[2018] UKUT 0129 (TCC)

Appeal number: UT/2017/0058
UT/2017/0061

VALUE ADDED TAX – "points" based rewards scheme – whether payments made to redeemers third party consideration for supply of rewards – no – whether redeemers made separate supplies to operator of scheme – yes – whether those separate supplies relate to immovable property or constitute advertising services – no – appeals dismissed.

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

MARRIOTT REWARDS LLC
WHITBREAD GROUP PLC

Appellants

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE HENRY CARR
JULIAN GHOSH QC

Sitting in public at The Rolls Building EC4A 1NL on 5, 6 and 9 February 2018

Nicola Shaw QC, instructed by Baker & McKenzie LLP, for Marriott Rewards LLC

Amanda Brown of KPMG LLP for Whitbread Group plc

Nigel Pleming QC and Andrew Macnab, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

© CROWN COPYRIGHT 2018

DECISION

Introduction

1. These appeals concern a customer loyalty scheme ("the Program") operated by Marriott Rewards LLC ("MR") and its predecessor Marriott Rewards Inc. in connection with hotels ("Participating Hotels") operated under the Marriott, and other, brands. A summary of the Program was provided by the First Tier Tribunal ("the FTT") at paragraphs [2] and [14] of the decision under appeal ("the FTT Decision").[1] The FTT made detailed findings of fact in Part 1 of the Decision at paragraphs [8] – [96].

2. There are two appeals made respectively by MR and Whitbread Group Plc ("Whitbread"). There is an issue as to whether payments made by MR to Participating Hotels under the Program were payments made in consideration for supplies made to MR or, alternatively, "third party consideration" paid by MR, for supplies made by the Participating Hotels to customers who redeemed points under the Program ("Issue 1"); we shall refer to such customers as "Members". If MR's payments to Participating Hotels under the Program were paid as consideration for services supplied to MR, a further issue arises concerning whether those supplies made by the Participating Hotels to MR are aptly categorised, for VAT purposes, as either (a) services which were "connected with immovable property", within Article 47 of the Council Directive 2006/112/EC ("the Principal VAT Directive")[2], or (b) "advertising

[1] [2017] UKFTT 140 (TC).
[2] As amended by Council Directive 2008/8/EC with effect from 1st January 2010.

services", within Article 9(2)(e) of the Sixth Council VAT Directive 77/388 ("the Sixth Directive")[3], or neither ("Issue 2").

3. The Program operated in a materially similar way for all of the Participating Hotels[4] and we therefore refer (at least in relation to Issue 1) only to MR and not to Whitbread. MR and Whitbread made separate submissions on Issue 2 with which we deal below.

4. Marriott International Inc, a company incorporated in the United States, is the ultimate parent of the Marriott Group which owns, operates, franchises or licenses hotels under (amongst other brands) the Marriott brand. MR is a company incorporated in the United States which is a wholly-owned indirect subsidiary of Marriott International Inc. The Marriott Group does not typically own Marriott branded hotels. It either manages hotels owned by third parties or grants a Marriott franchise to third party hotel owners. Whitbread is the representative member of a VAT group which operates in the retail, hospitality and leisure sectors. During the relevant VAT periods,[5] Whitbread owned and operated Participating Hotels under the Marriott brand in the UK, pursuant to "International Franchise Agreements" between Whitbread and International Hotel Licensing Company Sarl ("IHLC"), a Marriott company. IHLC was the predecessor of a company now called Global Hospitality Licensing Sarl ("GHL").

---

[3] For reasons we explain below, on Issue 2, MR's appeal is founded entirely on the relevant provisions of the Principal VAT Directive, whereas Whitbread's appeal is based entirely on the provisions of the Sixth Directive.

[4] FTT Decision [70], [74] and [75].

[5] Until 2006, when Whitbread sold the hotels which are the subject of the Whitbread appeal.

5. MR, based in the United States, set the terms of the Program. It is common ground that MR, despite having no profit motive in operating the Program, and despite the involvement of GHL, conducts a taxable activity in relation to operating the Program, for the purposes of VAT: see FTT Decision [16]. The Program required Participating Hotels to make certain payments and enabled them to receive certain payments. MR, as operator of the Program thus had an economic activity of securing (through GHL) payments by Participating Hotels and making payments to Participating Hotels. It was no part of the case of the Respondents' ("HMRC") case that MR was any form of "cipher", or that the involvement of GHL affected the nature of MR's economic activity in operating the Program. Further, the FTT (at FTT Decision [184]) observed that "the services from Redeemers [Participating Hotels which received payments from MR]…enable MR to perform obligations associated with its business, not to promote or advertise it." The FTT made this observation in the context of whether there were supplies of advertising made by Redeemers to MR. Thus the FTT must, we consider, be taken to have concluded that the payments by MR were not payments to advertise MR's business and (inevitably) that promotion of the Marriott brand was not part of MR's business. We discuss this further below.

6. Customers of Participating Hotels were entitled to join the Program and it is these customers that we refer to as "Members". When a Member purchased a qualifying stay at a Participating Hotel, that Participating Hotel would pay monies to MR, so as to acquire points for Members. We refer to Participating

Hotels in this capacity as "Sponsors". UK Sponsors accounted for VAT on that payment pursuant to the reverse charge provisions in Section 8 of the Value Added Tax Act 1994 ("VATA 1994"). MR issued reward points to the Member. Reward points could also be earned at certain non-hotel participants such as Hertz and British Airways, but, save where otherwise indicated, these appeals do not concern such non-hotel participants. Participating Hotels accepted points from Members for free or discounted hotel rooms ("Redeemers") for which Redeemers received payments from MR. When a Member enjoyed a stay with a Redeemer, it would present a certificate ("the Certificate") obtained from MR in respect of points, which the Member would then exchange for the stay ("a Reward Stay"). MR then paid the Redeemer. Such payments were calculated by reference to the number of points redeemed and were met from funds received by MR from all contributing Sponsors when points were issued. [6]

7. The number of points issued by MR to the Member under the Program was calculated by reference to the amount paid by the Member to the Sponsor for the hotel room for which the Member had paid cash. The Program did not envisage that MR (or Marriott Rewards, Inc) would make a profit out of their operation of the Program. Payments to Redeemers were to be funded entirely out of payments received from Sponsors with no surplus left over. Any

[6] We should say that the relevant documentation does not use the terminology of "Sponsor" or "Redeemer", this terminology having been borrowed by the FTT (at least as to "Sponsor" and "Redeemer") from that used in *HMRC v Aimia Coalition Loyalty UK Limited (formerly known as Loyalty Management UK Limited (No 2)* [2013] UKSC 42 ("*LMUK SC*"). Given the similarity of the Program to the loyalty scheme which was the subject of the Supreme Court's decision in *LMUK SC*, this is self-evidently sensible and we shall do the same.

surplus on termination of the Program would be distributed amongst Participating Hotels on a discretionary basis. UK Redeemers (including Whitbread) included VAT on invoices submitted to MR in respect of the services supplied in providing the Reward Stay to members and in return for the payment made by MR.

