Neutral Citation: **[2023] UKUT 178 (TCC)**

Case Number: UT/2022/000031

UPPER TRIBUNAL
(Tax and Chancery Chamber)

The Rolls Building, London

VAT – sale of shares – proceeds of sale used to fund taxable activities – input tax incurred on sale of shares – whether a direct and immediate link to the taxable activities – yes – appeal dismissed

Heard on: 13 June 2023
Judgment date: 24 July 2023

Before

MR JUSTICE ZACAROLI
JUDGE GUY BRANNAN

Between

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS
Appellants

and

HOTEL LA TOUR LTD
Respondent

Representation:

For the Appellants: Isabel McArdle, Counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

For the Respondent: Michael Firth, Counsel.

DECISION

INTRODUCTION

1. The Appellants ("HMRC") appeal against a decision of the First-tier Tribunal ("FTT") (Judge Richard Chapman QC and Ms Gill Hunter) issued on 3 December 2021 ("the Decision") allowing the appeal of Hotel La Tour Ltd ("HLT") against a decision of HMRC dated 26 June 2018 and a corresponding assessment. HMRC's decision and assessment were issued on the basis that HLT was not entitled to an input deduction in respect of certain services supplied to HLT because, in HMRC's view, they were directly and immediately linked to HLT's exempt supplies, viz the sale of shares in its subsidiary, Hotel La Tour Birmingham Limited ("HLTB").

2. HLT, however, maintains that the relevant services were directly and immediately linked to HLT's taxable supplies because the shares in HLTB were sold in order to raise funds for the building of a new hotel in Milton Keynes. HLT further argues that because HLT and HLTB were in the same VAT group, the sale of the shares in HLTB is to be treated as outside the scope of VAT rather than as an exempt supply.

3. The amount of VAT at stake is £76,822.

4. HMRC appeal to this Tribunal with the consent of the FTT.

5. For the reasons given later in this decision, we dismiss HMRC's appeal.

FACTUAL BACKGROUND

6. The relevant facts, which were set out in [3]-[13] of the Decision, were not in dispute before the FTT and are summarised below. References in square brackets are references to the relevant paragraphs of the Decision, unless the context otherwise indicates. References to the CJEU or to "the Court" include references to the ECJ.

7. HLT was a holding company and owned the entire share capital of HLTB. HLTB and HLT were members of a VAT group of which HLT was the representative member. HLTB owned and operated a luxury hotel in Birmingham. HLT provided HLTB with management services, which included the provision of key personnel, such as the general manager of the hotel.

8. HLT also owned certain intellectual property, including the "Hotel La Tour" name, which HLTB was permitted to use.

9. In 2015, HLT decided to construct a new hotel in Milton Keynes which was anticipated to cost approximately £34.5 million. In order to finance this development, it decided to sell HLTB and to borrow the shortfall from a bank. It was considered that HLTB's business had reached the stage where it could grow no further.

10. HLT sought the highest price possible for the shares in HLTB and it was clear that the proceeds of sale were to be used to fund the development of the Milton Keynes hotel.

11. On 17 May 2017, HLT agreed heads of terms with a purchaser ("the Purchaser") for the purchase of the shares in HLTB. The sale was completed by a share purchase agreement dated 21 July 2017 ("the SPA"). The SPA provided:

(1) HLT agreed to transfer the whole of its shares in HLTB to the Purchaser.

(2) The consideration for the purchase of shares was £4,812,231.24, subject to adjustments in completion accounts.

(3) The Purchaser undertook to put HLTB in funds to discharge its loan to HLT (£12,179,678.66) and to discharge a sum owing to a bank (£13,496,714) immediately after completion.

12. The completion accounts resulted in the consideration for the purchase of the shares being adjusted to £4,635,132.09. The sale was completed on 21 July 2017 and on that date HLTB was removed from HLT's VAT group.

13. The net amount received by HLT under the SPA was approximately £16 million (the consideration for the purchase of the shares and the repayment of HLT's loan to HLTB, less the cost of the sale including the fees for professional services).

14. HLT engaged various advisers to provide professional services ("the professional services") to assist in the sale of HLTB, including market research, buyer shortlisting, financial modelling and tax compliance. This was with a view to obtaining the highest sales price available, which would provide for the largest sum possible to pay towards the development of the Milton Keynes hotel. HLT incurred the following professional fees in the total amount of £382,899.51 plus VAT of £76,822.95:

(1) Marketing agents' fees of £255,000 plus VAT of £51,267.19.

(2) Solicitors' fees of £115,399.51 plus VAT of £23,055.76 for strategic advice and conveyancing costs.

(3) Chartered accountants' fees of £12,500 plus VAT of £2,500 in respect of tax support in respect of the sale of the shares in HLTB.

15. HLT commenced building the Milton Keynes hotel. As at 16 January 2020 £3 million of the £16 million (referred to in paragraph 13 above) had been utilised in the development of the Milton Keynes hotel. The arrangement with the bank funding was that the remainder of the £16 million was to be used before the bank loan could be drawn down. It was anticipated that this would take place before March 2021. The FTT concluded that the whole of the £16 million had been used towards the development of the Milton Keynes hotel.

