Case No: A3/2016/0680
A3/2016/0697

Neutral Citation Number: [2017] EWCA Civ 54
IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
Lord Justice David Richards and Judge Roger Berner
[2015] UKUT 641 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 10 February 2017

Before :

LORD JUSTICE JACKSON
LORD JUSTICE PATTEN
and
LADY JUSTICE BLACK

- -

Between :

A3/2016/0680	**ASSOCIATED NEWSPAPERS LIMITED**	**Appellant**
	- and -	
	THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondent**

And Between :

A3/2016/0697	**THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS**	**Appellant**
	- and -	
	ASSOCIATED NEWSPAPERS LIMITED	**Respondent**

- -
- -

Kieron Beal QC and **Simon Pritchard** (instructed by **The General Counsel and Solicitor to HM Revenue and Customs**) for the Revenue
John Walters QC (instructed by **KPMG LLP**) for Associated Newspapers Limited

Hearing dates : 13 and 14 December 2016

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Judgment

Lord Justice Patten :

Introduction

1. This appeal is concerned with the VAT consequences (in respect of both input and output tax) of two promotional schemes carried out by Associated Newspapers Limited ("ANL") in order to boost the circulation of the Daily Mail and the Mail on Sunday.

2. The first of these schemes (referred to by the acronym SPICE (Sales Performance Improvement by Circulation Excellence)) operated between 2007 and 2010. It involved the purchase from retailers such as Marks & Spencer of vouchers which were issued by the retailers directly to ANL usually at a discount from their face value but at a price which purported to include VAT. The face value of the vouchers varied between £10 and £100 during different times of the scheme and they were redeemable in that amount against the purchase of goods or services from the retailer who issued them. The customers of ANL were contractually entitled to the vouchers if they complied with the terms of the scheme by purchasing the newspapers seven days a week for the relevant promotional period but in that event they received the vouchers free of charge. Retailer vouchers were also provided to the participating newsagents relative to the number of their customers who qualified under the scheme. As a result of SPICE, the circulation of both the Daily Mail and the Mail on Sunday increased over the period of the scheme.

3. The other scheme which began in 2011 is described as the Mail Rewards promotion. Customers who wished to participate in the scheme would register an account with ANL. All copies of the Daily Mail and the Mail on Sunday during the period of the promotion contained unique reference numbers which could be registered by customers either online or by telephone against their accounts. The system then credited them with points which could be redeemed for various rewards including retailer vouchers.

4. The second scheme (and its underlying computer system) was managed for ANL by The Hut.com Limited ("the Hut") under a contract dated 25 May 2011. The Hut received a fee subject to VAT which ANL could deduct as input tax. It also purchased the retailer vouchers in batches (usually at a discount) and invoiced them to ANL at cost but also subject to VAT. A customer who participated in the scheme became contractually entitled to receive the vouchers from ANL once he or she had acquired the relevant number of points but otherwise free of charge.

5. Communications between ANL and HMRC about the correct tax treatment of the voucher schemes began in 2007 in relation to SPICE. ANL informed HMRC that it intended to reclaim the input tax charge to VAT made by Marks & Spencer but did not propose to account for output tax on the supply of the vouchers to its own customers. It received a temporary ruling from HMRC accepting that tax treatment but in July 2009 ANL was informed that the policy contained in paragraph 14 of VAT Information Sheet 12/2003 would now apply. This stated that:

> "Where face value vouchers are purchased by businesses for the purpose of giving them away for no consideration (e.g. to employees as 'perks' or under a promotion scheme) the VAT

> incurred is claimable as input tax subject to the normal rules. Output tax is due under the Value Added Tax (Supply of Services) Order 1993. Therefore all vouchers given away for no consideration will be liable to output tax to the extent of the input tax claimed".

6. I shall come to the provisions of the 1993 Order in more detail when I deal with the issue of output tax. But it is worth noting by way of introduction at this stage that the legislation is derived from what is now Article 26 of the Principal VAT Directive ("PVD") which treats as a supply of services for consideration (and therefore a taxable supply) a supply of services carried out free of charge for the private use of the taxable person or his staff "or more generally for purposes other than those of his business". Where these conditions are met the free supply is treated as one for consideration and under the 1993 Order this will give rise to a charge to output tax limited to the amount of any input tax otherwise allowable in respect of the supply.

7. These are not therefore provisions designed specifically to deal with free promotions involving the supply of vouchers. Their purpose is to ensure equal treatment between taxable persons and final consumers by ensuring that where business goods or services are used for private purposes by the taxable person he should be treated as the final consumer in respect of their acquisition. This is achieved by cancelling out any allowable input tax on the purchase of the goods and services by the imposition of output tax on their otherwise free onward supply.

8. If ANL was otherwise entitled to deduct input tax on the supplies of retailer vouchers it used for the purpose of the two schemes, the provisions of the 1993 Order would, if applicable, annul the financial benefit by imposing a counter-balancing charge to output tax on what (if free) would not otherwise constitute a taxable supply. The customer pays nothing extra in order to obtain the vouchers and HMRC contended that this brought the supply of the retailer vouchers within paragraphs 2 and 7 of Schedule 10A of the Value Added Tax Act 1994 ("VATA") which was introduced to prescribe the VAT treatment of face-value vouchers under UK law in the absence of any EU-wide directive on that issue. Paragraph 2 treats the issue of a face-value voucher (which these were), or any subsequent supply of it, as a supply of services and paragraph 7 treats the supply of a face-value voucher as part of a composite transaction for no additional consideration as a supply of the voucher for no consideration.

9. But Schedule 10A also has an application in respect of the input tax which ANL seeks to deduct in respect of its purchase of the retailer vouchers. Paragraph 4(2) requires the consideration for the issue of a retailer voucher to be disregarded unless it exceeds the face value of the voucher. The issue of a voucher which falls within paragraph 4 is not therefore treated as a taxable supply for VAT purposes and VAT is recovered on the full value of the supply by the retailer of the goods and services as payment for which the voucher is redeemed.

10. In the case of the SPICE scheme, Schedule 10A is relied on by HMRC as one reason why ANL is not entitled to deduct input tax in respect of its direct purchase from Marks & Spencer and others of the retailer vouchers. If that is right then no issue about output tax arises in respect of those supplies. But in relation to the Mail Rewards scheme where the vouchers were purchased through the Hut as intermediary,

paragraph 4 of Schedule 10A has no application and it is accepted in principle that these were taxable supplies of services in respect of which the Hut charged and accounted for VAT at a blended rate which reflects the VAT liability of the retailer on the supplies it makes on the redemption of the vouchers. The issue in respect of those vouchers and more generally in respect of the SPICE scheme is whether any input tax payable in respect of the purchase of the vouchers is deductible as a cost component of either a taxable supply made by ANL or as part of its overheads. ANL contends that the vouchers were acquired for use in connection with the making of taxable supplies of newspapers and advertising and that therefore (subject to Schedule 10A) any input tax is deductible. HMRC contend that the purchase of the vouchers was inextricably linked with their own onward supply to customers as part of the two schemes in neither case for consideration. If this is right they maintain (and ANL accept) that they were used for making a non-taxable supply and no input tax is deductible. In these circumstances, the issues about the effect of the 1993 Order do not arise.

11. Although many of these issues are interlinked and the incidence and recoverability of input tax determines both the application of the 1993 Order to the onward supplies of vouchers and whether that issue even arises, the first issue which came to be decided in the First-tier Tribunal ("FtT") was the output tax issue. In its decision released on 24 January 2014 the FtT (Judge Poole and Mr Adams) allowed ANL's appeal against the decision of HMRC that output tax was chargeable on the supply of vouchers by ANL to its customers under article 3 of the 1993 Order.

12. In a further decision released on 13 August 2015 the FtT went on to decide that any input tax which arose on the purchase of the vouchers was nonetheless deductible and as mentioned it was accepted that when the vouchers were purchased from an intermediary, input tax arises on the whole consideration at the retailer's blended rate. The FtT accepted that the supplies of vouchers purchased by ANL were used for the promotion of its sales of newspapers and that in the case of vouchers acquired directly from the retailers paragraph 4(2) of Schedule 10A should be read (consistently with article 26 of the PVD) as doing no more than to relieve the retailer of the obligation to account for the VAT payable on the issue of the voucher until the voucher is redeemed on a subsequent purchase of goods or services. Input tax would therefore remain payable on the issue of the voucher by the retailer and could be recovered by ANL if the voucher was used in connection with a taxable supply.