8. MR appealed to the FTT against decisions made by HMRC in relation to the period from July 2010 to June 2014, whereby HMRC refused MR's claim under s.39 VATA 1994 for recovery of approximately £8.3 million VAT associated with payments that MR made to Redeemers. HMRC refused that claim because it determined that the payments made by MR were third party consideration for the supply of hotel rooms made by Redeemers to Members. MR claimed that the payments that it made were consideration for a supply of services by Redeemers to MR.

9. Whitbread appealed against HMRC's refusal to pay approximately £2.4 million of output tax paid by Whitbread (qua Redeemer) in the VAT periods 12/99 to 12/02. This refusal was on the basis that the relevant supplies made by Redeemers to MR were those of advertising and their place of supply was in the US (where MR belonged).

The issues before the FTT and the Upper Tribunal

10. The FTT articulated Issue 1 and Issue 2 as the relevant issues for determination at FTT Decision [4].

i) **Issue 1**: whether, as MR and Whitbread submitted, when MR made payments to a Redeemer it provided consideration for a supply of services made by that Redeemer to MR; or whether, as HMRC submitted, MR was giving third party consideration for a supply by the Redeemer to the Member of hotel accommodation and ancillary services. If HMRC are correct on Issue 1, it was common ground that the appeals of MR and Whitbread must fail.

ii) **Issue 2**: In the event that MR and Whitbread succeed on Issue 1, then Redeemers were supplying services to MR. Issue 2 is concerned with the nature of those services, as to which MR, Whitbread and HMRC disagreed with each other. In particular:

(a) Whitbread submitted that the services which it supplied were "advertising services". Under the place of supply rules in force prior to 1 January 2010 (the period relevant to Whitbread's appeals) advertising services were treated as supplied in the USA, where MR belonged.[7] Therefore, according to Whitbread, the sums that it accounted for and paid by way of

[7] Article 9(2)(e) of the Sixth Directive.

VAT to HMRC were not VAT due and are repayable to Whitbread under s.80 VATA 1994. Conversely, HMRC submitted (in common with MR) that the relevant supplies were not of advertising services; that under the place of supply rules in force at the time, the place of supply was the United Kingdom where Whitbread, as supplier, belonged; that the supplies were properly chargeable to UK VAT; and that any claim to recover VAT fell to be made by MR under the 13th VAT Directive[8] and not by Whitbread under s.80 VATA 1994.

(b) MR submitted that the services that it received were "connected with immovable property" and/or "the provision of accommodation in the hotel sector" pursuant to Article 47 of the Principal VAT Directive. Under the place of supply rules in force after January 2010 (the period relevant to MR's appeals) the supply of such services was treated as made in the UK. Therefore, MR submitted that services that it received from UK-based Redeemers were subject to VAT with the result that MR could claim a repayment of VAT under the 13th VAT Directive. Conversely, HMRC submitted that the relevant supplies were of some form of redemption services; that following the changes in the place of supply rules from January

[8] i.e. the Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover taxes – Arrangements for the refund of value added tax to taxable persons not established in Community territory (OJ L 326, 21.11.1986, p.40)

2010, the place of supply was the United States (i.e. the place of establishment of MR as business recipient of the supply); that any supplies were outside the scope of UK VAT; that MR had no repayment claim, since VAT was not properly due on any supplies to it by the UK Redeemer and VAT was incorrectly included in the UK Redeemer's invoices; and that any claim to recover "VAT" could only be made by the UK Redeemer under s.80.

The FTT determined Issue 1 in favour of MR and Whitbread. However, it determined Issue 2(a) and (b) in favour of HMRC. Therefore, it dismissed the appeals of MR and Whitbread. MR and Whitbread appealed in respect of Issue 2 to the Upper Tribunal. HMRC supported the FTT Decision in respect of Issue 2 and in addition, advanced different grounds for upholding the FTT Decision, namely that the FTT ought to have decided Issue 1 in favour of HMRC**.**

The operation of the Program in more detail

The International Franchise Agreement and the International Services Agreement

11. Participating Hotels which used the Marriott brand operated either under an "International Franchise Agreement", or managed hotels under an "International Services Agreement".[9] The parties to the International Franchise Agreement were the Franchisee Participating Hotels and a

[9] See FTT Decision at [53] and [49].

"Management and Franchise Company", GHL.[10] In the case of the International Services Agreement, the parties were the managed Participating Hotels and GHL.[11] In both cases Participating Hotels were obliged to participate in the Program.[12] Participating Hotels had an obligation to contribute to the cost of the Program (as Sponsor) but had no right to require payment as Redeemer from any party.[13] The FTT (see FTT Decision [58(3) and (4)], [87] and [88]) held that there was an implied contractual right on the part of Participating Hotels to such payments from MR, under the International Franchise Agreement, and the management company, funded by MR under the International Services Agreement. We do not agree.

