[2013] UKUT 0250 (TCC)
Appeal number FTC/45/2012

VAT –grant of lease of commercial premises with provision of cold water - whether single supply of leasing of immovable property or independent supplies of property and water - single supply of immovable property - appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

THE HONOURABLE SOCIETY OF MIDDLE TEMPLE

Respondent

Tribunal: Judge Greg Sinfield
Judge Jill C Gort

Sitting in public in London on 21 March 2013

Raymond Hill, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Richard Bramwell QC and Michael Collins, counsel, instructed by Crowe Clark Whitehill LLP, for the Respondent

DECISION

Introduction

1. The Appellants ("HMRC") appeal against the decision of the First-tier Tribunal ("the FTT") released on 10 June 2011, [2011] UKFTT 390 (TC). The Respondent ("the Middle Temple") had appealed against HMRC's decision that the grant by the Middle Temple of a lease of land, subject to an option to tax, together with the provision of cold water, for which a separate charge was made, is a single supply chargeable to VAT at the standard rate. The Middle Temple, relying on the judgment of the Court of Justice of the European Union ("the CJEU") in Case C-572/07 *RLRE Tellmer Property sro v Financni reditelstvi v Usti nad Labem* [2009] ECR I-4983, [2009] STC 2006 ("*Tellmer*"), contended that it made two separate supplies to its tenants: namely, a standard rated supply of the letting of land and a zero-rated supply of cold water. The FTT allowed the Middle Temple's appeal holding that the grant of a lease of land and the provision of a supply of cold water are separate supplies.

2. The FTT granted HMRC permission to appeal to the Upper Tribunal on the ground that the FTT erred in law. The FTT then stayed the appeal until the CJEU had given judgment in two references from the UK, namely Case C-117/11 *Purple Parking and Airparks Services v HMRC* ("*Purple Parking*") and Case C-392/11 *Field Fisher Waterhouse LLP v HMRC* ("*Field Fisher Waterhouse*"). The CJEU gave judgment in *Purple Parking* on 19 January 2012 which is reported at [2012] STC 1680. The CJEU gave judgment in *Field Fisher Waterhouse* on 27 September 2012 and that is reported at [2013] STC 136.

3. The CJEU case law on the subject of whether a transaction should be regarded as a single composite supply or several independent supplies continued to develop. On 17 January 2013, the CJEU issued a further judgment concerning whether a transaction is a single service or two distinct services, namely Case C-224/11 *BGŻ Leasing sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie* ("*BGZ*").

4. In the light of the recent jurisprudence of the CJEU and for the reasons given below, we consider that the FTT's decision in this case cannot stand and we allow HMRC's appeal.

Facts

5. There was no dispute about the facts. The parties had agreed a statement of facts which is set out at [6] and [7] of the FTT's decision. For the purposes of this decision, the facts may be summarised as follows.

6. The Middle Temple is one of the four Inns of Court, associations whose members are barristers in England and Wales or studying to become barristers. The Middle Temple holds land and buildings ("the Inn") in the western part of the Temple in London between Strand and the River Thames under a Royal Charter dating from 1608. The Middle Temple lets most of its buildings. The appeal before the FTT was concerned with premises let to barristers as chambers and to some others for business

use. The Middle Temple has opted to tax its land under paragraph 2 of Schedule 10 to the VAT Act 1994. The effect of the option to tax is that the grants of leases in relation to the premises in the Inn by the Middle Temple are supplies chargeable to VAT at the standard rate.

7. For historical reasons, the Middle Temple owns a network of underground pipes through which cold water is supplied to the chambers in the Inn. Cold water is supplied to this network by Thames Water. The supply of water to the network is metered and Thames Water charges the Middle Temple for it. The Middle Temple supplies cold water to its tenants. The cold water supplied by the Middle Temple to each set of chambers or other premises in the Inn is not metered. The Middle Temple provides each tenant with a quarterly invoice which separately itemises rent for the premises and the charge for cold water. The amount of the charge for cold water is calculated by reference to the area occupied. The supply of cold water is zero-rated under item 2 of group 2 of Schedule 8 to the VAT Act 1994. The Middle Temple did not account for VAT on the amount charged for cold water.

8. At [6(4)], the FTT recorded that one of the facts agreed by the parties was that the tenants in the Inn had no practical alternative to taking their supply of cold water from the Middle Temple. The FTT also found, at [47], that the cold water was supplied by the Middle Temple because there was no practical choice of a supply from anyone other than the landlord. At [53], however, the FTT stated that it was possible for the tenants of the Middle Temple to have agreed, at the time of taking their leases, to have separate meters for their water supplies and, in that sense, the water would have been provided by a third party and invoiced by that third party once the meters had been read. Before us both parties accepted that the FTT's statement at [53] was not correct and the tenants had no possibility of having water provided under a separately metered system with separate pricing and invoicing.

Issue

9. The only issue before the FTT was whether the Middle Temple made a single composite supply of the leasing of immovable property, which incorporated the provision of cold water, or two independent supplies of property and water.

FTT's decision

10. Having set out the facts and the parties' submissions, the FTT discussed the relevant case law of the CJEU and addressed the issue before it. The FTT concluded, at [58] of the decision, that "the grant of a lease of land and the provision of a supply of cold water should be treated as two separate supplies and not a single supply". The FTT allowed Middle Temple's appeal.

11. The FTT's reasoning for reaching its conclusion was set out at [47] - [55] of the decision.

12. At [47], the FTT held that the supply of accommodation and cold water under the same contract was by reason of historical antecedents. The FTT concluded that

the supply of both elements together conferred no economic advantage on the tenants. The latter point was an acceptance of the Middle Temple's submission that, in each case where the courts had held that supplies could not be split without artificiality, there is an economic advantage, from the consumer's perspective, in obtaining two or more elements as a single supply.