13. Both these decisions were appealed to the Upper Tribunal (David Richards LJ and Judge Roger Berner) ("UT") which in a decision released on 1 December 2015 allowed HMRC's appeal against the FtT's input tax decision in relation to vouchers issued directly to ANL by the retailers in question. It did so on the basis that paragraph 4(2) of Schedule 10A VATA was not susceptible of any construction whether on *Marleasing* principles or more generally which would allow the direct issue of retailer vouchers to be treated as a taxable supply. No deductible input tax would therefore arise regardless of whether the retailers had in reality raised a charge to VAT as part of the cost of the vouchers to ANL.

14. But otherwise it dismissed the appeals holding in relation to the indirect supply of vouchers from the Hut that the supplies of services had formed a cost component of the taxable supplies of newspapers and advertising and that in relation to the supply of the vouchers by ANL to its customers under the two schemes the FtT had made no

error of law in concluding that the supply was for strictly business and related purposes and was not therefore caught by Article 3 of the 1993 Order. The finding that the purchase of vouchers was linked for VAT purposes to the taxable supply of newspapers and advertising would, of course, have made any input tax on directly supplied vouchers recoverable but for the provisions of Schedule 10A and no distinction needs to be made between the two types of supply for the purpose of considering that issue.

The statutory provisions

15. It is convenient at this stage to set out the relevant statutory provisions beginning with the PVD.

(1) The Principal VAT Directive (2006/112/EC)

16. The PVD replaced the Sixth Directive with no changes which are material to the issues on this appeal. Article 1(2) provides:

> "The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.
>
> On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components".

17. Under Article 2(1)(a) and (c) (like Article 2 of the Sixth Directive) taxable transactions include the supply of goods or services for consideration carried out by a taxable person. There is no dispute that ANL is a taxable person as defined in Article 9 in that it carried out an economic activity at least in relation to the supply of newspapers and advertising. It is common ground that this includes both standard and zero-rated supplies but it would not include a supply for no consideration which would fall outside the scope of Article 2(1). Mr Beal QC, on behalf of HMRC, took the point that ANL is not a fully taxable person because some of the supplies it makes are not taxable. This may require an exercise in apportionment if the input VAT claimed as deductible relates to overheads which include non-taxable supplies. But that lies outside the scope of this appeal and will fall to be determined, if at all, in subsequent proceedings.

18. The basis for Article 3 of the 1993 Order is Article 16 of the PVD which replaced Article 5(6) of the Sixth Directive and provides the vires for the imposition of VAT on gifts. It states:

> "The application by a taxable person of goods forming part of his business assets for his private use or for that of his staff, or their disposal free of charge or, more generally, their application for purposes other than those of his business, shall

> be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.
>
> However, the application of goods for business use as samples or as gifts of small value shall not be treated as a supply of goods for consideration."

19. This is reflected in Article 26 which extends the Article 16 treatment of a free disposal of goods other than for business purposes to supplies of services:

> "1. Each of the following transactions shall be treated as a supply of services for consideration:
>
> …
>
> (b) the supply of services carried out free of charge by a taxable person for his private use or for that of his staff or, more generally, for purposes other than those of his business."

20. The right to deduct input tax is contained in Articles 167-168. Article 168 states:

> "In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;"

(2) VATA 1994

21. VATA s.1 imposes a liability to account for VAT on persons making a supply of goods or services within the UK. The tax becomes due at the time of supply. "Supply" is defined in s.5(2)(a) as:

> "all forms of supply, but not anything done otherwise than for a consideration;"

22. Sections 24-6 deal with the payment of VAT by taxable persons including the recovery of input tax. This is defined in s.24(1) as the VAT on the supply to the taxable person of any goods or services "used or to be used for the purpose of any business carried on or to be carried on by him".

23. The provisions of Schedule 10A which set out the VAT treatment of face-value vouchers were added by the Finance Act 2003 in response to the decisions of the CJEU in Case C-288/94 *Argos v HMRC* and Case C-62/00 *Marks & Spencer*. These confirmed that where a retailer issues vouchers at a discount from their face value but which can be subsequently redeemed at their face value in payment for goods, the consideration received for the supply of goods is not the full face value of the

vouchers but the sum actually received by the retailer when it issued the vouchers. *Argos* was concerned with the VAT payable on the supply of goods by the retailer involving the redemption of the face value vouchers. In *Marks & Spencer* the issue was the amount of VAT payable on the issue of the vouchers themselves at a discount. The Commissioners had until the decision in *Argos* required Marks & Spencer to account for VAT on the face value of the vouchers rather than the discounted price it received. The CJEU was concerned with whether a claim for the overpaid tax was defeated by or limited to a three-year domestic limitation period. But it was common ground, in the light of *Argos*, that the relevant consideration for the supply of the vouchers was the amount which the retailer actually received.

24. The tax treatment of face-value vouchers was not expressly addressed in the PVD for the periods in question leaving member states to devise their own national measures to deal with the problems which can arise. Much of the difficulty stems from the existence of two linked supplies both for consideration in the form of the issue of the vouchers and the subsequent supply of goods or services on their redemption. The vouchers and the consideration for them are common to both transactions with a consistent value throughout and the principle of fiscal neutrality together with the need to avoid double taxation demands that account is taken of the price paid for the vouchers and any VAT on them when calculating the incidence of VAT on the use of the vouchers in connection with a purchase by the final consumer. The position is complicated by the possible non-redemption of vouchers and the inability of the retailer issuing the vouchers to know in advance whether the supply of goods or services on redemption will be a standard rated supply.

25. These difficulties (or some of them) could have been removed or alleviated in various ways such as by making the issue of the vouchers a standard rated supply right down the chain or by taking both the direct issue and any intermediate issue of vouchers out of any charge to VAT. The scheme adopted by the UK in Schedule 10A is to treat directly issued vouchers as non-taxable supplies and to recover the VAT attributable to their acquisition as part of the VAT payable on the consideration received for the goods and services supplied on redemption of the vouchers. Intermediate supplies of face-value vouchers remain taxable as standard rated supplies. This is in contrast to the position which has recently been adopted by the EU in the Council Directive on vouchers which will amend the effect of the PVD in relation to vouchers issued after 31 December 2018. Article 30B(2) excludes VAT on any transfer of the voucher prior to its use on redemption thereby postponing the recovery of VAT to that event in all cases.

26. Schedule 10A provides:

> "1. (1) In this Schedule *"face-value voucher"* means a token, stamp or voucher (whether in physical or electronic form) that represents a right to receive goods or services to the value of an amount stated on it or recorded in it.
>
> (2) References in this Schedule to the "face value" of a voucher are to the amount referred to in sub-paragraph (1) above.
>
> 2. The issue of a face-value voucher, or any subsequent supply of it, is a supply of services for the purposes of this Act.

….

4. (1) This paragraph applies to a face-value voucher issued by a person who—

(a) is a person from whom goods or services may be obtained by the use of the voucher, and

(b) if there are other such persons, undertakes to give complete or partial reimbursement to those from whom goods or services are so obtained.

Such a voucher is referred to in this Schedule as a *"retailer voucher"*.

(2) The consideration for the issue of a retailer voucher shall be disregarded for the purposes of this Act except to the extent (if any) that it exceeds the face value of the voucher.

(3) Sub-paragraph (2) above does not apply if—

(a) the voucher is used to obtain goods or services from a person other than the issuer, and

(b) that person fails to account for any of the VAT due on the supply of those goods or services to the person using the voucher to obtain them.

(4) Any supply of a retailer voucher subsequent to the issue of it shall be treated in the same way as the supply of a voucher to which paragraph 6 below applies.

…..

6. (1) This paragraph applies to a face-value voucher that is not a credit voucher, a retailer voucher or a postage stamp.

(2) A supply of such a voucher is chargeable at the rate in force under section 2(1) (standard rate) except where sub-paragraph (3), (4) or (5) below applies.

…..

7A. Paragraphs 2 to 4, 6 and 7 do not apply in relation to the issue, or any subsequent supply, of a face-value voucher that represents a right to receive goods or services of one type which are subject to a single rate of VAT."

