VAT focus

SAE Education Ltd: Court of Appeal defines 'colleges' of universities

Speed read

The Court of Appeal finds for HMRC in *SAE Education Ltd v HMRC*, ruling that eligible colleges are only those which are constituent parts of a university (for example, the colleges of Oxford, Cambridge and Durham universities), and that 'colleges' was not intended to cover educational providers to which a university has outsourced certain courses. This is an important decision on the nature and extent of the VAT exemption affecting higher education.

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The facts in *SAE Education Ltd v HMRC* [2017] EWCA Civ 1116 (reported in *Tax Journal*, 8 September 2017) are as follows. SAE Education Ltd (SAE) is part of the SAE (School of Audio Engineering) division of Navitas Ltd. Between 1 May 2009 and 29 February 2012, SAE made supplies of education services. It regarded these supplies as exempt, on the grounds that it was a college of Middlesex University (MU) and therefore an eligible body within the meaning of VATA 1994 Sch 9 Group 6 item 1. HMRC disagreed. It regarded these supplies as being standard rated and raised an assessment.

Exempt supplies of goods and services within the UK are specified in VATA 1994 Sch 9. Exemptions relating to education are contained in Group 6. Item 1 is: 'The provision by an eligible body of – (a) education…' 'Eligible body' is defined in note (1), which includes, in para (b): 'a United Kingdom university, and any college, institution, school or hall of such a university'.

For SAE to succeed in its appeal against HMRC's assessments, it had to demonstrate that it was an eligible body; i.e. that it was a college, institution or hall of MU.

The First-tier Tribunal

The First-tier Tribunal (FTT), in *SAE Education Ltd v HMRC* [2014] UKFTT 218, allowed SAE's appeal, finding that its supplies were exempt from VAT as it was a college of MU, and consequently an eligible body. In making this finding, the FTT focused on the High Court case of *Customs & Excise Commrs v School of Finance and Management (London) Ltd* [2001] STC 1690 (*SFM*). In *SFM*, the High Court considered 15 factors which, by their presence or absence, tended to show that a body was, or was not, a college of a university. These factors included: whether a college was constitutionally a part of a university; whether it was financially dependent on the university; whether it was nearby; and whether it provided courses leading to degrees at the university.

The FTT carried out a detailed examination of the evidence which was available to it with regard to these 15 factors. In finding that there was a substantial degree of integration between SAE and MU, the FTT considered that the following factors carried the greatest weight:

- the status of SAE as an associated college and accredited institution;
- long term links between SAE and MU, and similar purposes, namely the provision of higher education of a university standard;
- some of SAE's courses lead to a degree from MU, with such courses being supervised by MU, which regulated their entry standards; and
- the conferment of degrees by MU, received by SAE students at MU degree ceremonies.

The Upper Tribunal

In *HMRC v SAE Education Ltd* [2016] UKUT 193 (TC), the Upper Tribunal (UT) allowed HMRC's appeal against the decision of the FTT. While the UT agreed that the FTT was correct to focus on the multi-factorial approach suggested in *SFM*, it thought that the FTT was wrong in failing to consider the following two steps *before* it got onto the *SFM* factors:

- Step 1 was whether the university and college had a common understanding of their relationship.
- Step 2 was whether this common understanding was that they were in a relationship of university and college.

The UT found that SAE and MU did not have this common understanding and that MU did not regard SAE as its college. As SAE did not get past steps 1 and 2, the UT did not consider that it was necessary to get into step 3, which would have involved looking at the *SFM* factors to see whether the relationship was sufficiently close that SAE was a college of MU.

The Court of Appeal

In *SAE Education Ltd v HMRC* [2017] EWCA Civ 1116, the Court of Appeal (CA) dismissed SAE's appeal. However, it did so for different reasons than those of the UT. Indeed, the CA expressly rejected the UT's finding that the recognition of the taxpayer body's status by the university should be treated as in any way conclusive of the status which the college in fact enjoyed.

The principal reason that permission for a second appeal was granted by the UT was to allow the meaning of the phrase 'college of a university' to be considered by the CA. In considering that issue, the CA went back to the Finance Act 1972 (FA 1972), which first introduced VAT in the UK. In FA 1972, exempt supplies were those set out in Sch 5, which included in Group 6 item 1 the provision of education by a university. Note 3 to item 1 provided a

definition of university: 'university includes a university college and the college, school or hall of a university'.