16. HLT filed its 09/17 VAT return on 2 November 2017 seeking repayment of £68,883. This included the above-mentioned professional fees.

17. On 23 November 2017, HMRC commenced enquiries in respect of the 09/17 VAT return. This resulted in a decision letter dated 26 June 2018 which effectively disallowed the input tax in respect of the professional services. At that stage, HMRC were arguing that HLT was not carrying out an economic activity because the management services were provided by employees who were directors of both HLT and HLTB rather than being provided by HLT. After a review, the decision was upheld by a letter from HMRC dated 4 September 2018. However, in a letter dated 26 June 2019, HMRC accepted that sufficient management services were provided by HLT to constitute an economic activity carried on by HLT. HMRC maintained instead that the professional services which gave rise to the fees were used in making an exempt supply (sale of the shares in HLTB) rather than in making taxable supplies.

THE FTT'S DECISION

Direct and Immediate Link

18. After reviewing the authorities, the FTT found at [35] that there was a direct and immediate link between the professional services and HLT's downstream taxable general economic activities and that "the chain" was not broken by the sale of the shares in HLTB.

19. In the view of the FTT at [36], the effect of decision of the CJEU in *Skatteverket v AB SKF* (Case C-29/08) [2010] STC 419 ("*SKF*") and of the Supreme Court in *Frank A Smart & Son Ltd v Revenue and Customs Commissioners* [2019] UKSC 39, [2019] 1 WLR 4849 ("*Frank A Smart*") was that the relevant objective purpose was that of the fund-raising and the relevant use was the use of the funds. It was clear from the *Frank A Smart* decision at [65] (iv) that the *use* of professional services for the initial fund-raising transaction did not break the chain. However, the chain would be broken where the cost of the inputs was a cost component of the price of the shares in the initial transaction, referring to the judgment of Lord Hodge in *Frank A Smart* at [46] and [47]. The FTT noted at [37] that Lord Hodge at [38] treated the CJEU in *Kretztechnik AG v Finanzamt Linz* (Case C-465/03) ("*Kretztechnik*") as disregarding, in that case, the use of the services in the initial share transaction in fund-raising cases.

20. The FTT also noted that Lord Hodge in *Frank A Smart* at [49] regarded the CJEU as having extended the same VAT treatment of share disposals outside the scope of VAT to those where the share disposals were exempt from VAT. Therefore, the relevant consideration in fund-raising cases was whether the services were incorporated into the prices of the initial share transaction or of the downstream transactions. At [39] the FTT considered that when analysing the cost components, the manner in which the assets and services were paid for was not determinative.

21. At [40], the FTT agreed with HMRC that, in general, the necessary direct link (between the input transaction and the output transaction) existed if the services were part of the cost components of the person's taxable transactions which used those goods and services and that this had a chain-breaking effect. However, the FTT disagreed with HMRC's submission that this general position was not modified in fund-raising transactions. The FTT considered that it was clear from *Frank A Smart* that the general position was modified such that the use of services for a fund-raising transaction which was either outside the scope of VAT or exempt from VAT did not prevent deduction if (with all paragraph references to the judgment of Lord Hodge in *Frank A Smart*):

(1) The purpose in fund-raising was to fund its economic activity [65(iv)]. This was to be ascertained from the objective evidence [65(iv)] and [65(vii)]. As Lord Hodge notes, "The ultimate question is whether the taxable person is acting as such for the purposes of an economic activity" [65(vii)]. The circumstances to be taken into account included the nature of the asset and the period between acquisition and use for the economic activity: [65(vii)].

(2) The funds are later used for taxable supplies [65(iv)]. However, the right to deduct arises immediately, potentially resulting in a time lapse between deduction and use or retention of the right to deduct even if unable to use them in certain circumstances [65(vi)] and [69].

(3) The cost of the services are cost components of downstream activities which are taxable. The right to deduct will therefore be lost if the cost of the services are incorporated into the price of the shares sold in the initial transaction that is exempt or outside the scope of VAT [47] or of downstream activities which are exempt or outside the scope of VAT [65(v)]. If the downstream activities are a combination of taxable transactions, exempt transactions and transactions outside the scope of VAT, the inputs will have to be apportioned [65(v)].

22. At [41] the FTT agreed with HMRC's submission that an objective assessment of the purpose of the fund-raising was required as distinct from the subjective intentions of HLT. The FTT considered that the chain would be broken if the costs of the professional services were a cost component of the fund-raising. However, the FTT did not accept that the *use* of the professional services for the fund-raising transaction prevented deduction.