The Value Added Tax (Supply of Services) Order 1993

27. Articles 3 and 6 of the 1993 Order provide:

> "3. Subject to articles 6, 6A and 7 below, where a person carrying on a business puts services which have been supplied to him to any private use or uses them, or makes them available to any person for use, for a purpose other than a purpose of the business he shall be treated for the purposes of the Act as supplying those services in the course or furtherance of the business, except for the purposes of determining whether tax on the supply of the services to him is input tax of his under section 24 of the Act.
>
> 6. This Order shall not apply in respect of any services–
>
> (a) which are used, or made available for use, for a consideration;
>
> (b) except those in respect of which the person carrying on the business has or will become entitled under sections 25 and 26 of the Act to credit for the whole or any part of the tax on their supply to him;
>
> (c) in respect of which any part of the tax on their supply to the person carrying on the business was not counted as being input tax of his by virtue of an apportionment made under section 24(5) of the Act; or
>
> (d) of a description within paragraph 10(1) of Schedule 6 to the Act."

28. One of the difficulties about this appeal is to decide where to begin. The FtT dealt with the output tax issue first but the UT preferred to begin with the issues about input tax and to decide whether it was deductible at all. If the direct supplies of retailer vouchers to ANL are not taxable supplies because of paragraph 4 of Schedule 10A or are not deductible because they are not cost components of a taxable supply which ANL has made then, as already explained, the application or not of Article 3 of the 1993 Order is irrelevant. The second of these two issues is also conclusive in respect of the intermediate supply of vouchers by the Hut to which paragraph 4 of Schedule 10A has no application. If decided against ANL it will also make it unnecessary for HMRC to rely on Schedule 10A. I propose therefore to begin with that issue.

Were the supplies of vouchers to ANL cost components of a taxable supply?

29. It is common ground that both the direct and intermediate supplies of face-value vouchers to ANL were supplies of services: see VATA Schedule 10A paragraph 2. Putting aside the issue of whether the direct supplies were taxable having regard to Schedule 10A paragraph 4(2), the right of ANL to deduct any VAT which it has paid on its purchase of the vouchers depends in the first place on those services being "used for the purposes of the taxed transactions of a taxable person": see PVD Article 168. Under VATA s.24(1) this is expressed in terms of their being used for the purpose of a business carried on by the taxable person but it has not been suggested that these words were intended to do any more than to transpose into domestic law the

relevant provisions of the PVD and they fall to be construed conformably with the tests laid down by the authorities on what is now Article 168.

30. These establish that in order to be treated as what PVD Article 1(2) refers to as costs components of the output transactions, the taxable person must establish either a direct and immediate link between the goods and services and the relevant taxable transactions or that the cost of the goods or services purchased are part of the overheads of the taxable person and therefore cost components of the undertaking's taxable activities. If they are to be treated as overheads there may, as I have said, be an issue about the apportionment of the costs between ANL's taxable and non-taxable activities but that is an issue for the future. But to be overheads at all it is still necessary to establish a sufficient connection between the goods or services supplied to the taxable person and his taxable economic activities. Therefore, if in the present case the purchase of the vouchers by ANL should be treated as directly (and exclusively) linked to the free supply of the vouchers to its customers, the input tax will be irrecoverable.

31. The purpose of what is now Article 168 PVD is not in doubt. As the CJEU said in Case 268/83 *Rompelman v Minister van Financiën* [1985] ECR 655:

> "16. … a basic element of the vat system is that vat is chargeable on each transaction only after deduction of the amount of the vat borne directly by the cost of the various components of the price of the goods and services and that the deduction procedure is so designed that only taxable persons may deduct the vat already charged on the goods and services from the vat for which they are liable.
>
> …..
>
> 19. From the provisions set forth above it may be concluded that the deduction system is meant to relieve the trader entirely of the burden of the vat payable or paid in the course of all his economic activities. The common system of value-added tax therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to vat, are taxed in a wholly neutral way."

32. But the attribution of the input supplies of goods and services to some taxable economic activity, which is ultimately a question of law, will frequently involve a contest between specific and immediate supplies (which may not be taxable) and the wider business of the taxable person which will be. The present case is no exception. ANL succeeded in persuading the FtT that the vouchers were attributable for the purposes of Article 168 to its business of supplying newspapers and the advertising they contain. The voucher promotions were designed to and succeeded in boosting the circulation of its titles. But HMRC's case is that this takes no account, or no adequate account, of the existence of the supplies of services constituted by the free distribution of the vouchers. Since this provides the most direct and obvious link with the purchase of the vouchers, it is not legally necessary or possible to look beyond them to the supplies of newspapers or more generally the taxable business of ANL. The vouchers are not a necessary component of the cost of producing newspapers

even if they sell more and can therefore be said to have benefited the business as a whole.

33. A good illustration of this type of problem is the decision in Case C-4/94 *BLP Group v Customs and Excise Commissioners* [1995] STC 424. The issue was whether BLP could deduct input tax on the cost of professional services incurred in connection with the sale of a German subsidiary. The sale of the shares was an exempt transaction but BLP relied on the fact that the purpose of the sale was to raise money to pay off debts that had been incurred in connection with various taxable transactions. It made the point as part of its argument that had it taken out a loan to meet its liquidity requirements, the VAT payable on the services of an accountant or other professionals used to obtain the loan would have been recoverable.

34. The ECJ held that the input tax was not deductible:

> "19. Paragraph 5 lays down the rules applicable to the right to deduct VAT where the VAT relates to goods or services used by the taxable person 'both for transactions covered by paragraphs 2 and 3, in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible'. The use in that provision of the words 'for transactions' shows that to give the right to deduct under para 2, the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in this respect.
>
> …..
>
> 25. It is true that an undertaking whose activity is subject to VAT is entitled to deduct the tax on the services supplied by accountants or legal advisers for the taxable person's taxable transactions and that if BLP had decided to take out a bank loan for the purpose of meeting the same requirements, it would have been entitled to deduct the VAT on the accountant's services required for that purpose. However, that is a consequence of the fact that those services, whose costs form part of the undertaking's overheads and hence of the cost components of the products, are used by the taxable person for taxable transactions.
>
> 26. In that respect it should be noted that a trader's choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. The principle of the neutrality of VAT, as defined in the case law of the court, does not have the scope attributed to it by BLP. That the common system of VAT ensures that all economic activities, whatever their purpose or results, are taxed in a wholly neutral way, presupposes that those activities are themselves subject to VAT (see in particular

Rompelman v Minister van Financiën (Case 268/83) [1985] ECR 655 at 664, para 19)."

35. The decision is an illustration of the Court being unwilling to disregard the effect of the transaction which the trader had chosen to use in order (in that case) to solve its liquidity problems. There was no objective analysis of the chain of supplies which could avoid the recognition of a direct and immediate link between the professional services and the exempt sale of shares. The existence of alternative methods of achieving the same result was therefore irrelevant. The principal reason that the case is relied on by HMRC is for the Court's rejection of any analysis of the link between input and output supplies by reference to the ultimate aim of the taxable person. Transposing that to the facts of the present case, ANL cannot, it is said, establish the necessary link between the purchase of the vouchers and the taxable supply of newspapers simply by relying on the fact that the purpose of the voucher scheme was to boost circulation.

36. What then about overheads? Case C-98/98 *Midland Bank plc v Customs and Excise Commissioners* [2000] STC 501 concerned input tax on solicitors' fees that were incurred by Samuel Montagu & Co Ltd (a company in the Midland Bank group) in connection with a claim against it arising out of a takeover bid in which Samuel Montagu acted for one of the bidding parties. The bid resulted in an agreement with a rival bidder for the takeover of the target company that was not adhered to and led to litigation. Samuel Montagu sought to recover the VAT on the solicitors' fees on the basis that they were incurred solely in relation to the services which it had supplied to its client. The Commissioners contended that they were also attributable to Samuel Montagu's business more generally which included the making of both taxable and exempt supplies. The difficulty with the taxpayer's argument was that the costs in question had, of course, been incurred after the services rendered to the client had been performed and they arose out of a subsequent dispute between the parties to the agreement. The ECJ said:

> "29. It should be borne in mind that, according to the fundamental principle which underlies the VAT system, and which follows from art 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components (see, to this effect, *BP Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v Greece* (Case C-62/93) [1995] STC 805 at 821, [1995] ECR I-1883 at 1913, para 16).
>
> 30. It follows from that principle as well as from the rule enshrined in the judgment of *BLP Group plc v Customs and Excise Comrs* (Case C-4/94) [1995] STC 424 at 437, [1995] ECR I-983 at 1009, para 19 according to which, in order to give rise to the right to deduct, the goods or services acquired must have a direct and immediate link with the taxable transactions, that the right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost components of the taxable transactions. Such expenditure must therefore be part of the

> costs of the output transactions which utilise the goods and services acquired. That is why those cost components must generally have arisen before the taxable person carried out the taxable transactions to which they relate.
>
> 31. It follows that, contrary to what the Midland claims, there is in general no direct and immediate link in the sense intended in *BLP Group*, between an output transaction and services used by a taxable person as a consequence of and following completion of the said transaction. Although the expenditure incurred in order to obtain the aforementioned services is the consequence of the output transaction, the fact remains that it is not generally part of the cost components of the output transaction, which art 2 of the First Directive none the less requires. Such services do not therefore have any direct and immediate link with the output transaction. On the other hand, the costs of those services are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products. Such services therefore do have a direct and immediate link with the taxable person's business as a whole, so that the right to deduct VAT falls within art 17(5) of the Sixth Directive and the VAT is, according to that provision, deductible only in part."

