Neutral Citation Number: [2024] EWCA Civ 564

Case No: CA-2023-001883

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)
Mr Justice Zacaroli and First-tier Tribunal Judge Brannan
[2023] UKUT 00178 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 21 May 2024

Before :

LORD JUSTICE NUGEE
LADY JUSTICE ELISABETH LAING
and
LADY JUSTICE WHIPPLE

- -

Between :

COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS — **Appellant**

- and -

HOTEL LA TOUR LTD — **Respondent**

- -
- -

Isabel McArdle (instructed by **HMRC**) for the **Appellant**
Michael Firth KC (instructed by **direct access**) for the **Respondent**

Hearing dates: 10 and 11 April 2024

- -

Approved Judgment

This judgment was handed down remotely at 10.30am on 21 May 2024 by circulation to the parties or their representatives by e-mail and by release to the National Archives.

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Lady Justice Whipple:

Introduction

1. This is HMRC's appeal against the decision of the Upper Tribunal (Zacaroli J and Judge Guy Brennan) [2023] UKUT 00178 (TCC), which dismissed HMRC's appeal against the decision of the First-tier Tribunal (Judge Richard Chapman KC and Ms Gill Hunter) [2021] UKFTT 0451 (TC).

2. The issue is whether Hotel La Tour Ltd ("HLT"), the representative company of the Hotel La Tour Group which carries on the taxable business of providing hotel accommodation, can deduct input tax incurred in connection with a sale of shares in its managed subsidiary Hotel La Tour Birmingham Ltd ("HLTB").

3. The FtT and UT held that HLT could deduct the input tax. Their conclusions rested significantly on the judgment of the Court of Justice of the European Union in Case C-29/08 *Skatteverket v AB SKF* [2010] STC 419 (*"SKF")* as they understood *SKF* to have been interpreted by the Supreme Court in *Frank A Smart & Son Ltd v Revenue and Customs Commissioners* [2019] UKSC 39, [2019] 1 WLR 4849 ("*Frank Smart"*). For the reasons which follow, I disagree with the FtT and UT and conclude that HLT is prevented, by operation of the ordinary rules of VAT which are long-settled and not displaced by these or any other authorities, from recovering input tax which had a direct and immediate link with HLT's exempt supply of shares in HLTB. I am not persuaded that the existence of a VAT group between HLT and HLTB at the time of the share sale alters that conclusion.

Background

4. The facts are not controversial and can be shortly stated, drawing on the FtT's judgment at [2]-[13]. HLT is a holding company which owned the share capital of HLTB. HLT and HLTB formed a VAT group with HLT as the representative member. HLTB owned and operated a luxury hotel in Birmingham. HLT provided HLTB with management services including the provision of key personnel for the hotel business.

5. In 2015, HLT decided to develop a new hotel in Milton Keynes (the "Milton Keynes Development"). HLT decided to sell HLTB's business, which was mature, and use the proceeds of sale to part-fund the Milton Keynes Development. In July 2017, HLT sold the shares in HLTB to Dalata UK Ltd ("Dalata") for £4,812,231.24, together with an undertaking from Dalata to put HLTB in funds to repay its borrowings from HLT in the amount of £12,179,678.66 and to repay its bank borrowings in the amount of £13,496,714. The net amount received by HLT as a result of the share sale was £16,000,000 comprising consideration for the shares and repayment of HLT's loan to HLTB, less the costs of sale including the fees for professional services (the "Net Proceeds").

6. HLT engaged various third parties to provide professional services to assist with the sale including market research, buyer shortlisting, financial modelling and tax compliance (the "Services"). This was with a view to obtaining the highest price available for the shares, and thereby maximise the funds available for the Milton

Keynes Development. The Services cost HLT £382,899.51 plus VAT of £76,822.95. The third parties providing the Services were:

i) Marketing agents (Jones Lang La Salle Ltd), who charged £255,000 plus VAT of £51,267.19;

ii) Solicitors (Shoesmiths), who charged £115,399.51 plus VAT of £23,055.76 for strategic advice and conveyancing costs; and

iii) Chartered Accountants (Grant Thornton), who charged £12,500 plus VAT of £2,500 for tax support in respect of the share sale.

7. HLT commenced the Milton Keynes Development using the Net Proceeds to fund it.

8. HLT filed its 09/17 VAT Return seeking repayment of the input tax incurred on the Services. HMRC commenced enquiries and concluded that HLT was not entitled to repayment of that input tax, upholding that conclusion on internal review.

The Tribunal Decisions

First-tier Tribunal

9. HLT appealed to the FtT on 2 November 2018. The matter came before the FtT for hearing on 2 and 3 June 2021. The FtT allowed HLT's appeal. At paragraph [35] it found that:

> "… there is a direct and immediate link between the Services and HLT's downstream taxable general economic activities and … the chain is not broken by the share sale."

At [36] the FtT said:

> "We accept that the first stage of the analysis is to be modified in fundraising cases in the sense that (with one rider) the initial share transaction is to be disregarded."

The rider was that:

> "the chain will be broken where the cost of the inputs was a cost component of the price of the shares in the initial transaction" (see paragraph [36]).

At [41] the FtT said:

> "We do not accept that the *use* of the Services for the fundraising transaction prevents deduction" (emphasis in original).

10. The FtT held that, objectively ascertained, the purpose of the share sale was to fund HLT's taxable general activities, namely the Milton Keynes Development (see paragraph [43]). It held that "… the Services were all part of the process of selling the Shares" but that "goes to the question of whether or not the Services were used in

the fundraising transaction" and that while the FtT agreed that they were so used "this does not prevent deduction" (see paragraph [44]).

11. The FtT concluded as follows:

> "46. We find that the cost of the 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 is that the 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 Services and there was no allocation for such costs within the sale price. We note in this regard that although there is no requirement for such increased price or allocation in order for the costs to be components of the price of the Shares, the presence of such increase or allocation would support the cost of the Services being cost components of the initial transaction. Instead, the 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, for the reasons set out above, the objective purpose of incurring the costs of the Services was in order to raise the funds to pay for the downstream transactions."

12. The FtT refused to allow HLT to rely on a late argument that HLT and HLTB were in the same VAT Group, but held that the argument would not in any event have succeeded (see paragraphs [50] and [53]). The FtT dismissed HLT's alternative argument, which was not renewed on cross appeal to the UT or to this Court, that the share sale should be treated as a transfer of a going concern ("TOGC") for VAT purposes (see paragraph [62]). The appeal was allowed (see paragraphs [47] and [67]).

Upper Tribunal

13. HMRC appealed. The matter came before the UT on 13 June 2023. The UT rejected HMRC's submissions (see paragraph [59]) concluding that the reasoning and jurisprudence of the CJEU had evolved considerably since *BLP* (a reference to Case C-4/94, *BLP Group PLC v Customs and Excise Commissioners* [1996] 1 WLR 174, considered below) (paragraph [60] of the UT) and that the CJEU had applied the principle of fiscal neutrality to extend the *Kretztechnik* treatment (a reference to Case C-465/03 *Kretztechnik AG v Finanzamt Linz* [2005] 1 WLR 3755, also considered below) to what would "otherwise be an exempt transaction" by taking account of the ultimate purpose of the transaction (paragraph [61] of the UT). The UT held that *Frank Smart* had confirmed that approach and that "the *BLP* decision can no longer be regarded as representing a complete statement of the CJEU's jurisprudence in this area" (paragraph [62] of the UT). *SKF* had rejected the "chain-breaking" effect of an exempt transaction in the context of that transaction being a "fund-raising" transaction (paragraph [64] of the UT). It considered whether the costs were reflected in the price of the shares, interpreting *SKF* as requiring such an inquiry (see paragraph [66]).

14. The UT held that the FtT had correctly stated the law and was not in error in its application of the legal test to the facts, according to the "modified approach" signalled in *SKF* and *Frank Smart* (paragraph [67] of the UT). In those circumstances it was not necessary to address Mr Firth's alternative argument on VAT grouping (see paragraphs [68] and [70] of the UT). It dismissed HMRC's appeal (paragraph [71]).

Grounds of Appeal and Respondent's Notice

15. By her grounds of appeal, Ms McArdle, who has represented HMRC throughout, advances two grounds of appeal, which substantially overlap and which I shall consider under the heading the "**Deduction Issue**":

    i) That the UT (and, inferentially, the FtT before it) fell into error in failing to apply the two-stage test of asking, first, whether the Services have a direct and immediate link to a specific supply for consideration constituting an economic activity (here, the exempt sale of shares in HLTB); and secondly, if (and only if) the answer to the first stage is that there is no such direct and immediate link, whether there is a direct and immediate link between the Services and HLT's general taxable activity.

    ii) That the UT (and, inferentially, the FtT before it) fell into error in disregarding the exempt sale of shares in HLTB and concluding that the Services had a direct and immediate link with HLT's general taxable activities.

16. Mr Firth KC, who has represented HLT throughout, resists the two grounds of appeal, supporting the reasoning of both tribunals in doing so. By his Respondent's Notice, he advances a further ground for upholding their decisions in his favour, namely the "**VAT Grouping Issue**", by which he argues that the existence of a VAT Group between HLT and HLTB means that the supplies of management services from HLT to HLTB are disregarded for VAT purposes, such that the holding by HLT of shares in HLTB was not economic activity, so that on proper analysis the sale of shares was outside the scope of VAT, with the result that the input tax on Services was properly attributable to general overheads by parity of reasoning with *Kretztechnik*. Ms McArdle disputes this analysis and objects to the late introduction of this argument.

17. I shall address each party's arguments in detail when I come to discuss the issues raised in this appeal. At this point, however, I wish simply to acknowledge the clear and able submissions advanced by both Counsel, and to express my gratitude to them and the teams that support them for the excellent preparation and presentation of this appeal.

I. The Deduction Issue

Legal Framework

18. The first issue in this appeal relates to deductibility of input tax on the Services. That issue necessarily encompasses the related concepts of 'cost components', the 'scope' of value added tax and 'the principle of fiscal neutrality', as they are explained in the Directives and case law of the CJEU and the national courts. This appeal pre-dates the United Kingdom's departure from the European Union so that the applicable legal

framework is set in the Directives as they are interpreted by the CJEU and national courts.

19. The First Council Directive (67/227/EEC) on the harmonisation of legislation of Member States concerning turnover taxes, dated 11 April 1967, established the common system of value added tax. Article 2 described "a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged" and provided that value added tax would be chargeable on goods and services "after deduction of the amount of value added tax borne directly by the various cost components". This was the origin of the foundational principle of VAT as a tax on consumption of goods and services (sometimes described as output tax), which was itself subject to right of deduction or offset of tax incurred on the cost components of such output supplies (in other words, input tax).

20. The Sixth Council Directive (77/388/EEC), dated 17 May 1977, embedded the foundational principles of the First Directive. Article 2 required VAT to be paid on any "supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such". Supplies falling within that description were said to be "in scope" of VAT. Article 13 provided for certain types of supply to be exempt from VAT, including transactions in shares; exemption was an exception to the general rule that VAT was due on in-scope supplies of goods and services. Article 17 conferred the right to deduct input tax, noting Article 17.2 in particular which provided:

> "In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:
>
> (a) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person;
>
> …"

21. The Sixth Directive contained other provisions conferring a right of deduction in specific cases. But the basic principle underpinning Article 17 was that there was a right of deduction of input tax to the extent that (or "in so far as") the goods and services on which that input tax was incurred were *used* for the purposes of *taxable* outputs. This was an approach linked to Article 2 which provided for a right of deduction of tax on "cost components". The natural way to read Article 2 and Article 17 together, as the case law I shall come to confirms, is that they are different ways of articulating the principle that input tax is only deductible if it arises on goods and services (cost components) which are used for the purposes of a taxable person's taxable transactions.