23. Applying those principles to the facts of the appeal, the FTT found at [43] that, objectively ascertained, the purpose of the share sale was to fund HLT's taxable general activities, noting that HMRC appeared to accept, and the FTT agreed, that HLT was carrying out a downstream taxable business. HLT's financial position was that it could not afford to develop the Milton Keynes hotel without entering into the SPA for the sale of HLBT. The FTT recognised that the SPA went beyond the mere transfer of the HLTB shares, because it included a means by which HLTB paid its inter-company loan to HLT and that HLTB paid its own indebtedness to a bank. It was, however, part of the fund-raising purpose, as was clear from the terms of the SPA and the terms of the completion accounts, that the terms of the transaction were intended to result in a total sum being paid to HLT on completion, either directly or by placing HLTB in funds to pay the inter-company debts to HLT. The FTT noted that there was no suggestion that the £16 million had any purpose other than the development of the Milton Keynes hotel. The use of the £16 million to pay for the costs of the sale was not a purpose in its own right; the overall purpose of the fund-raising was to result in monies being payable to HLT which could then be used for the Milton Keynes hotel development and any monies used for the costs of sale represented by the professional fees were to facilitate that purpose. Objectively analysed, the professional services were only necessary to facilitate the sale itself.

24. At [44] the FTT noted HMRC's valid submission that the professional services in respect of the professional fees were all part of the process of selling the shares in HLTB. However, this went to the question whether or not the professional services were used in the fund-raising transaction. Whilst the FTT agreed that they were so used, this did not prevent deduction.

25. At [45], the FTT found that the £16 million was used in respect of the development of the Milton Keynes hotel. HMRC accepted that activities relating to the Milton Keynes hotel development constituted taxable activities.

26. At [46] the FTT found that the cost of the professional services was not incorporated in the price of the shares sold in (and were not cost components of the price of the shares in) the initial transaction. The agreed evidence was that the HLTB shares were sold for the best price achievable in the market. The price was not increased in order to provide for the costs of the professional services and there was no allocation for such costs within the sale price. The FTT noted that although there was no requirement for such increased price or allocation in order for costs to be components of the price of the HLTB shares, the presence of such an increase or allocation would support the cost of the professional services being cost components of the initial transaction. Instead, the professional services were paid for out of the proceeds of sale, thus reducing the amount available for the taxable transactions and so being a cost of those

taxable transactions. Further, the objective purpose of incurring the costs of the professional services was in order to raise funds to pay for the downstream transactions.

VAT group

27. Essentially, HLT's argument was that the fact that HLT and HLTB were in the same VAT group meant that the supply of HLT's management services to HLTB should be disregarded with the effect that there was no economic activity. Therefore, the sale of shares was outside the scope of VAT rather than being an exempt supply.

28. At [50]-[51] the FTT found that HLT was not entitled to rely on this VAT group argument because it did not appear in HLT's Grounds of Appeal or any statement of case of either party. The point had first been raised in written submissions after the hearing. After referring to the authorities (in particular *Quah International v Goldman Sachs* [2015] EWHC 759 (Comm) *per* Carr J at [36] to [38]), the FTT considered at [52] that the VAT group argument had been advanced extremely late and that there was no good reason for the failure to amend earlier. HMRC was prejudiced because it faced a new argument which had not been raised before, was introduced after the oral hearing, and which was entirely contrary to HLT's previous position. By contrast, HLT was not prejudiced as it succeeded in its appeal without the VAT group argument.

29. Even if the FTT had allowed HLT to argue the VAT group argument, the FTT at [53] indicated that it would have dismissed it. The effect of the VAT grouping was to disregard supplies between members for the purposes of the VAT consequences that would otherwise arise out of those supplies. The FTT concluded at [56] that the separate businesses within the VAT group retained their individual entity. An economic activity was therefore still taking place as a matter of fact, albeit that the economic activity was treated for VAT purposes as if it was the economic activity of the representative member.

30. At [57] the FTT considered that HLT's argument (viz that the supplies were to be disregarded and so the economic activity was to be disregarded) overlooked the fact that the group members are still to be treated as having separate existence with transactions taking place. Because the transactions which constituted economic activity, that economic activity could not be ignored.

31. On the basis of the first point raised, however, HLT's appeal was allowed by the FTT.

GROUNDS OF APPEAL

32. Permission to appeal has been granted on the following grounds.

Ground 1

33. The FTT erred in law and applied the wrong test for determining whether there was a direct and immediate link between the Services and the sale of the Shares.

Ground 2

34. The Decision was contrary to binding authority.

35. In particular, the FTT erred by:

(1) Disregarding the use of the professional services entirely when determining whether they were a cost component of the supply of HLTB shares (Stage 1) or in HLT's downstream taxable transactions.

(2) Failing to draw a proper distinction between Stages 1 and 2, or to consider them in the proper order. In doing so, the FTT erred in law by:

(a) predicating its analysis on the subjective intention of HLT and HLTB, as opposed to objective evidence;

(b) mis-interpreting the SPA: The SPA, properly construed, did not disclose a purpose of funding taxable supplies only. Not only did the FTT reach a factual conclusion not open to it in relation to the objective purpose of the sale of Shares, but it reached that conclusion in support of a finding that there is no direct and immediate link between the professional services and the sale of the HLT shares (Stage 1), when it is irrelevant to Stage 1 and only relevant if Stage 2 is reached.