37. The decision confirms that to be treated as a cost component of the business as a whole there must be a direct and immediate link with the whole of the taxable person's economic activity rather than with any particular supply. In most cases the purchase of goods or services for use as part of a business will always qualify as overheads with a concomitant right to recover the input tax subject only to arguments about apportionment if the business is not wholly a taxable economic activity. And the real question therefore is how to determine when, as in *BLP*, the supply of the goods or services falls to be treated as linked to a particular output supply as opposed to the business as a whole. To some extent this may depend upon the nature of the supplies on which the input tax arises. The purchase by a company of, for example, stationery or secretarial services is more likely to be linked to the business as a whole than to any particular supply which the taxable person makes. But when goods or services are acquired specifically in order to satisfy an order from a customer or to make some other identifiable supply, their treatment as cost components of that particular supply may become unavoidable.

38. Another relevant factor identified in the authorities is the sequence in which the relevant events occurred. In *Midland Bank* the court emphasised that in order to be treated as cost components of any particular taxable transaction it would usually be necessary for the goods or services to be supplied before the taxable transaction giving rise to the right to deduct rather than in consequence of it. The bank was unable to link its expenditure on solicitors' fees incurred in the subsequent litigation with the services it provided to its clients some time earlier. In Case C-435/05 *Investrand BV v Staatssecretaris van Financiën* [2007] ECR 1315; [2008] STC 518 a similar attempt by the revenue authorities to link the costs incurred in subsequent litigation about the price to be paid for the disposal of a subsidiary company with the

exempt supply of the shares also failed as did Investrand's attempt to treat them as part of its general overheads. The CJEU held that the recovery of monies due under the contract of sale was not itself an economic activity within the Sixth Directive and that the costs were not part of the company's overheads because they would have been incurred regardless of its other economic activity and not as part of it.

39. A case also involving the disposal of shares in a subsidiary company is Case C-29/08 *Skatteverket v AB SKF* [2010] STC 419 ("*SKF*"). *SKF* wished to dispose of the shares in the subsidiary company as part of a re-structuring of the group and sought a preliminary ruling as to whether VAT payable in relation to the professional fees for the valuation of the shares and their disposal would be deductible. This turned on whether supplies of services associated with the disposal of the shares could be linked to *SKF*'s economic activity either in the form of the taxable management services it had provided to the subsidiary or in the form of its general overheads rather than to the disposal of the shares which was an exempt transaction. The taxpayer had relied on an argument similar to that employed and rejected in *BLP* which was that a link could be made to its taxable business because the purpose of the disposal of the subsidiary, although an exempt transaction in itself, was to facilitate the re-alignment of the structure of its business. The intermediate exempt transaction could therefore be ignored in determining the correct tax treatment of the input supplies.

40. In his Opinion at [73] Advocate General Mengozzi expressed the view that in considering this question it might be relevant to distinguish between services that were arguably linked to an exempt supply and those that on one view related to an output supply that fell entirely outside the scope of VAT such as the supply of vouchers for no consideration in this case. Supplies of the latter kind were to be treated as irrelevant to the determination of whether there was or was not a right to deduct and did not therefore break what Advocate General Jacobs in Case-408/98 *Abbey National plc v Customs and Excise Commissioners* [2001] STC 297 described as the chain of VAT transactions leaving the recipient of the services in the last link of the chain as the final consumer. To break the chain it was necessary for the next link to be an exempt supply:

> "76. It appears to me that the Court has accepted the distinction made by Advocate General Jacobs in his Opinion referred to above between, on the one hand, output transactions exempted from payment of VAT, and, on the other hand, those which entirely escape any VAT liability, because the latter cannot be deemed to be either supplies of goods or supplies of services, and has accordingly also confirmed the decision made in *BLP Group*, on which, moreover, the Advocate General's argument was based.
>
> 77. The approach outlined above, which seems to me to be that adopted in the case-law, may appear to treat share disposal transactions which fall outside the scope of VAT more favourably than those which, although within its scope, are exempted from VAT under the provisions of the Sixth Directive (and/or those of Directive 2006/112). Whereas the right to deduct may arise on services acquired to carry out a transaction outside the scope of VAT when such services are

> regarded as directly and immediately linked to the general economic activity of the taxable person, the VAT payable on services acquired to carry out an exempt transaction, on the other hand, cannot be deducted.
>
> 78. However, that situation is no more than the consequence inherent in the common system established by the Sixth Directive (confirmed by Directive 2006/112) and in the dividing line which must be drawn as clearly as possible between taxable transactions, on the one hand, and exempt transactions, on the other; hence the direct and immediate link test and the breaking of the VAT chain when an input transaction on which VAT is payable is directly and immediately related to an output transaction which is exempted from VAT.
>
> 79. Moreover, since the VAT chain is not broken when the share disposal transaction is one which falls entirely outside the scope of VAT, there is equally, to my mind, no difference in treatment which adversely discriminates against the taxable person who acquires supplies of services in order to carry out disposal transactions which are covered by the exemption from VAT provided for in Article 13B(d)(5) of the Sixth Directive and who, consequently, does not have the right to deduct the input VAT, even in respect of general overheads which that taxable person has incurred."

41. This analysis was not, however, adopted by the CJEU in its judgment. At [59] it drew no distinction between exempt transactions and those falling outside the scope of VAT for the purpose of determining whether the input tax was deductible. The determination of a direct and immediate link with the taxpayer's overall economic activity (as opposed to the exempt disposal of the shares) depended on:

> "whether the costs incurred are likely to be incorporated in the prices of the shares which SKF intends to sell or whether they are only among the cost components of SKF's products."

42. The most recent consideration of this issue by the CJEU seems to be its decision in Case C-126/14 (ECLI:EU:C:2015:712) *'Sveda' UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos and Another* which was relied on by the Upper Tribunal in reaching its conclusion that the supplies of vouchers to ANL were linked economically to the sale of newspapers rather than to the provision of free vouchers as part of the two schemes. *Sveda* was concerned with the recoverability of input tax on the supply of goods purchased in connection with the construction of a 'Baltic mythology recreational/discovery path'. The project was subsidised by the government of Lithuania on the basis that there would be free public access to it but Sveda did intend to carry out some economic activities at the discovery path in the form of the sale of food or souvenirs.

43. The question therefore was whether the goods purchased for the construction of the facility had a direct and immediate link for the purposes of Article 168 with the

commercial activities I have described or were cost components of the construction of the discovery path which was to be made available to the public free of charge.

44. In her Opinion Advocate General Kokott, after referring to *BLP*, set out the direct and immediate link test in similar terms to the judgment in *Skatteverket*:

> "33. However, the Court has further developed its case-law since that case. It still remains the case that for Article 168 of the VAT Directive to apply a direct and immediate link must have been found between a given input transaction under examination and a particular output transaction or transactions giving rise to the right of deduction. Such a link may nevertheless also exist with the economic activity of the taxable person as a whole if the costs of the input transactions form part of the general costs of the taxable person and are therefore cost components of all goods or services delivered or provided by him.
>
> 34. According to recent case-law, the decisive factor for a direct and immediate link is consistently that the cost of the input transactions be incorporated in the cost of individual output transactions or of all goods and services supplied by the taxable person. This applies irrespective of whether the use of goods or services by the taxable person is at issue.
>
> 35. Consequently, there is a right of deduction in the present case if the cost of acquiring or manufacturing the capital goods of the recreational path is incorporated, in accordance with case-law, in the cost of the output transactions, taxed under the VAT Directive."