12. It is true that (1) the Participating Hotels were obliged to participate in the Program, (2) GHL would "cause" them to do so and (3) Members had a contractual right to earn and redeem points against MR. But we do not see (applying either a business efficacy test or an officious by-stander test[14]) that the Participating Hotels, qua Redeemers, had a contractual right as against MR to have MR fund GHL to make payments to Redeemers. The costs of participating in the Program, qua Sponsors, could just as easily be viewed as absolute compulsory contributions to promotions of the Marriott brand which is consistent with all of the objectives of the Program we set out below (broadly, to attract customers, increase revenue and to encourage hotels to join

10 FTT Decision [53].
11 FTT Decision at [49].
12 FTT Decision [50] and [54].
13 FTT Decision [56] and [52].
14 Both the International Services Agreement and International Franchise Agreement were governed by English Law: FTT Decision [49], [53].

the Marriott brand). However, we do conclude that it was clear (and we infer, if this is necessary, from the International Franchise Agreement/International Services Agreement and the Participation Agreement, together with the arrangements as found by the FTT) that MR would pay Redeemers who accepted Certificates on the redemption of points, as a quid pro quo for the Redeemer's participation in the Program (see for example FTT Decision [63], where the FTT records that MR paid net sums to Redeemers, that is, sums net of payments due to satisfy Participating Hotels' obligations to pay monies qua Sponsors matched against payments due to Participating Hotels, qua Redeemers). And since we conclude below that the Redeemers' participation in the Program resulted in the Redeemers making supplies to MR, we consider that the payments by MR to the Redeemers are properly consideration for those supplies, despite the absence of any contractual obligation to make those payments for MR.

The Participation Agreement

13. Under a separate Participation Agreement,[15] between MR and GHL (that is to say, the Participating Hotels were not parties), it was agreed that the Participating Hotel would buy points,[16] at a particular "price"[17], which points would be credited by MR to the Members, at a price calculated by reference to a particular formula. The Member could redeem the points and obtain free or

[15] Discussed by the FTT at FTT Decision [41].

[16] FTT Decision [42], referring to a Recital in the Participation Agreement. We disagree with the FTT's conclusion at [69] that Participating Hotels as Sponsors did not purchase points from MR in the light of these express provisions to the contrary in the Participation Agreements.

[17] FTT Decision [45].

discounted hotel rooms from Participating Hotels. MR would pay monies to Participating Hotels which supplied hotel rooms on the presentation of a certificate by a Member, again by reference to a formula. MR and GHL (the management company) would establish:-

i) the price paid by a Participating Hotel (as Sponsor) for points issued to its customers[18]; and

ii) the price paid by MR to a Participating Hotel (as Redeemer) who provided a free/discounted hotel room on the presentation of a certificate (although there is no express contractual obligation on the part of MR to pay such sums to a Participating Hotel taking into account occupancy rates in excess of marginal cost[19]).[20]

14. GHL would "cause" Participating Hotels (as Redeemers) to participate om the Program (FTT Decision [14](2), [48])[21] and therefore to accept the redemption of points; and any surplus on termination of the Program was to be distributed amongst Participating Hotels (that is, neither to MR, nor to GHL, the management company).[22]

---

18 FTT Decision [45], [51], [55], [59(1)-(4)].

19 It is common ground that, despite the terminology in the Participation Agreement, this was not a "reimbursement": see FTT Decision [51].

20 FTT Decision [61].

21 As we have already observed, this does not affect the common ground between the parties that MR has an economic activity of operating the Program, as set out in FTT Decision [16].

22 FTT Decision [47]. We were shown a pro forma invoice, discussed by the FTT at [62] which was issued by a Participating Hotel, to MR, in order to obtain payment. This invoice records a particular Member's stay at a particular hotel room of the Redeemer but was used for notification purposes only.

15. The objective of the Program was to attract more customers for the Marriott brand as a whole, to encourage hotels to use the Marriott brand and increase revenue.[23] However, we repeat our observation, which is significant to Issue 2, that the FTT found (FTT Decision [184]) that it was not part of MR's particular business to advertise the Marriott brand.

Terms and Conditions

16. The only document to which the Members who earned points and redeemed them were parties was that termed the "Terms and Conditions" of the Program ("T&Cs"). In the T&Cs we were shown, the parties were the Members on the one hand and "the Company" (being Marriott International Inc. and the Ritz Carlton Hotel Company LLC and their "affiliates; clause 18 of the T&Cs provides that the Marriott Rewards Program and The Ritz-Carlton Rewards Program were operated by Marriott Rewards Inc). MR succeeded Marriott Rewards Inc as operator of the Marriott Rewards Program. There was no precise basis in the T&Cs for the points either earned or redeemed but these were set out in detail on a website.[24] MR had a wide discretion to alter or indeed terminate the Program, albeit that the FTT found, on the basis of unchallenged evidence, that MR would endeavour to be fair to the customers

[23] FTT Decision at [13] and [79].

[24] FTT Decision [18], [24], [27-29]. The FTT held that there was an "irreducible contractual entitlement" for Members to earn and redeem points, despite wide-ranging discretion on the part of MR to amend or terminate the Program [37], [38]. We agree. Members were told they "may" earn points, which we take to mean that Members were "entitled" to earn points and the redemption scheme was set out in detail on the relevant website, which we take to be incorporated into the T&Cs. Discretion on the part of MR to modify of terminate the Program does not change the nature of any such contractual entitlement on the part of Members until MR exercises its discretion.

who had earned and sought to redeem points.[25] As in the case of the International Franchise Agreement, the International Services Agreement and the Participation Agreement, there was no provision in the T&Cs for a Redeemer to be paid on accepting the redemption of points by a Member.[26] However, we repeat our observation that payments by MR to Redeemers were clearly a quid pro quo for Redeemers' participation in the Program.

17. Although the Program has certain features of a "pooling arrangement", albeit compulsory, in that Sponsors pay monies to MR, which uses those monies to fund payments to Redeemers, the Program is not merely the pooling of cash by Participating Hotels. The Program is operated by MR, which accepts compulsory payments from Sponsors and makes payments to Redeemers, as operator of the Program, in the course of MR's own economic activity, which is distinct from the economic activities of Participating Hotels, whether Sponsors or Redeemers.

ISSUE 1

The parties' submissions in outline

18. The judgment of the Supreme Court in *Aimia Coalition Loyalty UK Ltd (formerly Loyalty Management UK Ltd)* [2013] UKSC 15, [2013] STC 784 *("LMUK SC")*, which considered the judgment of the Court of Justice of the European Union ("CJEU") in Joined Cases C-53/09, *RCC v Loyalty*

[25] FTT Decision [19], [20].
[26] FTT Decision [32].

Management UK Ltd ("LMUK CJEU"), and C-55/09 *Baxi Group Ltd v RCC ("Baxi CJEU")*[27], together with principles set out by the House of Lords in *Customs and Excise Commissioners v Redrow Group plc* [1999] STC 161 ("*Redrow*") were central to the parties' submissions in relation to Issue 1. We consider all of these judgments below. *Redrow* was expressly applied in *LMUK SC* at [65] by Lord Reed, at [109] by Lord Hope and at [117] by Lord Walker, who were in the majority.