(3) The effect of the supply of the HLT shares being used to fund repayment of loans shows that the cost of the professional services was not "solely attributable to downstream economic activities" and not "consequently are among only the cost components activities".

(4) Failing to recognise that *Frank A Smart* was a case concerning Stage 2.

(5) Reaching a decision that was incompatible with the decision of the CJEU in *BLP Group Plc v Customs & Excise Commissioners* [1996] 1 WLR 174 ("*BLP*")

LEGISLATION

36. Article 2(1)(c) of the Principal VAT Directive ("PVD") provides for, amongst other things, the supply of services for consideration within the territory of a Member State by a taxable person acting as such to be subject to VAT. The definition of a "taxable person" appears in Article 9:

> "1. 'Taxable person' shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity."

37. Article 168 provides for the right of a taxable person to deduct input tax insofar as goods and services are "used for the purposes of the taxed transactions of the taxable person".

38. These provisions were implemented in domestic legislation by section 24 of the Value Added Tax Act 1994 ("VATA"), the relevant sub-sections of which are as follows:

> "(1) Subject to the following provisions of this section, 'input tax', in relation to a taxable person, means the following tax, that is to say –
>
> (a) VAT on the supply to him of any goods or services; and
>
> …
>
> being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.
>
> (2) Subject to the following provisions of this section, 'output tax', in relation to a taxable person, means VAT on supplies which he makes.

…"

39. Article 135(1)(f) of the Principal VAT Directive provides that transactions in shares are exempt from VAT. This was implemented in domestic law by paragraph 1 of Group 5 to Schedule 9 of VATA as follows:

> "6. The issue, transfer or receipt of, or any dealing with, any security or secondary security being –
>
> (a) Shares …"

THE RELEVANT AUTHORITIES

Decisions of the CJEU

40. HMRC relied heavily upon the CJEU's decision in *BLP*. In that case, the taxpayer had sold shares in a company to raise funds for the purpose of paying off debts incurred while making taxable transactions. The taxpayer then sought to recover the input tax associated with the sale of shares (charged by its bankers, solicitors and accountants) on the grounds that the VAT was linked to its taxable transactions. The taxpayer was carrying on an economic activity of supplying management services to its subsidiaries. The CJEU held that where a taxable person supplied services to another taxable person who used them for an exempt transaction, the latter person was not entitled to deduct the input of VAT paid, even if the ultimate purpose of the transaction was the carrying out of a taxable transaction.

41. In *Kretztechnik* an Austrian company listed its shares on the Frankfurt stock exchange and incurred certain listing and other expenses on which VAT was charged. The company sought to recover this input tax. The CJEU reiterated its previous jurisprudence to the effect that the acquisition, holding and selling of shares do not amount to economic activity, before proceeding to hold that the same analysis also applied to the issue of shares. The issue of shares was, therefore, "outside the scope" of VAT. The Court held that because the share issue had been undertaken 'in order to increase its capital for the benefit of its economic activity in general', there was 'a direct and immediate link with the whole economic activity of the taxable person'. The cost of the supplies received by the company were to be regarded as part of its overheads and thus as component parts of the price of its products. The input tax was therefore deductible provided that the whole of the company's economic activity comprised taxable transactions.

42. In *Sveda* (Case C-126/14), *Iberdrola* (Case C-132/16) and *Hartstein-Industrie* (Case C-528/19), the Court reiterated that if a non-economic activity was undertaken for the purposes of an economic activity, this created the link that was necessary to make any input VAT, incurred in relation to the non-economic activity, deductible.

43. In the next decision of the CJEU, *SKF*, on which HLT particularly relied, the parent company of an industrial group, SKF, played an active role in the management of its subsidiaries and, thus, carried on an economic activity. It followed, therefore, that any sale of the shares in its subsidiaries would be an exempt transaction. As part of a proposed group restructuring, SKF intended to dispose of two companies (a wholly owned subsidiary and a controlled company which was in the past wholly owned by it), to which it had provided services subject to VAT. The proceeds of sale were to be used to finance other (taxable) activities of the group. The CJEU concluded that the principle of fiscal neutrality required that SKF had the right to deduct input tax incurred during exempt sales of shares. The Court said:

> "33.By the disposal of all of its shares in the subsidiary and in the controlled company, SKF brought to an end its holdings in those companies. That disposal, carried out in order to enable the parent company to restructure a group of companies, can be regarded as a transaction that consists in obtaining income on a continuing basis from activities which go beyond the compass of the simple sale of shares (see, to that effect, *Kretztechnik AG v Finanzamt Linz* (Case C-465/03) [2005] STC 1118, [2005] 1 WLR 3755, para 20 and the case law there cited). That transaction has a direct link with the organisation of the activity carried out by the group and constitutes accordingly the direct, permanent and necessary extension of the taxable activity of the taxable person within the terms of the case law cited in para 31 of this judgment. Such a transaction consequently comes within the scope of VAT."