22. Article 17.5 provided that where goods and services were used by a taxable person both for transactions giving rise to a right of deduction (typically, taxable supplies) and for goods and services in respect of which input tax is not deductible (typically, exempt supplies) "only such proportion of the value added tax shall be deductible as

is attributable to the former transactions" (ie those giving rise to a right of deduction). Thus, Article 17.5 emphasised, if emphasis was needed, that the principle of deduction did not extend to input tax on goods and services used for the purposes of exempt supplies. Article 19 provided the means for determining the relevant proportion in cases where a taxable person's outputs were mixed, comprising taxable and exempt supplies.

23. Directive 2006/112/EEC on the Common System of VAT (known as the "Principal VAT Directive" or "PVD") was a consolidating directive. Article 1 repeats the foundational principles found in the First and Sixth Directives:

> "*Article 1*
>
> 1. This Directive establishes the common system of value added tax (VAT).
>
> 2. 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.
>
> The common system of VAT shall be applied up to and including the retail trade stage."

24. Article 2 establishes the scope of VAT:

> "*Article 2*
>
> 1. The following shall be subject to VAT:
>
> a. the supply of goods for consideration within the territory of a Member State by a taxable person acting as such;
>
> …
>
> c. The supply of services for consideration within the territory of a Member State by a taxable person acting as such;
>
> …"

25. The meaning of taxable person is explained at Article 9 as: "any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity".

26. Article 135.1 requires Member States to exempt certain transactions from VAT, including share sales: "(f) transactions, including negotiation but not management or safekeeping, in shares …"

27. Title X of the PVD is headed "Deductions", and Chapter 1 of that title is headed "Origin and scope of right of deduction". Article 167 provides for a right of deduction at the time the deductible tax became chargeable. The right of deduction is contained in Article 168, in the following terms:

> "*Article 168*
>
> 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;
>
> …"

28. It is common ground that these provisions are reflected in domestic primary legislation (the Value Added Tax Act 1994) and relevant secondary legislation.

Case Law

29. Input tax deduction has been considered in very many European and domestic cases. It is necessary to cite a number of those cases. I shall keep the citation to a minimum whilst acknowledging that much of the ground has been traversed in other cases. But the exercise is in my view necessary in order to frame the discussion which follows.

BLP

30. I have already referred to Case C-4/94 *BLP Group plc v Customs and Excise Commissioners* [1996] 1 WLR 174. In that case, the taxpayer company provided management services for a number of trading companies which it controlled. The trading companies produced goods for use in the furniture and DIY industries - taxable supplies. BLP sold shares in one of those companies in the group in order to raise funds to pay off debts. It claimed a deduction for the input tax on services of bankers, solicitors and accountants for services rendered in connection with the sale of shares. The claim was refused by Customs and Excise (as it then was) and the taxpayer's appeal to the VAT tribunal (as it then was) was dismissed; but the taxpayer appealed again and the High Court referred a question to the Court of Justice of the European Communities (as it then was) seeking guidance on whether the input tax was deductible. The question stated in terms that the services had been "used … for an exempt transaction (sale of shares)" but asked whether, in circumstances where the

purpose and result was to raise money to discharge BLP's indebtedness, the inputs were:

> "(a) services used for the purpose of an exempt transaction such that input tax thereon is not deductible; (b) services used for the purpose of the taxable transactions (namely [BLP's] core business of making taxable supplies) such that input tax thereon is deductible in whole; (c) services used for both exempt and taxable transactions such that input tax thereon is deductible in accordance with article 17(5) of the Sixth Directive?"

31. Advocate General Lenz noted that it was common ground that the sale of shares fell within the scope of VAT (see [23]). The AG considered Article 2 of the First Directive and Article 17.2 of the Sixth Directive and said this:

> "30. A consideration of those provisions together shows that the Community legislature, proceeding from an ideal image of "chain of transactions" (to adopt the neat phrase used at the hearing by the representative of the United Kingdom), intended to attach to each transaction only so much VAT liability as corresponds to the added value accruing in that transaction, so that there is to be deducted from the total amount the tax which has been occasioned by the preceding "link in the chain:" see, for example, the judgment in *Commission of the European Communities v. French Republic* (Case 50/87) [1988] E.C.R. 4797, 4817, para. 16.
>
> 31. On the question whether the goods or services supplied to taxable persons, on which input tax has been charged, can be *attributed* to a transaction by the taxable person in such a way that deduction of input tax is justified, the Community legislature decided on a criterion corresponding to the system: the amount which is to be deducted as input tax must have been "borne directly by the various cost components." "

32. AG Lenz recalled that the High Court found that the services in question on which input tax had been paid were "used for an exempt transaction" and that it was "thus established that those services form a cost component precisely of the exempt supply (effected by the sale of the shares)" (paragraph [36]). It was irrelevant that the costs of the services on which input tax has been paid were ultimately incorporated into the price of the goods and services which the group sold by means of its taxable transactions, because "even if it were possible to construct such an effect in commercial or book-keeping terms, that would merely be a cascade effect, which can always occur if taxable and exempt transactions are carried out at the same time within a unitary undertaking" (see paragraph [37]). He concluded that the right to deduct input tax was excluded in BLP's case, "it being of no relevance whether the sale of the shares was for the benefit of the taxable activity of the taxable person on the basis of the discharge of indebtedness intended and effected" (paragraph [38]). BLP had argued that fiscal neutrality required the same fiscal treatment to be given to different forms of raising money, but the AG dismissed that argument because the "objectives of the common system of VAT do not by any means require all forms of

raising money to be treated alike" and the taking up of a loan and the sale of an interest in a company were not operations of the same type for VAT purposes (see paragraph [47]); fiscal neutrality required that all transactions which have the same characteristics were treated in the same way (see paragraph [51]).

33. The Court agreed with the Advocate General. The Court held that the right to deduct under Article 17.2 required that 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" (see paragraph [19]). The Court dealt with BLP's arguments based on fiscal neutrality in the following way:

> "24. Moreover, if B.L.P's interpretation were accepted, the authorities, when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out inquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard, save in exceptional cases, to the objective character of the transaction in question.
>
> 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 advisors for the taxable person's taxable transactions and that if B.L.P. 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 B.L.P. 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] E.C.R. 655, 664, para. 19."

The Court concluded:

> "28. The answer to question (1) must therefore be that article 2 of the First Directive and article 17 of the Sixth Directive are to be interpreted as meaning that, except in the cases expressly provided for by those Directives, where a taxable person

> supplies services to another taxable person who uses them for an exempt transaction, the latter person is not entitled to deduct the input VAT paid, even if the ultimate purpose of the transaction is the carrying out of a taxable transaction."

34. *BLP* was decided in 1995. Since then, a number of cases have tested the limits of the right of deduction of input tax in light of *BLP*. We were invited to consider three in particular.

Midland

35. The first of those is Case C-98/98 *Midland Bank plc v Customs and Excise Commissioners* [2000] 1 WLR 2080, decided in 2000. In that case, the bank had incurred input tax on legal services provided in connection with advisory services it supplied to its US client in relation to a proposed but ultimately unsuccessful takeover bid, and in connection with the bank's defence of a claim for negligent misrepresentation brought by that client against it in relation to that bid. The bank sought to deduct the totality of the input tax on the basis that it was attributable to its advisory work on the takeover bid (which was a "zero-rated" activity giving rise to a right of deduction of input tax) but the Commissioners argued that the inputs relating to the litigation were not attributable to the bid but were consequential on it, and were for VAT purposes attributable to the bank's general business which was largely exempt.

36. In considering the issue referred, which was whether the inputs had a direct and immediate link with the bank's zero-rated activities, or not, Advocate General Saggio noted that the direct and immediate link test was not contained in the Community legislation but was a product of case law, namely *BLP* (see paragraph [23]) and went on:

> "31. That having been said, I am of the opinion that, in circumstances such as those set out by the national court, there is always a "direct and immediate link" between a taxable transaction and the supply of certain goods or services whenever, in the light of an objective assessment (which it is for the national court to carry out), the goods or services are used by the taxable person to carry out one or more taxable transactions. Such a link exists, in particular, in accordance with the second paragraph of article 2 of the First Directive, if the amount of the tax paid in respect of the supply of a good or for the provision of a service was borne directly by the various cost components of the taxable transaction. The mere fact that a service (such as legal defence) was supplied as a consequence of a deductible transaction is not sufficient, however, for the purposes of deducting the whole of the VAT paid by a taxable person (such as the Midland) in respect of the supply of that service. Moreover, the link must be identifiable according to objective criteria - that generally means that the link should reflect the normal relationship between the two supplies, so that the second should follow the first not in a mechanical way, but according to the normal and regular order of causal chains."

He answered the question referred to the effect that there was no direct and immediate link between legal services supplied as a consequence of the takeover bid and the supply of advisory services in connection with that bid; it followed that the input tax on the legal services was attributable to the whole of Midland's business activity (see paragraph [32]).

37. The Court agreed, emphasising that the question of whether a direct and immediate link exists is fact-specific and for the national courts to determine:

> "25. In so far as the national court seeks, in the first part of the second question, clarification of the nature of the "direct and immediate link," the Midland, the United Kingdom Government and the Commission rightly agree that it would not be realistic to attempt to be more specific in that regard. In view of the diversity of commercial and professional transactions, it is impossible to give a more appropriate reply as to the method of determining in every case the necessary relationship which must exist between the input and output transactions in order for input VAT to become deductible. It is for the national courts to apply the "direct and immediate link" test to the facts of each case before them and to take account of all the circumstances surrounding the transactions at issue."

The Court concluded that, on the facts of this case, there was no direct and immediate link between the inputs in question and the bank's advisory role in the bid, but instead the direct and immediate link existed with the bank's business as a whole so that the input tax in question was only partially deductible, in proportion to the taxable element of the bank's business as a whole:

> "29. It should be borne in mind that, according to the fundamental principle which underlies the VAT system, and which follows from article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of VAT directly borne by various cost components: see, to this effect, *B.P. Supergas Anonimos Etairia Geniki Emporiki-Viomichaniki kai Antiprossopeion v. Greek State* (Case C-62/93) [1995] E.C.R. 1-1883, 1913, para. 16.
>
> 30. It follows from that principle as well as from the rule enshrined in paragraph 19 of the judgment in *B.L.P. Group Plc. v. Customs and Excise Commissioners* (Case C-4/94) [1996] 1 W.L.R. 174, 198-199, 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 the *B.L.P.* judgment 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 article 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 article 17(5) of the Sixth Directive and the VAT is, according to that provision, deductible only in part."

38. *Midland* therefore demonstrates that the mere fact of a connection between an input and a specific output is not sufficient. The relevant link must be "direct and immediate", and that depends on all the circumstances of the case.

Abbey National

39. The second post-*BLP* case we were shown was Case C-408/98 *Abbey National plc v Customs and Excise Commissioners* [2001] 1 WLR 769. In that case, the taxpayer disposed of a long lease in a building. That disposal came within the domestic rules for a transfer of a going concern (or "TOGC") which provided that no VAT was due on the transfer, which was treated as neither a supply of goods nor a supply of services for VAT purposes (treatment authorised by Article 5(8) of the Sixth Directive). The issue was whether input tax on conveyancing and other costs incurred in connection with the TOGC was deductible.