MR's submissions on Issue 1

19. Whitbread adopted MR's submissions on Issue 1. MR's submissions on Issue 1 were presented by Ms Shaw QC, whose submissions were clear and concise. She summarised the essential reasoning of the FTT as follows, which she submitted was unimpeachable:

i) a majority of the Supreme Court concluded in *LMUK SC*, which concerned the Nectar Reward Loyalty Scheme, that when LMUK, the promoters of the Nectar reward scheme, made payments to Redeemers, it provided consideration for a supply of services made by those Redeemers to LMUK. MR and Whitbread contended that the Program in the present appeal was indistinguishable in all material respects from the Nectar reward scheme in *LMUK SC*. Therefore, the same conclusion should be reached, which was determinative of Issue 1;

[27] [2010] STC 2651

ii) like LMUK's business in *LMUK SC*, MR's business consisted of it assuming obligations to Members to issue points and ensuring that those points were redeemable for reward stays. As such, in order to honour its obligations to Members, it needed to ensure that Redeemers would provide reward stays to Members (FTT Decision [127]);

iii) in issuing points to Members, MR supplied services to Sponsors and was entitled to payment by the Sponsors. Had MR belonged in the UK, those services would have been taxable supplies. Instead, Sponsors accounted for VAT in respect of those services under the reverse charge provisions (FTT Decision [128]);

iv) the economic reality of MR's business is that it agreed to pay Redeemers because it attached value to those Redeemers' acceptance of points in exchange for the provision of reward stays to Members, on receipt of a Certificate. It is immaterial in assessing the economic reality of MR's business that it does not seek to make a profit. What matters is that it carried out economic activities and needed Redeemers to provide complimentary hotel rooms to Members in order to discharge its obligations under the Program (FTT Decision [129]);

v) as in *LMUK SC* and *Redrow*, Redeemers were making two separate supplies: first, a supply to the Member of a hotel room in consideration for the Reward Certificate; and secondly, a supply to MR of the service

of agreeing to provide complimentary hotel rooms to Members (FTT Decision [130]);

vi) the payments by MR to Redeemers did not amount to third party consideration for the supply of a hotel room to a Member because there was no obligation, either on the part of the Member or on the part of MR, to pay for the room which the payments might be said to have discharged and thus no understanding that payments would be made for the room. Rather, MR paid Redeemers because of the economic reality of its business described above (FTT Decision [131] to [132]); and

vii) the payment made by MR to Redeemers represents consideration, for VAT purposes, only in respect of a supply made by such Redeemers to MR (FTT Decision [132]).

The Respondents' submissions on Issue 1

20. Mr Pleming QC, who, together with Mr MacNab, appeared on behalf of the Respondents, contended that under the Program, reward stays were supplied by Whitbread/UK Redeemers to Members on the basis that they would be paid for by MR, not the Members. He suggested that the Program had none of the elements of the Nectar scheme that the majority of the Supreme Court in *LMUK SC* regarded as crucial for distinguishing the Nectar scheme from the scenario under consideration by the Court of Justice in *LMUK CJEU*. The

FTT erred in reaching a contrary conclusion in its analysis of the *LMUK CJEU*, *LMUK SC* and *Redrow* decisions. Payment to a Redeemer under the Program was not consideration for any supply of any service by the Redeemer to MR. The payment was third party consideration for the provision of the reward stay made by the Redeemer to the Member. The Redeemer was not, in redeeming points or accepting Certificates at its hotel, discharging any obligation of MR towards the Member. The Program was simply one in which MR arranged to pay for the supply of hotel accommodation (and related services) by the Participating Hotel to the Member. Further, should MR and Whitbread succeed on Issue 1, there would, according to Mr Pleming, be no irrecoverable VAT ("sticking tax") on the supply of hotel rooms by Redeemers at all, which would be contrary to principle.

Discussion on Issue 1

21. We set out the following propositions in relation to VAT (all of these propositions will be familiar to the well-informed reader). We set them out at this stage since it is the application of these principles which will determine Issue 1, restricting references, where possible, to relevant passages of *LMUK CJEU* and the Judgment of Lord Reed in *LMUK SC*:-

    i) VAT is a tax on consumption: Article 2 of the First EC Council Directive 67/227/EEC ("the First Directive"); *LMUK CJEU* [58]; *LMUK SC* [14], [95];

ii) VAT is proportional to the price paid for the supply of goods and services (that is, VAT output tax is payable on the "taxable amount") (ibid);

iii) the burden of VAT should fall on the final consumer who suffers irrecoverable VAT ("sticking tax"): *LMUK SC* [75];

iv) VAT is only chargeable if a supply of goods and services is for consideration; for a supply to be for a "consideration" for VAT purposes there need not be a legal relationship between the parties (the payment may be binding "in honour only") but the payment on the one hand and the goods or services on the other must be the function of a relationship of "reciprocity"[28]: *Town & County Factors v CEC* (Case C-498/99) ("*Town & Country Factors*") [2002] STC 1263 [18], [24]; *LMUK CJEU* [51], *LMUK SC* [81][29];

v) VAT is chargeable on the value added in the chain of production and distribution, so that a trader is entitled to a deduction of input tax for consideration paid for goods and services supplied which are used in the course or furtherance of *its* business (that is, the payment is a cost

[28] That is, "the remuneration received by the provider of the service [must be] the value actually given in return for the service".

