Appeal reference
UT/2015/0191

Value add tax – input tax – supplies purchased for the purposes of both generating revenue from activities outside the scope of VAT and making taxable supplies – entitlement of taxpayer to deduct – whether revenue based apportionment justified

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

VEHICLE CONTROL SERVICES LIMITED **Appellant**

- and –

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

Tribunal: The Hon Mr Justice Arnold and Judge John Walters QC

Sitting in public in London on 16 June 2016

Lord Marks QC, instructed by Freeths, for the Appellant

Alan Bates, instructed by the Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal from a decision of the First-Tier Tribunal (Tax) (Tribunal Judge Michael Connell and Peter Whitehead) dated 2 March 2015 [2015] UKFTT 443 (TC) dismissing an appeal by Vehicle Control Services Ltd ("VCS") against a decision of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") to require an apportionment of the input VAT incurred by VCS on supplies purchased for the purposes of both generating revenue from activities outside the scope of VAT and making taxable supplies.

Background

2. VCS is a car park operator, which manages and operates car parking on private land. Its clients are the owners of the car parks, which VCS operates for them under contract. The central features of the contracts are as follows:

   i) VCS provides a parking control service.

   ii) VCS provides signage at its discretion.

   iii) VCS supplies to the client (at a fee) parking permits for the client to issue to those people the client wishes to be allowed to park in its car park. Permit instruction sheets are also supplied by VCS. Permits are, on their face, issued by VCS, so that the distribution by the client is an onward issue by the client of VCS's permits.

   iv) The client undertakes to give exclusivity in managing the car park to VCS. The agreement is for a fixed one year initial term, but extends automatically.

   v) The warnings as to the enforcement action that VCS will take in the event of contraventions are entirely a matter for VCS. The action actually to be taken is also in VCS's discretion.

3. In practice, most of VCS's revenue is derived not from parking permits, but from parking charge notices ("PCNs") which it issues to motorists who are in breach of the rules for parking in the clients' car parks ("PCN revenue"). This formerly included clamping and tow-away charges which were charged to motorists prior to such charges being outlawed by the Protection of Freedoms Act 2012. In the tax year 2012/13 92% of VCS's income came from PCNs, and just 8% from parking permits.

4. On 13 March 2013 the Court of Appeal decided that the PCN revenue was not subject to VAT ([2013] EWCA Civ 186, [2013] STC 892). This was because VAT is chargeable only in respect of revenue from the supply of goods or services. The Court of Appeal held that the PCN revenue was not earned in respect of supplies of services liable to VAT. Rather, the PCN revenue represented damages for breach of contracts between VCS and the motorists and/or damages for trespass by the motorists.

5. Following the decision of the Court of Appeal, and no doubt consequent upon it, on 18 July 2013 HMRC denied VCS a VAT credit for the VAT period 04/13 in respect

of input tax reclaimed by VCS which related to the PCN revenue and issued an assessment in which HMRC applied a revenue-based apportionment of the VAT claimed. In short, HMRC decided that, since only 8% of VCS's total revenue was taxable consideration, VCS could only reclaim 8% of the input tax claimed by VCS. On 16 August 2013 VCS requested a statutory review of the decision to require an apportionment of the VAT incurred by the company. That decision was upheld on 11 November 2013, and again by the First-Tier Tribunal.

6. By the time of the hearing before this Tribunal, the scope of the dispute had narrowed slightly. VCS accepted that VAT incurred on supplies purchased exclusively for the purpose of generating PCN revenue, and hence revenue from activities outside the scope of VAT, was not recoverable. HMRC accepted that VAT incurred on supplies purchased exclusively for the purpose of generating revenue from parking permits, and hence revenue from taxable supplies, was recoverable. The issue is over supplies purchased by VCS for the purposes of making both transactions outside the scope of VAT and taxable supplies, i.e. the general overheads of the business. VCS contends that it is entitled to recover 100% of the VAT paid on such supplies, whereas HMRC contend that the VAT should be apportioned between the out of scope revenue and the consideration attributable to taxable supplies with only the VAT apportioned to the latter being recoverable.

The legal framework

European legislation

7. Article 1(2) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ("the Principal VAT Directive" or PVD) provides:

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

8. Article 2(1) PVD provides that the following transactions 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;
>
> …".

9. Article 9(1) PVD defines "taxable person" as meaning "any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity". Article 9(1) also defines "economic activity" as including "[t]he exploitation of tangible or intangible property rights for the purposes of obtaining income therefrom on a continuing basis".

10. Title X of the PVD concerns "Deductions", and Chapter 1 concerns the "Origin and scope of the right of deduction". Article 168 provides, so far as material, that:

> "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;
>
> ..."

