the single annual fee and there was no dispute about the VAT treatment
40 of that fee. Other members agreed to pay their membership fee monthly by direct debit. If a monthly fee was not paid, the defaulting member's access to the club and its facilities was withdrawn. Esporta preferred to retain members where possible and so it did not terminate the membership of a defaulting member but sought payment of the outstanding fees. Once any arrears had been paid, a member regained access to

the club and its facilities although the majority of defaulting members did not reactivate their membership.

6. Esporta originally treated the late paid fees as standard rated membership fees and accounted for output tax on them in its VAT returns. In 2010, Esporta took the view that the late fees were not consideration for any supply but damages or compensation for a breach of contract and outside the scope of VAT. Esporta made a claim for repayment of the output tax which it considered that it had overpaid. HMRC refused Esporta's claim and Esporta appealed to the FTT.

FTT's decision

7. Having set out the facts, reviewed the membership terms and conditions in detail and discussed the submissions, the FTT gave its interpretation of the contract between Esporta and the members at [81] of the decision:

“It must be remembered that the supply must be made “for” consideration, there must be a clear link between the two - the payment and the supply. In our case the supply, which is the use of facilities, is not made. Each monthly payment is made for a supply, namely the use of and access to the club’s facilities. Where compensation has been recovered for any one month where access has been denied to a member then those sums are not related to a supply of services and therefore no VAT is chargeable. There is no requirement for the contractual relationship relating to the supply to be terminated. The tribunal does not interpret the contract as providing for a monthly fee which represents instalments by way of payment for a 12 month supply of “membership” at the time the contract was made. The services are dependent on payment and, for our purpose, that payment is linked to the supply, which is access to the facilities. It is quite clear that the service has ceased [when access is denied].”

8. The FTT set out its conclusions at [84] and [85] as follows:

“84. Since there is no direct and immediate link between the payment and any services provided by the Appellant, no output tax is due. The simple fact is that access to the gym is denied and no payment means that there is no service. The payments which are made are compensatory in nature. The Tribunal does not accept the Respondents’ argument that there is a supply of facilities and membership, regardless of whether those facilities are used. The fact that the member can resume use of the facilities upon payment of the arrears and does not need to re-apply for membership are not convincing arguments to show that membership itself constitutes a separate and distinct service above and beyond access to the facilities. The tribunal cannot identify any direct connection between payment and the provision of “membership”. The club chooses not to terminate the contract, which is an election an innocent party to a breach can elect to make. Rather the supply is the actual use of the facilities and the consideration is the monthly fee.

85. The Tribunal also finds that it is not required that the contract be terminated formally in order for the payment to be outside the scope of VAT. There is a breach not a suspension of the contract. It is the breach which gives rise to the barring of the member by stopping access to the facilities. This operates to break the link between the supply and payment. The Tribunal finds no merit in the Respondents' argument that the payment made by the member is to procure an alteration in the contract."

The FTT allowed Esporta's appeal.

Summary of the parties' submissions

9. Ms Hui Ling McCarthy, who appeared for HMRC, submitted that the FTT erred in law because it misconstrued what Esporta supplied to the members who paid on time. HMRC contended that the supply by Esporta is the provision of facilities ie making the club gym and sports facilities available to a reasonable standard. Mr David Scorey, who appeared for Esporta, submitted, as he had done before the FTT, that the real supply was the right to access such facilities. He submitted that there was no supply by Esporta of making the facilities available. The existence of the facilities was a necessary pre-condition of the supply of the right of access to them. Esporta's case was that the amounts recovered from late paying members were not payments for any service but damages and/or compensation for breach of contract and, as such, not subject to VAT.

Legislation

10. Article 2(1)(c) of Council Directive 2006/112/EC (the "VAT Directive") provides that the supply of services for consideration by a taxable person acting as such is subject to VAT. Article 24(1) of the VAT Directive defines a supply of services as "any transaction which does not constitute a supply of goods".