[29] There is no dispute that payments made by MR to Redeemers in this case are "consideration" paid to Redeemers; the question is whether this consideration is for a supply made by Redeemers to MR or consideration for a supply made by Redeemers to Members.

component of the paying trader's business): *LMUK SC* [73], [74], [75], the Principal VAT Directive,[30] Article 168;

vi) It follows that "third party consideration", paid by a VAT trader, for goods and services supplied to another party, where those goods and supplies are not used by the paying trader, in *its* trade, cannot give rise to a deductible input tax in the hands of that paying trader. It is convenient to explain, at this stage, what is meant by "third party consideration"; this is the circumstance where one person (A) pays the price for goods and services supplied to another person (B) by the supplier (C);

vii) As to when A might do this, in circumstances in which A is a trader and it is no part of A's business costs to be paying C for its supplies to B, this would include, for instance, where A had an outstanding liability to B and A simply discharged this liability by paying off B's liability to C. In such circumstances, where A did not receive anything from B, except a discharge of A's liability to B and A did not receive anything from C which was used by A in the course or furtherance of A's business (because the goods or services supplied by C to B were consumed by B and B alone), it is easy to see why the payment by A is not any sort of cost component of A's economic activity. However if the payment by A is, in the light of "economic reality", a cost

[30] The Principal VAT Directive which superseded the Sixth Directive applies for at least some of the VAT periods in issue: for convenience we refer to the provisions of the Principal VAT Directive.

component of A's business, any VAT element comprised in A's payment to C ought, at least *prima facie*, to be deductible input tax in A's hands (ignoring complications of VAT exemption, in relation to A). As Lord Reed observed at [67] of *LMUK SC* "commercial reality being what it is, commercial businesses do not usually pay suppliers unless they themselves are the recipients of the supply for which they are paying (even if it may involve the provision of goods or services to a third party), but that possibility cannot be excluded *a priori*. A business may, for example, meet the cost of a supply of which it cannot realistically be regarded as a recipient in order to discharge an obligation owed to the recipient or to a third party. In such a situation the correct analysis is likely to be that the payment constitutes third party consideration for the supply."[31];

viii) The same transaction may yield two simultaneous supplies; so if a builder, in order to promote sales of houses the builder has constructed, pays an estate agent to market houses currently owned for prospective buyers of a house constructed by that builder, the estate agent makes supplies both to the prospective buyer and to the builder: *Redrow*, discussed and applied by *LMUK SC* at [65], [109][32];

---

31 This formulation of *Redrow* was approved by Lord Hope at [110] of *LMUK SC*, albeit observing that the observations of Lord Millett at *Redrow* 171e-f (that a trader which "received anything at all" in consequence of expenditure was entitled to an input tax deduction for the VAT element of that expenditure) to the extent that it encompassed discharging a third party's obligation, were too wide.

32 Per Lord Hope.

ix) The nature of a supply, the identity of the parties to that supply and the nature and quantum of the consideration for a particular supply are all matters for determination by the national court, to be ascertained by reference to the contractual documentation, informed by an acknowledgment of "economic reality", taking account of all circumstances: *LMUK CJEU* [39], *LMUK SC* [38].

Preliminary observation on "sticking tax"

22. As a preliminary observation we should make it clear that, were HMRC to succeed on Issue 1, it would, we consider, give rise to more VAT being paid to HMRC than principle should permit. Contrary to Mr Pleming's submissions, should MR recover the VAT paid to the Redeemers, this will not deprive HMRC of "sticking tax". Indeed, if HMRC were to succeed on Issue 1 it would result in their having more VAT than was properly due to them.

23. The Program has, as we have observed, features of (without being identical to) a compulsory "pooling arrangement", whereby the Participating Hotels, in their capacity as Sponsors, pay monies to MR to fund the Program. Those sums bear VAT. The points were issued by MR to Members by reference to how much the Member has paid the Sponsor, for his or her hotel stay. That payment also bears VAT. Those Participating Hotels (as Redeemers) who supply hotel rooms to Members, on the redemption of points (the presentation of a Certificate) are paid a sum of money out of that pool. Those sums also bear VAT. Without (yet) addressing the central question in Issue 1 in this

appeal, which is whether the payment by MR to a Participating Hotel, qua Redeemer, is consideration (for VAT purposes) for the Redeemer accepting the redemption of points from the Member, or consideration for the supply by the Redeemer to the Member of the hotel room (and hence third party consideration paid by MR to the Redeemer), if HMRC were to succeed on Issue 1 it would result in their having more VAT than was properly due to them.

24. Consider a customer who pays £1,000 plus VAT (say of £200)[33] for four nights at a hotel and receives a fifth night free. The customer has paid £200 VAT for five nights rather than four, but HMRC have not been deprived of any VAT or any "sticking tax". This is true even though a different customer would have had to pay £250 plus VAT for that room.[34] Any expense incurred by the hotel in providing that extra night free of charge should, as to the VAT element, be deductible as input tax since it would be a cost component of the hotel's taxable business. The Program achieves exactly the same result. Members acquire points by staying in (and paying for) hotel rooms supplied by Sponsor Participating Hotels. Members are given reduced or free stays (in Participating Hotels which may or may not be the same Participating Hotel in which the Member paid to stay). The fact that the Member may redeem points in a hotel other than the Participating Hotel in which the Member stayed, in order to earn points, is neither here nor there. Participating Hotels, qua

[33] Which for a non-business customer would be irrecoverable sticking tax.
[34] For a similar observation, see the FTT Decision at [155].

Sponsors, fund the discounted or free hotel rooms under the Program and recover money, qua Redeemers.

25. Of course, if a non-business customer paid cash to a Participating Hotel, that cash-paying customer would pay irrecoverable VAT. But this observation is irrelevant to the question of whether a free or discounted hotel stay under the Program is in any sense depriving HMRC of irrecoverable sticking tax. We consider the answer to be "no". The expenditure of Participating Hotels, qua Sponsors, in the sense of having to pay MR compulsorily under the Program and recovery of monies qua Redeemer are two separate money-flows, which serve to fund the free or discounted hotel rooms. But these money-flows do not affect our observation that there is no relevant absence of "sticking tax" were MR to obtain recovery of the VAT paid to Participating Hotels, qua Redeemers.

26. Further, we note, just like the customer who pays £1000 plus VAT for four nights and obtains a fifth night free, the Member who pays for a hotel room to earn points has indeed suffered irrecoverable "sticking tax", in purchasing a hotel room from Sponsor Participating Hotels, which, in turn, leads to the issue of points by MR to the Member, on payment by a Sponsor to MR. We do not make this observation to support a conclusion that there is always (somewhere) sticking tax paid by a customer who earns points under the Program and this means that MR ought to recover the VAT element of monies paid to Redeemers. Rather we make this observation to refute HMRC's' submission that were MR to recover the VAT element of monies paid to

Redeemers, the absence of sticking tax in relation to the free or discounted hotel stay under the Program shows that analysis to be wrong.

Different types of loyalty schemes have different VAT analyses

27. So far as "loyalty schemes" are concerned, the relevant case law reveals that, although they have a common feature, that of rewarding customers, different loyalty schemes have different contractual and commercial arrangements and dynamics. This may, in turn, fundamentally change the VAT analysis of the relevant transactions. We have identified three different "models" (of course there may be others).