40. Advocate General Jacobs described the deduction system giving rise to a "chain of transactions" (a reference to the discussion by AG Lenz in *BLP* and echoed by AG Saggio in *Midland*) (see paragraph [3] of his Opinion). He reviewed the Community legislation and suggested that "the legislature deliberately chose wording intended to limit the scope of the right to deduct to the situation where inputs are used for the purposes of identifiable taxable transactions" (see paragraph [31]). He returned to the image of transaction chains:

> "32. Seen in that light, the position of exempt supplies is anomalous in the scheme of VAT, particularly where they are cost components of subsequent taxable supplies. Their full cost, including the VAT levied on inputs, will – presumably – be reflected in the price charged. In that situation, there will be double or cumulative taxation, since VAT will be charged in

> full on an output one of whose cost components already includes VAT. There is a potentially serious departure from the principle on which VAT is levied in that a chain of supplies may be broken in this manner at more than one point, with a concomitant repetition of cumulative taxation. Such factors suggest that the treatment accorded to exemptions should be applied restrictively: to the extent possible, the VAT treatment of each transaction should conform to the basic principle, in order to avoid distortions. (The court has recognised that the terms used to specify the exemptions envisaged by article 13 are to be interpreted strictly, since they constitute exemptions to the general principle that VAT is levied on all supplies made for consideration by a taxable person: see, for example, *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën* (Case 348/87) [1989] ECR 1737, para 13, and more recently, *Gregg v Customs and Excise Comrs* (Case C-216/97) [1999] ECR 1-4947, 4973, para 12.)"

He suggested that *BLP* had been decided at least in part on the basis that it would be contrary to legal certainty and facility of application to require the revenue authorities to determine the intention of the taxable person when supplies were not objectively linked to taxable transactions (see paragraph [33]). He contrasted that with a different approach taken in other cases:

> "34. However, in other cases the court has taken what appears to be a broader approach. In *Leesportefeuille "Intiem" CV v Staatssecretaris van Financiën* (Case 165/86) [1988] ECR 1471, 1487, para 13, for example, it held that the right to deduct input tax "applies to goods and services connected with the pursuit of the taxable person's business"; in *Sofitam SA v Ministre chargé du Budget* (Case C-333/91) [1993] ECR 1-3513, 3542, para 11, it stated that "the right to deduct must be applied in such a way that its scope corresponds as far as possible to the sphere of the taxable person's business activity", and in *Belgian State v Ghent Coal Terminal NV* (Case C-37/95) [1998] ECR 1-1, 24-26, paras 17 and 24 and operative part, it ruled that a taxable person acting as such was entitled to deduct VAT payable on supplies acquired for the purpose of investment work intended to be used in connection with taxable transactions, even where, for reasons beyond that taxable person's control, those taxable transactions were never in fact carried out (see also *Intercommunale voor Zeewaterontzilting (Inzo) v Belgian State* (Case C-110/94) [1996] ECR 1-857, 877, paras 20 and 21). Indeed in *BLP* [1996] 1 WLR 174 itself the court also stated, at p199, para 25, that if the company had raised the money by way of a bank loan rather than by making an exempt transaction, it could have deducted VAT on professional fees incurred for that purpose since such fees would have constituted overheads which would have formed cost components of its taxable transactions.

> 35. The contrast between those two approaches may be more apparent than real. The reference to cost components in the *BLP* judgment is a reminder of the basic principle set out in article 2 of the First Directive: "On each transaction, value added tax…shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components." Thus, what matters is whether the taxed input is a cost component of a taxable output, not whether the most closely linked transaction is itself taxable. As the Commission submitted at the hearing, the conclusion to be drawn from the *BLP* judgment is that the question to be asked is not what is the transaction with which the cost component has the most direct and immediate link but whether there is a sufficiently direct and immediate link with a taxable economic activity. … Indeed, it may be stressed that in *BLP* the court was concerned with supplies which were not objectively linked to taxable transactions: see paragraph 24 of the judgment. Nevertheless, it remains clear from *BLP* that the "chain breaking" effect which is an inherent feature of an exempt transaction will always prevent VAT incurred on supplies used for such a transaction from being deductible from VAT to be paid on a subsequent output supply of which the exempt transaction forms a cost component. The need for a "direct and immediate link" thus does not refer exclusively to the very next link in the chain but serves to exclude situations where the chain has been broken by an exempt supply. (I agree here with the opinion of Mr Advocate General Saggio in *Midland Bank plc v Customs and Excise Comrs* (Case C-98/98) [2000] 1 WLR 2080, 2091-2092, para 29, where he considers that the words "direct" and "immediate" refer to a "particularly close link" between two transactions, in which no third transaction has taken place "breaking the causal chain".)"

He concluded that a TOGC was not a taxable supply so could not form the basis for deduction; but nor was it a chain-breaking exempt supply (see paragraphs [37]-[38]). His view was that VAT on services relating to the TOGC was attributable to, or had a direct and immediate link with, supplies made by the part of the business whose assets had been transferred and if the supplies of that part of the business were taxable, the inputs would therefore be deductible in full; if the supplies were mixed (ie partly taxable and partly exempt) then the input tax would be apportioned accordingly (see paragraph [49]).

41. The Court agreed with the Advocate General. It held that the costs of the services acquired formed part of the taxable person's overheads and as such were cost components of the products of the business: "Even in the case of a transfer of a totality of assets, where the taxable person no longer effects transactions after using those services, their costs must be regarded as part of the economic activity of the business as a whole before the transfer" (see paragraph [35]). It went on:

> "36. Thus in principle the various services used by the transferor for the purposes of the transfer of a totality of assets or part thereof have a direct and immediate link with the whole economic activity of that taxable person."

It referred to *Midland* and held that the rule in that case applied, so that it was necessary to consider whether the inputs had a direct and immediate link with a part of the taxable person's business:

> "40. So if the various services acquired by the transferor in order to effect the transfer of a totality of assets or part thereof have a direct and immediate link with a clearly defined part of his economic activities, so that the costs of those services form part of the overheads of that part of the business, and all the transactions relating to that part are subject to VAT, he may deduct all the VAT charged on his costs of acquiring those services."

It was for the national court to determine the outcome on the facts (see paragraph [41]).

42. The Court summarised the position in this way:

> "42. The answer to the questions referred must therefore be that, where a member state has made use of the option in article 5(8) of the Sixth Directive, so that the transfer of a totality of assets or part thereof is regarded as not being a supply of goods, the costs incurred by the transferor for services acquired in order to effect that transfer form part of that taxable person's overheads and thus in principle have a direct and immediate link with the whole of his economic activity. If, therefore, the transferor effects both transactions in respect of which VAT is deductible and transactions in respect of which it is not, it follows from article 17(5) of the Sixth Directive that he may deduct only that proportion of the VAT which is attributable to the former transactions. However, if the various services acquired by the transferor in order to effect the transfer have a direct and immediate link with a clearly defined part of his economic activities, so that the costs of those services form part of the overheads of that part of the business, and all the transactions relating to that part of the business are subject to VAT, he may deduct all of the VAT charged on his costs of acquiring those services."

Kretztechnik

43. The third case post-*BLP* case we were shown is C-465/03 *Kretztechnik AG v Finanzamt Linz* [2005] 1 WLR 3755. In that case, a company which developed and sold medical equipment (and thus made supplies giving rise to a right of deduction of input tax) obtained a listing on the stock exchange and issued new shares in order to raise capital. The company sought to deduct the input tax on services supplied to it in

connection with the listing and the share issue but that deduction was refused on the ground that the costs had been incurred for the purposes of transactions in shares within the scope of the exemption. Three questions were referred by the Austrian tax tribunal, converging on two main issues: (i) whether the taxpayer had made a supply for consideration, within the scope of VAT, in becoming listed on the stock exchange and issuing shares in itself; and (ii) depending on the answer to (i), whether the input tax was deductible on the basis that it was attributable to the taxpayer's general taxable supplies made in the course of its business.

44. Advocate General Jacobs provided an Opinion to the Court. He referred to the "direct and immediate link" test (see paragraph [26]) and noted the Court's case law (notably *BLP* and *Abbey National*) which had established that a taxable person's "general overheads are in principle cost components of, and thus have a direct and immediate link to, the whole of that person's economic activity" (see paragraph [27]). He said that if the share issue was an exempt supply, "there can be no right to deduct the VAT paid on services directly and immediately attributable to that supply" (see paragraph [29]). He accepted that "where a shareholder sells a share, that is clearly a supply of services" (see paragraph [58]); but the issue of shares was different because the company "is not selling any existing intangible property or any right over a fraction of its existing assets. It is increasing its assets by acquiring capital …" (see paragraph [59]). His conclusion was that "an issue of new shares by a company is not a supply by the company at all and/or … it is a transaction of a type with which VAT is not concerned"; it was, thus, outside the scope of VAT (see paragraph [68]). Turning to the question of deduction, he said that any link which the inputs might have with transactions purely internal to the taxpayer's business which were outside the scope of VAT was irrelevant (see paragraph [72]). If the transaction with which the input was most closely linked was outside the scope of VAT, it was irrelevant for the purpose of determining deduction; what matters was the link, if any, with output supplies (citing his Opinion in *Abbey National*) (see paragraph [74]). These inputs were attributable to the taxpayer's economic activity as a whole (see paragraph [76]) with the consequence that the input tax was wholly deductible because the company made taxable supplies in the course of its business; this was in accordance with *BLP* and *Abbey National* (see paragraph [77]).

45. The Court agreed. It distinguished between the mere acquisition and holding of shares, which is not an economic activity (ie is outside the scope of VAT), and other types of transactions in shares which do fall within the scope of VAT and are exempt (see paragraphs [19] and [20]). It held that the issue of shares for the purpose of raising capital is not a supply of services for consideration and falls outside the scope of VAT (see paragraph [24]-[26]). On the issue of deductibility of input tax, the Court concluded:

> "36. In this case, regard being had to the fact that, first, a share issue is an operation not falling within the scope of the Sixth Directive and, secondly, that operation was carried out by the claimant in order to increase its capital for the benefit of its economic activity in general, it must be considered that the costs of the supplies acquired by that company in connection with the operation concerned form part of its overheads and are therefore, as such, component parts of the price of its products.

> Those supplies have a direct and immediate link with the whole economic activity of the taxable person: see the *BLP Group* case [1996] 1 WLR 174, 199, para 25; the *Midland Bank* case [2000] 1 WLR 2080, 2100, para 31; the *Abbey National* case [2001] 1 WLR 769, 787, paras 35 and 36, and the *Cibo Participations* case [2001] ECR 1-6663, 6693, para 33.
>
> 37. It follows that, under article 17(1) [and] (2) of the Sixth Directive, the claimant is entitled to deduct all the VAT charged on the expenses incurred by that company for the various supplies which it acquired in the context of the share issue carried out by it, provided, however, that all the transactions carried out by that company in the context of its economic activity constitute taxed transactions. A taxable person who effects both transactions in respect of which VAT is deductible and transactions in respect of which it is not may, under the first sub-paragraph of article 17(5) of the Sixth Directive, deduct only that proportion of VAT which is attributable to the former transactions: the *Abbey National* case, para 37, and the *Cibo Participations* case, para 34."

46. Pausing there, and so far as is relevant to this appeal, the following three general propositions would appear to be established:

    i) input tax incurred on services having a direct and immediate link with an exempt supply of shares is irrecoverable (*BLP*);

    ii) by inference based on *Midland,* input tax incurred on services connected with an exempt supply of shares but not having a direct and immediate link with that supply, may nonetheless have a direct and immediate link with the business as a whole and be recoverable to the extent that the overall business is taxable;

    iii) input tax incurred on services connected with a fund-raising transaction which falls outside the scope of VAT (either because it was a TOGC as in *Abbey National* or because it was a share issue as in *Kretztechnik*) may have a direct and immediate link with the business as a whole and be recoverable to the extent that the overall business is taxable.