11. The VAT Directive is implemented in UK law by the VAT Act 1994. Section 5(2)(b) of the VAT Act 1994 defines a supply of services as "anything which is not a supply of goods but is done for a consideration ..."

Discussion

12. As is made clear by article 24(1) of the VAT Directive and section 5(2)(b) of the VAT Act 1994, the issue is whether Esporta has done anything for a consideration. If so then, regardless of what that 'anything' is (so long as it is not a supply of goods), Esporta has made a supply of services.

13. In Case C-270/09 *MacDonald Resorts Limited v HMRC* [2011] STC 412 ("*MacDonald Resorts*"), the Court of Justice of the European Union ("CJEU") was asked to provide guidance as to the classification of supplies of services by the appellant in the course of its timeshare usage rights business. The CJEU referred at [16] to the well-established rule that a supply of services is effected 'for consideration', within the meaning of what is now Article 2(1)(c) of the VAT Directive, and hence is taxable, only if there is a legal relationship between the

provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient. The CJEU then observed at [18] that:

5 “... it is necessary to examine the components of that contract in order to identify the services supplied as consideration for the fees charged by the supplier of services.”

14. Applying the CJEU's guidance in *MacDonald Resorts*, we consider that the appropriate starting point in a case such as this is the contract under which the services are supplied. In examining the agreement between Esporta and its members, we adopt the same approach as the First-tier Tribunal in *Reed Employment Ltd v HMRC* [2011] UKFTT 200 (TC). The Tribunal set out its approach at [64] – [72] of the decision. At [64], the Tribunal stated:

15 “64. There was no dispute between the parties as to the approach we should adopt in determining the nature of the supply. We were referred to a number of authorities, key among which, in our view, are the recent judgment of the ECJ in *HM Revenue and Customs v Loyalty Management Ltd and Baxi Group Ltd* (Cases C-53/09 and C-55/09) [2010] STC 2651 and *Customs and Excise Commissioners v Reed Personnel Services Ltd* [1995] STC 588.”

20 15. Having reviewed those cases, as well as others such as *Tesco plc v Customs and Excise Commissioners* [2003] STC 1561 and *A1 Lofts Ltd v HMRC* [2010] STC 214, the Tribunal summed up the approach to determining the nature of a supply at [72] as follows:

25 “72. What we take from all this is that the contracts between the various parties are necessarily a starting point, but may not be determinative of the nature of the supply or the consideration that has been given for it. That may depend on an objective analysis of all the facts, having regard to the economic purpose of the transactions. The search is for the economic reality, which may or may not be determined by the contractual arrangements between the parties.”

35 16. We start by looking at the agreement between Esporta and its members. There were three versions of the standard membership terms and conditions during the relevant period in 2005, 2009 and 2010. We understand it to be common ground that the 2009 and 2010 terms were substantially the same as the 2005 terms and we refer only to those below.

17. Clause 1.1 of the standard membership terms and conditions deals with the duration of membership and provides

40 “When you join the Club you are agreeing to remain a member for a Commitment Period. For administrative reasons this period covers the rest of the calendar month in which you join (if you join after the first day of the month) and the following 12 full months.

The Commitment Period is a core term of membership necessary to allow us, as a private club, to commit to the level of investment required in providing equipment and facilities to the standard expected by our members ..."

5 18. Clause 1.2 describes the effect of termination during the Commitment Period as follows:

"You can give notice to terminate at any point during the Commitment Period but this cannot end your membership before the end of the Commitment Period (unless a shorter period of notice is permitted under these terms or the Club rules)."

10 19. Clause 2 deals with the use of the facilities. Clause 2.1 provides:

"You will only be permitted to use the Club facilities provided that your membership is current and fully paid up or you have made payment arrangements acceptable to the Club."

15 Clause 2.2 states that the Club may change opening hours or facilities, eg for maintenance, but if there is a significant change then the member may have the right to cancel his or her membership under clause 6.