Simple own customer model

28. First, in a (relatively) simple case, where a trader issues "points" to a customer free of charge and the customer subsequently redeems those points for further goods or services (for no additional consideration), the issue of points by the trader to the customer is not a taxable supply since there is no consideration for the issue of the points. The supply of goods or services on the redemption of points is a separate supply made free of charge, dealt with under special, specific provisions of the VAT Code. So if a customer acquires petrol and obtains "points", which entitle that customer to further supplies of petrol, where the customer's purchase price of the petrol is the same whether or not the customer obtains points, the issue of points is not a taxable supply from the trader to the customer. The subsequent supply of petrol, on the redemption of

points is a supply of petrol made free of charge: *Kuwait Petroleum (GB) Limited v CEC* (Case C-48/97) ("*Kuwait Petroleum*") [1999] STC 488. We shall refer to this type of loyalty scheme as a "simple own customer model" where the trader itself operates the loyalty scheme by issuing points to its own customers and by accepting redemption of the points. The simple own customer model would, in the light of economic reality, include a case where the loyalty scheme was administered by a distinct person who had no real part to play in the issue of points or their redemption, distinct from the trader, in operating the loyalty scheme ("a cipher").

Sub-contractor model

29. Second, loyalty schemes where a trader issues points to its own customers but sub-contracts the operation of the redemption of the points to a distinct entity, involve different considerations. In *Baxi CJEU*, Baxi issued points to Baxi's own customers. The customers were entitled to redeem those points for further goods (gifts). Baxi sub-contracted the supply of those goods, on the redemption of points, to a sub-contractor (@1). @1, in its capacity as sub-contractor, acquired the relevant goods for a particular acquisition price and supplied those goods to Baxi's customers, who redeemed points, at no additional charge to the customers. However, @1 submitted an invoice for the full retail price of the boiler (which exceeded the acquisition price) to Baxi, so that @1 made a profit.

30. In this case, the CJEU concluded that @1's transaction with the customers involved two supplies by @1, one (to Baxi's customers) being the supply of goods and the other (to Baxi) being a supply of services (the acceptance of points on terms that @1 would issue an invoice to Baxi for the retail price of those goods). The CJEU decided that the payment by Baxi to @1 was apportionable into two elements. One element (equal to the acquisition price of the goods by @1) was third party consideration paid by Baxi, for the supply of goods to Baxi's customers, on the redemption of points (that supply of goods being made by @1). The balance (the profit element for @1) was attributable to a supply of services made by @1 to Baxi (the acceptance of points from Baxi's customers).

31. We shall refer to this model as the "sub-contractor model". The issue of points on the sub-contractor's model is made by a VAT trader to its own customers. But the trader pays a sub-contractor (who is not a cipher) to acquire the goods/services and accept redemption on terms that the trader will pay the sub-contractor. We consider this is what Lord Reed had in mind when he refers to traders issuing points "*with the assistance of a third party*" in *LMUK SC* at [40].

32. In the sub-contractor model, there are two money-flows. One is the payment by the sub-contractor for the goods to permit redemption of the points by the trader's customers. The second is the payment by the trader to the sub-contractor. So far as the second payment is concerned, the CJEU, in *Baxi CJEU* [60]-[63] (without, seemingly, any express analysis) held that the

payment by the trader (Baxi) must have been a payment in consideration for the sub-contractor's supply to Baxi's customers up to the sum expended by the sub-contractor for the goods and the balance (the profit element for the sub-contractor) was attributable to a supply of services by the sub-contractor to the VAT trader (the acceptance of points for a supply of goods to the trader's customers).

Separate operator models

33. Third, loyalty schemes may be operated by an economic actor who issues points to customers of traders, as part of a business wholly distinct from the traders' businesses. So in *LMUK SC*, the loyalty scheme (the well-known Nectar scheme) was operated by the applicant (LMUK, the "promoter"), which issued "points" to the customers ("collectors") of particular retailers ("sponsors"), which points were paid for by those sponsors. Those points could be redeemed against retailers ("redeemers"), which may be the same as or different from the sponsors, and LMUK would pay the redeemers a sum of money. The amounts obtained by LMUK from sponsors always exceeded the monies paid by LMUK to redeemers, since LMUK operated this type of "loyalty scheme" as part of its own, distinct profit-making business. LMUK, in this type of loyalty scheme, undertook contractual obligations to the

collectors who earned points (issued by LMUK) and it was in order to fulfil those contractual obligations that LMUK procured that redeemers would accept the redemption of points from collectors. In those circumstances, the Supreme Court held that the monies paid by LMUK to redeemers was consideration for a supply of services by the redeemers (that of accepting points) and not (as to any part) third party consideration for the supply of goods or services by the redeemers to collectors.

34. We shall term this type of loyalty scheme "the separate operator model". Here, there are two money-flows. The payment to the promoter (here LMUK) by the sponsors, who paid for the issue of points to the sponsors' customers (not, as in the sub-contractor's model, monies paid to acquire goods or services to permit redemption) and the payments made by the promoter (LMUK) to the retailers who are redeemers, who accepted the points for the supply of goods and services to the collectors, in order that the promoter (LMUK) might fulfil specific contractual obligations to those points-holding customers, in the course of the promoter's own business. As we set out below, the Supreme Court, in *LMUK SC* recognised (having identified certain misapprehensions as to the nature of the loyalty scheme made by the CJEU in *LMUK CJEU*) that the payments made by the promoter (LMUK) to the redeemers were necessary to fulfil the operator's (business) contractual obligations (and was hence, in relation to the VAT element, deductible input tax in the paying-operator's hands).