44. The Court continued:

> "64. In order to give a useful answer to the referring court, it must be recalled that the court has held, on numerous occasions, that there is a right to deduct VAT paid on consultancy services used for the purposes of various financial transactions, on the ground that those services were directly attributable to the economic activities of the taxable persons (see, inter alia, *Midland Bank* (para 31); *Abbey National* (paras 35 and 36); *Cibo Participations* (paras 33and 35) *Kretztechnik* (para 36); and *Securenta* (paras 29 and 31)).
>
> 65. Admittedly, the output transactions in shares in the cases which led to the above-mentioned judgments, unlike those in the main proceedings in the present case, were outside the scope of VAT. However, as is clear from the case law cited in paras 28 and 30 of this judgment, the main factor distinguishing the legal classification of those transactions from that of transactions which come within the scope of VAT but are exempt from it is whether the company which is liable to the tax is or is not involved in the management of the companies in which a shareholding has been taken.
>
> 66. However, if the right to deduct input VAT paid on consultancy costs relating to a disposal of shares which is exempted because of involvement in the management of the company whose shares are sold was not allowed, and if the right to deduct input VAT in respect of such costs relating to a disposal which is outside the scope of VAT was allowed on the ground that those costs constitute general costs of the taxable person, that would amount to treating objectively similar transactions differently for tax purposes, and would be an infringement of the principle of fiscal neutrality.
>
> 67. In that regard, the court has ruled that the principle of fiscal neutrality, which is a fundamental principle of the common system of VAT, precludes treating similar supplies of services, which are thus in competition with each other, differently for VAT purposes (see, inter alia, *Kingscrest Associates Ltd v Customs and Excise Comrs* (Case C-498/03) [2005] STC 1547, [2005] ECR I-4427, para 41; *Turn-und Sportunion Waldburg v Finanzlandesdirektion für Oberösterreich* (Case C-246/04) [2006] STC 1506, [2006] ECR I-589, para 33; and *R (on the application of Teleos plc) v Revenue and Customs Comrs* (Case C-409/04) [2008] STC 706, [2008] QB 600, para 59) and, further, precludes economic operators who carry out the same activities from being treated differently as far as the levying of VAT is concerned (see, inter alia, *Gregg v Customs and Excise Comrs* (Case C-216/97) [1999] STC 934, [1999] ECR I-4947, para 20, and *Revenue and Customs Comrs v Isle of Wight Council* (Case C-288/07) [2008] STC 2964, [2008] ECR I-7203, para 42).
>
> 68. It follows that, if the consultancy costs relating to disposals of shareholdings are considered to form part of the taxable person's general costs

in cases where the disposal itself is outside the scope of VAT, the same tax treatment must be allowed if the disposal is classified as an exempted transaction.

69. That interpretation is borne out by the purpose of the common system introduced by the Sixth Directive, which is, in particular, to secure equal treatment for taxable persons (see, inter alia, *Muys' en de Winter's Bouw-en Aannemingsbedrijf BV v Staatssecretaris van Financiën* (Case C-281/91) [1997] STC [1993] ECR I-5405, para 14). That principle would be disregarded if the costs incurred by a parent company managing a group of companies in connection with a sale of shares which is part of its economic activity were to be taxable, while a holding company which carries out the same transaction outside the scope of VAT would be entitled to deduct VAT paid on the same costs by reason of the fact that those costs form part of the general costs of its overall economic activity."

45. The next relevant CJEU authority is its decision in *'Sveda' UAB v Valstybine mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* (Case C-126/14) [2016] STC 447 ("*Sveda*"). The case concerned 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 intended to carry out some taxable economic activities at the discovery path in the form of the sale of food or souvenirs. The issue was whether the goods purchased for the construction of the path had a direct and immediate link with the economic activities or were cost components of the construction of the discovery path which was to be made available to the public free of charge.

46. The Court looked for 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 art 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 *Finanzamt Köln-Nord v Becker* (Case C-104/12) (21 February 2013, unreported), paras 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 OOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto'—Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-118/11) [2012] STC 982], para 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 para 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.'

Decisions of the UK courts

47. These decisions of the CJEU have received recent consideration from the UK courts.

48. In *Associated Newspapers Ltd v HMRC* [2017] STC 843 ("*Associated Newspapers*") the Court of Appeal considered whether the issue of vouchers gave rise to a right to deduct input tax in circumstances where the taxpayer purchased vouchers from retailers and intermediaries which were then gratuitously distributed by the taxpayer to its customers. In dismissing the taxpayer's appeal, Patten LJ (with whom Black and Jackson LJJ agreed) reviewed the CJEU authorities, including *SKF* and *Sveda*, and said:

> "[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."