13. In [48], the FTT found that there was nothing artificial about having a separate supply of accommodation and a separate supply of water and that a supply of water would not normally be made under a lease.

14. In [49], the FTT noted that the pipes had been installed in the Inn some hundreds of years ago and that the supply arrangements had arisen from a historical position. The FTT found that there was no inherent economic value in the provision of the pipes through which water flowed from Thames Water and to suggest otherwise would be contrary to the principle of fiscal neutrality.

15. At [50], the FTT noted that it was concerned to look only at the position of economic divisibility "objectively from the perspective of the typical customer rather than the supplier". The FTT went on to do so in [51]. The FTT found that the tenants of the Middle Temple had no interest in who supplied their water. The FTT further found that the supply of water was an aim in itself for the tenants because water is required for human life. The FTT also held that the CJEU treated separate elements as a single composite supply where the single supply has a greater economic value than the elements supplied separately. The FTT found that there was simply a recharging of the cost of the water by the Middle Temple. Mr Richard Bramwell QC, who appeared with Mr Michael Collins for the Middle Temple, submitted that [51] is the core of the FTT's reasoning.

16. At [52], the FTT found that the packaging of the water and the premises in a single contract did not result in either service losing its identity. The FTT also found that the lease did not have practical utility without the supply of water and that would also be true of any commercial lease.

17. In [53], the FTT referred to the possibility of the tenants agreeing, at the time of taking their leases, to have separate meters for their water supplies but, as stated at [8] above, this was never an option for the Middle Temple's tenants.

18. We do not accept that [51] is the core of the FTT's reasoning. It seems to us that the FTT's conclusion, based in part on fiscal neutrality, is contained in [54] and [55] which are as follows:

> "54. The fact that two supplies are provided under one contract is not conclusive of a composite supply being made. It is important to consider all factors objectively. In particular, whether the combining of the supplies into one would breach the principle of fiscal neutrality. A supply may be capable of being supplied outside the contract, separately priced and invoiced and its absence from the contract may not significantly impact on the packaged contractual price being supplied. Such a supply would clearly be a stand alone supply.

> 55. Finally, there is a sui generis category, of a supply being made, which due to a historical accident means the supply has to be made or packaged in a certain way. Such a situation is different to where supplies are commercially required to be combined and this, on its own, should not cause a non-taxable supply to become taxable."

19. There is no reference to fiscal neutrality, however, in the FTT's conclusions at [56] and [57]. The FTT set out its conclusions which may be summarised as follows:

(1) The letting of property and the supply of water are treated differently in the UK VAT legislation.

(2) Objectively, the supply of water can be made by a third party, Thames Water, under a separately metered system which can be separately priced and separately invoiced.

(3) The nature of the supply is not changed by the Middle Temple recharging for the supply of water.

(4) The inclusion of the supply of water in the package provided to the tenants is an accident of history due to the fact that the pipes connected to the mains of Thames Water through which the water flows to the tenants were laid several hundred years ago.

(5) The water flowing through the pipes of the Middle Temple to the tenants provides no economic benefit in doing so other than that which would be provided to tenants of premises outside of the Inn who obtain cold water directly from Thames Water.

Summary of the parties' submissions

20. Mr Raymond Hill, who appeared for HMRC, submitted that the FTT erred in law when it considered that fiscal neutrality required that the provision of accommodation and water be treated as separate supplies because the tenants could have obtained a lease and cold water from separate suppliers had they entered into a lease outside of the Inn. The possibility of obtaining the relevant elements separately is inherent in the concept of a single composite supply. The treatment of several services as a single composite supply for the purposes of VAT necessarily leads to tax treatment different from the treatment that those services would have received if supplied separately. Therefore, the principle of fiscal neutrality does not require that the supply of cold water as part of a lease of premises inside the Inn be given the same VAT treatment as the supply of cold water independently of a lease outside the Inn.

21. Mr Hill submitted that obtaining a supply of cold water from the Middle Temple was a means of better enjoying the lease of the premises. The cold water was not an aim in itself for the tenants because a supply of cold water was of no use without a lease of the premises concerned. He submitted that this was the approach taken by the CJEU in *Field Fisher Waterhouse* in which the Court gave a firm indication that a lease of office premises under which the landlord also agreed to supply other associated services, including cold water, was a single supply.

22. Mr Hill also submitted that the two elements of letting of property and provision of water form a single indivisible economic supply. The economic purpose of the lease is to provide the tenants with functioning premises, which require a supply of cold water. Both supplies are so closely linked that in isolation, from the perspective of the average consumer, they did not have the necessary practical benefit for customers.

23. Mr Hill contended that it was irrelevant that the two elements of the lease and the cold water were packaged together as a matter of historical accident. He also submitted that it was irrelevant whether the lease and the cold water together provided "greater economic value" to the tenant than the two elements provided separately.

24. Mr Bramwell submitted that the FTT reached a conclusion that was open to it on the facts and made no error of law. He contended that the FTT's conclusion was supported by the subsequent decision of the CJEU in *BGZ*. The FTT was plainly right to hold that there was no difference between a supply of water to a tenant in the Inn and supplies of water to tenants of other premises and nothing required the VAT treatment of the supply by the Middle Temple to be standard rated rather than zero rated. The question for the FTT (and us) was whether the supply in question fairly falls within the zero rating provisions of the VAT Act 1994. The starting point is to consider the zero rating provision itself and to identify the type of case to which it is intended to apply, namely the supply of water to occupiers of premises.