11. Chapter 2 of Title X of the PVD concerns "Proportional deduction". Article 173 provides, so far as material:

> "1. In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.
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> The deductible proportion shall be determined, in accordance with Articles 174 and 175, for all the transactions carried out by the taxable person.
>
> 2. Member States may take the following measures:
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> …
>
> (d) authorise or require the taxable person to make the deduction in accordance with the rule laid down in the first subparagraph of paragraph 1, in respect of all goods and services used for all transactions referred to therein;
>
> (e) provide that, where the VAT which is not deductible by the taxable person is insignificant, it is to be treated as nil."

Domestic legislation

12. Section 4 of the Value Added Tax Act 1994 ("VATA") provides:

"(1) VAT shall be charged on the supply of goods or services made in the United Kingdom where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

(2) A taxable supply is a supply of goods or services made in the United Kingdom other than an exempt supply."

13. Section 24 VATA provides, so far as material:

"(1) Subject to the following provisions of this section, 'input tax', in relation to a taxable person, means the following tax, that is to say -

(a) VAT on the supply of any goods or services;

…

being (in each case) goods or services used or to be used for the purpose of any business carried on or to be carried on by him.

…

(5) Where goods or services supplied to a taxable person … are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes-

(a) VAT on supplies, acquisitions and importations shall be apportioned so that so much as is referable to the taxable person's business purpose is counted as that person's input tax, and

(b) the remainder of that VAT ('the non-business VAT') shall count as that person's input tax only to the extent (if any) provided for by regulations under subsection (6)(e).

(6) Regulations may provide:

...

(e) in cases where an apportionment is made under subsection (5), for the non-business VAT to be counted as the taxable person's input tax for the purposes of any provision made by or under section 26 in such circumstances, to such extent and subject to such conditions as may be prescribed."

14. Section 26 VATA provides, so far as material:

"(1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.

(2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—

(a) taxable supplies;

(b) supplies outside the United Kingdom which would be taxable supplies if made in the United Kingdom;

(c) such other supplies outside the United Kingdom and such exempt supplies as the Treasury may by order specify for the purposes of this subsection.

(3) The Commissioners shall make regulations for securing a fair and reasonable attribution of input tax to supplies within subsection (2) above, and any such regulations may provide for—

(a) determining a proportion by reference to which input tax for any prescribed accounting period is to be provisionally attributed to those supplies;

…"

15. Regulation 100 of the Value Added Tax Regulations 1995, SI 1995/2518 ("the Regulations") provides:

> "Nothing in this Part shall be construed as allowing a taxable person to deduct the whole or any part of VAT on the importation or acquisition of goods or the supply to him of goods or services where those goods or services are not used or to be used by him in making supplies in the course or furtherance of a business carried on by him."

16. Regulation 101 of the Regulations (as amended) provides, so far as material:

"(1) Subject to regulations 102, 103A, 105A and 106ZA, the amount of input tax which a taxable person shall be entitled to deduct provisionally shall be that amount which is attributable to taxable supplies in accordance with this regulation.

(2) Subject to paragraph (8) below and regulation 107(1)(g)(ii), in respect of each prescribed accounting period—

(a) goods imported or acquired by and goods or services supplied to, the taxable person in the period shall be identified,

(b) there shall be attributed to taxable supplies the whole of the input tax on such of those goods or services as are used or to be used by him exclusively in making taxable supplies,

(c) no part of the input tax on such of those goods or services as are used or to be used by him exclusively in making exempt supplies, or in

carrying on any activity other than the making of taxable supplies, shall be attributed to taxable supplies,

(d) where a taxable person does not have an immediately preceding longer period and subject to subparagraph (e) below, there shall be attributed to taxable supplies such proportion of the residual input tax as bears the same ratio to the total of such input tax as the value of taxable supplies made by him bears to the value of all supplies made by him in the period,

(e) the attribution required by subparagraph (d) above may be made on the basis of the extent to which the goods or services are used or to be used by him in making taxable supplies,

…"

Principles of interpretation

17. A European directive falls to be interpreted according to principles of interpretation of European legislation developed by the Court of Justice of the European Union. The basic rule of interpretation, which has been frequently reiterated by the CJEU, is that it is necessary to consider not only the wording of the provision, but also the context in which it occurs and the objectives pursued by the rules of which it is part: see e.g. Case C-156/98 *Germany v Commission* [2000] ECR I-6857 at [50] and Case C-53/05 *Commission v Portugal* [2006] ECR I-6215 at [20].