49. In *Frank A Smart & Son Ltd* [2019] UKSC 39, the Supreme Court considered the taxpayer's acquisitions of units under the single farm payment (SFP) scheme. HMRC had denied an input deduction for the VAT incurred on the acquisition of SFP units on the basis that this was a non-economic activity which merely enabled the taxpayer to claim subsidies. However, the taxpayer argued that the SFP units related to its holding of land which, in turn, improved its overall (taxable) farming business; in other words, the taxpayer's inputs had a direct and immediate link to its overall taxable activity. The Supreme Court dismissed HMRC's appeal, upholding the decision of the Court of Session. Lord Hodge delivered the judgment of the Court, with the remaining justices concurring.

50. Lord Hodge referred to *SKF* and observed at [41] that "the CJEU has called into question its ruling in *BLP* in the light of its developing jurisprudence attributing input expenditure on the raising of capital to the general overheads of an undertaking". Lord Hodge then summarised the CJEU's case law at [65]:

> "(iii) Summary of the case law
>
> [65] I derive the following propositions which are relevant to this appeal from the case law:
>
> (i) As VAT is a tax on the value added by the taxable person, the VAT system relieves the taxable person of the burden of VAT payable or paid in the course of that person's economic activity and thus avoids double taxation. This is the principle of deduction set out in article 1(2) and operated in article 168 of the PVD and vouched, for example, *in Rompelman v Minister van Financiën* (Case C-268/83)[1985] ECR 655, para 19; *Abbey National* [2001] 1 WLR 769, para24; *Kretztechnik* [2005] 1 WLR 3755, para 34 and *SKF* [2010] STC 419, paras 55—56.
>
> (ii) There must be a direct and immediate link between the goods and services which the taxable person has acquired (in other words the particular input transaction) and the taxable supplies which that person makes (in other words its particular output transaction or transactions). This link gives rise to the right to deduct. The needed link exists if the acquired goods and services are part of the cost components of that person's taxable transactions which utilise those goods and services: see for example *Midland Bank* [2000] 1 WLR 2080, paras 24 and 30; *Abbey National*, para 28; *Kretztechnik*, para 35; *Securenta* [2008]STC 3473, para 27; *SKF*, para 57 and *Revenue and Customs Comrs v University of Cambridge* EU:C:2019:559, para 31.
>
> (iii) Alternatively, there must be a direct and immediate link between those acquired goods and services and the whole of the taxable person's economic activity because their cost forms part of that business's overheads and thus a component part of the price of its products: see for example *BLP* [1996] 1 WLR 174, para 25; *Midland Bank*, para 31; *Abbey National*, paras 35 and 36; *Kretztechnik*, para 36; *SKF*, para 58 and *University of Cambridge*, para 31.
>
> (iv) Where the taxable person acquires professional services for an initial fund-raising transaction which is outside the scope of VAT, that use of the services does not prevent it from deducting the VAT payable on those services as input tax and retaining that deduction if its purpose in fund-raising, objectively ascertained, was to fund its economic activity and it later uses the funds raised to develop its business of providing taxable supplies. See, for example, *Abbey National*, paras 34—36; *Kretztechnik*, paras 36—

38; *Securenta*, paras 27—29 and *SKF*, para 64. The same may apply if an analogous transaction involving the sale of shares is classified as an exempt transaction: *SKF*, para 68.

(v) Where the cost of the acquired services, including services relating to fund-raising, are a cost component of downstream activities of the taxable person which are either exempt transactions or transactions outside the scope of VAT, the VAT paid on such services is not deductible as input tax. See for example *Securenta*, paras 29 and 31; *SKF*, paras 58—60 and *Sveda* [2016] STC 447, para 32. Where the taxable person carries on taxable transactions, exempt transactions and transactions outside the scope of VAT, the VAT paid on the services it has acquired has to be apportioned under article 173 of the PVD.

(vi) The right to deduct VAT as input tax arises immediately when the deductible tax becomes chargeable: article 167 of the PVD, *Securenta*, paras 24 and 30 and *SKF*, para55. As a result, there may be a time lapse between the deduction of the input tax and the use of the acquired goods or services in an output transaction, as occurred in *Sveda*. Further, if the taxable person acquired the goods and services for its economic activity but, as a result of circumstances beyond its control, it is unable to use them in the context of taxable transactions, the taxable person retains its entitlement to deduct: *Midland Bank*, paras 22 and 23.

(vii) The purpose of the taxable person in carrying out the fund-raising is a question of fact which the court determines by having regard to objective evidence. The CJEU states that the existence of a link between the fund-raising transaction and the person's taxable activity is to be assessed in the light of the objective content of the transaction: *Sveda*, para 29; Iberdrola [2017] BVC 39, para 31. The ultimate question is whether the taxable person is acting as such for the purposes of an economic activity. This is a question of fact which must be assessed in the light of all the circumstances of the case, including the nature of the asset concerned and the period between its acquisition and its use for the purposes of the taxable person's economic activity*: Eon Aset Menidjmunt OOD v Direktor na Direktsia "Obzhalvane i upravlenie na izpalnenieto" - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-118/11) [2012] STC 982, para 58; *Klub OOD v Direktor na Direktsia "Obzhalvane i upravlenie na izpalnenieto" - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite* (Case C-153/11) [2012]STC 1129, paras 40—41 and *a*, para 21."(emphasis added)

SUBMISSIONS AND DISCUSSION

51. Ms McArdle, appearing for HMRC, accepted that HMRC's two Grounds of Appeal were strongly interrelated and were best addressed together.