25. Mr Bramwell pointed out that, in the cases where the CJEU had found that there was a single composite supply of different services, it is common to find that a compendious expression describes the collective services, such as weight loss programme; customising software; airport parking. He contended that in this case, however, the transaction can only be described as a supply of premises and a supply of water to the premises. A supply of hotel accommodation is an example of a transaction which it would be artificial to split into supplies of accommodation and water. A hotel guest expects the room rate to cover the supply of the room and the hot and cold water. From an economic or business point of view, the supply can only be categorised as a single supply of "hotel accommodation" and the zero rating in group 2 of Schedule 8 to the VAT Act 1994 is not engaged.

26. Mr Bramwell contrasted the supply of hotel accommodation with the transaction between the Middle Temple and the tenants. The Middle Temple made separate charges for the supply of premises and the supply of cold water. The tenants in the Inn who pay the water charge are in exactly the same position economically as tenants outside the Inn who take water directly from Thames Water. Mr Bramwell submitted that the fact that water is charged for separately by the Middle Temple, although not determinative, is material as tending show that the parties regarded the supplies as separate.

27. Mr Bramwell contended that counterpart to the principle against artificially splitting what, to the consumer, is a single supply is that supplies which are separate supplies from the point of view of the consumer must not be artificially combined as a single supply. Applying that principle, it would be artificial to treat the supplies of

water and premises as a single supply and would distort the system of VAT as tenants within the Inn would be liable to pay VAT at the standard rate on their supplies of water whereas tenants outside the Inn would not.

Case law of the CJEU

28. As is now well-established, the CJEU recognises two distinct types of single composite supply, namely:

> (1) where one or more supplies constitute a principal supply and the other supply or supplies constitute one or more ancillary supplies which do not constitute for customers an end in themselves but a means of better enjoying the principal service supplied (see Case C-349/96 *Card Protection Plan Limited v HM Customs and Excise* [1999] STC 270 ("*CPP*") at [30]); and
>
> (2) where two or more elements or acts supplied by the taxable person are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split (see Case C-41/04 *Levob Verzekeringen and OV Bank v Staatssecretaris van Financien* [2006] STC 766 ("*Levob*") at [22]).

29. It is worth examining the CJEU's approach in *Levob* in more detail, as the FTT did at [28] of the decision. The CJEU set out the approach at [19] – [22] of the judgment as follows.

> "19. According to the Court's case law, where a transaction comprises a bundle of features and acts, regard must be had to all the circumstances in which the transaction in question takes place in order to determine, firstly, if there were two or more distinct supplies or one single supply and, secondly, whether, in the latter case, that single supply is to be regarded as a supply of services (see, to that effect, *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* (Case C-231/94) [1996] STC 774, [1996] ECR I-2395, paras 12 to 14, and *Card Protection Plan* [1999] STC 270, [1999] 2 AC 601, paras 28 and 29).
>
> 20. Taking into account, firstly, that it follows from art 2(1) of the Sixth Directive that every transaction must normally be regarded as distinct and independent and, secondly, that a transaction which comprises a single supply from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must in the first place be ascertained in order to determine whether the taxable person is making to the customer, being a typical consumer, several distinct principal supplies or a single supply (see, by analogy, *Card Protection Plan* [1999] STC 270, [1999] 2 AC 601, para 29).
>
> 21. In that regard, the Court has held that there is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal supply, whilst one or more elements are to be regarded, by contrast, as ancillary supplies which share the tax treatment of the principal supply (*Card Protection Plan* [1999] STC 270, [1999] 2 AC 601, para 30, and *Customs and Excise v Primback Ltd* (Case C-34/99) [2001] STC 803, [2001] 1 WLR 1693, para 45).

> 22. The same is true where two or more elements or acts supplied by the taxable person to the customer, being a typical consumer, are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split."

30. In summary, the CJEU in *Levob* recognised two types of single supply: the principal/ancillary supply and the indivisible/artificial to split supply. The latter type of single supply was described as consisting of two or more elements or acts "so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split".

31. What is a single economic supply that would be artificial to split? The CJEU gave some guidance on this point in its judgement in Case C-44/11 *Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG* [2012] STC 1951. That case concerned whether portfolio management services consisting of a number of elements, including deciding what to buy and sell as well as implementing those decisions by buying and selling securities, should be regarded as a single supply. The CJEU held at [23] - [28]:

> "23. Having regard, in accordance with the case-law referred to in paragraph 18 of this judgment, to all the circumstances in which that portfolio management service takes place, it is apparent that the service basically consists of a combination of a service of analysing and monitoring the assets of client investors, on the one hand, and of a service of actually purchasing and selling securities on the other.
>
> 24. It is true that those two elements of the portfolio management service may be provided separately. A client investor may wish only for an advisory service and prefer to decide on and make the investments himself. Conversely, a client investor who prefers to take the decisions on investments in securities and, more generally, to structure and monitor his assets himself, without making purchases or sales, may call on an intermediary for the latter type of transaction.
>
> 25. However, the average client investor, in the context of a portfolio management service such as that performed by Deutsche Bank in the main proceedings, seeks precisely a combination of those two elements.
>
> 26. As the Advocate General stated at point 30 of her Opinion, to decide on the best approach to the purchase, sale or retention of securities would be pointless for investors within the context of a portfolio management service if no effect were given to that approach. Likewise, to make – or not, as the case may be – sales and purchases without expertise and without a prior analysis of the market would also be pointless.
>
> 27. In the context of the portfolio management service at issue in the main proceedings, those two elements are therefore not only inseparable, but must also be placed on the same footing. They are both indispensable in carrying out the service as a whole, with the result that it is not possible to take the view that one must be regarded as the principal service and the other as the ancillary service.