20. Clause 3 deals with fees. Clause 3.1 states

20 "The Membership Application forms set out the joining fee and membership fee payable on joining. If you pay membership fees monthly, they are payable in advance by direct debit."

Clause 3.3 states that:

25 "If your bank fails to make a due direct debit payment from your account, we (or our processing agent) will write a letter to advise you of this. We (or our processing agent) may continue to apply to your bank for payment by direct debit for up to two times and we (or our processing agent) reserve the right to refer any missed due payments to a debt collection agency ..."

30 21. Clause 6 contains provisions relating to termination of membership by Esporta and the member. Clause 6.1 provides that Esporta may terminate a member's membership of the club immediately if, among other things, any part of the membership fee remains unpaid 30 days after its due date. The clause also states that:

35 "If we terminate your membership for any of these reasons (or you terminate without giving the due notice period) you will remain liable to pay the membership fees for the due notice period and, if applicable, the remainder of any unexpired Commitment Period. The only exceptions to this are that the Club will allow a reduction for any operating costs saved through your not using the Club (though such savings are likely to be minimal) or for any membership fees recovered from a replacement member (but only if the Club has a waiting list for membership)."

22. Clause 6.2 provides for termination by the member. It provides that:

"You may terminate your membership immediately on giving notice to the Club:

- if we commit a serious breach of these terms; or
- 5 • on grounds of the unavailability of facilities where the unavailable facilities comprise either a substantial part of any particular facilities or a substantial part of the Club's overall facilities. In either case such unavailability must have a material adverse effect on your use of the Club and the whole or greater part of the affected facilities must be
10 unavailable for at least 20 days in any period of 60 days (or for at least 60 days in any period of 365 days). If the unavailability is less than this (in effect, timing or extent) then you may be entitled to compensation but not to terminate your membership.

15 If you terminate your membership in these circumstances, you will be entitled to an appropriate refund of membership fees paid in advance and/or compensation as a matter of law."

23. Prospective members were sent a Welcome Pack that as well as including the membership terms and conditions also included an application form on the back of which was a section headed "Important Points to Note about Membership of Your
20 Esporta Club". Those points included the following:

"Your Esporta club endeavours to provide superior facilities and excellent levels of service in a safe and enjoyable environment. As a private club we are dependent on the fee income from our members to finance the high cost of investing in equipment, facilities and health and safety to the standard
25 expected by our members. The terms and conditions of Club membership and the Club reflect our commitment to maintaining these high standards and in meeting your expectations.

This Membership Application together with the Club terms and conditions, and the Club rules, form a legal membership agreement. You should read the
30 full Club terms and conditions and rules enclosed in your membership folder. Although the essential aspects of these are discussed with you prior to your joining, we draw your attention to the following:

(a) On joining, you are agreeing to commit to an initial Commitment Period of membership for the remainder of the month in which you join (if you join after
35 the 1st) and the following 12 complete calendar months (or the number of months specified in your membership Application if it is not 12).

(b) Except where you pay your membership fee for your full Commitment Period in advance your Club membership continues indefinitely until expiry of 3 complete calendar months' notice of resignation given at any time, to expire

on or after the end of the Commitment Period. Circumstances providing for a shorter period of notice may apply under the terms and conditions or rules.

..."

24. In summary, the agreement between Esporta and a member provides that Esporta will grant the member the right to enter the club and use the superior facilities and excellent levels of service which Esporta provides at the club, subject to availability, and in return the member will pay the membership fee for the Commitment Period ie 12 months. Membership fees can be paid monthly in advance by direct debit. If any monthly payment is not paid then the member will not be permitted to use the facilities while the payment is outstanding, but the member will remain liable to make the monthly payments for the Commitment Period. Esporta can terminate membership if any part of the membership fee remains unpaid for more than 30 days but the member remains liable to pay membership fees for the remainder of the Commitment Period although they may be reduced to the extent that Esporta can mitigate its loss.