45. But part of her analysis suggested a return to the distinction between exempt supplies and non-taxable supplies as a relevant factor in the determination of the economic link:

> "41. However, should the national court find that the creation of the recreational path by Sveda does not represent a taxed transaction, the right of deduction would then depend solely on whether the capital goods of the recreational path are used, for the purposes of Article 168 of the VAT Directive, for the provision of chargeable services to visitors in the future. For that to be the case, the costs of the acquisition and manufacture of these capital goods would have to be incorporated into the cost of these services.
>
> a) Objective definition of costs
>
> 42. Contrary to the view of the United Kingdom, this question is independent of the taxable person's intention of incorporating the relevant costs into the pricing of his output transaction.

43. In accordance with the judgment in *Becker*, the finding of a direct and immediate link between the input and output transactions depends on the objective content of the input supplies acquired. In the *BLP Group* judgment the Court had already found to this effect that the link required between input and output transactions may not be determined by the taxable person's intentions.

44. Furthermore, in the common system of VAT services are also taxed which were provided at less than cost price. Where this occurs, the pricing is set subjectively by the taxable person without including all the costs of providing the output transaction. None the less, where this is the case there is no doubt that all input transactions that objectively belong to the cost components of the output transactions in accordance with the second subparagraph of Article 1(2) of the VAT Directive also confer entitlement to deduct input VAT. According to settled case-law, the right of deduction is meant to relieve the trader *entirely* of the burden of the VAT payable or paid in the course of all his economic activities, because in the common system of VAT it is ultimately not the taxable trader, but the final consumer who is intended to be taxed.

45. The existence of an objective economic link between input and output transactions is therefore crucial to the question whether the costs are incorporated into the price of a service as understood in case-law. A merely causal link is clearly not sufficient. However, if an input transaction objectively serves the purpose of the performance of certain or all output transactions of a taxable person, there is a direct and immediate link between the two as understood in case-law. This is because in such a case the input transaction constitutes, from an economic perspective, a cost component in the provision of the respective output transaction. As the wording of Article 168 of the VAT Directive already indicates, that therefore depends on the objective purpose of the use of an input transaction.

46. In the present case the national court found that the creation of the recreational path serves to attract visitors who may then be supplied with goods and services for consideration. Consequently, the creation of the recreational path belongs, from an economic perspective, to the cost components of these transactions.

47. It follows that there is in principle a direct and immediate link, as understood in case-law, between the acquisition or manufacture of the capital goods of the recreational path and the chargeable services offered to visitors."

46. The Court in its judgment largely adopted the approach of looking for what it describes as an objective link between the expenditure and the taxpayer's subsequent economic activity whilst making no distinction for these purposes between exempt and non-taxable supplies:

> "22. In the present case, the referring court has described the expenses relating to the capital goods at issue in the main proceedings as being ultimately intended for carrying out the economic activities planned by Sveda. According to that court's findings, supported by objective evidence from the file it submitted, the recreational path concerned may be regarded as a means of attracting visitors with a view to providing them with goods and services, such as souvenirs, food and drinks as well as access to attractions and paid-for bathing.
>
> 23. Therefore, it would appear from those findings that Sveda acquired or produced the capital goods concerned with the intention, confirmed by objective evidence, of carrying out an economic activity and did, consequently, act as a taxable person within the meaning of Article 9(1) of the VAT Directive.
>
> …..
>
> 29. It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment in *Becker*, C-104/12, EU:C:2013:99, paragraphs 22, 23 and 33 and the case-law cited).
>
> 30. The findings of the referring court establish that, in the case in the main proceedings, the expenditure incurred by Sveda as part of the construction work on the recreational path should come partly within the price of the goods or services provided in the context of its planned economic activity.
>
> 31. The referring court nevertheless harbours doubts as to whether there is a direct and immediate link between the input transactions and Sveda's planned economic activity as a whole, owing to the fact that the capital goods concerned are directly intended for use by the public free of charge.
>
> 32. In that regard, the case-law of the Court makes it clear that, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or

> input tax deducted (judgment in *Eon Aset Menidjmunt*, C-118/11, EU:C:2012:97, paragraph 44 and the case-law cited). In both cases, the direct and immediate link between the input expenditure incurred and the economic activities subsequently carried out by the taxable person is severed.
>
> 33. First, in no way does it follow from the order for reference that the making available of the recreational path to the public is covered by any exemption under the VAT Directive. Second, given that the expenditure incurred by Sveda in creating that path can be linked, as is apparent from paragraph 23 of this judgment, to the economic activity planned by the taxable person, that expenditure does not relate to activities that are outside the scope of VAT.
>
> 34. Therefore, immediate use of capital goods free of charge does not, in circumstances such as those in the main proceedings, affect the existence of the direct and immediate link between input and output transactions or with the taxable person's economic activities as a whole and, consequently, that use has no effect on whether a right to deduct VAT exists.
>
> 35. Thus, there does appear to be a direct and immediate link between the expenditure incurred by Sveda and its planned economic activity as a whole, which is, however, a matter for the referring court to determine."

47. It seems to me that the CJEU has clearly moved away in these recent decisions from any disregard of the ultimate economic purpose of the relevant expenditure in considering whether it should be treated as linked to the taxpayer's wider economic activities. This is not a question of subjective intent but requires an objective analysis in terms of the taxpayer's identifiable economic activities of why the input supplies were acquired. Although there must, I think, be some evidence that the cost of the input supplies was passed on as part of the cost of the supplies which the taxable person subsequently makes, the absorption of those costs as part of the expenditure of running the business is not to be ignored merely because they also facilitated the making of supplies which in themselves were either exempt or outside the scope of the PVD.

48. So in the present case the cost to ANL of acquiring the vouchers can be treated in purely causal terms as attributable to the onward supply of the vouchers. Without the purchase of the vouchers their free distribution could not have taken place. However, in economic terms, the cost of purchasing the vouchers was also part of ANL's overall expenditure in the production and sale of its newspapers which the vouchers were intended to promote. The fact that the vouchers were provided free to buyers of the newspapers merely serves to confirm that they were cost components of the business rather than the onward supply of the vouchers.

49. The FtT dealt with this issue very shortly in its second input tax decision and in terms which do not really disclose the basis of its reasoning. But the Upper Tribunal considered all the relevant cases in some detail, although the judgment of the CJEU in

Sveda did not become available until after argument had taken place. It concluded that there was, on an objective analysis, a link between the purchase of the vouchers and ANL's business of supplying newspapers and advertising:

> "72. Although a right to a deduction exists if expenditure can be regarded as having a direct and immediate link to a taxable person's economic activity as a whole, the initial focus must be on whether there is a link with a particular activity, or type of activity. That accords with the view of the Advocate General in *Kretztechnik* at [76]; it is only where inputs cannot be linked to specific output transactions that they may fall to be attributed to a taxable person's activity as a whole. If such a link can be established, there is then the question whether the link is with both economic and non-economic activity (in which case there must be an apportionment, as in *Securenta* and *VNLTO*), and whether the input VAT is fully or partially recoverable having regard to the taxable and exempt supplies that constitute the economic activity with which the link has been established.
>
> 73. In our judgment, having regard to all the circumstances and viewed objectively from an economic perspective, the answer in this case is plain. The vouchers were acquired for the purpose of the business promotion scheme to increase the circulation of ANL's newspapers, and also to facilitate the associated sales of advertising. That is not to rely on the subjective intention of ANL; it can be objectively discerned from the nature of the business promotion scheme itself. It is to that element of the economic activity of ANL to which the acquisition of the vouchers and any input tax attributable to that acquisition is directly and immediately linked. Viewing the circumstances from an economic perspective, no such link can be established with the provision of the vouchers by ANL to its customers for no consideration, and the immediate use of the vouchers acquired by ANL in providing those vouchers to its customers free of charge cannot affect the direct and immediate link with ANL's economic activity. The costs associated with the acquisition of the vouchers were cost components of the sales of the newspapers and of advertising, and thus cost components of transactions within the scope of ANL's taxable activities. The output supplies by ANL in that respect were taxable supplies, and input tax is accordingly deductible."