18. Domestic legislation, and in particular legislation specifically enacted or amended to implement a European directive, must be construed so far as is possible in conformity with, and to achieve the result intended by, the directive: Case C-106/89 *Marleasing SA v La Comercial Internacional de Alimentación SA* [1990] ECR I-4135 at [8]. This is a strong duty of interpretation. For a distillation of the relevant jurisprudence with regard to this duty, see *Vodafone 2 v Revenue and Customers Commissioners (No 2)* [2009] EWCA Civ 446, [2009] STC 1480 at [37]-[38].

Matters not in dispute

19. It is common ground that VCS's business encompasses the generation of revenue from both parking permits and PCNs. It is also common ground that VCS is a taxable person within Article 9(1) PVD. Counsel for VCS submitted that VCS's exploitation of its contracts with its clients constitutes economic activity within Article 9(1) PVD both in so far as such exploitation generates revenue from parking permits and in so far as such exploitation generates revenue from PCNs, but that nevertheless the PCN revenue is not subject to VAT under Article 2(1) PVD because it does not derive from the supply of any goods or services. While it may seem surprising, viewed from the perspective of European law, that the PCN revenue is not subject to VAT, this is clearly established by the decision of the Court of Appeal.

20. Furthermore, it is also common ground that there is a direct link between the general overheads of the business in respect of which VCS incurred input VAT on the one hand, and *both* VCS's taxable supplies in respect of parking permits *and* the PCN revenue on the other hand.

Analysis

21. Viewed from the perspective of European law, the appeal raises a short point of interpretation of Article 168 PVD. Article 168 provides that input VAT may be deducted "[i]n so far as goods or services are used for the taxed transactions of a taxable person". HMRC contend that "in so far as" should be interpreted as meaning "to the extent that", and hence as requiring an apportionment of input tax incurred on supplies used for both taxed transactions and non-taxed transactions. Furthermore, HMRC contend that it makes no difference whether the non-taxed transactions are not taxed because they are exempt or because they are outside the scope of VAT. VCS contends that "in so far as" should be interpreted as meaning "where", and hence as entitling the taxable person to deduct all the input tax if the goods or services are used to any extent for the purposes of taxed transactions. VCS accepts that Article 173 PVD requires an apportionment where the goods or services are used for transactions which are not taxed because they do not constitute economic activity or are exempt, but contends there is no equivalent provision for apportionment where the goods or services are used for transactions which constitute economic activity but are out of scope.

22. We consider that HMRC's interpretation of Article 168 is the correct one for the following reasons. First, as a matter of language, we consider that HMRC's interpretation of Article 168 is the natural one. Furthermore, that interpretation is supported by other language versions of the PVD, for example "*Dans la mesure où*" (French), "*Soweit*" (German), "*Nella misura in cui*" (Italian) and "*En la medida en que*" (Spanish).

23. Secondly, we consider that HMRC's interpretation of Article 168 is supported by consideration of the context and purpose of that provision. As Article 2(1) PVD states, the general principle of VAT is that it is exactly proportional to the price of the goods and services however many transactions there are before they are consumed. In order to achieve this, traders can reclaim the VAT paid or payable by them. This is sometimes expressed by saying that VAT is neutral with respect to the taxable person liable to pay the tax to HMRC. As the facts of the present case demonstrate, however, VCS's interpretation of Article 168 gives rise to a result which is far from neutral in this sense. The result of VCS's interpretation is that, excluding the small percentage of its supplies which VCS now accepts were purchased exclusively for the purpose of generating PCN revenue, it can deduct all the input tax it pays even though most of its revenue is not taxed because it is out of scope. Moreover, we can see no logic in an apportionment being required where the supplies are purchased and are directly linked to an activity involving the making by the taxable person of supplies which are exempt (and not taxed for that reason), but not where supplies are purchased and are directly linked to an activity involving the effecting by the taxable person of transactions which are outside the scope of VAT (and not taxed for that reason). Nor in the latter case do we see any logic in distinguishing between transactions which are outside the scope of VAT because the activity in question is not economic activity and transactions which are outside the scope of VAT because, although the activity in question is economic activity (or at least of a business nature), it does not amount to the making of supplies of goods or services.

24. Thirdly, we consider that HMRC's interpretation of Article 168 is supported by the jurisprudence of the CJEU. We were referred to a number of relevant decisions which

we will consider in chronological order. Some of these concerned Article 17(2) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – common system of value added tax ("the Sixth VAT Directive" or 6VD), the predecessor to Article 168 PVD, but there is no material difference in the wording.