52. Ms McArdle submitted that the facts of the present appeal were on all fours with those in *BLP*. She submitted that the direct and immediate link test was satisfied where the inputs were cost components of output transactions and "used for the purposes of transactions" (Article 168 PVD). There was a right to deduct input tax in one of two situations: either there was a direct and immediate link through the use of inputs in a specific taxable transaction or, instead, there was a direct and immediate link to the use of inputs in the general taxable supplies made by the business. There could not be a direct and immediate link of an input in its entirety both to specific transactions and to general activities.

53. There was, on Ms McArdle's case, a two-stage approach:

(1) Stage 1 – the Tribunal was required to ask whether there was an output transaction or transactions (i.e. a taxable or exempt supply falling within the scope of VAT) to which the inputs were directly and immediately linked; and

(2) Stage 2 – only if there was no direct and immediate link to an output transaction in the scope of VAT was it necessary to consider whether there was a direct and immediate link to general economic activity.

54. Ms McArdle derived this two-stage approach from her interpretation of the following passages in *SKF*:

> "60 It follows that whether there is a right to deduct is determined by the nature of the output transactions to which the input transactions are assigned. Accordingly, there is a right to deduct when the input transaction subject to VAT has a direct and immediate link with one or more output transactions giving rise to the right to deduct. *If that is not the case*, it is necessary to examine whether the costs incurred to acquire the input goods or services are part of the general costs linked to the taxable person's overall economic activity. In either case, whether there is a direct and immediate link will depend on whether the cost of the input services is incorporated either in the cost of particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities." (Emphasis added)

55. The words "*If that is not the case*" signified the need, according to Ms McArdle, to perform the two-stage test. First, it was necessary to ask if there was a use of the inputs in a specific transaction and only if that test was not satisfied was it possible to go on to address the second question of the use of the inputs in the overall economic activity. Ms McArdle noted that there was a finding of fact at [44] of the Decision that the professional services were used in the exempt share sale.

56. It was noteworthy, in Ms McArdle's submission, that the CJEU at [61]-[62] had observed that the national court had found that the inputs were "directly attributable" to the sale of shares, but also "part of the general costs". The CJEU, Ms McArdle argued, emphasised that there could be only one direct and immediate link to the whole input when the alternatives are a specific transaction, on the one hand, and the general business activity on the other. The Court said:

> "61 In the present case, the referring court describes the costs linked to the services acquired by SKF, first, as 'directly attributable' to the disposal of shares and, second, as forming part of the general costs associated with SKF's overall economic activities.
>
> 62 In that regard, it must be held that it is not possible from the case-file submitted to the Court to determine whether those costs have a direct and immediate link, within the meaning of the case-law cited in paragraphs 57 and 58 of this judgment, with the envisaged share disposals or with SKF's overall economic activity, given that, according to the referring court, the purpose of those transactions was to secure funds to finance other activities of the group. In order to establish whether there is such a direct and immediate link, it is necessary to ascertain 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."

57. The Court's comments at [66]-[68] in respect of fiscal neutrality, Ms McArdle contended, had to be understood in their proper context. Fiscally neutral treatment only came into play when Stage 2 was engaged i.e. where there was no direct and immediate link between inputs and a specific transaction but, rather, where it had been established that the inputs were part of a taxable person's general costs.

58. Ms McArdle said that the Supreme Court in *Frank A Smart* had expressly cited the two-stage approach at [49]. In that case, there could never be satisfaction of the Stage 1 test because of the absence of an exempt or taxable transaction with a direct and immediate link to the inputs. It followed, therefore, that the decision in that case was authority only in relation to the Stage 2 approach and it had to be read as applying the *SKF* reasoning at Stage 2.

59. We reject these submissions.

60. It seems clear to us that the reasoning and jurisprudence of the CJEU has evolved considerably since *BLP*. First, in *Kretztechnik* the CJEU concluded that it was possible to recover input tax as a general overhead in circumstances where that input tax had been incurred in relation to a transaction which was outside the scope of VAT. Next, in *SKF* the CJEU grappled with the issue of fiscal neutrality in circumstances where essentially the same transactions could be either:

> (1) outside the scope of VAT (e.g. where a holding company, which did not provide management services to its subsidiary and therefore did not carry on an economic activity, sold the shares in the subsidiary) or
>
> (2) exempt from VAT (e.g. where a holding company, which did provide management services to its subsidiary and therefore was carrying on an economic activity, sold the shares in the subsidiary)

but there was potentially a right to deduct input tax in (1) in accordance with *Kretztechnik* but, according to *BLP*, there was no right to deduct input tax in (2).