50. It seems to me that this is a correct application of the test required under the authorities to determine whether the expenditure on the vouchers falls to be treated as a cost component of the free onward supply of the vouchers as opposed to ANL's general overheads. The Upper Tribunal rightly placed no reliance on the fact that the supplies of the vouchers to customers were non-taxable as opposed to being exempt and it makes no difference in my view in economic terms whether one treats this as a choice between non-taxable supplies and the taxable supplies of newspapers and advertising or between non-taxable supplies and ANL's general overheads. In both

cases one is looking to identify a link with the company's taxable transactions and therefore its taxable activities generally as opposed to with the specific onward supply of the vouchers.

51. Mr Beal in his skeleton argument has highlighted the fact that the purchase of the vouchers was not necessary for the operation of ANL's business but was a necessary pre-condition to the operation of a non-business activity comprised in the free issue of the vouchers. They were supplies of the same physical items. So far as that argument goes, I agree with it and there is no dispute between the parties that the issue of the vouchers as part of the scheme was not in itself an economic activity. But the characterisation of the onward supply is not what is in issue and a simple causative test of whether the newspapers could have been produced and sold without the benefit of the vouchers does not answer the question of whether the cost of the vouchers was economically a cost component of those supplies and that business when the vouchers were acquired in order to sell the papers.

52. Part of HMRC's argument is that the test adopted by the Upper Tribunal risks conflating the commercial objective of the acquisition of the vouchers with the selection of the output transaction to which they are most closely linked. Mr Beal drew our attention to the decision of this Court in *Mayflower Theatre Trust Ltd v HMRC* [2007] STC 880 which considered whether various production expenses on which the Trust incurred input tax could be linked to its business which included the taxable sales of programmes and refreshments at performances as opposed to the exempt supplies of tickets. On an application of the decision in *BLP* it was held that the expenses were linked to the supply of tickets.

53. Reliance was also placed on part of the Opinion of Advocate General Mengozzi in Case C-40/09 *Astra Zeneca UK Limited v HMRC* [2010] STC 2298 in which the principal issue was whether vouchers provided to employees as part of their overall remuneration package constituted a taxable supply of services on which Astra Zeneca was required to account for output tax. The short answer was that since the employees gave up part of their cash remuneration in exchange for the vouchers, the supplies were to be treated as taxable. But the Advocate General considered an alternative argument by the taxpayer that it was entitled to deduct input tax even if the supply of vouchers to the employees was for no consideration on the basis that the cost of acquiring the vouchers fell to be treated as an overhead of its business. He said:

> "Indeed, far from constituting a component the acquisition cost of which forms part of the undertaking's overheads, the voucher is transferred directly, together with the VAT which it incorporates, by the employer to the employee, who 'pays' for the value of the voucher with a corresponding reduction in that part of his remuneration that is paid in cash. By contrast, in the cases in which the Court acknowledged the right to deduct input VAT in respect of the acquisition of goods or services used to carry out exempt transactions, the VAT in question related to activities (typically, consultancy work) for which the tax was, clearly, ultimately borne by the undertaking."

54. The Advocate General is there referring to a scheme under which the vouchers were acquired and then effectively sold on to the employees. He himself drew a distinction between two linked taxable supplies and the situation in which in relation to the making of an exempt supply, expenses (such as consultancy fees) were incurred which could be linked to its business more generally. The *Mayflower Theatre Trust* case is more pertinent because there it was held that the expenses were linked to the exempt supply of tickets even though the purpose of the performance was in part to enable the Trust to make taxable supplies of refreshments.

55. In the *Mayflower Theatre Trust* case Carnwath LJ seems to have been concerned to remain true to the reasoning in *BLP* as he understood it by not extending the test of what constitutes a direct and immediate link: see the references at [33] of the judgment to a slippery slope. But, in the light of the judgment in *Sveda*, a different approach seems now to be required. The fact that services in the form of the vouchers were acquired in order to make non-taxable output supplies of the same items to ANL's customers is not determinative if the cost of those supplies is in fact a component of ANL's taxable business: see *Sveda* at [34].

Are the supplies of free vouchers to be treated as made for consideration and therefore taxable by reason of Article 3 of the 1993 Order?

56. In these circumstances I propose to turn to the main output tax issue which is whether the supply of vouchers to ANL's customers under the two schemes was a free supply of services other than for business purposes so as to attract a charge to output tax under Article 3 of the 1993 Order. In opening this second appeal against the FtT's output tax decision Mr Beal explained that, in the view of the Commissioners, the ability of ANL to reclaim any input tax on the vouchers it had purchased without any associated output tax charge on the supply of the vouchers to its customers created two fundamental problems for the VAT regime as a whole. It offended against the principle of fiscal neutrality by enabling ANL to recover any VAT it had paid to the retailers or to the Hut without passing any corresponding liability to VAT down the distribution chain to the final consumer who receives the vouchers and can ultimately use them to acquire goods or services from the retailer. This problem is avoided in the case of directly acquired vouchers because the effect of Schedule 10A VATA is to ignore the intermediate supplies of retailer vouchers for VAT purposes and to recover the tax when the vouchers are redeemed. But in the case of vouchers purchased from intermediaries like the Hut it is common ground that VAT is payable on the purchase of the vouchers but not on their supply free of charge to ANL's customers. There is therefore no "sticking VAT" imposed on the final consumer.

57. The second concern is that not all of the vouchers will be redeemed so that no VAT will be paid by the retailer in such cases or by ANL if it is able to retain the input tax. The Revenue will therefore end up out of pocket by having to refund the VAT to ANL without any corresponding recovery by way of output tax.

58. In order to redress the imbalance, HMRC rely upon Article 3 of the 1993 Order as their preferred means of making the transaction tax neutral. It is, as Mr Beal I think recognises, what one might call a theologically imperfect solution because it relies on a part of the VAT code that is intended to address a slightly different problem in the form of the use of business assets for private purposes. As explained earlier in this judgment, PVD Articles 16 and 26 are designed to prevent a taxable person who is

entitled to deduct the input tax he has paid on goods or services acquired for his business to then use them for his private (non-business) purposes whilst still being able to recover the input tax. An output tax charge is levied to remove the unfair and anti-competitive position he would otherwise enjoy in being able to use the goods or services for his own purposes free of VAT. The imposition of the charge to output tax treats him as the final consumer.

59. Article 3 of the 1993 Order, like Article 26 PVD, does however make an exception when the services are used for the purpose of the taxpayer's business. In such cases the legislation therefore recognises that in situations in which the goods or services are used to run the business the right to recover input tax should not be restricted. This is no more than a confirmation of the principle underlying the overheads cases that VAT on goods and services acquired as part of the general costs of the business is recoverable to the extent that the business is made up of taxable activities. To that extent the VAT is passed on to the final consumer in the tax he pays on the goods or services which the business supplies in order to recover those costs. The provision therefore of goods or services free of charge is treated as compatible with principles of fiscal neutrality and not anti-competitive in cases where that supply is a necessary expense of running the business.

60. Looked at in this way one would expect to find consistency in these cases between the treatment of the input tax paid to acquire the goods or services and the application of PVD Articles 16 and 26. One of the reasons why I have dealt first with the general issue of the recoverability of input tax has been to identify the correct tax structure of the transactions in issue. It seems to me that if input tax is recoverable (apart from Schedule 10A) on the basis that the vouchers were purchased as cost components of ANL's general business then any concerns that the resultant tax treatment does not properly respect the principles of fiscal neutrality are unsustainable. ANL reclaims the input tax it has paid not by reference to the non-taxable supply of vouchers to its customers, but by reference to the incorporation of those costs into the overheads of its taxable business. The provision of vouchers as part of the two promotions remains therefore a supply or activity outside of the VAT code which is fiscally irrelevant to the right of deduction which ANL seeks to enforce under s.24(1) VATA. The VAT chain is not broken without a corresponding charge to tax.

61. Similarly the non-redemption of vouchers, although a problem in itself, does not create VAT consequences for the Revenue which are the product of a breach of any fundamental principles in relation to the tax treatment of the purchase of the vouchers by ANL. VAT is recovered through the taxation of the supplies which the business makes. Not through the use by the customers of the vouchers.

62. Against that background, I can now turn to the specific criticisms made by HMRC in relation to the FtT's decision about the applicability of Article 3. The main issues are how to interpret Article 26 and whether it imposes a strict test of necessity which excludes anything (such as the vouchers) that are not necessary for the running of ANL's business.