> 28. Consequently, those elements must be considered to be so closely linked that they form, objectively, a single economic supply, which it would be artificial to split."

32. It seems to us that the CJEU in *Deutsche Bank* is saying that, in order for different elements to form a single economic supply which it would be artificial to split, they must, from the point of view of the typical consumer, be equally inseparable and indispensable.

33. In the FTT, the Middle Temple referred to the CJEU's judgment in *Tellmer*. Tellmer is a Czech company that owns and lets residential apartments. Tellmer let residential flats to tenants in return for rent. The letting of residential flats is an exempt supply for VAT purposes. Tellmer also separately charged and invoiced the tenants for the cleaning of the common parts of the building which was carried out by the caretaker employed by Tellmer. Tellmer did not charge VAT in relation to the cleaning services. The Czech tax authorities assessed Tellmer for VAT on the cleaning activities which they regarded as a separate supply from the letting of the flats. Tellmer argued that the cleaning was not a separate supply chargeable to VAT because the letting and cleaning should be regarded as a single exempt supply of letting. The Czech Court asked the CJEU two questions, the first of which was

> "Can the provisions of art 6 … and art 13 … of the Sixth Directive be interpreted as meaning that the letting of an apartment (and possibly of non-residential premises) on the one hand and the related cleaning of the common parts on the other hand can be regarded as independent, mutually divisible taxable transactions?"

34. The CJEU referred to its decision in Case C-425/06 *Ministero dell'Economia e delle Finanze v Part Service Srl* [2008] ECR I-897 at [50] - [53] and the case-law cited therein, namely *CPP* and *Levob*. The CJEU observed that cleaning can be supplied by a third party invoicing the tenants direct or by the landlord providing cleaning services using its own staff or a third party contractor. The CJEU noted that Tellmer invoiced the tenants for the cleaning services separately from the rent. At [24], the CJEU said that:

> "… since the letting of apartments and the cleaning of the common parts of an apartment block can, in circumstances such as those at issue in the main proceedings, be separated from each other, such letting and such cleaning cannot be regarded as constituting a single transaction within the meaning of the case-law of the Court."

35. We understand this statement to refer to the indivisible/artificial to split supply first discussed in *Levob*. The CJEU in *Tellmer* was simply saying that the letting and cleaning in that case are not indivisible and it would not be artificial to split them. That seems clear on the facts of *Tellmer* as, adopting the same approach as the CJEU in the later case of *Deutsche Bank*, the letting and cleaning are not equally indispensable and inseparable from the point of view of the typical tenant in that case.

36. The CJEU in *Tellmer* concluded that the letting of immovable property and the cleaning of the common parts of that property must, in the circumstances of that case, be regarded as independent, mutually divisible operations so that the cleaning cannot

be regarded as an exempt supply of letting. That was sufficient to answer the question which the CJEU had been asked, namely can the Sixth Directive be interpreted as meaning that the letting of an apartment and the related cleaning of the common parts be regarded as independent, mutually divisible taxable transactions? The CJEU was not asked to (and did not) determine that the letting and the cleaning services were separate supplies. Having made a reference at [18] to the *CPP* principal/ancillary test, the CJEU in *Tellmer* does not refer to it again. In our view, the CJEU's judgment in *Tellmer* left open the possibility that the provision of formally distinct services such as the letting of premises together with supplies of related cleaning services could, in some circumstances, be a single transaction when they are not independent, for example when one is ancillary to the other.

37. In *Purple Parking*, the CJEU was asked to give guidance on whether a transaction is a single supply or several independent supplies in the context of "off-airport" car parking. The issue was whether the mini-bus shuttle service to the airport terminals was a separate zero-rated transport service or formed an ancillary part of a single standard rated supply with the car parking service. The CJEU at [31] held that "the fact that, in other circumstances, the elements in issue can be or are supplied separately is of no importance, given that the possibility is inherent in the concept of a single economic transaction".

38. In relation to fiscal neutrality, the CJEU in *Purple Parking* held at [38] – [40] that

> "38. As regards the principle of fiscal neutrality inherent in the common system of VAT, which in particular precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes, so that those goods or supplies must be subject to a uniform rate (see, in particular, Case C-481/98 *Commission v France* [2001] ECR I-3369, paragraph 22; Case C-267/99 *Adam* [2001] ECR I-7467, paragraph 36; judgment of 3 March 2011 in Case C-41/09 *Commission v Netherlands*, not yet published in the ECR, paragraph 66; and judgment of 10 November 2011 in Joined Cases C-259/10 and C-260/10 *The Rank Group*, not yet published in the ECR, paragraph 32 and the case-law cited), it must be recalled that the determination as to whether two supplies which are taxed differently are similar is for the national court to make in the light of the circumstances of the case, and in particular from the point of view of the average consumer (see *The Rank Group*, paragraphs 43, 44 and 56 and the case-law cited).
>
> 39. In that context, it should be taken into consideration that it follows from the case-law cited in paragraphs 26 to 30 of the present order that the treatment of several services as a single supply for the purposes of VAT necessarily leads to tax treatment different from that that those services would have received if they had been supplied separately (see to that effect, in particular, *CPP*, paragraph 27; *Levob Verzekeringen and OV Bank*, paragraph 18; *Part Service*, paragraph 49; and *Everything Everywhere*, paragraph 19). Accordingly, a complex supply of services consisting of several elements is not automatically similar to the supply of those elements separately.