35. The "separate operator model" (at least in the form present in *LMUK SC*) is completely different from both the simple own customer model and the sub-contractor model. In the simple own customer model there are, quite simply, no relevant money-flows either to or by the VAT trader. In the sub-contractor model, so far as the VAT trader is concerned, the loyalty scheme seeks to reward the trader's own customers but the trader must pay a sub-contractor for its "assistance" in implementing that loyalty scheme when the trader's customers wish to redeem points. The national court (implementing the principles and guidance of the CJEU) must ascertain the extent to which that payment by a trader to the sub-contractor has a direct and immediate link to the service of the sub-contractor in accepting the redemption of points and the extent to which that payment has a direct and immediate link to the payment of consideration to the sub-contractor in supplying goods and services to the trader's customers. In the separate operator model, the operator undertakes contractual obligations to someone else's customers (for perfectly intelligible commercial reasons) and expends money to fulfil those obligations as part of a business wholly distinct from both the Sponsors who pay the operator and the Redeemers who accept points (again for their own distinct commercial reasons). Here it is easy to see why the majority in the Supreme Court in *LMUK SC* held that the payment by the operator (LMUK) was wholly a cost component of LMUK's (own) economic activity and, therefore, that the VAT element in that payment was deductible input tax in LMUK's hands.

36. This (brief) description of loyalty schemes shows that the contractual framework and commercial dynamic of particular loyalty arrangements (in the light of "economic reality") fundamentally affects the relevant VAT analysis.

37. Having identified the different types of loyalty schemes which the case law has had to consider over time, we turn to examine the respective decisions in *LMUK CJEU* and *LMUK SC* in more detail since these decisions were central to the submissions of all of the parties in this appeal on Issue 1. As we have observed, the Supreme Court in *LMUK SC* identified fundamental misconceptions of the loyalty scheme in *LMUK SC*, on the part of the CJEU.

The *LMUK CJEU* decision

38. *LMUK CJEU* and *Baxi CJEU* were referred as Joined Cases to the CJEU.[35] We have identified that the respective loyalty schemes in *LMUK CJEU* and *Baxi CJEU* were very different (the former involved a separate operator scheme and the latter involved a sub-contractor model). But in the Joined Cases in *LMUK CJEU* and *Baxi CJEU*, the CJEU treated the LMUK loyalty scheme and the Baxi loyalty scheme as, effectively, identical. This was, as observed by the Supreme Court in *LMUK SC* at [31], [50], simply a mistreatment and

[35] The two references were joined by the order of the President of the Court on 11 March 2009, for the purpose of the written and oral procedure and judgment

"potentially misleading". The Supreme Court in *LMUK SC* concluded that this misapprehension led the CJEU to fail to address the pertinent question so far as LMUK was concerned. We note that at paragraph [11] of *LMUK CJEU*, the CJEU describes LMUK's loyalty scheme as one in which the s*ponsors* (our emphasis) award points to customers. This completely misdescribes the Nectar loyalty scheme, as it was LMUK (the promoter) which issued the relevant points.[36] It is fundamentally different for a trader (here a sponsor) to issue points to its own customers, than for a distinct operator to issue points to someone else's customers. It is unsurprising, therefore, that the UK Supreme Court felt that the CJEU had misunderstood the nature of LMUK's loyalty scheme.

39. In *LMUK CJEU*, the CJEU held that:

i) it was evident from the orders for reference that the loyalty reward schemes in issue were designed to encourage customers to make their purchases from particular traders. To that end, the operators provided a number of services linked to the operation of the schemes (*LMUK CJEU* [41]);

ii) nevertheless, the economic reality was that, under those schemes, loyalty rewards, which may consist of both goods and services, were supplied by the redeemers to the customers (*LMUK CJEU* [42]);

[36] *LMUK SC*, per Lord Reed [3], [4].

iii) in order to determine whether the supply of a loyalty reward is subject to VAT, it is necessary to ascertain whether it constituted a supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such (*LMUK CJEU* [43];

iv) it was evident from the orders for reference that the redeemers supplied to the customers goods and services within the meaning of Article 6(1) of the Sixth Directive (*LMUK CJEU* [46] – [49]);

v) the price customers paid to the sponsors for goods and services was the same whether or not the customers participated in the loyalty rewards schemes (*LMUK CJEU* [52]);

vi) consideration for a VAT supply may be obtained from a third party; and

vii) it was evident from the order for reference that the exchange of points by the customers with the redeemers gave rise to the making of a payment by LMUK to those redeemers. That payment corresponded to the consideration for the supply of the loyalty rewards.

40. At paragraph 65 of its judgment, the Court of Justice answered the question that had been referred to it in the *LMUK* case as follows:

> "In relation to a customer loyalty rewards scheme such as those at issue in the cases in the main proceedings, arts 5, 6, 11(A)(1) … of the Sixth Directive must be interpreted as meaning that:

> payments made by the operator of the scheme concerned to redeemers who supply loyalty rewards to customers must be regarded, in case C-53/09, as being the consideration, paid by a third party, for a supply of goods to those customers or, as the case may be, a supply of services to them. It is, however, for the referring court to determine whether those payments also include the consideration for a supply of services corresponding to a separate service:…"

The *LMUK SC* decision

41. Following the preliminary reference, a majority of the Supreme Court (Lords Reed, Hope and Walker; Lords Wilson and Carnwath dissenting) dismissed HMRC's appeal. Lord Reed said at [56] that the CJEU's analysis of the legal issues, on the basis of the facts as it understood them, was not open to question. Nevertheless, the UK court was required to take into account all of the relevant facts, including those elements left out of account by the CJEU, and to consider all arguments, including those which were not reflected in the questions referred. He said [56]:

> "In the exceptional circumstances of this case, this court cannot therefore treat the ruling of the Court of Justice as dispositive of its decision, in so far as it was based upon an incomplete evaluation of the facts found by the tribunal or addressed questions which failed fully to reflect those arguments. This court must nevertheless reach its decision in the light of such guidance as to the law as can be derived from the judgment of the court of justice. In that regard, important aspects of the judgment include the statement that consideration of economic realities is a fundamental criterion for the application of the common system of VAT… and the statement that, 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."

42. Lord Reed said at [11]:

> "The facts of this case, as I have described them, are both complex and unusual. In particular, the business operated by LMUK differs in fundamental respects from sales promotion and loyalty schemes which are operated by retailers as part of their own business, and under which the issue of points or vouchers does not involve a taxable supply. That being so, LMUK's business cannot be assumed to fall within the scope of decided cases concerned with schemes of the latter kind."

He also stated at [68] that:

> "It is also important to bear in mind that decisions about the application of the VAT system are highly dependent upon the factual situations involved. A small modification of the facts can render the legal situation in one case inapplicable to another."