25. Mr Scorey submitted on behalf of Esporta that the central issue is what did Esporta agree to provide in return for the payments by members. He contended that Esporta agreed to provide the members with the right to have access to the facilities of the clubs. Mr Scorey submitted that each monthly payment conferred such right of access to the facilities for the month ahead. Esporta's case is that when Esporta denied a defaulting member access to the facilities (in the case where Esporta had chosen not to terminate the membership), there was no supply of any service: the right of access no longer existed and no other benefit of substance was provided to the member. Mr Scorey submitted that when a member paid late fees then Esporta could not retrospectively provide access for the past months. The FTT accepted this submission and concluded at [84] that there was no direct and immediate link between the payments by the defaulting members and any services provided by Esporta.

26. Ms McCarthy submitted that Esporta does do something in return for the fees, namely it continues to perform its obligations under the membership agreement for the remainder of the Commitment Period ie it continues to make facilities available notwithstanding that the member is denied access until all outstanding fees have been paid. HMRC relied on Case C-174/00 *Kennemer Golf & Country Club v Staatssecretaris van Financiën* [2002] STC 502 ("*Kennemer Golf*"). One of the questions considered by the CJEU in that case was whether annual subscription fees paid in advance by members of the club were consideration for services provided by the club even where the members did not use or did not regularly use the club's facilities. The CJEU held in *Kennemer Golf* at [40] that:

"The services provided by the association are constituted by the making available to its members, on a permanent basis, of sports facilities and the associated advantages and not by particular services at the members' request. There is therefore a direct link between the annual subscription fees paid by members of a sports association such as that concerned in the main proceedings and the services which it provides."

27. Mr Scorey submitted that when the CJEU says "making available" it means the provision of the right of access to use the facilities. He says that *Kennemer Golf* does not mean that the mere existence of the facilities can be a supply; the existence of facilities is a precondition to the supply of the services. In relation to the latter point, Mr Scorey relied on *MacDonald Resorts* where the CJEU held, at [24], that the purchase of 'Points Rights' was not an aim in itself for the customer but was a preliminary transaction in order to exercise the right to use a time share property. Mr Scorey contended that Esporta's position was similar in that membership was not an aim in itself for members but a preliminary transaction to the actual use of the facilities.

28. The FTT said in the last sentence of [84] that "the supply is the actual use of the facilities and the consideration is the monthly fee". Earlier in the same paragraph, the FTT rejected HMRC's argument that there is a supply of facilities and membership, regardless of whether those facilities are used. In our view, the FTT erred in [84] when it concluded that the members' fees were consideration for the actual use of the facilities. It is clear from the membership terms and conditions that the membership fee is payable, whether as a one-off payment or monthly, for the duration of the Commitment Period regardless of actual use of the facilities. The CJEU's analysis in *Kennemer Golf* shows that making sports facilities available on a permanent basis in return for an annual fee is a supply of services for consideration even where the member does not use the facilities. It is clear from *Kennemer Golf* that Esporta makes a supply to a member who pays the membership fee even where the member does not use the facilities or only uses them infrequently. In our view, the FTT was wrong to conclude that the actual use of the facilities was the only service provided by Esporta. It does not necessarily follow that the FTT's decision was wrong. The issue is whether Esporta did anything in return for the late paid fees.

29. Mr Scorey accepted that if a member paid an annual fee by a single payment at the beginning of the year then Esporta would properly be regarded as making a supply to that member even if the member never set foot in the club during that year. Equally, Esporta makes a supply where a member makes a monthly payment but does not use the club's facilities during that month. Is the position any different where a member has defaulted on his or her obligation to make a monthly payment and, as a consequence, has been denied access to the facilities? In our view, the answer is no. We accept that the consequence of a member not making a monthly payment was that the right to use the facilities for the month ahead was denied. However, that fact does not lead to the conclusion that the monthly payment is consideration for a separate supply of services for that month. We consider that the FTT was wrong, at [81], to conclude that each monthly fee was consideration for the right to access to the facilities for the month to which it related. The member agrees that he or she will remain a member for the Commitment Period and will pay the membership fee monthly throughout that period. In return, Esporta agrees that it will provide membership and with it the right of access to the club to use the facilities for the Commitment Period.