> 40. Furthermore, as regards the importance of the judgment in Case C-94/09 *Commission v France*, referred to in the second question, it follows from paragraphs 25 to 29 and 31 to 34 of that judgment that it concerns the possibility for a Member State to apply, in a selective manner, on the basis of general and objective criteria, a reduced rate of VAT to certain aspects of a category of supplies that is listed in the Sixth Directive and, accordingly, concerns a different question from that raised by the first and second questions referred for a preliminary ruling. Indeed, the sole purpose of the latter is whether two services constitute, in the light of the specific circumstances of their supply at issue in the main proceedings, a single supply."

39. It is clear from the paragraphs set out above that the principle of fiscal neutrality is concerned with ensuring that supplies of similar goods and services, which are thus in competition with each other, are treated the same way for VAT purposes. The CJEU clearly states, at [39] of *Purple Parking*, that "the treatment of several services as a single supply for the purposes of VAT necessarily leads to tax treatment different from that that those services would have received if they had been supplied separately … Accordingly, a complex supply of services consisting of several elements is not automatically similar to the supply of those elements separately". This passage shows that the principle of fiscal neutrality is not a factor to be taken into account in determining whether a transaction consisting of more than one element should be regarded as a single supply or as several independent supplies. Further, [40] indicates that the fact that the UK zero rates the supply of cold water is not relevant to the question whether the different elements provided by the Middle Temple are a single supply of services or several supplies.

40. At [33] and [34] of the decision, the FTT refers to passages from the opinion of the Advocate General (Trstenjak) in *Tellmer* to decide that fiscal neutrality requires that all economic activity must be taxed in the same way. The FTT in [37] appears to adopt a submission of Mr Bramwell that treating the provision of cold water as part of the supply of the premises, and thus chargeable to VAT at the standard rate, when tenants outside the Middle Temple would obtain water directly with no charge to VAT would be (emphasis supplied):

> "an infringement of the principle of fiscal neutrality since it would treat similar *businesses* differently for tax purposes".

In our view, this is a misapplication of the principle of fiscal neutrality. As can be seen from Joined Cases C-259/10 and C-260/10 *HMRC v The Rank Group plc* [2012] STC 23 and the passage quoted above from *Purple Parking*, the principle of fiscal neutrality precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes. The principle does not require supplies of services to similar businesses to be treated the same way for VAT purposes. The fact that the recipients of a supply carry on similar businesses is irrelevant when considering whether the principle of fiscal neutrality is engaged. The only consideration is whether the goods or services are similar.

41. In any event and notwithstanding the references to the principle by the Advocate General, the CJEU in *Tellmer* did not refer to the principle of fiscal

neutrality in its judgment. Further, the principle of fiscal neutrality is not mentioned by the CJEU in *CPP*, *Levob* or *Field Fisher Waterhouse*. Finally, the CJEU's discussion of fiscal neutrality in *Purple Parking* shows that it is not relevant in determining whether a transaction is a single supply or several independent supplies.

42. The CJEU referred to the principle of fiscal neutrality in *BGZ* but only in the context of whether the insurance provided by the lessor in that case should be treated as exempt in the same way as a supply of insurance by an insurance company. The CJEU in *BGZ* made no reference to the principle of fiscal neutrality in relation to the question of whether the equipment lease and the insurance should be regarded as a single supply or as several independent supplies.

43. We consider that the FTT in this case erred in holding that the provision of cold water should be taxed in the same way whether it is supplied to a tenant in the Inn by the Middle Temple or to a tenant of premises outside the Inn by a water company.

44. The CJEU in *Field Fisher Waterhouse* considered a lease of offices which required the tenant to pay three separate amounts, namely an amount in relation to the occupation of the premises, a proportion of the cost of insuring the building and, thirdly, an amount for services provided by the landlord under the lease. The services provided by the landlord included, among other things, the supply of water as well as heating, repair and maintenance, cleaning of the common parts and security. The lease provided that if the tenant fails to pay those three rents the landlord can terminate the lease. The landlord had not opted to tax the building and had not charged VAT on any of the amounts payable by the tenant under the lease.

45. Unlike in *Tellmer*, the CJEU in *Field Fisher Waterhouse* was asked whether, in the circumstances of the case, the leasing of immovable property and the supplies of services linked to that leasing must be regarded as constituting a single supply, entirely exempt from VAT, or several independent supplies, assessed separately to VAT.

46. The CJEU in *Field Fisher Waterhouse* adopted the same approach as it had in *Levob* (see [19] - [22] quoted above). The CJEU then stated at [19] that:

> "None the less, there is no absolute rule for determining the extent of a supply from the point of view of VAT, and consequently, to determine the extent of a supply, all the circumstances must be taken into consideration."

Although it might appear a statement of the obvious, the CJEU had never previously acknowledged that there is no absolute rule for determining whether two or more elements or acts are a single composite supply subject to the same VAT liability or are several independent supplies which must be treated separately for VAT purposes. There are some indicators that may point in one direction or another but they are not individually conclusive. These indicators must be evaluated once all the circumstances of the case have been taken into consideration. The CJEU's statement in [19] of *Field Fisher Waterhouse* clearly shows that the assessment of whether

transactions are a single composite supply or several independent supplies is highly fact sensitive.