63. One can begin with the wording of Article 26 compared with that of Article 16. In the case of goods, Article 16 imposes output tax on any free supply of goods comprising business assets apart from goods supplied as business samples or gifts of small value. A free supply of goods not in these categories will be treated as a supply for

consideration and therefore a taxable supply even if made for business purposes. The wording of Article 26 is, however, materially different and treats as a taxable supply only supplies of services:

> "carried out free of charge by a taxable person for his private use or for that of his staff or, more generally, for purposes other than those of his business."

64. The words "carried out free of charge ….. for" qualify all of the specified uses which follow and Articles 3 and 6 of the 1993 Order are to the same effect.

65. In Case C-48/97 *Kuwait Petroleum (GB) Ltd v Customs and Excise Commissioners* [1999] STC 488 the ECJ had to consider whether the exchange of vouchers issued by Kuwait at its petrol stations for goods supplied by Kuwait amounted to the supply of those goods free of charge for the purposes of what was then Article 5(6) of the Sixth Directive. One of the questions for the Court was whether Article 5(6) required the supply of goods on redemption of the vouchers to be treated as a supply for consideration notwithstanding that it was made for business purposes. The Court said:

> "[22] However, it is clear from the very wording of Article 5(6), first sentence, of the Sixth Directive that this provision treats as a supply made for consideration, and therefore as subject to VAT, a taxable person's disposal free of charge of goods forming part of his business assets, where input VAT was deductible on those goods, it being in principle immaterial whether their disposal was for business purposes. The second sentence of that provision, which precludes taxation of applications for the giving of samples or the making of gifts of small value for the purposes of the taxable person's business would make no sense if the first sentence did not make VAT payable on the disposal free of charge of such goods by the taxable person, even where this is done for business purposes."

66. Although the ECJ made no reference to what was then Article 6(2)(b) dealing with the supply of services, the Advocate General did mention the contrast between the two provisions in his Opinion:

> "25. Secondly, it is difficult to avoid the conclusion that the contrasting treatment of services by Article 6(2)(b) of the Sixth Directive is deliberate. Without wishing to speculate, I suggest that among the obvious differences between goods and services is that services do not lend themselves, at least not so readily, to free promotion schemes. The more significant labour content would presumably reduce capacity for mass supply of free services. Thus, it seems likely that the disparity in the wording of the two provisions was deliberate."

67. Mr Beal placed some reliance on the fact that in Case C-371/07 *Danfoss A/S and another v Skatteministeriet* [2009] STC 701, which I will come to shortly, Advocate General Sharpston (at [47]) treated Article 5(6) and Article 6(2) as a whole in considering whether the provision of free meals at business meetings should be treated as the "private use of the taxable person or of his staff" or "purposes other than

those of his business". But in relation to those questions no distinction needed to be made between the two provisions whereas the ultimate question in this case of whether a supply of services free of charge is to be treated as made for consideration turns not on whether it was made free of charge but on whether it can be said to have been made for the purpose of the taxpayer's business.

68. The question whether a free supply of services was made for purposes other than those of the taxpayer's business has been considered in the leading cases mainly in relation to the provision of benefits such as transport and free meals. *Julius Fillibeck Söhne GmbH&Co. KG v Finanzamt Neustadt* (Case C-258/95: [1998] STC 513) concerned free transport to work for employees who lived more than 6 kms away. In *Danfoss* the issue was whether the provision of free meals in the staff canteen to employees and business contacts during the course of business meetings could be treated as made for the purpose of the employer's business.

69. In *Fillibeck* the Court held that the provision of free transport would ordinarily fall to be treated as for the private use of the employee rather than for business purposes because the distance from work depended on the choice made by the employee as to where he or she wished to live. Absent special circumstances (e.g. the inaccessibility of the workplace to public transport), no business purpose would exist for the provision of free transport. Similarly in *Danfoss* the Court accepted that free meals provided to staff in the canteen would usually be treated as made for the private use of the employees who could choose whether or not to eat there. But it accepted that in particular circumstances this element of choice would be excluded:

> "60. It must be acknowledged that, for the employer, ensuring the provision of meals to its employees allows it, in particular, to limit the reasons for which meetings are interrupted. Therefore, the fact that the employer alone is in a position to guarantee that meetings will run smoothly and without interruptions might oblige it to ensure that meals are provided for participating employees.
>
> 61. On the other hand, as Danfoss explained at the hearing, the meals at issue consist of sandwiches and cold platters, served in the meeting room in particular circumstances. It is clear from those explanations that employees have no choice as to where, when and what they eat, the employer itself being responsible for those choices.
>
> 62. In such particular circumstances, the provision of meals to employees by the employer is not for the private use of the employees and is not for purposes other than those of the business. The personal advantage which employees derive from such provision appears to be merely accessory to the requirements of the business.
>
> …..
>
> 64. It is, however, for the national court to establish whether, in the light of the indications provided by the Court, the particular characteristics of the main proceedings before it make it necessary, having regard to the requirements of the companies in question, for

> the employer to provide meals free of charge to business contacts and to staff in connection with work meetings held on company premises."

70. HMRC contend that Article 26 should be given a purposive construction so as to minimise the circumstances in which the untaxed private consumption of services is permitted. This amounts to formulating a test of strict necessity under which the free supply of services would be deemed to be taxable unless it was in effect impossible to operate the business without it. In relation to vouchers, Mr Beal drew our attention to the Opinion of Advocate General Mengozzi in *Astra Zeneca* who observed in passing at [65] that the ultimate purpose of the vouchers supplied to staff as part of their remuneration package "cannot be said to relate to the business's activities, since they are clearly intended for the private needs of the staff". The vouchers in this case were provided, he says, for the private needs of ANL's customers which cannot be equated with use for business purposes.

71. Article 26 clearly imports a restrictive test as the decisions in *Fillibeck* and *Danfoss* illustrate. In *Danfoss* at [55] the Court said that the objective information must indicate that the meals in question "have been provided for strictly business-related purposes". But, as the Upper Tribunal has explained, there is an obvious difference between the need to demonstrate that the meals have been provided for strictly business-related purposes in the sense of being exclusively provided for that purpose and a requirement that they should be strictly necessary in order for the business purpose to be carried out. The fact that the removal of the element of choice was sufficient to establish a business use in the context of a meeting suggests that a strict test of the kind contended for by Mr Beal is not warranted by the legislation. What one is looking to identify is a provision of services made in order to fulfil a business purpose and nothing else. In *Danfoss* the distinction between private and business use in relation to the meals served to employees turned solely on the fact that when attending business meetings they were required to accept the set meal provided. As the Court acknowledged, the provision of a meal by the employer had the effect, from the employer's point of view, of reducing the scope for interruptions in the meeting and so furthered the business purpose of the occasion. This will be a question of fact in every case. But the issue is whether the supply of services better fulfils a business purpose and no other purpose rather than whether it is a *sine qua non* for the achievement of the business purpose at all.

72. In the present case we are not concerned with the voluntary provision of a supply of services to an employee as in *Fillibeck, Danfoss* and potentially *Astra Zeneca*. The output supply of the vouchers was made to satisfy a contractual obligation which ANL owed to its customers as a result of their participation in one of the two schemes. In factual terms, one is dealing therefore with a situation where ANL was obliged to provide the vouchers and where it did so in the context of a scheme designed to boost the circulation of the papers. The provision of services to a third party under contractual arrangements of this kind seems to me a long way removed from the provision of services to an employee in circumstances similar to those in *Danfoss*. The commercial context is different and if the voluntary provision of free meals to an employee in order to streamline a business meeting is not to be treated as taxable it is difficult to see why the compulsory provision of free vouchers as part of a commercial scheme designed to sell newspapers should be. To achieve this result it is

necessary to remove the supply of the vouchers from their context and to consider the supply of vouchers in isolation from the purpose for which the schemes were established. There is nothing in the authorities which seems to support this construction of Article 26.

73. Mr Beal's alternative argument (ground 1(e)) is that a supply of services for no consideration falls outside the VAT regime and therefore almost by definition cannot constitute economic or business activity. It must follow, he submits, that it cannot be construed or treated as made for a business purpose within the terms of Article 3. The first part of this argument is not controversial but the second part seems to me to be an attempt to have it both ways. If the correct treatment of the purchase of the vouchers was to regard them as cost components of the free supply of the same vouchers to ANL's customers then it is common ground that this is an activity outside the scope of the VAT legislation and no input tax would be deductible. In that event Article 3 of the 1993 Order would have no application.