25. In Case C-465/03 *Kretztechnik AG v Finanzamt Linz* [2005] ECR I-4357 Kretztechnik was an Austrian company which obtained a listing on a stock exchange and issued new shares for the purpose of raising capital. The company sought to deduct the VAT it had paid on the costs of services supplied to it in connection with the listing and issue of shares. Questions were referred to the Court of Justice as to whether a new share issue constituted a transaction falling within the scope of Article 2(1) 6VD, which the Court answered in the negative, and as to whether Article 17(2) 6VD conferred a right to deduct input VAT paid on supplies linked with a share issue. The Court answered the latter question as follows:

> "34. The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (see, to that effect, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 19; Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 15; *Gabalfrisa and Others*, paragraph 44; *Midland Bank*, paragraph 19, and *Abbey National*, paragraph 24).
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> 35. It is clear from the last-mentioned condition that, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction. Thus, 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 *Midland Bank*, paragraph 30, and *Abbey National*, paragraph 28, and also Case C-16/00 *Cibo Participations* [2001] ECR I-6663, paragraph 31).
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> 36. In this case, in view of the fact that, first, a share issue is an operation not falling within the scope of the Sixth Directive and, second, that operation was carried out by Kretztechnik 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 *BLP Group*, paragraph 25; *Midland Bank*, paragraph 31; *Abbey National*, paragraphs 35 and 36, and *Cibo Participations*, paragraph 33).
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> 37. It follows that, under Article 17(1) and (2) of the Sixth Directive, Kretztechnik 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 subparagraph of Article 17(5) of the Sixth Directive, deduct only that proportion of the VAT which is attributable to the former transactions (*Abbey National*, paragraph 37, and *Cibo Participations*, paragraph 34)."

26. As counsel for VCS pointed out, this passage does not in terms address the question of what the position would be if some of the taxable person's economic activities were outside the scope of VAT rather than exempt. It does, however, make clear that the entitlement to deduct input VAT does not extend to VAT on supplies acquired which are linked to transactions which are not taxed transactions. As we have said, we see no logical distinction between the case where some of a taxable person's revenue arises from exempt supplies and the case where some of a taxable person's revenue arises from transactions outside the scope of VAT. In our view it is clear from the Court of Justice's reasoning that a taxable person who effects transactions in respect of which VAT is deductible and transactions which are out of scope may only deduct that proportion of VAT which is attributable to the former.

27. In Case C-437/06 *Securenta Göttinger Immobilienanlagen und Vermögensmanagement AG v Finanzamt Göttingen* [2008] ECR I-1597 Securenta was a German company which acquired, managed and sold real estate, securities, financial holdings and investments. It acquired the capital necessary for this by means of the issue of shares and so-called "atypical silent partnerships". Securenta sought to deduct all of the VAT it had incurred on expenditure connected with the acquisition of new capital. Securenta's taxable income was about 46% of its total income. Questions were referred to the Court of Justice, the first of which was in essence how the right to deduct input VAT was to be determined in the case of a taxpayer who carried out both economic and non-economic activities, and the second of which was in essence how any apportionment should be carried out.

28. The Court answered the first question as follows:

> "26. It is apparent from the information supplied by the national court that Securenta carries out three types of activity: (i) non-economic activities, which do not fall within the scope of the Sixth Directive; (ii) economic activities, which as such fall within the scope of that directive but are exempt from VAT; and (iii) taxed economic activities. The question therefore arises, in that context, whether – and, if so, to what extent – such a taxable person has the right to deduct input VAT relating to expenditure which is not attributable to specific output transactions.
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> 27. With regard to expenditure connected with the issue of shares or atypical silent partnerships, it should be noted that, in order for the input VAT paid in respect of such a transaction to give rise to a right to deduct, the expenditure incurred in that regard must be a component of the cost of the output transactions that gave rise to the right to deduct (see Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 28; Case C-16/00 *Cibo Participations* [2001] ECR I-6663, paragraph 31; and Case C-435/05 *Investrand* [2007] ECR I-1315, paragraph 23).

28. In those circumstances, the input VAT paid in relation to the expenditure connected with the issue of shares or atypical silent partnerships can give rise to the right to deduct only if the capital thus acquired was used in connection with the economic activities of the person concerned. The Court has held that the deductions scheme laid down by the Sixth Directive relates to all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT (see *Gabalfrisa and Others*, paragraph 44; Case C-98/98 *Midland Bank* [2000] ECR I-4177, paragraph 19; and *Abbey National*, paragraph 24).

29. In the main proceedings, as the national court has observed, the expenditure connected with supplies of services carried out in the context of the issue of shares and financial holdings was not solely attributable to downstream economic activities carried out by Securenta and was not therefore among the elements which, alone, go to make up the cost of the transactions relating to those activities. If, however, that had been the case, the supplies of services concerned would have had a direct and immediate link with the taxpayer's economic activities (see *Abbey National*, paragraphs 35 and 36, and *Cibo Participations*, paragraph 33). However, it is apparent from the documents before the Court that the costs incurred by Securenta for the financial transactions at issue in the main proceedings were, at least in part, for the performance of non-economic activities.