SKF

47. I come next to the 2009 case of *SKF* on which the appeal largely turns. SKF was a Swedish parent company which played an active part in the management of its group companies by supplying them with management, administration and marketing services. As part of a restructuring, SKF proposed to dispose of shares in two of its group companies (one wholly-owned subsidiary and one controlled company in the group), in order to obtain funds to finance other group activities. SKF applied for an advance ruling on the deductibility of input tax on the services of share valuation, assistance with negotiations and specialised legal advice which it proposed purchasing with a view to these share disposals and the restructuring. The Swedish tax authority held that the input tax would not be deductible. SKF appealed. The first instance

tribunal held that the input tax would be deductible, and the tax authority appealed. The appeal court referred questions to the CJEU, asking whether the share disposals fell within the scope of VAT, if so, whether they were exempt transactions, and, in any event, whether there was a right of deduction of expenditure directly attributable to the disposal transactions.

48. Advocate General Mengozzi gave an Opinion. He recognised that, as a general rule, the disposal of shares by a holding company fell outside the scope of VAT (see paragraph [27]) but the position was different where a holding company managed its subsidiaries (see paragraph [28]) so that the answer to the first question was that SKF's disposal of shares in the companies was an economic activity within the scope of VAT because SKF had been involved in the management of the companies (see paragraph [35]). AG Mengozzi noted the Commission's argument that the share sales should be treated as a strategic redeployment of assets for the purpose of raising funds for the other activities of the group, and as such fell outside the scope of VAT, citing *Kretztechnik* (see paragraph [38]), but rejected that argument on the basis that the exemption contained in Article 13B(d)(5) of the Sixth Directive (now Article 135(1)(f)) did apply to these share disposals which were consequently within the scope of VAT (see paragraph [49]). He was not persuaded by the Commission's further argument that the share disposals were akin to a TOGC (see paragraphs [51]-[56]). He turned to the question whether the inputs would be deductible. He noted that the national court had made a finding that the services acquired by SKF were directly linked to the disposals of shares and that the inputs on services acquired in order to carry out the share sales, which were themselves exempt transactions, could not "in all logic" be deducted because they were costs of an exempt transaction (see paragraph [64]), citing *BLP* (see paragraphs [68] and [70]). The inputs could not be treated as overheads having a direct and immediate link with the whole of the taxable person's economic activity because that treatment was available only where the transaction with which the inputs were linked was outside the scope of VAT (citing *Abbey National*) in which case it was permissible to look for a direct and immediate link with the taxable person's general economic activity (see paragraph [73]); that point was reinforced by the reasoning in *Kretztechnik* where the share issue was outside the scope of VAT so that the inputs formed part of the company's overheads (see paragraph [74]). The differential treatment between share disposals outside the scope of VAT and those falling within exemption was inherent in the common system of VAT; a share sale falling outside the scope of VAT did not break the chain unlike a share sale which was exempt (see paragraph [79]). He offered this comment on the taxpayer's case, supported by the Commission:

> "80. Further, the consequence of allowing a right to deduct input VAT when the transaction on which VAT is charged has a direct and immediate link to an output share disposal transaction covered by the exemption of art 13B(d)(5) of the Sixth Directive, would be that a new opportunity to deduct input VAT would be created by judicial decision."

49. His conclusions were summarised in a series of propositions at paragraph [89], including this:

> "(3) A taxable person who has acquired supplies of services in order to carry out a disposal of shares in a subsidiary and in a

> controlled company, a transaction which is covered by the exemption provided for by art 13B(d)(5) of the Sixth Directive 77/388, as amended by the Directive 2006/112, and by art 135(1)(f) of the Directive 2006/112, and with which those services have a direct and immediate link, does not have the right to deduct input value added tax on those services, even when the disposal of shares is a transaction which contributes to the objective of restructuring the taxable person's industrial activities."

50. The Court agreed with the Advocate General on the first question relating to scope of the exemption. It held that because SKF was involved in the management of the subsidiaries, the disposal of its shares in the subsidiaries came within the scope of VAT (paragraphs [32]-[33]). The Court addressed the Commission's argument that the share sale should be treated as a TOGC, holding that it was not possible on the basis of the case-file submitted to the Court to determine whether these disposals amounted to TOGCs (paragraph [38]). However, the Court did accept that if the TOGC provisions, as they were implemented in Sweden, applied then the share sale would be outside the scope of VAT (paragraph [40] and [41]).

51. The Court turned to the second question, which was whether the disposals of shares, if within the scope of VAT, were exempt supplies. The Court rejected as too narrow the Commission's proposed interpretation of the exemption as being limited to commercial share-dealing (see paragraph [46]), and in the course of its reasoning relied on *BLP* to uphold the VAT system's objectives of ensuring legal certainty and facilitating application of the tax by having regard to the objective character of the transactions in question (see paragraph [47]). It held that these share sales did alter the legal and financial position of the parties to the transaction and for that reason came within the exemption (see paragraph [50]-[53]). This appears to be in agreement with AG Mengozzi's view.

52. The Court turned to the third question. The Court recited the basic principles, in terms which are familiar, at paragraphs [55]-[59], including this:

> "59. On the other hand, 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 …"

The Court summarised the approach, again in terms which are familiar, at [60]:

> "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 is based on the

> premise that the cost of the input services is incorporated either in the cost of the particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities."

53. There then followed a passage which is important in understanding the judgment overall:

> "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 paras 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 with SKF intends to sell or whether they are only among the cost components of SKF's products.
>
> 63. However, in proceedings brought under art 234 EC, since the court has no jurisdiction to assess or characterise the factual circumstances which gave rise to the questions referred for a preliminary ruling, it is for the referring court to apply the direct and immediate-link test to the facts of the case in the main proceedings and to take account of all the circumstances surrounding the transactions at issue (see, to that effect, *Midland Bank* (para 25))."

54. This passage requires a bit of unpacking. First, in these paragraphs, the Court notes the referring court's finding that the inputs were "directly attributable" *both* to the share sale *and* to SKF's general outputs (see paragraph [61]), which conflicted with the Court's formulation of the test in "either/or" terms, see the last sentence of paragraph [60]. Secondly, the Court noted that it was not possible from the case file for the Court to determine whether the inputs in question had a direct and immediate link *either* with the share sale *or* with SKF's general outputs (my emphasis, echoing the Court's formulation of the test at paragraph [60]), which meant the Court was unable to determine the question referred (see paragraph [62]). Thirdly, and in consequence, the Court returned the case to the national court for that court to apply the direct and immediate link test to the facts of the case, something which lay outside the remit of the CJEU (see paragraph [63]). Fourth, in so directing, the Court departed from the Advocate General who had, at paragraphs [59] and [63] of his Opinion, treated the referring court's finding that the services acquired by SKF were directly linked to the disposals of the shares as dispositive of the reference; the Court did not share that view.

55. The Court then offered some further observations in order to give a "useful answer" to the referring court. These observations were the subject of much debate in this appeal and I set them out in full, to return to them later in the discussion:

> "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 33 and 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 transaction 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 the 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 the 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, *Kingcrest Associates Ltd v Customs and Excise Comrs* (Case C-498/03) [2005] STC 1547, [2005] ECR 1-4437, para 41; *Turn-und Sportunion Waldburg v Finanzlandesdirektion für Oberösterreich* (Case C-246/04) [2006] STC 1506, [2006] ECR 1-589, para 33; and *R (on the application of Teleos plc) v Revenue and Customs Comrs* (Case C-409/04) [2008] STC 706, [2008] QB 500, 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 1-4947,

para 20, and *Revenue and Customs Comrs v Isle of Wight Council* (Case C-288/07) [2008] STC 2964, [2008] ECR 1-7203, 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 665 ECR 1-5405, 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.

70. Any other interpretation would burden the trader with the cost of VAT in the course of his economic activity without giving him the possibility of deducting it (see, to that effect, *Gabalfrisa SL v Agencia Estatal de Administración Tributaria* (Joined cases C-110/98 to C147/98) [2002] STC 535, [2000] ECR 1-1577, para 45, and *Abbey National* (para 35)).

71. In the case in the main proceedings, while it is admittedly true, as is correctly argued by the Skatteverket and by the Swedish, German and United Kingdom governments, that a disposal of shares which is exempt from VAT does not give rise to a right to deduct, the fact remains that that interpretation holds true only if a direct and immediate link is established between the input services and the exempted disposal of shares as an output transaction. If, on the other hand, there is no such link and the cost of the input transactions is incorporated in the prices of SKF's products, the right to deduct VAT charged on the input services should be allowed.

72. It must, lastly, be stated that there is a right to deduct input VAT in respect of services carried out in connection with financial transactions if the capital acquired by means of those transactions is used in connection with the economic activities of the person concerned. Furthermore, the costs associated with input services have a direct and immediate link to the taxable person's economic activities in circumstances where they are

> solely attributable to downstream economic activities and consequently are among only the cost components of transactions within the scope of those activities (see *Securenta*, paras 28 and 29).
>
> 73. It follows from the foregoing that the answer to the third question is that there is a right to deduct input VAT paid on services supplied for the purposes of a disposal of shares, under art 17(1) and (2) of the Sixth Directive, as amended by art 28f(1) thereof, and art 168 of Directive 2006/112, 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 is for the referring court to take account of all the circumstances surrounding the transactions at issue in the main proceedings and to determine whether the costs incurred are likely to be incorporated in the price of the shares sold or whether they are among only the cost components of transactions within the scope of the taxable person's economic activities."

56. The Court's dispositif was in the following terms, so far as the third question is concerned:

> "80. …
>
> 3. There is a right to deduct input value added tax paid on services supplied for the purposes of a disposal of shares, under art 17(1) and (2) of Sixth Directive 77/338, as amended by Directive 95/7, and art 168 of Directive 2006/112, 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 is for the referring court to take account of all the circumstances surrounding the transactions at issue in the main proceedings and to determine whether the costs incurred are likely to be incorporated in the price of the shares sold, or if they are among only the cost components of transactions within the scope of the taxable person's economic activities."

57. Ms McArdle showed us a translation of the Swedish court's decision in the case on its return from the CJEU to the domestic court. Mr Firth argued that this report was inadmissible, alternatively irrelevant. I am satisfied that the report from the Swedish court is admissible, and that the weight to be attached to it is for this Court to determine. I would attach little weight to it, although I have found it interesting. The national court directed itself that the issue for it to determine was whether there was a direct and immediate link between the services purchased and the exempt disposals of shares, applying paragraph [71] of the CJEU's judgment. It held that the services of assistance during negotiations, the writing of contracts and legal services were directly and immediately attributable to the sale of shares, which was exempt, and thus there was no right of deduction of VAT incurred on those services; but that it was not possible to know whether other services, of, for example, obtaining financial due diligence, or remunerating market participants who were helpful in getting the deal

done by referring potential customers (these other services also being referred to by SKF) gave rise to a right of deduction, so that part of the appeal was dismissed for lack of particularity. The national court held that it was too late to raise any issue about whether the disposals by SKF were TOGCs. Two members of the Court dissented; they thought there was no direct and immediate link between the services and the share sales, so that input tax deduction should be allowed.

Sveda

58. At paragraphs [60] and [62] of *SKF,* the Court adopted a formulation of the direct and immediate link test which focussed on whether the costs of the inputs were *incorporated* in the costs of particular transactions or in the goods and services supplied by the taxable person as part of his overall economic activity. This formulation is not the same as the formulation in *Midland* at paragraphs [30] and [31], nor does it match precisely the formulation in *Kretztechnik* at paragraph [36] (in passages which I have already cited). But that slightly revised formulation does appear and is further explained in Case C-126/14 *Sveda UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* (Case C- 126/14) [2016] STC 447. In *Sveda*, the taxpayer company had constructed a Baltic mythology recreational path which it undertook to offer to the public free of charge for a period of five years. It incurred 10% of the cost of construction itself, the rest coming by way of subsidy from public funds. It reclaimed input tax on construction costs, attributing the inputs to its economic activity of selling food, drinks and souvenirs to visitors, which were taxable supplies.