The CA said that the phrase 'college, school or hall of a university' had an obvious meaning in the context of UK universities as they were operated in 1972. It meant universities such as Oxford, Cambridge and Durham, which operated on a collegiate basis. These universities had been organised for centuries on a federal system, under which colleges and halls, although legally independent and self-governing, provided the students of the university and assumed the primary responsibility for their tuition. If 'university' had not been defined in this way, collegiate universities, such as Oxford and Cambridge, would not have come within the exemption.

SAE contended that the words in note 1(b) to Group 6 item 1 extended the scope of the exemption for university education; and should be read as including any body which can reasonably be called a college of the university, having regard to the degree of cooperation between them in the de facto running of degrees and other courses validated by the university. SAE said that this reflected the fact that, for economic and technological reasons, university education was now provided in many more different ways than it had been in 1972.

Until the extent of the exemption is clarified, interested stakeholders are in an uncertain position, both historically and going forward

However, while the CA acknowledged that there were stylistic differences between note 1(b) and the definition of 'university' in FA 1972 note 3, these differences did not, in the view of the CA, affect a change in the substance of the provisions. The CA did not believe that it should give a much wider meaning to what was essentially the same language. This was particularly so, as exemptions were to be strictly construed. The CA considered that there was nothing in the relevant provisions of either the Sixth or the Principal VAT Directives to justify a wider interpretation.

Because it believed that the meaning of the provisions had not changed between FA 1972 and VATA 1994, the CA thought that the test of eligibility set out in note 1(b) was considerably more 'hard edged' than the approach which had been adopted in *SFM* and subsequent tribunal decisions.

The CA rejected the multi-factorial approach adopted in the *SFM* line of cases. It determined that, in order to succeed, the taxpayer body had to show that it was a constituent part of the university, with all the rights and privileges for its students and other members which that entailed. Inherent in that concept was the need to show some legal relationship between the university and the college, which established and confirmed the status of the latter. The college must, in a real sense, be a part of the university and not simply a suitable educational provider to which the university has outsourced courses that it has been unable to provide itself.

Of the 15 *SFM* factors, the one factor which would ordinarily be decisive of the issue was the presence of a foundation or constitutional document establishing the college as part of the university. The starting point (and often, the only point) was to look at the core legal relationship between the college and the university, which ought to be apparent from this foundation document.

In considering whether SAE met the test of being part of MU in the constitutional and structural sense, the CA held that test was not satisfied for the following reasons. From the available documents, it was clear that SAE was not, in any legal sense, a composite part of MU. Even the appointment of it as a special associate college fell short of making it a college of the university in a constitutional or structural sense. While, as far as the CA was concerned, that was all that it had to look at, it went on to say that the fact of it not being a composite part was evidenced by:

- SAE providing only a very small number of highly specialised courses for MU;
- the fact that SAE students enrolled on courses had strictly defined rights in terms of the use of MU's facilities, rather than becoming full members of MU by virtue of their acceptance as SAE students; and
- the fact that the arrangements were subject to periodic review and could be terminated in certain circumstances.

What next?

Although SAE has lost its appeals at the UT, and now the Court of Appeal, it is too soon to be certain that the litigation is concluded. If SAE applies for permission to appeal to the Supreme Court, it may take five to six months for this permission application to be determined. The courts may be willing to grant permission so that the Supreme Court can give a definitive ruling on what constitutes a college of a university.

If SAE does not seek permission, or if it does and permission is not obtained, we expect that HMRC will, at some point, issue revised guidance on how to identify eligible colleges, but this could take some time. It is also complicated by the fact that HMRC has itself given rulings on many of these arrangements to date, which are in line with the case authorities which preceded the SAE decision. This is not surprising, as HMRC has said in its internal guidance that it accepted the *SFM* decision. Many providers have relied on the *SFM* tests when trying to reach agreements with HMRC that they are sufficiently closely linked to universities to be eligible for the exemption.

As this is yet another challenge to the nature and extent of the education exemption, it may be that the government will have a long hard look at the VAT exemption for education and its application to private sector providers. This is particularly so in view of the number of private providers with courses which lead to university-recognised degrees, and the potential fiscal neutrality issues which may arise from SAE. HMRC did start doing so in 2013 by releasing a consultation on the matter but it was withdrawn soon after release.

Until the extent of the exemption is clarified, interested stakeholders are in an uncertain position both historically and going forward. Partnering and collaboration arrangements may have to be reviewed. It is advisable for all stakeholders currently applying the 'college of a university' VAT exemption to ensure that their reasons for doing so are known, documented and, in light of the potential implications of the *SAE* decision, reviewed. ■

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- Cases: *SAE Education Ltd v HMRC* (8.9.17)
- *The Open University*: what is education? (Laurie Pay & Robert Holland, 19.4.16)