30. To the extent that input VAT relating to expenditure incurred by a taxpayer is connected with activities which, in view of their non-economic nature, do not fall within the scope of the Sixth Directive, it cannot give rise to a right to deduct."

29. Having noted that the 6VD did not specify how input tax was to be apportioned, the Court answered the second question as follows:

"34. In those circumstances, and so that taxpayers can make the necessary calculations, it is for the Member States to establish methods and criteria appropriate to that aim and consistent with the principles underlying the common system of VAT.

35. In that regard, the Court has held that, where the Sixth Directive does not contain the guidance necessary for such precise calculations, the Member States are required to exercise that power, having regard to the aims and broad logic of the Directive (see, to that effect, Case C-72/05 *Wollny* [2006] ECR I-8297, paragraph 28).

36. In particular, and as the Advocate General noted in point 47 of his Opinion, the measures which the Member States are required to adopt in that regard must comply with the principle of fiscal neutrality on which the common system of VAT is based.

37. Accordingly, the Member States must exercise their discretion in such a way as to ensure that deduction is made only for that part of the VAT proportional to the amount relating to transactions giving rise to the right to deduct. They must therefore ensure that the calculation of the proportion of economic

activities to non-economic activities objectively reflects the part of the input expenditure actually to be attributed, respectively, to those two types of activity."

30. Counsel for VCS pointed out that this case was concerned with the three types of activity listed in [26], and not with activities which were economic but outside the scope of VAT. Accordingly, he submitted that the passages we have cited do not in terms address the question of what the position would be if some of the taxable person's economic activities, as opposed to non-economic activities, were outside the scope of VAT. As we have said, however, we see no logical distinction between the case where a taxable person carries out both taxed economic activities and economic (or business) activities which are outside the scope of VAT and the case where a taxable person carries out both taxed economic activities and non-economic activities which are outside the scope of VAT. In our view it is clear from the Court of Justice's reasoning that a taxable person who effects taxable transactions (giving rise to an entitlement to deduct VAT) and transactions which are out of scope may only deduct that proportion of VAT which is attributable to the former, and this is so whether the latter are out of scope because the transactions are non-economic in nature or because they are transactions which are economic in nature but do not amount to the supply of goods or services.

31. In Case C-515/07 *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaris van Financiën* [2009] ECR I-839 VNLTO was an organisation which promoted the interests of its members in the agricultural sector in certain Dutch provinces. VNLTO provided services to both members and non-members in return for fees. The profits generated by those activities were used to promote the general interests of members. VNLTO sought to deduct input tax on goods and services which it used both for its taxable activities and for its activities in promoting the general interests of its members which were not taxable. Questions were referred to the Court of Justice, the first of which concerned the extent of the right to deduct VAT under Article 17(2) 6VD where the taxable person has used goods and services both for the purposes of its business and for the purposes of transactions other than taxable transactions.

32. The Court began its answer to this question by observing:

> "27. It is necessary to recall, at the outset, that the deduction system established by the directive is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. Thus, the common system of VAT seeks to ensure complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT (see Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 24 and the case-law cited).
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> 28. Consequently, 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 (see Case C-184/04 *Uudenkaupungin kaupunki* [2006] ECR I-3039, paragraph 24, and Case C-72/05 *Wollny* [2006] ECR I-8297, paragraph 20)."

33. Having considered the facts of the case, and noted that it was common ground that VNLTO's activities of promoting the general interests of its members were not taxable, the Court went on:

> "35. With regard to the question whether such activities may be considered to be carried out for 'purposes other than' those of the business within the meaning of Article 6(2)(a) of the directive, it should be noted that in Case C-437/06 *Securenta* [2008] ECR I-1597, … , inter alia, a question was referred to the Court as to how to determine the right to a deduction of the input VAT paid in the case of a taxable person simultaneously carrying out economic activities and non-economic activities.
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> 36. In that regard, the Court stated, at paragraph 26 of that judgment, that non-economic activities do not fall within the scope of the directive, specifying, at paragraph 28 thereof, that the deductions scheme laid down by the directive relates to all economic activities of a taxable person, whatever their purpose or results, provided that they are, in principle, themselves subject to VAT.
>
> 37. The Court accordingly held, at paragraphs 30 and 31 of the judgment in *Securenta*, that the input VAT relating to expenditure incurred by a taxable person cannot give rise to a right to deduct in so far as it relates to activities which, in view of their non-economic nature, do not come within the scope of the directive and that, where a taxable person simultaneously carries out economic activities, whether taxed or exempt, and non-economic activities outside the scope of the directive, deduction of the input VAT relating to expenditure is allowed only to the extent to which that expenditure may be attributed as an output to the economic activity of the taxable person.
>
> 38. It follows from these considerations that, as the Advocate General has noted in point 38 of his Opinion, Article 6(2)(a) of the directive is not intended to establish a rule that transactions outside the scope of the system of VAT may be considered to be carried out for 'purposes other than' those of the business within the meaning of that provision. Such an interpretation would have the effect of rendering Article 2(1) of the directive meaningless.
>
> 39. It is also appropriate to state that, unlike *Charles and Charles-Tijmens*, which concerned immoveable property allocated to the assets of the business before being attributed, in part, to private use, by definition completely different from the business of the taxable person, the situation in the main proceedings in the present case relates to transactions other than VNLTO's taxable transactions, consisting in safeguarding the general interests of its members, and not capable of being considered, in this case, to be non-business transactions, given that they constitute the main corporate purpose of that association.
>
> 40. Consequently, the answer to the first question is that Articles 6(2)(a) and 17(2) of the directive must be interpreted as not being applicable to the use of goods and services allocated to the business for the purpose of transactions other than the taxable transactions of the taxable person, as the VAT due in respect of the acquisition of those goods and services, and relating to such transactions, is not deductible."