61. Far from restricting the right of input tax recovery to transactions within (1) above, the CJEU applied the principle of fiscal neutrality to extend the same treatment to what would otherwise be an exempt transaction (which would break the chain between the supply of services and a taxpayer's general economic activities). It did so by taking account of the ultimate economic purpose of the transaction. As Patten LJ observed in *Associated Newspapers* at [47]:

> "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."

62. Similarly, Lord Hodge commented at [41] in *Frank A Smart*, that subsequent decisions of the CJEU had called the *BLP* decision into question in the light of its developing jurisprudence attributing input expenditure on the raising of capital to the general overheads of an undertaking. Although not formally overruled, the *BLP* decision can no longer be regarded as representing a complete statement of the CJEU's jurisprudence in this area.

63. Moreover, we accept the submission made by Mr Firth, appearing for HLT, that the CJEU in *SKF* was addressing the distinction between a transaction which is exempt and one which is outside the scope of VAT and that this distinction is one which arises, in Ms

McArdle's terms, at Stage 1 and not Stage 2. Stage 2 is not concerned with whether a share sale is exempt or outside the scope. It concerns the taxpayer's general economic activity rather than the share sale. No matter how we read the decisions in *SKF* and *Sveda* (and their interpretation by the Supreme Court in *Frank A Smart*) we cannot give them the limited application for which Ms McArdle contends.

64. As Mr Firth observed, the Supreme Court at [42] noted that in *SKF* the CJEU rejected the "chain breaking" effect (i.e. that an exempt transaction breaks the chain between a supply and the taxable person's taxable economic activities) as being applicable to a fund-raising transaction. Lord Hodge said:

> "[42] In his opinion, Advocate General Mengozzi endorsed the distinction which Advocate General Jacobs made in *Abbey National* between the chain-breaking effect of an exempt transaction and the absence of such an effect where the fund-raising transaction is outside the scope of VAT (paras 69 and 79). He opined (para 89(3)) that where the taxable person acquires supplies of services in order to carry out a share disposal which is an exempt transaction, he does not have the right to deduct input VAT on those services, even when the disposal of shares is a transaction which contributes to the restructuring of the taxable person's industrial activities."

65. We agree with Mr Firth's submission that the approach of the Advocates General is, in substance, the approach which HMRC urge us to adopt in this appeal. However, the Supreme Court held that the CJEU had rejected this approach in *SKF*. At [43] Lord Hodge said:

> "[43] The CJEU disagreed with his conclusion in relation to an exempt transaction involving a sale of shares in circumstances which were analogous to the facts of the case and held (para 73) that there was a right to deduct input VAT paid on services acquired for the purposes of a disposal of shares 'if there is a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person'. It held that the referring court should take account of all the circumstances surrounding the transactions to determine whether the costs incurred were likely to be incorporated in the price of the shares sold or whether they were among only the cost components of transactions within the scope of the taxable person's economic activities."

66. In *SKF* the CJEU at [62] and [73] instructed the national court to determine this question by reference to whether the taxable inputs were likely to be incorporated in the price of the shares or whether they were among the cost components of the downstream taxable transactions of the taxpayer. In our view, it would be unusual to see such costs being reflected in the price paid for the shares in a standard share sale agreement. This would particularly be the case where the price is ascertained by common share valuation techniques used for private companies, such as a multiple of earnings or net asset value. It would rarely be the case that the price of shares in a standard arm's length share sale would be determined on a "cost plus" basis (i.e. a margin above cost) or for the costs of the sale to be specified as a component of the price. Although the costs of fees incurred in relation to the disposal may (but not necessarily will) be paid out of the proceeds of sale, in most cases it is unlikely that the price itself will be influenced by the professional fees incurred by the seller.

67. In our view, the FTT was correct when it applied what Lord Hodge referred to at [46] as the modified approach adopted by the CJEU in *SKF* as interpreted by the Supreme Court in *Frank A Smart*. The key passage in the Decision is at [40] (which we have set out, mostly verbatim, at paragraph 21 above).

68. We consider that this passage correctly states the law. It discloses no error. Furthermore, we also consider that the FTT's application of these principles to the facts of the present appeal at [41]-[46] to be unimpeachable.

69. After the hearing, HMRC supplied us with a copy of the Swedish court's decision in *SKF*, following the decision of the CJEU, together with an unofficial translation. We do not, however, find the Swedish court's decision on the facts of that case to be of assistance here. It does not, in our judgment, impact on the legal principles to be derived from the CJEU decision in *SKF* or the Supreme Court decision in *Frank A Smart*.

70. Our conclusion on Grounds 1 and 2 is sufficient to dispose of this appeal. It is therefore unnecessary to address the VAT group argument raised by HLT.

71. Accordingly, we dismiss HMRC's appeal.

MR JUSTICE ZACAROLI
JUDGE GUY BRANNAN

Release date: 24 July 2023