59. Advocate General Kokott noted that for the inputs to be deductible, they would have to be used for the purposes of the taxpayer's taxable transactions (see paragraph [26]). She referred to *BLP,* describing the case in this way:

> "32. In *BLP Group*, the court came to the general conclusion on this question that a direct and immediate link of the acquired goods or services with the taxable transactions is necessary and that the 'ultimate' aim pursued by the taxable person is irrelevant in this respect. The court therefore refused the deduction of input VAT in a situation in which services had been provided to the taxable person in relation to the exempt sale of shares, even though this sale was a means of enabling the taxable activity of the taxable person. In other words, the court made a distinction in this case between the solely decisive primary and the merely secondary use of an input transaction."

She then said this:

> "33. However, the court has further developed its case law since that case. It still remains the case that for art 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 be 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."

Her answer to the national court was at paragraph [41] in the following terms:

> "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 art 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."

60. The Court endorsed the Advocate General's Opinion, and specifically her analysis of the development of the Court's case law since *BLP*, as follows:

> "27. According to settled case law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to an entitlement to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct (see, inter alia, judgment in *SKF*, para 57).
>
> 28. Nevertheless, as the Advocate General observed in points 33 and 34 of her opinion, the court has held that a taxable person also has the right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the expenditure incurred is part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such expenditure does have a direct and immediate link with the taxable person's economic activity as a whole (see, to that effect, judgments in *Investrand BV v Staatssecretaris van Financiën* (Case C-435/05) [2008] STC 518, [2007] ECR 1-1315, para 24, and *SKF*, para 58).

> 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 criteria 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)."

61. The Court held that if inputs were used for making exempt or outside the scope supplies, there was no right of deduction because in both cases the direct and immediate link between the inputs and the economic activities carried out by the taxable person were severed (see paragraph [32]), but in this case the construction of the path did not relate to exempt or outside the scope activity, but rather to the taxpayer's economic activities as a whole and there was a right of deduction despite the immediate use of the capital goods free of charge (paragraph [33]).

Securenta and Volkswagen

62. For completeness, and to make sense of the arguments discussed below, I deal briefly with two further CJEU decisions on input tax deduction. The first is Case C-437/06 *Securenta Göttinger Immobilienanlagen und Vermögensmanagement AG v Finanzamt Göttingen* [2008] STC 3473, mentioned at paragraph [72] of *SKF.* That case involved a company which made taxable and exempt supplies as well as receiving dividend income in consequence of transactions which fell outside the scope of VAT. In other words, this taxpayer's overall business involved both economic activity (in the form of taxable and exempt supplies) and non-economic activity (transactions in securities and shares giving rise to dividend income). The Court held that deduction of input tax on the share issue was permissible only to the extent that the input tax was attributable to that part of the taxpayer's economic activity which consisted of taxable supplies (paragraph [31]), and it was for the Member States to establish a method of apportionment between economic and non-economic activity in order to determine the recoverable proportion (paragraph [34], [37]). The second is Case C-153/17 *Volkswagen Financial Services (UK) Ltd v Revenue and Customs Commissioners* [2019] 4 WLR 32 where the Court confirmed that the inclusion of particular costs (which were overheads, in that case) in the price of particular outputs is not determinative of the question of attribution for deduction purposes:

> "43. In this case, it is apparent from the order for reference that the general costs at issue in the main proceedings have a direct and immediate link with the activities of VWFS as a whole, and not merely with some of them. In that regard, the fact that VWFS decided to include those costs not in the price of the taxable transactions, but solely in the price of the exempt transactions, can have no effect whatsoever on such a finding of fact."

Frank Smart

63. Finally, I come to *Frank A Smart & Son Ltd v Revenue and Customs Commissioners* [2019] UKSC 39, [2019] 1 WLR 4849, on which Mr Firth places considerable reliance. This was not a case involving a share sale, and no question about the possible attribution of inputs to an exempt supply arose. In *Frank Smart*, the taxpayer purchased a number of units of entitlement to single farm payments ("SFPE units") which gave it the right to receive single farm payments ("SFPs") from the Scottish Government, which were outside the scope of VAT. The taxpayer claimed a deduction of input tax incurred in purchasing the SFPEs and sought to deduct that input tax on the basis that its intention was to use the SFPs – consequent on ownership of the SFPEs – to fund its current and future business activities which involved making taxable supplies. HMRC refused the deduction. The First-tier Tribunal allowed the appeal on the basis that by the acquisition of SFPEs, the taxpayer had raised finance for its future economic activities as a whole and there was a direct and immediate link between that expenditure and the taxpayer's future taxable supplies. HMRC's appeal to the Upper Tribunal failed. HMRC's appeal to the Inner House of the Court of Session failed. HMRC appealed to the Supreme Court. Lord Hodge JSC gave the only judgment of the Court with which the other members of the Court agreed, dismissing the appeal.

64. Lord Hodge reviewed a number of cases at [27]-[65], including *BLP, Midland, Abbey National, Kretztechnik* and *SKF.* He introduced *SKF* at paragraph [41] in this way: "More recently, the CJEU has called into question its ruling in the *BLP* [sic] in the light of its developing jurisprudence attributing input expenditure on the raising of capital to the general overheads of an undertaking". Lord Hodge noted Advocate General Mengozzi's conclusion at paragraph [89(3)] of his Opinion in *SKF* (see paragraph [42] of *Frank Smart*) and then said this at [43]:

> "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."

65. Lord Hodge summarised paragraphs [55]-[68] of *SKF* (see paragraphs [44]-[46] of *Frank Smart*). He added this in relation to [68] of *SKF* at paragraph [46]:

> "… In my view it is implicit in the CJEU's reasoning that it accepted the distinction which Advocate General Jacobs made in his opinions in *Abbey National* and *Kretztechnik* but recognised the need to modify the result for the purpose of

> VAT of an exempt initial transaction in order to avoid discriminatory fiscal treatment".

He considered further the statement at paragraph [59] of *SKF* (which I have already cited, see paragraph 52 above), saying this:

> "47. It is important to consider further the statement in para 59 of the judgment, summarised in para 44(iv) above. It was that, in contrast to the circumstance where the costs of services are part of a taxable person's general costs and components of the price of the goods and services which he supplies (para 58), "where goods and 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". In order to be consistent with the CJEU's reasoning outlined above, that statement, when applied in the context of a fund-raising transaction such as a sale of shares, must be a reference to the downstream transactions of which the input costs form a cost component, and not the initial fundraising transaction, unless the cost of the inputs was a component of the price of the shares in the initial transaction.
>
> 48. It is also noteworthy that the cases to which the CJEU referred in para 59 of its judgment as vouching its proposition of law did not involve an initial fund-raising transaction and a downstream transaction."

He finished his review of *SKF* in this way:

> "49. In my view, it is clear that in *SKF* … the CJEU has not extended the reasoning of *BLP* … to apply it to fund-raising transactions which are outside the scope of VAT. On the contrary, in order to avoid discriminatory treatment of taxable persons, it has extended the reasoning in the cases about share disposals that are outside the scope of VAT to share disposals which are exempt, by requiring an examination as to whether the costs associated with the input services are incorporated in the price of the shares sold in the initial transaction or in the prices of the taxable person's products in downstream transactions. If the latter, the costs would be "among only the cost components of transactions within the scope of the taxable person's economic activities"."

66. Lord Hodge then considered three further cases decided by the CJEU. The first was *Sveda* to which I have already referred. The second was Case C-132/16 *Direktor na Direktsia "Obzhalvane i danachno-osiguritelna praktica" – Sofia v Iberdrola Inmobiliaria Real Estate Investments EOOD* () [2017] BVC 39, in which the taxpayer incurred input VAT on the costs of reconstructing a waste water pump station which belonged to a third party but which the taxpayer wished to use as part of its development of holiday apartments. The CJEU held that the input tax was deductible even though the third party would have use of it free of charge for its economic

activity, in so far as the expenditure was necessary for the taxpayer's own taxable transactions and where the costs were included in the price of those transactions. The CJEU referred in its judgment to paragraphs [56], [57], [58] and [59] of *SKF,* and paragraph [29] of *Sveda.* The third case was C-316/18 *Revenue and Customs Commissioners v University of Cambridge* [2019] 4 WLR 126 where the CJEU held that the university could not deduct input tax on fees paid to third party managers of its investments because those costs were directly linked with the non-economic activity of raising and collecting donations and endowments, and did not form part of the university's overheads in making supplies for VAT purposes.

67. From the cases he had considered, Lord Hodge derived a number of propositions "relevant to the appeal" (see paragraph [65]), of which propositions (ii) to (iv) are of relevance:

> "(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."

68. Lord Hodge refused HMRC's application for a reference to the CJEU (see paragraph [59]). He dismissed the appeal on the basis of the First-tier Tribunal's findings of fact that the taxpayer purchased the SFPEs in support of its current and planned future taxable activities; on the facts as found, there were no downstream exempt supplies or activities which were outside the scope of VAT (see paragraph [68]). He held that fund-raising costs may, where the evidence permits, be treated as general overheads of a taxable person's business; that may involve HMRC in more investigations than the CJEU envisaged in *BLP* but that is an inevitable consequence of the CJEU's interpretation of the PVD (see paragraph [70]).

Submissions

69. For HMRC, Ms McArdle submitted that the ordinary and well-established approach involved a two-stage test of asking, first, whether the inputs in question were used in making a specific supply to which they could be directly attributed; and if not, and only if not, in asking alternatively whether the inputs in question were part of the overheads of the business attributable to the taxpayer's downstream outputs. The test was an "either/or" and as *SKF* showed the answer could not be both. Deduction depended on the supplies to which the inputs were attributed, by application of the "either/or" test, being taxable outputs. She submitted that both tribunals had accepted the existence of the "either/or" test, which she referred to as a "two-stage" test, but had erred in their application of that test by adopting too narrow an approach to attribution at the first stage. *BLP* remained good law on the analysis at the first stage; the CJEU's approach to input tax deduction had changed since *BLP* only to the extent that it was now accepted that it was permissible to look at a taxpayer's overall purpose, objectively construed, to determine at the second stage (if you got there) whether particular inputs should be treated as overheads. But in this case, that issue did not arise because the attribution of these inputs was to the exempt share sale, as the FtT had found, and so the inquiry was determined at the first stage.

70. This was, she said, in line with *SKF* and *Frank Smart. Frank Smart* was in any event a different case, not involving any sale of shares (or any exempt supply), and the judgment of Lord Hodge was not binding on this Court. *SKF* was an old case, dating back to 2009, but to her knowledge there had not been any wholesale shift in treatment of fund-raising transactions in this jurisdiction or elsewhere in the EU since that decision. She referred us to one domestic case post-dating *SKF* where the FtT had attributed costs to an exempt sale of shares and not treated them as overheads, a conclusion which was not appealed (*TLLC Ltd v HMRC* [2013] UKFTT 467, see paragraphs [206]-[209]).