34. As we understood his submissions, counsel for VCS again argued that this case was concerned with the distinction between economic activities and non-economic activities, and not with the distinction between economic activities within the scope of VAT and activities which were of a business nature and economic, but outside the scope of VAT. That is so, but nevertheless it is clear in our view from the Court's answer that input tax can only deducted to the extent that the goods and services are acquired for the purpose of taxable transactions.

35. In Case C-126/14 *'Sveda' UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [EU:C:2015:254], [2016] STC 447 the taxpayer was a Lithuanian company which organised trade fairs, conferences and leisure activities. It entered into a subsidy agreement with the Ministry of Agriculture to set up a particular attraction. 90% of the costs were to be covered by the Ministry and the public was to be admitted free of charge. The taxpayer sought to deduct its input tax on certain goods used for constructing a recreational path. A question was referred to the Court of Justice about the interpretation of Article 168 PVD. In answering this question the Court stated:

> "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 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*, C-29/08, EU:C:2009:665, paragraph 57).
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> 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 a 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*, C-435/05, EU:C:2007:87, paragraph 24, and *SKF*, C-29/08, EU:C:2009:665, paragraph 58).
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> 29. It is apparent from the case-law of the Court that, in the context of the direct-link test that is to be applied by the tax authorities and national courts, they should consider all the circumstances surrounding the transactions concerned and take account only of the transactions which are objectively linked to the taxable person's taxable activity. The existence of such a link must thus be assessed in the light of the objective content of the transaction in question (see, to that effect, judgment in *Becker*, C-104/12, EU:C:2013:99, paragraphs 22, 23 and 33 and the case-law cited).
>
> 30. The findings of the referring court establish that, in the case in the main proceedings, the expenditure incurred by Sveda as part of the construction

work on the recreational path should come partly within the price of the goods or services provided in the context of its planned economic activity.

31. The referring court nevertheless harbours doubts as to whether there is a direct and immediate link between the input transactions and Sveda's planned economic activity as a whole, owing to the fact that the capital goods concerned are directly intended for use by the public free of charge.

32. In that regard, the case-law of the Court makes it clear that, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (judgment in *Eon Aset Menidjmunt*, C-118/11, EU:C:2012:97, paragraph 44 and the case-law cited). In both cases, the direct and immediate link between the input expenditure incurred and the economic activities subsequently carried out by the taxable person is severed."

36. Although this case was referred to in the skeleton argument of counsel for HMRC, neither counsel cited it during oral submissions. Nevertheless we consider that the reasoning of the Court of Justice is supportive of HMRC's interpretation of Article 168.

37. In Case C-11/15 *Odvolací finanční ředitelství v Český rozhlas* [EU:C:2016:470] the taxpayer was a Czech public radio broadcasting company which was financed by a compulsory statutory fee similar to the UK licence fee. The taxpayer sought to deduct input tax although the fees it received were outside the scope of VAT because they did not constitute remuneration for the service it provided. A question was referred to the Court of Justice as to whether the taxpayer's activities constituted a supply of services effected for consideration within the meaning of Article 2(1) 6VD. The Court answered that question in the negative.