47. The CJEU in *Field Fisher Waterhouse* stated, at [20], that it is for the national court to decide whether there is a single supply in a particular case. The CJEU did not decide that the transactions were or were not a single supply but provided guidance to enable the national court to determine the case. In its answer to the national court, the CJEU confirmed at [21] that the leasing of immovable property and supplies of services linked to that leasing can constitute a single supply. The CJEU stated that the fact that the lease includes the provision of the services and gives the landlord the right to terminate it if the tenant fails to pay the service charges supported the view that there is a single supply, although neither point is decisive. In particular, the inclusion of supplies that have only an artificial link to the principal supply could not be regarded as part of a single composite supply. The CJEU also stated that the fact that services, such as those at issue in *Field Fisher Waterhouse*, could, in principle, be supplied by a third party does not mean that they cannot constitute a single supply.

48. Having stated that it is for the national court to determine whether there is a single supply, the CJEU in *Field Fisher Waterhouse* provided some further guidance intended to help the national court to decide the case. At [23], the CJEU looked at the economic reason for concluding the lease, ie what the tenant would obtain, and observed that:

> "… the content of a lease may be a factor of importance in assessing whether there is a single supply. In the main proceedings, it appears that the economic reason for concluding the lease is not only to obtain the right to occupy the premises concerned, but also for the tenant to obtain a number of services. The lease accordingly designates a single supply agreed between the landlord and the tenant. Moreover, it should be observed that the leasing of immovable property and the supply of associated services … may objectively constitute such a supply. Obtaining the services concerned cannot be regarded as constituting an end in itself for an average tenant of premises such as those at issue in the main proceedings, but constitutes rather a means of better enjoying the principal supply, namely the leasing of commercial premises."

49. At [24], the CJEU observed that supplies of services, such as those in *Field Fisher Waterhouse*, did not necessarily fall within the concept of leasing or letting of immovable property (it had already said the same thing in *Tellmer* at [21]) but then said:

> "However, that does not mean that those supplies of services, which are linked to the leasing of immovable property and are supplied in accordance with the provisions of a lease, cannot constitute ancillary supplies or be indivisible from that leasing."

This passage clearly shows that *Tellmer* is not authority for the proposition that the letting of immovable property and the cleaning of the common parts of that property cannot be regarded as a single composite supply.

50. The CJEU in *Field Fisher Waterhouse* gave further guidance in [25] and [26]:

> "25. … even though in the circumstances of the main proceedings the inclusion of services in the lease in question supports the view that there is a single supply, it must be noted that the mere fact that a supply is included in a lease cannot in itself constitute the decisive element to that effect. Thus if a lease were to provide for the inclusion of supplies which by their nature could not objectively be regarded as indivisible from or ancillary to the principal supply of the leasing of immovable property, but were independent of it, such supplies having only an artificial link to the principal supply, those supplies would not form part of a single supply of the leasing of immovable property, exempt from VAT. In the dispute in the main proceedings … the obtaining of the services in question does not, however, appear to constitute an end in itself for the tenant.
>
> 26. As to the relevance of the fact that a third party could in principle supply certain services, it must be observed that the existence of such a possibility is not decisive in itself either. As may be seen from the Court's case-law, the possibility that elements of a single supply may, in other circumstances, be supplied separately is inherent in the concept of a single composite transaction …"

51. In the light of *Field Fisher Waterhouse*, we consider that in determining whether the Middle Temple makes a single composite supply (regardless of whether it is an "indivisible/artificial to split" or a "principal/ancillary" single supply), it is necessary to have regard to the economic reason or purpose of the whole transaction from the point of view of the typical customer. This approach appears to us to be essentially the same as that taken by Warren J in *Byrom* at [70] where he referred, reflecting the language of Lord Hoffmann in *Dr Beynon and Partners v HMC&E* [2005] STC 53 at [31], to the "description which reflects the economic and social reality" of a single supply and considers it from the point of view of the recipient of the services.

52. The *BGZ* case concerned the leasing of goods (not being immovable property) by BGZ. The lessee was liable for any loss or damage to the leased goods, other than normal wear and tear. BGZ required the leased goods to be insured at the cost of the lessee. BGZ offered to provide the insurance but the lessee also had the option of insuring the leased goods with an insurance company of its choice. If the lessee accepted BGZ's offer of insurance then BGZ would take out insurance with an insurer and re-invoice the cost of that insurance to the lessee. BGZ took the view that the cost of the insurance for the leased goods was exempt from VAT. The Polish tax authority disagreed and the matter was ultimately referred to the CJEU. The CJEU was asked two questions, the first of which was whether the supply of leasing services and of insurance for the leased item are, for VAT purposes, a single supply to which a single rate of VAT must be applied, or whether they are independent transactions which must, therefore, be assessed separately for VAT.

53. As it often does, the CJEU answered the first question by providing general guidance as to the approach to be taken while leaving it to the national court to decide whether there is a single composite supply or several independent services in the

particular case. In *BGZ*, it seems to us that the CJEU provided more specific guidance than it had done previously. The CJEU began in familiar vein by referring to the circumstances, first established in *Levob* and *CPP*, in which formally distinct services constitute a single supply of services. The CJEU repeated the observation, first made in *Field Fisher Waterhouse*, that there is no absolute rule for determining whether something is a single supply or several independent supplies. The CJEU then, from [34] – [50], sought "to provide the national courts with all the guidance as to the interpretation of European Union law which may be of assistance in adjudicating on the case pending before them".

54. The CJEU acknowledged that the leasing of the goods and the supply of insurance of the leased goods by the lessor are linked because the insurance is only of any use with respect to the leased goods. The CJEU observed that insurance is by its nature linked to the item insured but that connection is not sufficient in itself to determine whether or not there is a single supply. The CJEU stated at [36]:

> "If any insurance transaction were subject to VAT because the services relating to the item it covers were subject to VAT, the very aim of Article 135(1)(a) of the VAT Directive, that is the exemption of insurance transactions, would be called into question."