71. She submitted that the FtT had been in material error of law in a number of fundamental ways: (i) in accepting that there was a modification of the first stage of the analysis in fundraising cases by disregarding the initial share transaction (paragraphs [36] and [40] of the FtT), (ii) in applying a test of whether the Services were incorporated in the price of the shares in disregard of the usual test of "direct and immediate link" (paragraphs [38] and [46] of the FtT), (iii) in concluding that the use of the Services for the exempt share sale did not prevent deduction (paragraphs [41] and [44] of the FtT); and (iv) in failing to address a number of arguments advanced by HMRC, in particular the incoherence of HLT's analysis in light of paragraphs [71]-[73] of *SKF* and paragraph [32] of *Sveda*.

72. She submitted that the UT had been in material error of law in upholding the FtT's approach and making the same errors as she had already identified in the FtT's decision (see paragraph [68] where the UT concluded that the FtT had correctly stated the law). She identified further material errors of law by the UT, as follows: (i) an overstatement of the extent to which the jurisprudence of the CJEU has evolved since *BLP* (paragraphs [60] and [62] of the UT); (ii) a suggestion that the CJEU had applied the principle of fiscal neutrality to equate the treatment of inputs incurred on an exempt supply of shares with that of inputs incurred in the course of a fund-raising transaction which was not a supply for VAT purposes at all, when that was not what the CJEU had decided and stretched the principle of fiscal neutrality far beyond its proper bounds (paragraphs [60]-[61] of the UT); and (iii) understanding *SKF* (as interpreted by the Supreme Court in *Frank Smart*) to mean that the national court had to determine the question of deduction by reference to whether the inputs were incorporated in the price of the shares, which was not the test (paragraph [66] of the UT).

73. Mr Firth agreed that there was a two-stage test which would normally apply. He further accepted that the Services in this case were closely connected with the share sale. However, he argued that where, as here, there is a share sale which comes within the scope of tax (and is an exempt supply) only because the company selling the shares supplies management services to the subsidiary, the approach is modified in the way that the FtT and UT found. In such a case, *SKF* (drawing on paragraph [64] of the judgment in that case) operates to apply the treatment in *Kretztechnik* (drawing on paragraph [36] of that case) to that share sale, in order to achieve fiscal neutrality (drawing on paragraphs [66] and [67] of the judgment in *SKF*) with the effect that the inputs on the share sale are treated as overheads having a direct and immediate link with the company's general outputs and are deductible to the extent that the company makes taxable supplies (drawing on *SKF,* paragraphs [66] and [68] of the judgment). He contended that this special treatment was mandatory in any case where the share sale was undertaken to increase the company's capital for the benefit of the business overall. He accepted that his argument was not consistent with parts of *SKF,* for example, the second part of paragraph [73] of the judgment in that case, but said that the judgment read as a whole was clear enough and displaced the ordinary rules in the specific circumstances of a fund-raising transaction. This modification was confirmed by the Supreme Court in *Frank Smart* at paragraphs [46], [49] and [65], point (iv) in particular.

Discussion

74. Three key questions arise from the decisions of the tribunals and the submissions advanced on appeal:

    i) What did the CJEU decide in *SKF*?

    ii) To what extent has the approach in *BLP* been altered?

    iii) Has the direct and immediate link test been varied to a test of incorporation of costs?

Question (i): what did the CJEU decide in SKF?

75. The judgment in *SKF* is not easy to understand and taken out of context, phrases and sentences can be found in the judgment to support both parties' submissions. It is important to read the case as a whole to make sense of it. Before considering the case in detail, there are a number of points to make about it. First, the questions referred arose out of the taxpayer's request for an advance indication about the tax treatment of inputs; the Court was ruling on hypotheticals, not established facts. Secondly, the Court indicated more than once that the case file was unsatisfactory, containing insufficient details to enable the Court to answer the questions referred. Third, the inputs in question, as appears from the domestic court's subsequent judgment, ranged quite widely from services of assistance during negotiations, the writing of contracts and legal services to financial due diligence and referral commissions.

76. It is the third question referred which is particularly pertinent to this appeal. The question asked whether there could be a right to deduct for expenditure directly attributable to the disposal transaction (ie the sale of shares) in the same way as there is for general costs (see paragraph [25] of the judgment). That question was rephrased by the Court to this: "whether there is a right to deduct input VAT … on services required for a disposal of shares, on the ground that the costs of those services form part of the taxable person's general costs" (see paragraph [54]). In answering that question the Court set out the established rules at paragraphs [55] to [60]. In several places the Court emphasised the "either/or" approach to determining whether input tax is deductible. So, for example, at paragraph [57] the Court referred to the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduction (which I paraphrase as "direct attribution", the first alternative), and at paragraph [58] the Court goes on to say that there is a right to deduct, even where there is no such direct attribution, where the costs are part of the general costs (or "overheads", as it can be paraphrased) which have a direct and immediate link with the taxable person's economic activity as a whole (the second alternative). These are the two possible routes to deduction embodied in the "either/or" approach. The Court adopted that approach at paragraphs [60], [62], [71] and [73].

77. Further, the Court confirmed that if the inputs are directly attributable to exempt supplies or supplies outside the scope of VAT, then that is the end of the analysis and the input tax cannot be deducted: see, for example, paragraphs [59] and [71]. (This was to confirm the "chain-breaking" effect of an exempt supply as it was explained in the earlier cases, see again, *BLP, Midland* and *Abbey National*).

78. Paragraphs [61] and [62] reveal the problem facing the CJEU. The referring court had made what was, in VAT terms, an impermissible finding, by attributing the inputs in question *both* directly to the share sale *and* to overheads. That was a VAT nonsense. That meant the case had to go back to the national court for that court to try again and determine which outcome was correct: was there a direct and immediate link between the inputs and the share sale (by way of direct attribution), or were these overheads bearing a direct and immediate link with the business as a whole (see paragraph [63])? It is in this respect that the Court departed from the view of the Advocate General, who had considered the finding of direct and immediate link with the share sale to be sufficient to dispose of the case (see paragraph [63] of the Opinion).

79. It must follow from the Court's remission of the case to the national court on this point that the mere existence of the exempt share sale, with which these costs were undoubtedly connected, was not sufficient to answer the question whether the inputs nonetheless gave rise to a right of deduction. It is in this respect, it seems to me, if at all, that the Court in *SKF* departed from *BLP*. *BLP* might be taken to suggest that on these sorts of facts there was room for only one conclusion, namely that the inputs connected with the sale of shares were directly attributable to that share sale and for that reason the input tax was not deductible. That is how the AG in *SKF* appears to have approached this case. It was on this point that the Court disagreed with him. The Court in *SKF* accepted *the possibility* that the inputs might have a direct and immediate link with the taxpayer's general outputs such that they should be treated as overheads. That was to conclude that they were not *necessarily* directly attributable to the exempt share sale.

80. Before us there was much argument about whether that was a real or fanciful possibility. I am satisfied that the possibility is not merely fanciful. As the case law has developed since *BLP*, it has become clear that there are ways in which input tax incurred in connection with (or, to use the CJEU's own language at paragraphs [66] and [68] of *SKF*, "relating to") a share sale is not necessarily directly attributable to that share sale. As examples: in *Midland,* the fact that legal services were connected with an initial transaction was not sufficient to establish a direct and immediate link with that transaction so that the inputs were properly characterised as overheads of the business; from the domestic case report in *SKF*, we see that *SKF* incurred a range of costs and the domestic court was not able to say, on the evidence, that all of them were directly attributable to the share sale – they may or may not have been; from *Abbey National* we see that if a share sale can be characterised as a TOGC (a matter for the national court to determine, depending on the specifics of the transaction and the national legislation) the inputs are attributable to the overall economic activity of the taxpayer. The facts of individual cases are infinitely variable, and doubtless other real or hypothetical examples could be found where input tax connected with a share sale might have a direct and immediate link with the taxpayer's general business.

81. In my judgment, that is all the Court decided in *SKF.* It did not decide that these inputs were overheads, just that they might be. It did not decide that the existence of the exempt share sale must be disregarded in this type of case, rather it accepted that it was for the national court to decide whether the inputs in question were directly attributable to that exempt share sale, or not.

82. The irony of the Court's suggestion that it was providing a "useful answer" to the national court (see paragraph [64], introducing paragraphs [64]-[73]) is not lost on me. Having got to the point of deciding to send the case back to the national court to find the basic facts applying the ordinary test, leaving open the possibility that the costs were directly and immediately linked either to the exempt share sale or to the taxpayer's economic activities, the CJEU could have simply stopped there. But it went on. Reading paragraphs [64]-[73] as a whole, in light of what had gone before, I am satisfied that the Court was simply confirming explicitly the point that was already implicit in its judgment, namely that the inputs could, in theory at least, be attributed to overheads if (and only if) there was no direct and immediate link established by way of direct attribution to the share sale. Some parts of paragraphs [66] and [68] are the most difficult to understand, because they are capable of being

read consistently with either party's case, but in the end I am persuaded that they should be read consistently with HMRC's case, as being addressed only to the stage of the analysis, if you get there, when you ask whether the costs constitute overheads of the taxable person, ie whether they have a direct and immediate link with the taxpayer's business as a whole, which could only be the case if they did not have a direct and immediate link with the share sale. It is only in the context of that part of the analysis that the principle of fiscal neutrality becomes relevant to test the treatment of a case like this against the treatment in other cases where there is no direct attribution to the initial transaction (as in *Midland, Abbey National, Kretztechnik* and to an extent *Sveda*) so that similar treatment as overheads must be "allowed" (using the language of paragraph [66] and [68]). If the inputs are directly attributable to the initial transaction, then there is no analogy to be drawn with these cases and no issue of fiscal neutrality arises; moreover, the input tax is not deductible because it is directly attributable to an exempt or outside the scope supply (confirmed in paragraphs [71] and [73] – paragraphs which are in my view impossible to reconcile with HLT's case, and paragraphs which were not considered in any detail by the FtT or the UT).

83. I consider this reading of *SKF* to be compelling, taking the judgment as a whole. I am confirmed in that view by considering the somewhat dramatic consequences of HLT's reading of *SKF*. If HLT were correct, there would be a different rule which operates in the context of share sales for the purpose of fund-raising. Yet that rule is nowhere stated clearly by the CJEU and is of wholly uncertain ambit. It would represent a departure from the Directives which ever since the inception of VAT have emphasised that input tax deduction depends on how the inputs in question are *used* and which contain no derogation from that rule for share sales for the purposes of raising funds for the business. Such a departure would undermine the principle of fiscal neutrality which requires that sales of shares should be treated similarly, according to their objective characteristics, and regardless of the ultimate purpose of the taxpayer in effecting such sales – that disregard of purpose remaining an important foundation stone, key to the objective application of the tax and recited in the Directives (see for example Article 9 of the PVD). It would mean that the first proposition extracted from the cases (see paragraph 46 above) no longer represented the law, even though that proposition finds confirmation in the very case (*SKF*) which is said to undo it.

84. I am not persuaded, even by a close margin, that that is what the CJEU meant in *SKF*. To the contrary, I am satisfied that *SKF* preserved the existing rules (summarised by the propositions at paragraph 46 above), whilst adding a rider to the first proposition to the effect that input tax connected with a share sale may have a direct and immediate link *either* with the share sale *or* with the taxpayer's business as a whole, that being a matter for the domestic court to determine.

85. I do not detect any inconsistency between my reading of *SKF* and the Supreme Court's understanding of that case at paragraphs [41] to [49] of *Frank Smart*. Although Mr Firth considered paragraph [65(iv)] of *Frank Smart* (set out above at [67]) to support his case that paragraph goes no further than accepting that inputs *may* (depending on the evidence) be treated as overheads even in a case where there is an exempt share sale: "The same *may* apply if an analogous situation [to *Abbey National, Kretztechnik* and *Securenta*] involving the sale of shares is classified as an exempt

transaction: *SKF,* para [68]" (my emphasis). That is a proposition with which I agree and which is consistent with HMRC's case.