74. If, however, as the Upper Tribunal found, the economic link for input tax purposes is between the purchase of the vouchers and the general business so as to engage Article 168 PVD, the free supply of the vouchers to ANL's customers remains an activity outside the VAT regime with two possible consequences. The first is that it should be ignored for all purposes including those of Article 26 so that there is no supply of services which exists to attract a charge to output tax. The other is to recognise the provision of the vouchers as a free supply of services but to apply Article 26 in a way that is consistent with the premise that the vouchers were acquired as part of the general costs of the business. In these circumstances, Article 26 (and therefore Article 3 of the 1993 Order) could operate to impose a charge to output tax if the vouchers were used (e.g.) to make gifts to employees. But they would not impose a tax charge if the vouchers were supplied to customers in accordance with the promotional scheme. In that case the only realistic finding would be that they were being used to fulfil the commercial purpose for which they were acquired.

75. For these reasons, I would dismiss HMRC's appeal in relation to the output tax issues.

Does Schedule 10A VATA preclude the recovery of input tax on the direct supplies of retailer vouchers?

76. I can now turn to ANL's appeal which concerns only directly supplied vouchers. The Upper Tribunal held that the effect of Schedule 10A paragraph 4(2) was to treat the direct supply of a retailer voucher as one for no consideration with the result that it fell outside the VAT regime so that no question of deducting input tax could therefore arise. The provision of the vouchers by Marks & Spencer and other retailers was not a taxable supply of services.

77. The FtT had held that the direct issue of retailer vouchers was a taxable supply because it was a supply of services under paragraph 2 of Schedule 10A. It construed paragraph 4(2) as a provision designed to avoid the double taxation of vouchers by relieving the retailer of the obligation to account for VAT until the voucher was redeemed but preserving the status of the sale of the vouchers as a taxable supply with the result that any input tax payable on the supply remained deductible.

78. The Upper Tribunal accepted Mr Beal's argument that in order to deduct input tax there must be "VAT due or paid in respect of supplies to [the taxable person] of goods or services": see Article 168(a) PVD. "Due" refers to tax which the taxable person has an enforceable obligation to pay at the time that the deduction is sought: see *Véleclair SA v Ministre du Budget, des Comptes publics et de la Réforme de l'État*: Case C-414/10: [2012] STC 1281.

79. Relying in part on the analysis of a voucher transaction contained in the Opinion of Advocate General Mengozzi in *Astra Zeneca*, it accepted that the VAT for which the retailer eventually accounts is the VAT due on the supply of goods or services which he makes in exchange for the voucher: not on the supply of the voucher itself. The voucher (or at least the amount paid for it) is no more than the consideration for the supply which the retailer makes on redemption. If the voucher is not redeemed then no VAT is ever payable. Consistently with this, there is no need or reason for Article 4(2) to preserve the status of the supply of the vouchers as a taxable supply and, properly construed, it has the effect of taking the direct supply of retail vouchers out of tax:

> "88. Merely bearing the VAT on a supply is not, however, sufficient to found a right to deduct VAT. The right to deduct can arise only with respect to "VAT due or paid … in respect of supplies to [the taxable person] of goods or services" (art 168(a), Principal VAT Directive). The fact therefore that the consideration paid by ANL for the acquisition of the voucher includes an amount that, on redemption, would satisfy the VAT element of the price for the goods or services supplied to the customer redeeming the voucher does not render ANL the consumer of the relevant supply. The consumer of that supply is the customer to whom ANL has provided the voucher. The supply to ANL is the supply of the voucher on which, by virtue of para 4(2), Sch 10A, no VAT is chargeable at all.
>
> 89. We respectfully disagree therefore with the analysis of the FTT in this respect, and with the submissions of Mr Walters to the same effect. We see no possible construction of Schedule 10A, whether by reference to the *Marleasing* principle or otherwise, according to which the effect of paragraph 4(2) is confined to relieving the retailer of the obligation of accounting for the VAT on the supply of the voucher, or in subsuming the original supply of the voucher into the supply on redemption of the voucher."

80. Looked at in economic rather than fiscal terms, what lies at the heart of this dispute is the fact that part of the amount paid by ANL for the directly supplied vouchers will be used on redemption to pay the VAT which the retailer will have to account for on its supply of the goods or services to the voucher holder. In that sense it is paying an amount which includes both the consideration which the retailer will accept for its goods and services and an amount attributable to the eventual charge to VAT.

81. Mr Walters QC for ANL accepts that, on a literal construction of paragraph 4(2), the direct supply of vouchers is one for no consideration and therefore not a taxable

supply. But he contends that it must either be construed on *Marleasing* principles or disapplied so as to accommodate the right of ANL under Article 168 PVD to deduct the input tax inherent in the voucher. The vouchers were in fact issued for consideration and, but for paragraph 4(2), their issue was therefore a chargeable event under Article 63 PVD. The purpose of paragraph 4(2) was, he says, to relieve the issuer of the voucher of the obligation to account for output tax on the issue of the voucher: not to make the transaction a non-taxable activity with no corresponding right to recover the VAT included in the price paid for the voucher. The Upper Tribunal's construction of paragraph 4(2) is said to be inconsistent with EU law which does not permit an actual supply of services for consideration to be treated as if it were a supply for no consideration. In these circumstances, ANL has a directly enforceable right to deduct input tax under Article 168 PVD which cannot be removed by the domestic legislation.

82. The difficulty about this argument is its premise. The Court has no reason to resort to a *Marleasing* construction of paragraph 4(2) or to consider its disapplication unless it is clear that the domestic legislation conflicts with some directly enforceable principles of EU law. Looked at simply in domestic terms, there is no doubt that paragraph 4(2) removes the taxable status of the supply of directly issued vouchers by deeming them to have been made for no consideration. This is, of course, a fiction but it has legal and fiscal consequences by converting the sale of the vouchers into one for no charge.

83. The retailer who would be accountable for the output tax on the sale of the vouchers is therefore treated as having made a non-taxable supply and VAT becomes recoverable on the price paid for the vouchers, not as a charge on their supply but as a charge on the supply of goods or services for which they are eventually exchanged. Like the Upper Tribunal, I consider that any other construction of paragraph 4(2) would require a significant re-wording of the sub-section. This could probably be accommodated under *Marleasing* principles (see e.g. *Revenue and Customs Commissioners v IDT Card Services Ireland Ltd* [2006] STC 1252 at [80]) but only if it can be shown that the operation of the provision would otherwise infringe ANL's rights under EU law.

84. I agree with Mr Beal that this is not demonstrated simply by the economic analysis I have already referred to. It matters not for fiscal purposes that Parliament has chosen to impose VAT on the supplies which the retailer makes on redemption of the vouchers rather than on the supply of the vouchers themselves. The UK was not required at the time of those transactions to adopt any particular tax treatment for vouchers and, in particular, to treat them as supplies made for consideration. It was therefore at liberty to leave them out of account for VAT purposes by deeming them to be issued for no consideration even if a price was in fact paid. ANL's argument amounts to saying that the UK was obliged to charge VAT on their issue but it is clear that it was not.

85. The consequence therefore of paragraph 4(2) was that there was no legally enforceable obligation on Marks & Spencer and the other retailers to include VAT within the price of the vouchers and to account for it in respect of their issue. Correspondingly ANL had no right to deduct input tax and there was therefore no infringement of their Article 168 rights. For the same reason, the principles of fiscal neutrality are not infringed.

86. The fact that ANL paid a price to the retailer which will enable the voucher holder to pay the VAT on the goods or services he buys on redemption is of no consequence in fiscal terms. ANL has done no more than to acquire a voucher which can be negotiated to pay for a separate taxable supply. If the voucher is not redeemed then no taxable supply will have taken place. In one sense, ANL can be said to have wasted its money in buying vouchers which were not used but that is not an infringement of any of its rights under EU law.

87. I would therefore dismiss ANL's appeal.

A reference

88. The points raised by the two appeals are not without their difficulties but they do in the end turn upon the application of established principles which can be deduced from the existing decisions of the CJEU. Those principles are, I think, *acte clair* and I do not therefore consider that a reference is necessary in order to dispose of the appeals.

Conclusion

89. I would therefore dismiss both appeals.

Lady Justice Black :

90. I agree.

Lord Justice Jackson :

91. I also agree.