55. The CJEU then observed, at [38], that leasing transactions are generally subject to VAT and insurance services are normally exempt from VAT. This observation led the CJEU to conclude, at [39], that, applying the general rule that each supply must normally be regarded as separate and independent,

> "… as a general rule, a leasing service and the supply of insurance for the leased item cannot be regarded as being so closely linked that they form a single transaction. The fact of assessing such supplies separately cannot constitute in itself an artificial splitting of a single financial transaction, capable of distorting the functioning of the VAT system."

56. The CJEU then followed that statement of the general rule with an analysis of whether, in the particular circumstances of *BGZ*, there was a single supply. The CJEU began by considering the *CPP* principal/ancillary test at [41] - [47]. The CJEU held, at [42], that:

> "In that connection, although it is true that as a result of the insurance for the leased item, the risks faced by the lessee are normally reduced as compared with those incurred in a situation in which such insurance is lacking, it remains the case that that derives from the very nature of the insurance. That, in itself, does not mean that such insurance must be regarded as being ancillary to the leasing service of which it forms part. Although such insurance supplied to the lessee through the lessor facilitates the enjoyment of the leasing service, in the manner described above, it must be held that constitutes essentially an end in itself for the lessee and not only the means to enjoy that service under the best conditions."

57. At [43], the CJEU referred to the fact that the lessee does not have to take the insurance offered by BGZ but can insure with the insurance company of its choice. The CJEU stated that this showed that the requirement that the goods are insured does not, in itself, mean that a supply of insurance by the lessor is indivisible or ancillary to the supply of the leasing services. We consider that this indicates that the ability of the customer to choose whether or not to be supplied with a particular element of a transaction is an important factor in determining whether there is a single composite supply or several independent supplies, although it is not decisive. At [44], the CJEU stated that separate invoicing and pricing of services supported the view that the services are independent, without being decisive. The CJEU then referred, at [45], to the separate pricing and invoicing reflecting the interests of the parties in *BGZ*. The CJEU also stated that the lessee's decision to obtain insurance from the lessor was made independently of the decision to lease the goods. In our view, this shows that, while the ability to choose is an important factor in determining that there is more than one supply, it must be a genuine freedom to choose which reflects the economic reality of the arrangements between the parties.

58. The CJEU in *BGZ* rejected the idea that the leasing and insurance cannot be separate services simply because the lease provided that BGZ may terminate the lease if the lessee does not pay the re-invoiced cost of the insurance. The CJEU stated that while such a provision may indicate that there is a single supply in other circumstances, it does not do so where the transactions cannot be objectively regarded as constituting a single service.

59. Finally, at [48], the CJEU addressed the *Levob* test and held that "the insurance and leasing services at issue in the main proceedings cannot be regarded as being so closely linked that, objectively, they form a single indivisible economic supply which it would be artificial to split".

Principles derived from CJEU cases

60. The key principles for determining whether a particular transaction should be regarded as a single composite supply or as several independent supplies may be summarised as follows:

(1) Every supply must normally be regarded as distinct and independent, although a supply which comprises a single transaction from an economic point of view should not be artificially split.

(2) The essential features or characteristic elements of the transaction must be examined in order to determine whether, from the point of view of a typical consumer, the supplies constitute several distinct principal supplies or a single economic supply.

(3) There is no absolute rule and all the circumstances must be considered in every transaction.

(4) Formally distinct services, which could be supplied separately, must be considered to be a single transaction if they are not independent.

(5) There is a single supply where two or more elements are so closely linked that they form a single, indivisible economic supply which it would be artificial to split.

(6) In order for different elements to form a single economic supply which it would be artificial to split, they must, from the point of view of a typical consumer, be equally inseparable and indispensable.

(7) The fact that, in other circumstances, the different elements can be or are supplied separately by a third party is irrelevant.

(8) There is also a single supply where one or more elements are to be regarded as constituting the principal services, while one or more elements are to be regarded as ancillary services which share the tax treatment of the principal element.

(9) A service must be regarded as ancillary if it does not constitute for the customer an aim in itself, but is a means of better enjoying the principal service supplied.

(10) The ability of the customer to choose whether or not to be supplied with an element is an important factor in determining whether there is a single supply or several independent supplies, although it is not decisive, and there must be a genuine freedom to choose which reflects the economic reality of the arrangements between the parties.

(11) Separate invoicing and pricing, if it reflects the interests of the parties, support the view that the elements are independent supplies, without being decisive.

(12) A single supply consisting of several elements is not automatically similar to the supply of those elements separately and so different tax treatment does not necessarily offend the principle of fiscal neutrality.

61. It appears that the difference between *Field Fisher Waterhouse* and cases such as *Tellmer* and *BGZ* is that in *Field Fisher Waterhouse*, it is apparent from the questions asked by the referring court that, under the terms of the leases, the tenants had no choice but to receive the services from the landlords. Unlike the tenants in *Tellmer* and the customers in *BGZ*, the tenants in *Field Fisher Waterhouse* had no right or opportunity to obtain the services in question from a third party. In our view, the CJEU cases show that where there is genuine contractual freedom to obtain a service from a third party and, consequently, a separately identified charge is made for the service, this supports the existence of several independent supplies rather than a composite single supply.

Application of principles to Middle Temple

62. The FTT found that the supply of water was an aim in itself for the tenants and we would not interfere with that finding of fact by the FTT. Nevertheless, the fact that the supply of water was an aim in itself does not mean that the supply of water is not indivisible from the supply of the premises. The FTT's finding means that the supply by the Middle Temple cannot be regarded as a composite single supply under a

CPP principal/ancillary analysis but still leaves open the possibility of a *Levob* indivisible/artificial to split single supply.