38. In his Opinion ([EU:C:2016:181]) Advocate General Szpunar pointed out at [17] that the context in which the question had been raised was a dispute between the taxpayer and the tax authorities with regard to the taxpayer's right to deduct input tax. Accordingly, he proceeded to analyse the right to deduct input tax enjoyed by taxable persons carrying out both taxable transactions and transactions falling outside the scope of VAT in detail at [44]-[63]. The following passages in his analysis are particularly pertinent (footnotes omitted):

"47. … the Sixth Directive does not contain specific rules applicable to the situation of a taxable person who performs both taxable transactions and transactions that do not fall within the scope of the VAT system at all. So far as concerns goods and services the taxable person's use of which in connection with either of those categories of transaction (that is to say, taxable and non-taxable) is easy to determine, the solution is simple and follows directly from Article 17(2) of the Sixth Directive. After all, goods and services used in connection with taxable transactions confer a right to deduct (unless those transactions are exempt) and goods and services used in connection with transactions falling outside the scope of the VAT system do not confer a right to deduct. The question of the extent of the right to deduct arises, however, in the context of goods and services used, simultaneously and indissociably, in

connection with taxed transactions and transactions falling outside the scope of the VAT system. There may be many such goods and services and they may represent a significant proportion of the cost of the economic activity, such as electricity, office rental, cleaning services, certain facilities and so on.

…

50. ... In accordance with my proposed answer in the present case, therefore, [the charging of the fee] cannot be regarded as an activity carried on for consideration within the meaning of Article 2(1) of the Sixth Directive. The question, therefore, is whether that activity is capable of conferring a right to deduct input VAT on goods and services used for the purposes of both that activity and taxed activities.

51. In my view, the answer to that question should be negative. After all, granting a right to deduct input tax on goods and services used for the purposes of an activity that falls outside the scope of the VAT system would be contrary to the logic of that system and, more specifically, to the categorical and clear wording of Article 17(2) of the Sixth Directive. If that were the case, input VAT would not be deducted from the output VAT owed by the taxable person on his taxed transactions (because there were not be any) and he could apply to have it refunded. Consequently, the input VAT would end up not being paid by anyone and the goods and services in the chain of downstream transactions would be effectively exempt, in breach of the principle of the universality of VAT.

…

56. The finding that an activity financed from a fee does not confer any right to deduct input VAT applies not only to the goods and services which the taxable person uses exclusively for the purposes of his non-taxable activities but also to those which he uses simultaneously and indissociably for the purposes of both non-taxable and taxed activities. Goods and services falling into the first category do not pose a problem because the taxable person simply does not have the right to deduct. So far as concerns the second category, however, it is important to determine the extent to which the taxable person must be able to benefit from his right to deduct so as to ensure, first, that that right can be maintained in so far as it relates to taxable transactions and, secondly, that there is no undue 'overcompensation'.

…

62. In my view, the issue of fees used to finance public broadcasters must be resolved on the basis of the solution adopted by the Court in its judgment in *Securenta*. In that judgment, the Court, having noted that the provisions of the Sixth Directive contain no rules for determining the extent of the right to deduct enjoyed by taxable persons who carry out both taxable (and taxed) activities and non-taxable activities, held that the determination of the methods and criteria for apportioning input VAT between taxable and non-taxable activities is in the discretion of the Member States, who, when exercising that discretion, must have regard to the aims and broad logic of the Sixth Directive

and, on that basis, provide for a method of calculation which objectively reflects the part of the input expenditure actually to be attributed, respectively, to those two types of activity."

39. Although the Court of Justice did not feel the need to endorse this part of the Advocate General's Opinion in its judgment, there is nothing in the judgment which is inconsistent with it. Moreover, the Advocate General's analysis is entirely consistent with the previous case law of the Court discussed above. Counsel for VCS boldly submitted that the Advocate General was wrong, and in any event distinguishable. We disagree. In our judgment the Advocate General's analysis is directly in point, highly persuasive, and strongly supportive of HMRC's interpretation of Article 168 PVD.

40. Fourthly, although it is the jurisprudence of the CJEU that is determinative, we note that the case law of the domestic courts is consistent with the case law discussed above. Again we were referred to a number of relevant decisions which we will consider in chronological order, albeit rather more briefly than in the case of the CJEU decisions.

41. In *The Church of England Children's Society v Revenue and Customs Commissioners* [2005] EWHC 1692 (Ch), [2005] STC 1644 Blackburne J stated at [33]:

> "…. For this purpose [i.e. that of determining the extent of use of general overheads in the making of taxable supplies] it will be necessary to determine what proportion of the Society's activities are not for the purpose of its business at all (and as such outside the scope of value added tax) and what proportion of what remains is properly attributable to taxable supplies."