86. The only part of *Frank Smart* which has caused me to pause is the last sentence of paragraph [46], set out at [65] above, where Lord Hodge says that it is implicit in the CJEU's reasoning that it recognised the need to "modify the result for the purpose of VAT of an exempt initial transaction in order to avoid discriminatory fiscal treatment". I agree that *SKF* modified the result (of *BLP*, I would interpose) by leaving open the possibility that inputs relating to fund-raising transactions could be treated as overheads, even if the particular transaction in question was an exempt share sale; but if Lord Hodge was going further than that to the point of suggesting that *SKF* decided that such inputs were invariably and by operation of law to be treated as overheads, then with respect I would have to part company with him. In the end, however, *Frank Smart* was dealing with a different issue and is not determinative of the outcome of this appeal.

87. I do not consider my reading of *SKF* to offend fiscal neutrality, either. The principle of neutrality is a principle of interpretation and not of substantive law: see Case C-44/11 *Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG* [2012] STC 1951 at paragraph [45]:

> "That principle is not a rule of primary law which can condition the validity of an exemption, but a principle of interpretation, to be applied concurrently with the principle of strict interpretation of exemptions".

Fiscal neutrality is not relevant when inputs are incurred to make an exempt supply of shares, by comparison with a situation where inputs are incurred to raise funds otherwise than by a share sale. The two situations are different, precisely because in the first there is an exempt supply of shares (with the consequences of exemption mandated by the PVD) and in the other there is no such exempt supply. That was the answer given in *BLP* (see paragraphs [25] to [26]) and in my judgment, that remains good law, reflecting the fundamentals of VAT. As I have already indicated, fiscal neutrality and the comparison with other cases where there has been no exempt sale of shares only become relevant in considering whether the inputs are properly treated as overheads (*ex hypothesi* because they are not used in making the exempt supply of shares).

Question (ii) To what extent has BLP been altered?

88. In *BLP,* the inputs in question were held to be directly attributable to the exempt share sale. That followed, axiomatically, from the national court's finding that the inputs had been used in making that share sale. The Court did not consider whether the inputs might be overheads of the taxpayer's business; indeed, the Court emphasised the irrelevance of the ultimate aim pursued by the taxable person (see paragraph [19] of the judgment). The AG in *Sveda* characterised that as a distinction between the "solely decisive primary and the merely secondary use of an input transaction" (see paragraph [32] of AG Kokott's opinion, set out at [59] above). In *Abbey National,* AG Jacobs contrasted the narrower approach in *BLP* (that approach reflecting, he said, the aims of legal certainty and facility of application) with the "broader approach" taken in other cases: see paragraph [34] of his opinion (see [40] above).

However, as AG Jacobs noted (at paragraph [35] of his opinion, also at [40] above) the "contrast between those two approaches may be more apparent than real".

89. I agree with Lord Hodge in *Frank Smart* that the CJEU has called its ruling in *BLP* into question (paragraph [41] of *Frank Smart*), that *SKF* does not represent an extension of the *BLP* approach (paragraph [49] of *Frank Smart*) and that HMRC may in consequence be involved in more investigations than the CJEU envisaged in *BLP* (paragraph [70] of *Frank Smart*). The outcome will depend in part on the sort of inputs which have been incurred, as was explained by Patten LJ in *Revenue and Customs Commissioners v Associated Newspapers Ltd* [2017] EWCA Civ 54, [2017] STC 843:

> "37. [*Midland*] 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 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 the 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."

In a passage relied on by the UT, specifically on the question of what had changed since *BLP,* Patten LJ held that:

> "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."

90. The thing that has changed since *BLP,* so far as is relevant to this appeal, is the removal of any assumption that might have been implicit in *BLP* that inputs incurred in the context of a share sale are necessarily directly attributable to that share sale (so as to be irrecoverable); it is now accepted that those inputs *may* bear a direct and immediate link with the taxpayer's economic activity as a whole so as to be treated as overheads and recovered in proportion to taxable outputs forming part of that economic activity (applying the ordinary rules and subject to *Securenta*). Establishing the direct and immediate link and the extent of input tax deduction remain matters for the national court to determine on the evidence. I prefer to characterise the direct and immediate link test as "either/or"*,* even though the parties refer to a two-stage test; perhaps I am over-cautious, but I have a concern that the latter might suggest an order of priority, such that the first stage takes precedence over the second stage, which I do not believe to be an accurate reflection of the case law.

Question (iii): has the direct and immediate link test been varied to a test of incorporation of costs?

91. This point played an important part in the tribunals' reasoning, see the FtT at [46] and the UT at [66] in particular.

92. Neither party on appeal suggested that the direct and immediate link test had been varied, in fund-raising transactions or in any other type of transaction, to depend on where and how the input costs were *incorporated* into the price of outputs. Indeed, Mr Firth, while adopting the tribunals' conclusions in other respects, distanced himself from this aspect of the tribunals' reasoning.

93. In *SKF,* the CJEU at paragraph [62] formulated the test by reference to the incorporation of costs but I do not understand that to signal a wholesale change in the rules of input tax deduction. Elsewhere in the judgment, the Court referred to and applied the Court's "settled case law" (paragraph [57]), there is repeated reference to "direct and immediate link" which is the test which comes from that case law (eg paragraphs [57], [58], [60], [62], [63], [71], [72] and [73]), the Court refers to the concept of inputs being "cost components" (eg, paragraphs [57], [58], [62], [72] and [73] – that phrase being found in the Directives) and to the inputs being "used" in the making of exempt supplies (paragraph [59] – a word also found in the Directives).

94. I note that the Supreme Court in *Frank Smart,* having reviewed *SKF* and many other cases, said that 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" (paragraph [65(ii)]), using conventional language without any suggestion of fundamental change.

95. It may be that the emphasis has, in some contexts at least, shifted towards an analysis of how the particular inputs are used. In *Sveda,* AG Kokott referred to *Kretztechnik* and *SKF,* amongst other cases, to support her view that recent case law indicated that "the decisive factor" for a direct and immediate link was that the cost of the inputs was incorporated in given outputs and that the existence of an "objective economic link" was crucial (paragraph [45]). The Court endorsed what she said at paragraph [34], focussing on the circumstances surrounding the transactions and the objective links with economic activity (see paragraphs [28]-[29]). In *Associated Newspapers* at paragraph [47] (see [89] above) Patten LJ suggested that evidence about how the costs

were "passed on as part of the cost of supplies" was relevant to the objective analysis. This is a change of emphasis at most, because *Volkswagen Financial Services* makes it very clear that deduction does not depend on where costs are incorporated in the prices of outputs.

96. I would respectfully agree with the statement of the position by David Richards LJ (as was) in *Revenue and Customs Commissioners v Royal Opera House Covent Garden Foundation* [2021] EWCA Civ 910, [2021] STC 1374 at [17]-[18] by way of explanation of Articles 1 and 168 of the PVD, and in particular this passage:

> "17. The reference to 'costs components' in art 1 might suggest that the cost of the goods or services supplied to the taxable person must be reflected in the price charged for the relevant output supplies made by the taxable person. That is not, however, the case. As art 168 makes clear, it is the fact that the goods or services supplied to the taxable person are used 'for the purposes of' the taxed supplies made by the taxable person that gives rise to the right of deduction. The taxable person's purpose is to be objectively ascertained from the facts and circumstances of the transactions, not by investigating the subjective intentions of the taxable person."

Disposal on Issue I

97. I agree in substance with both grounds of appeal advanced by Ms McArdle. She is right to say that the UT failed to apply the direct and immediate link test and erred in disregarding the existence of the exempt share sale. She is also right to submit that the UT overestimated the changes in the CJEU jurisprudence post-*BLP* and got wrongly distracted into an analysis of where the costs were incorporated. The errors are plainly material and this appeal must be allowed.

98. What, then, should happen now? HLT might suggest that the case should be remitted to the FtT in order for facts to be found and the test of direct and immediate link (properly understood) to be applied. I am not persuaded, however, that remission is appropriate or necessary here. Unlike *SKF,* these events are in the past, the inputs have been purchased, the supplies have been made and the facts have been found. The inputs here were marketing costs, solicitors' and accountants' fees. The FtT found that these inputs were "part of the process" of selling the shares and were "used" in the fundraising transaction (paragraph [44] of the FtT's judgment).

99. That, in my judgment, is the answer to the appeal and to the case. These inputs were used in, were cost components of, were directly and immediately linked with, the exempt share sale. If incorporation is a test which stands separately (which I doubt) the costs were incorporated – in the sense of having an objective economic link to – in the sale of shares because they were used to make the share sale and were met from the proceeds of sale. I see no room in this case for any different outcome on the facts, even if the matter were remitted.

100. I accept that the consequence of allowing this appeal is that HLT has "sticking" (ie irrecoverable) input tax despite being, in the ordinary course of its hotel business, a fully taxable trader. Whether that is the right or the wrong answer as a matter of tax

policy is a question for those who design the tax, not for the courts and tribunals who apply the law as it is.

101. I would, subject to Mr Firth's Respondent's Notice, allow this appeal.

II. VAT Grouping Issue

Outline

102. VAT Grouping is authorised by Article 11 of the PVD, previously Article 4(4) of the Sixth Directive. This issue centres on the scope and meaning of the domestic provisions for VAT grouping, now contained in s 43 of the Value Added Tax Act 1994:

> "43 Groups of companies
>
> (1) Where under sections 43A to 43D any persons are treated as members of a group, any business carried on by a member of the group shall be treated as carried on by the representative member, and –
>
> > (a) any supply of goods or services by a member of the group to another member of the group shall be disregarded; and
> >
> > (b) any supply which is a supply to which paragraph (a) above does not apply and is a supply of goods or services by or to a member of the group shall be treated as a supply by or to the representative member; and
> >
> > (c) any VAT paid or payable by a member of the group on the importation of goods shall be treated as paid or payable by the representative member and the goods shall be treated, for the purposes of sections 38 and 73(7), as imported by the representative member;
>
> and all members of the group shall be liable jointly and severally for any VAT due from the representative member."

103. It is common ground that a distinction exists between the mere acquisition, holding and sale of shares which do not constitute economic activities for VAT purposes on the one hand, and involvement in the management of a company which does constitute economic activity, on the other, as explained in *SKF*:

> "28. According to settled case law, the mere acquisition, holding and sale of shares do not, in themselves, constitute economic activities within the meaning of the Sixth Directive (see, inter alia, *Empresa de Desenvolvimento Mineiro SGPS SA v Fazenda Pública (Ministério Público, intervening*) (Case C-77/01) (*'EDM'*) [2005] STC 65, [2004] ECR 1-4295, para 59, and *Investrand BV v Staatssecretaris van Financiën* (Case C-435/05) [2008] STC 518, [2007] ECR 1-1315, para 25 and the

case law there cited). Those transactions cannot amount to exploitation of an asset intended to produce revenue on a continuing basis, as the only consideration for those transactions consists of a possible profit on the sale of those shares (see, to that effect, *EDM* (para 58)).

29. The court has stated that only payments which are the consideration for a transaction or an economic activity come within the scope of VAT and that such is not the case in respect of payments which arise simply from ownership of the asset, as in the case of dividends or other yields from a shareholding (see, to that effect, *Sofitam SA (formerly Satam SA) v Ministre chargé du Budget* (Case C-333/91) [1997] STC 226, [1993] ECR 1-3513, para 13; *Harnas & Helm CV v Staatssecretaris van Financiën* (Case C-80/95) [1997] STC 364, [1997] ECR 1-745, para 15; and *EDM* (para 49)).