63. We cannot see that the fact that the pipes that permitted the connection of the area's water system to the mains network provided by Thames Water were installed in the Inn "some hundreds of years ago" is a relevant consideration. If so then it would lead to the conclusion that a landlord with an identical arrangement to the Middle Temple but with recently installed pipes might be subject to a different VAT treatment than a landlord, such as the Middle Temple, with older pipes. In our view, the historical position must be irrelevant.

64. As stated above, we do not consider that the principle of fiscal neutrality requires the provision of cold water to be taxed in the same way whether it is supplied to a tenant in the Inn by the landlord or to a tenant of premises outside the Inn by a water company. As can be seen from the passage from *Purple Parking* quoted at [38] above, the principle is concerned with the VAT treatment of similar supplies of goods and services and does not consider whether the recipients of supplies are similar businesses. The CJEU in *Purple Parking* also shows that the principle of fiscal neutrality does not require a service to have the same VAT liability when it is supplied separately and when it is part of a single complex supply.

65. We also cannot agree with the FTT's analysis in [51] of the decision that the CJEU treated separate elements as a single composite supply where the single supply has a greater economic value than the elements supplied separately. From our review of the CJEU's cases on this subject, we can find no warrant for an economic value test. In our view, whether a single composite supply has an economic value which is greater (or less) than the value of its constituent elements is irrelevant in establishing whether there is a single supply.

66. The FTT found, at [48], that there was nothing artificial about having a separate supply of accommodation and a separate supply of water and that a supply of water would not normally be made under a lease. We agree that water is not normally supplied under a lease and the reason that there are separate supplies in such a case is, simply, that there are separate suppliers. The question is not, however, is there anything artificial about separate supplies of the different elements? If that were the case then the CJEU would have addressed it (and given a different answer) in *Field Fisher Waterhouse*. The question is whether, in all the circumstances, there is a single indivisible supply, from an economic point of view, which it would be artificial to split.

67. We apply the approach taken by the CJEU in *Levob* at [19] - [22] (as explained in *Field Fisher Waterhouse* and *BGZ* as well as many other cases). We have regard to all the circumstances in which the letting by the Middle Temple takes place. In particular, we note that there is a long established practice under which the Middle Temple acts as a supplier of cold water to its tenants. The leases provide that the charges for water incurred by the Middle Temple are paid by the tenants in proportion to the area of the leased premises (and not according to the water used by the tenant).

68. We bear in mind that, in order not to distort the functioning of the VAT system, account must be taken of the requirement that every transaction must normally be regarded as distinct and independent and a transaction which comprises a single supply from an economic point of view should not be artificially split.

69. The Middle Temple provides the right to occupy the premises in the Inn and also provides cold water to those premises. We acknowledge that the two elements supplied by the Middle Temple to the tenants may be provided separately in other circumstances. A tenant of a landlord (including the Middle Temple) outside the Inn may obtain a supply of water directly from the water company. However, the tenants of premises in the Inn have no choice but to obtain water from the Middle Temple. As both accommodation and water are essential if they are to occupy and use the premises, the tenants must be assumed to require a combination of those two elements if the premises are to fulfil their economic purpose. We consider that the leasing of the premises and the supply of the water to those premises under the lease form a single economic supply which it would be artificial to split because, from the point of view of the typical tenant, both the premises and the water are equally indispensable and inseparable. It cannot be disputed that the right to occupy the premises is an indispensable part of the supply to the tenants. The FTT accepted that water was indispensable when it found, at [51], that it was required for human life and, at [52], that the lease would not have any practical utility without the supply of water. Likewise, a supply of water would be pointless without the premises. As both premises and water are required in order for the tenants to occupy and use the premises, we consider that the two elements are not only indispensable but also inseparable. Applying the analysis of the CJEU in *Deutsche Bank*, our view is that the provision of the premises and the cold water is an indivisible supply which it would be artificial to split.

70. It was agreed before the FTT that the tenants had no practical alternative to obtaining their supplies of water from the Middle Temple. It follows that the tenants could not choose to obtain water by way of a separate supply by a third party. There is no need to consider whether the tenants had a genuine freedom to choose which reflected the economic reality of the arrangements between the parties because the tenants had no freedom of choice at all. From the perspective of the tenants, the choice was to take a lease of the premises which included the provision of water by the Middle Temple or not to take any lease at all.

71. We conclude that the two elements are, therefore, not only inseparable but also indispensable in relation to the letting and use of the premises from the point of view of a typical tenant. Consequently, it is not possible to regard one element as the principal service and the other as the ancillary service. It follows from the fact that the premises and the water are inseparable and indispensable that those elements must be considered to be so closely linked that they form, objectively, a single indivisible economic supply which it would be artificial to split. That supply is a single supply of the leasing of immovable property which is chargeable to VAT by virtue of the Middle Temple's option to tax.

Decision

72. For the reasons set out above, our decision is that the FTT erred in law when it concluded that the Middle Temple made separate supplies of the leasing of property and the supply of cold water. Accordingly, HMRC's appeal against the decision of the FTT is allowed.

73. HMRC asked for their costs in the event that the appeal was allowed. We direct that the Middle Temple shall pay HMRC's costs of the appeal. If the parties are unable to agree any issue as to costs, then we direct that, within one month of the release of this decision, they are to serve on each other and on the Upper Tribunal written submissions on any remaining issue as to costs.

Greg Sinfield

Upper Tribunal Judge

Jill C Gort

Upper Tribunal Judge

Release date: 24 May 2013