42. In *Volkswagen Financial Services v Revenue and Customs Commissioners* [2015] EWCA Civ 832, [2016] STC 417 Patten LJ stated:

> "35. ... there is an obvious factual difference between cases like *BLP* and *Sveda* where what Advocate General Kokott describes as the primary use of the capital goods or supplies is in connection with an exempt or non-taxable transaction and the only relevant taxable supply is one further link down the causative chain, and cases like *Midland Bank* where the inputs relate to the whole of the taxable person's business including the making of both taxable and exempt supplies. In the latter case there can be said to be a direct and immediate link with both types of output transaction and the only issue is one of fairly apportioning the residual input tax between the two according to use.
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> …
>
> 52 ...Where that is demonstrated [i.e. that inputs constitute expenditure incurred by the taxable person in order to maintain his economic activity as a whole], the overheads are treated as cost components of the supplies which are made and the only issue is how to apportion those costs between exempt and taxable supplies. …"

43. In *Revenue and Customs Commissioners v Associated Newspapers Ltd* [2015] UKUT 641. [2015] STC 1143 David Richards LJ stated:

> "71. Thus, as can be discerned from the established case law on which the Court's judgment in *Sveda* is based, it is always a question of identifying, in economic terms, the true direct and immediate link between the input expenditure and activity of the taxable person. If such a link is established with a particular transaction, whether exempt or outside the scope, no input tax will be permitted. In those circumstances, any link that might have been found with subsequent economic activity will not be capable of being established; it will, in effect, be severed. …
>
> 72. Although a right to a deduction exists if expenditure can be regarded as having a direct and immediate link to a taxable person's economic activity as a whole, the initial focus must be on whether there is a link with a particular activity, or type of activity. … it is only where inputs cannot be linked to specific outputs transactions that they may fall to be attributed to a taxable person's activity as a whole. If such a link can be established, there is then the question whether the link is with both economic and non-economic activity (in which case there must be an apportionment, as in *Securenta* and *VNLTO*), and whether the input VAT is fully or partially recoverable having regard to the taxable and exempt supplies that constitute the economic activity with which the link has been established."

44. For the reasons given above, we accept HMRC's interpretation of Article 168 PVD. Accordingly, where purchased goods or services are used by a taxable person both for transactions in respect of which VAT is deductible (i.e. taxable supplies) and for transactions in respect of which VAT is not deductible (i.e. where the transactions do not constitute economic activity or do not constitute taxable supplies (even though they may be transactions undertaken in the course of a taxable person's business) or where the supplies are exempt), VAT may only be deducted in so far as (that is, to the extent that) it is attributable to taxable supplies.

45. It is important to note that VCS does not contend that the domestic legislation is incompatible with the European legislation. On the contrary, it is common ground that it is possible to construe the domestic legislation consistently with the European legislation. Counsel for VCS nevertheless placed considerable reliance upon the domestic legislation and his submissions on how it should be interpreted. In reality this amounted to an attempt to construe Article 168 PVD by reference to the domestic legislation; but, as counsel for VCS accepted, the domestic legislation is not an admissible aid to interpretation of the PVD. In these circumstances we shall deal with the domestic legislation briefly, simply to explain how we consider that it may be interpreted consistently with Article 168 PVD.

46. On its face, section 24(5) VATA requires an apportionment to be made of VAT incurred on purchased supplies so as to reflect the extent to which those supplies are used for "for the purposes of a business" and other purposes. Read in the light of Article 168 PVD, "for the purposes of a business" must be understood to mean for the purposes of a business which involves making supplies within section 4 VATA, that is to say, economic activity within the scope of VAT.

47. Consistently with this, section 26 VATA provides only three activities for which a taxable person is able to deduct as input tax. One of these is "taxable supplies" which are "made … by the taxable person in the course or furtherance of his business". Non-

taxable supplies, such as exempt supplies and activities outside the scope of VAT, are not listed.

48. Furthermore, regulation 100 of the Regulations prohibits a taxable person deducting "the whole or any part of VAT" paid on the supply to him of goods or services where those goods or services "are not used or to be used by him in making supplies in the course or furtherance of a business carried on by him." Thus, if and to the extent that revenue is generated without making supplies, VAT incurred on supplies used in generating that revenue cannot be deducted. It follows that it is unnecessary to consider the correct interpretation of regulation 101(2) of the Regulations.

49. Turning to the present case, for the reasons explained above we conclude that the First-Tier Tribunal was correct to hold that it is necessary to make an apportionment of the input VAT incurred by VCS on its general overheads between VCS's taxable transactions and its non-taxable transactions. As is common ground, the PVD does not specify how the apportionment should be carried out. It is clear from the case law of the CJEU discussed above, however, that the method of apportionment selected by the Member State must be in accordance with the aims and broad logic of the PVD. In the present case HMRC has used a revenue-based apportionment i.e. it has apportioned the input VAT pro rata to the two different types of revenue. There is no challenge to the method of apportionment adopted by HMRC, as opposed to HMRC's entitlement to make an apportionment.

Disposition

50. The appeal is dismissed.

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MR JUSTICE ARNOLD

JUDGE JOHN WALTERS QC

Release date: 13 July 2016