30. However, the court has held that the position is otherwise where a financial holding in another company is accompanied by direct or indirect involvement in the management of the company in which the holding has been acquired, without prejudice to the rights held by the holding company as a shareholder (see *Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen, Arnhem* (Case C-60/90) [1993] STC 222, [1991] ECR 1-3111, para 14; *Floridienne SA v Belgium* (Case C-142/99) [2000] STC 1044 [2000] ECR 1-9567, para 18; order in *Welthgrove BV v Staatssecretaris van Financiën* (Case 102/00) [2001] ECR 1-5679, para 15; and *Cibo Participations SA v Directeur règional des impôts du Nord-Pas-de-Calais* (Case C-16/00) [2002] STC 460, [2001] ECR 1-6663, para 20), in so far as involvement of that kind entails carrying out transactions which are subject to VAT by virtue of art 2 of the Sixth Directive, such as the supply of administrative accounting and information-technology services (*Floridienne and Berginvest* (para 19); *Welthgrove* (para 16); *Cibo Participations* (para 21); and *Finanzamt Groβ-Gerau v MKG-Kraftfahrzeuge-Factoring GmbH* (Case C-305/01) [2003] STC 951, [2003] ECR 1-6729, para 46).

104. The Court described the circumstances in which share disposals would constitute economic activity in Case C-80/95 *Harnas & Helm CV v Staatssecretaris van Financiën* [1997] STC 364, one of the cases cited by the Court in *SKF* (paragraph [29]), in the following way:

"16. It is true that the transactions referred to in art 13B(d)(5) of the Sixth Directive may fall within the scope of VAT where they are effected as part of a commercial share dealing activity, in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired or where they constitute the direct, permanent and

> necessary extension of the taxable activity (see *Polysar Investments* [1993] STC 222 at 239, [1991] ECR 1-3111 at 3137, para 14; *Wellcome Trust Ltd v Customs and Excise Comrs* (Case C-155/94) [1996] STC 945 at 959, para 35; and *Régie Dauphinoise – Cabinet A Forest SARL v Ministre du Budget* (Case C-306/94) [1996] STC 1176 at 1191, para 18). "

105. Building on this case law, it was common ground that, VAT Grouping aside, HLT's management of HLTB brought its sale of shares in HLTB within the scope of VAT, because those management services constituted economic activity by HLT in relation to HLTB.

106. Mr Firth argued that the existence of the VAT Group comprising HLT and HLTB meant that the management services were to be disregarded for VAT purposes with the consequence that HLT was not engaged in economic activity, after all. The consequence of that, he argued, was that the case fell into the *Kretztechnik* model, whereby the share sale fell outside the scope of VAT with the consequence that the inputs should be treated as overheads, in which case they would be deductible because the group business involved the making of taxable supplies of hotel accommodation.

107. Ms McArdle resisted this argument on three grounds. First, she raised a procedural objection on the footing that HLT was not permitted to run this argument at the FtT and should not be permitted to raise the point now on appeal. Secondly, in the alternative, she argued that the FtT was correct to dismiss this argument on the basis that s 43 does not have that effect in law. Thirdly, and in the further alternative, she raised a new argument that, in any event, the effect of s 43(1)(b) was to deem HLT, the representative member of the group, the person who made the supplies of hotel services (in fact supplied by HLTB); that, she submitted, was plainly economic activity, such that HLT's sale of shares in HLTB was conducted in the course of HLT's economic activity and was an exempt supply.

Procedural Objection

108. The FtT held it was too late for HLT to raise the argument (see paragraphs [50]-[52] of the FtT). That was a case-management decision which, as Ms McArdle correctly notes, was not appealed. The FtT's reasons for ruling it inadmissible were that HMRC had not had sufficient time to consider the point and counsel lacked instructions on it. The position is now different, because HMRC has had time to consider it and is prepared to argue it. It is common ground that the point is one of pure law not involving any further analysis of fact or evidence.

109. I am not persuaded that there is any proper procedural objection to this argument being raised by HLT at this stage. These are my reasons:

    i) The argument was raised by way of Respondent's Notice and permission is not required to advance it (see, for an illustration of CPR 52.13 at work, *Braceurself Ltd v NHS England* [2023] EWCA Civ 837, [2024] 1 WLR 669, paragraphs [31(a)], [51] and [55] in particular). The position might have been otherwise if HLT had been the appellant, but it is not (see, as an example of the Court's approach to late-introduced grounds of appeal, *Altrad Services Ltd*

and another v Commissioners for HM Revenue and Customs [2023] EWCA Civ 474, [2023] STC 931).

ii) To the extent that the Court might nonetheless retain a discretion to exclude the argument, there is no good reason for excluding the argument in this case. The argument is legal in character, it causes no prejudice to HMRC to admit it, and it is in the wider interests of justice that this Court should consider it as part of its search for the right answer in law to this appeal.

iii) Mr Firth is not obliged to raise the point by way of appeal from the FtT's refusal to hear the point. He is not challenging the FtT's case-management decision to exclude the point from argument before that tribunal and accepts that there were good reasons why the FtT took that decision when it did. He is seeking to raise the point in answer to HMRC's appeal to this Court. He is entitled to do that.

iv) Mr Firth should not in any event be in a worse position because he failed to get the point "in" at first instance than he would have been if he had raised the point for the first time by Respondent's Notice at an appeal stage.

Scope and effect of s 43

110. Section 43 contains a statutory fiction, to the effect that the business carried on by any member of the group shall be treated as carried on by the representative member. This is a provision of domestic legislation and the issue is ultimately one of construction: see *Fowler v Revenue and Customs Commissioners* [2020] UKSC 22, [2020] 1 WLR 2227 per Briggs JSC at paragraph [27(1)].

111. The House of Lords construed the statutory predecessor to s 43 (s 29(1) of the Value Added Tax Act 1983) in *Customs and Excise Commissioners v Thorn Materials Supply Ltd and Thorn Resources Ltd* [1998] STC 725. Lord Nolan described the provision as being:

> "designed to simplify and facilitate the collection of tax by treating the representative member as if it were carrying on all the businesses of the other members as well as its own, and dealing on behalf of them all with non-members" (p 733 a-b).

112. In *Intelligent Managed Services Ltd v Revenue and Customs Commissioners* [2015] UKUT 341 (TCC) the UT (Barling J sitting with UTJ Roger Berner) held that:

> "49. By virtue of the single taxable person fiction, as applied by s43(1) of the VATA, the group is to be treated as carrying on all the businesses carried on by group companies. That fiction does not, however, change the nature of those businesses. They remain separate businesses as a matter of fact. The fiction does not extend to treating the group as carrying on a different, amalgamated, business in which the separate businesses of the group lose their individual identity. That is clear, in our view, from the opinions of the House of Lords in *Customs and Excise Comrs v Thorn Materials Supply Ltd and Thorn Resources Ltd*

> [1998] STC 725, [1998] 1 WLR 1106, in particular that of Lord Nolan ([1998] STC 725 at 733, [1998] 1 WLR 1106 at 1113), where his Lordship referred to the representative member of the group being treated 'as if it were carrying on all the businesses of the other [group] members as well as its own'. We accept, in this respect, Mr Pleming's submission that this is the case whether or not those individual businesses themselves make supplies outside the group. The treatment of such supplies is dealt with separately by s43(1)(b)."

113. These two authorities emphasise the limited effect of the statutory fiction contained within s 43. The provision does not mean that supplies are disregarded for all purposes, nor that the facts can be overlooked. The statutory fiction is a simplification measure for VAT accounting purposes.

114. The case of *R (on the application of Northumbria Healthcare NHS Foundation Trust) v Revenue and Customs Commissioners* [2020] EWCA Civ 874, [2020] STC 1720, on which Mr Firth relies, is not concerned with s 43 and for that reason is of little utility in the resolution of this issue. That case concerned the Value Added Tax (Treatment of Transactions) Order 1992 SI 1992/630, which "de-supplied" the provision of cars to employees, in terms that such provision "shall be treated as neither a supply of goods nor a supply of services". That language is materially different from the "disregard" in s 43. Case C-28/16 *MVM Magyar Villamos Müvek Zrt v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*, cited in *Northumbria* and relied on by Mr Firth, is not of assistance either, given that the issue in that case was whether management services which were not invoiced amounted to economic activity for VAT purposes; the case did not involve s 43 or any foreign law equivalent.

115. The FtT held that, notwithstanding the existence of a VAT group, HLT and HLTB retained their individual identities, and economic activity was still taking place (constituted by the supplies of management services by HLT to HLTB) in fact, albeit the effect of s 43 was to treat that economic activity as being carried on by HLT (see paragraph [56]). The FtT concluded:

> "57. HLT's argument is that the supplies are to be disregarded and so the economic activity is to be disregarded. However, this would overlook the fact that the group members are still to be treated as having a separate existence with transactions taking place. Given that it is the transactions which constitute economic activity, the economic activity (as opposed to the VAT supplies the economic activity gives rise to) is not to be ignored."

116. I agree with the FtT on this point. The facts are that HLT supplied management services to HLTB. It is that activity, that position in fact, which means that HLT was engaged in economic activity in the form of managing its subsidiary. That brings the share sale within economic activity, as an exempt supply.

117. Section 43 does not allow the facts to be overlooked. The statutory fiction created by s 43 does not extend as far as Mr Firth submits and his argument must fail.

118. In light of that conclusion, it is not strictly necessary to address Ms McArdle's further point raised in her grounds of appeal, but I do so in the alternative and in case I am wrong in the view just expressed. Mr Firth did not raise any objection to this late argument (not advanced before either tribunal below), which is in any event an argument of pure law and one which Ms McArdle should be able to raise now, even if late, especially as it responds to HLT's arguments on the VAT Grouping Issue.

119. Ms McArdle argued that by operation of s 43, HLT as the representative member of the VAT Group was carrying on the hotel business of HLTB, so that on any view, and regardless of the status of management services supplied by HLT to HLTB, HLT was engaged in economic activity. Mr Firth says this argument is wrong, because for a disposal of shares to come within the scope of VAT, the way those shares are held must itself constitute economic activity and it is not sufficient that the holder of the shares might in some other capacity be engaged in economic activity, relying in particular on *Harnas & Helm* at [16] (cited at [104] above); see also *Magyar* at [33].

120. This argument only arises if, contrary to the view I have just expressed, s 43 means that the management services provided by HLT to HLTB are to be disregarded so that they do not amount to economic activity as between HLT and HLTB. If the statutory fiction did extend that far, then it would surely follow, by parity of reasoning, that HLT *was* making supplies of taxable hotel services as representative member of the VAT Group. Mr Firth cannot take the benefit of s 43(1)(a) (to disregard the intra-group management services for present purposes) without also taking the burden of s 43(1)(b) (that HLT is treated as making supplies of taxable hotel services). In that hypothetical event, the disposal of the shares would not be part of a merely passive holding activity which is non-economic in character; rather, the disposal would be seen as closely linked to HLT's active management of and engagement in the hotel business itself. By reference to the categories specified in *Harnas & Helm* at paragraph [16], HLT would be selling the shares as part of its direct involvement in the management of HLTB, alternatively, as part of the direct, permanent and necessary extension of its taxable activity as representative member of the VAT group.

Disposal on Issue 2

121. I am not persuaded by the argument in the Respondent's Notice. HMRC's counter-arguments of substance are correct. The share sale was conducted as part of HLT's economic activity and was an exempt supply for VAT purposes.

Conclusion

122. I would allow this appeal. In my judgment, the Services were used in (or, to use an alternative phrase, had a direct and immediate link with) the exempt supply of shares.

Lady Justice Elisabeth Laing

123. I agree.

Lord Justice Nugee

124. I also agree.