30. Esporta can terminate membership for late payment of fees but may (and usually does, for good commercial reasons) choose not to do so. The right to enter the

club premises and use the facilities may be withdrawn if the member fails to make one or more monthly payments but that does not mean that the member ceases to be a member, at least for the remainder of the Commitment Period, or that Esporta ceases to have any obligation to the member during that period. Where a member pays the outstanding fees then Esporta must once more allow that member to have access to the facilities. We do not regard allowing a member to have access to the facilities after a period of default as the making of a separate supply of services. The standard membership terms and conditions do not specifically grant a right to reinstatement of access on payment of outstanding fees and we do not regard such payment as consideration for the restoration of rights of access: the contract simply continues to be fully performed by both parties.

31. The FTT rejected the suggestion that continuation of membership, which meant that a defaulting member was not required to reapply, possibly after joining a waiting list, for membership, could be a separate and distinct service above and beyond access to the facilities. We do not disagree with that conclusion as Esporta is not required to do anything other than allow an existing state of affairs, membership, to continue. Although refraining from doing something in return for consideration can be a supply of services, doing nothing for no consideration is not a supply.

32. We consider that it is clear from the standard membership terms and conditions that the monthly payments are part payments or instalments of the membership fee for the Commitment Period. Each monthly payment is not consideration for membership for that month but is part of the consideration for supplies of services by Esporta during the Commitment Period. It follows that the payment of an outstanding monthly payment is not consideration for retrospective access to the facilities for a particular month but part of the consideration for services supplied during the Commitment Period. The extent to which the member avails himself of the facilities which Esporta provides access to may vary during the Commitment Period: the period may include months where the member used the facilities, others where the facilities were unused even though the member had the right to do so and months where access to the facilities was denied following non-payment of the monthly amount.

33. The fact that the right of access to the facilities was denied for some months does not, in our view, break the link between the late paid fees and the services provided by Esporta when access was allowed during the Commitment Period. Take the example of a person who joins Esporta on 1 January, makes the first monthly payment and uses the facilities of the club every week for the rest of that month. In February, she pays the monthly fee and uses the club on two occasions. In March, she makes the monthly payment but does not visit the club. After March, the member stops the monthly payments. Esporta granted the member the right to enter the club premises and use the facilities in consideration of the member agreeing to pay the fees monthly throughout the Commitment Period. If the member had not agreed to pay the fees for the Commitment Period then Esporta would not have granted her the right of access to use the facilities in January, February and March. The monthly fees for the remainder of the Commitment Period, if Esporta recovers them, are consideration for the service that has been supplied which in this example is the right to enter the club premises and use the facilities in January, February and March. The situation would,

of course, be different if there was no supply but there was no suggestion that Esporta never supplied any services to a member. This must be because there would always be at least one monthly payment so there would always be a right of access to use the facilities for at least one month.

5 34. We consider that the correct analysis is that the monthly payments are
consideration for supplies of services by Esporta, namely the grant of the right to
enter the premises of the club and to use the facilities and services provided there,
subject to availability, during the Commitment Period. The monthly payments are
consideration for the supply of the services whether they are paid in advance, on time
10 or late. The fact that access to the facilities is denied for months where payment is not
made on time does not break the link between the payments and the services that are
provided during those months where monthly fees are paid on time and access is
allowed. We also consider that the same analysis applies where the unpaid fees are
recovered after the Commitment Period has ended as then the payment is also late
15 payment for services that have been supplied during the Commitment Period.

Decision

35. For the reasons set out above, our decision is that HMRC's appeal against the
decision of the FTT is allowed.

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Greg Sinfield
Upper Tribunal Judge

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Edward Sadler
Upper Tribunal Judge
Release date: 26 April 2013

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