43. Lord Reed observed that the Nectar scheme in *LMUK SC* involved (i) a promoter (LMUK), (ii) members ("collectors"), (iii) retailers ("sponsors") who paid to have points issued (critically) by LMUK *as operator* to the customers and (iv) Redeemers who supplied goods and services on the redemption of points.[37] Lord Reed went on to observe that LMUK was obliged contractually to ensure that Collectors could redeem points as against Redeemers.[38] LMUK (as promoter) provided collectors with the identities of sponsors and Redeemers, LMUK (as promoter), credited points for which the sponsors had paid and undertook to secure (to collectors) that redeemers would provide goods and services. LMUK agreed individually with redeemers that

---

37 *LMUK SC* [2]-[5].

38 Ibid, [7], [8].

redeemers would provide collectors with specified goods and services, according to the number of points redeemed.

44. Lord Reed considered that it was apparent that the CJEU had not taken into account, in reaching its conclusion, the following facts:

> "the fact that (1) LMUK had agreed to make a taxable supply when it granted to collectors the right to receive goods and services at no cost or at a reduced cost, and (2) collectors receiving goods and services on that basis were therefore exercising a right for which LMUK had already been paid, and the consideration for which had already been subject to VAT."

45. Further, Lord Reed, set out at [48] certain facts found by the Tribunal and relied upon by LMUK which were not included in the terms of reference to the CJEU. Amongst those facts were the following:

> "(1) The fact that sponsors pay LMUK for the grant to collectors of the right to receive goods and services, (2) the fact that LMUK meets the cost of the provision of goods and services to collectors out of those payments, (3) the fact that LMUK has, in return for those payments, granted collectors their right to receive goods and services without further payment at a reduced cost, (4) the fact that collectors obtaining goods and services from redeemers are therefore exercising a right which has already been paid for, (5) the fact that the provision of goods and services by the redeemers is the means by which LMUK discharges its obligations to sponsors and collectors and (6) the fact that the payments made by LMUK to redeemers are therefore an essential cost of its business."

46. Lord Reed emphasised the unusual nature of LMUK's business, which the CJEU was not requested to consider, at [77]:

> "LMUK's business is of an unusual character. Through the Nectar scheme, it provides collectors with a contractual right to obtain goods and services from redeemers in exchange for points. It is common ground before this court that that is a taxable supply and the taxable supply is the whole of the consideration which is received by LMUK. The counterpart of the rights applied to collectors is an obligation on the part of LMUK to procure that redeemers provide goods and services in exchange for points. The payments made to redeemers constitute the cost of fulfilling that obligation, and therefore are a cost of LMUK's business."

47. At [79] Lord Reed stated:

> "LMUK carries on a genuine business for its own benefit. It issues the point in its own name and on its own behalf: it is not a mere cipher for the sponsors. As a matter of economic reality, the payments which it makes to redeemers are an essential cost of its business. Its business model is to sell the right to receive goods and services, pay redeemers to provide goods and services, and derive a profit from the difference between its income from the sponsors and its expenditure on the redeemers."

48. Lord Reed was simply observing that *LMUK SC* involved what we have termed a separate operator model, not a simple own customer model, or a sub-contractor model. The payments made by LMUK to redeemers were an essential cost of its particular business. The remuneration received by the redeemers represented the value to LMUK of the service which the redeemers provided. If the provision of goods or services by redeemers to the collectors was treated as a taxable supply (other than to the extent to which money was paid by the collectors), the tax authorities would receive not only VAT on the amount received by LMUK from sponsors for supplying the right to receive those goods or services, but also VAT on the amount which LMUK had to pay

to satisfy that right. However, if the service charge was regarded as consideration for the supply of a service to LMUK (a service which encompasses the provision of goods and services to collectors), the tax authorities would still receive VAT from LMUK on the difference between the value of the supplies which it made in the course of its business and the value of supplies which it received for the purposes of that business. Therefore, LMUK should be authorised to deduct from the VAT for which it was accountable the VAT charge by the redeemers, so that it accounted for VAT only on the added value for which it was responsible [80] – [85].

49. Lord Hope agreed with Lord Reed[39] but, in addition, observed that the CJEU, having, apparently, ignored LMUK's submissions that there were two separate supplies made by the Redeemers, on the redemption of points (one to LMUK, the other to collectors), did not, on the terms of its judgment, issue definitive guidance as to how the transaction should be analysed (especially in the light of the ignorance of the CJEU, through no fault of its own) of many relevant factors.[40] Contrary to Mr Pleming's submissions we find no inconsistency between the analyses of Lord Reed and Lord Hope, with both of whom Lord Walker agreed. It may be that Mr Pleming quarrels with the observations of Lord Reed and Lord Hope that the CJEU, in *LMUK CJEU,* misunderstood the nature of LMUK's loyalty scheme. If so, not only do we consider that such a submission would be misconceived but, in any event, we are bound by *LMUK SC.*

39 Ibid, [111].
40 [95]-[110].

50. Having regard to all the circumstances, Lord Hope concluded at [108] that the economic realities test did not exclude the possibility that there can be more than one relevant supply for VAT purposes. He decided that, as a matter of economic reality, the redeemers should be treated as having made, in the same transaction, both a supply of "reward" services to the customers and a supply of "redemption" services to LMUK; see also Lord Reed at [83] and Lord Walker at [115].

Discussion and conclusion on Issue 1

51. In this case, as in *LMUK SC* (and indeed *Baxi CJEU*), the question is whether the payment by MR to the Redeemers is the payment of a cost component of MR's business or whether it is a payment in consideration of the supply of services (hotel accommodation) which are not used by MR in its business. Put another way, the question is whether the amount paid by MR is "for" (is consideration for) the acceptance of points by the Redeemer or, rather, the supply of a hotel room by the Redeemer to the Member. We consider it to be the former. This is a compulsory "pooling" arrangement, where Sponsors must pay MR to issue points to Members and Redeemers accept the redemption of points and are paid upon such acceptance. The Program is operated by MR, as a distinct economic actor from both Sponsors and Redeemers (collectively, the Participating Hotels). MR is no sort of "cipher". No point was taken by Mr Pleming as to the absence of any profit motive on MR's part, or the involvement of GHL. Indeed, as we have observed, it is

common ground that MR has an economic activity of its own, that of operating the Program.

52. The Program, in this case, is a separate operator's model which is, relevantly, indistinguishable from that in *LMUK SC*. Participating Hotels, as Sponsors, make payments to MR to promote the Marriott brand (and increase revenue for all of the Participating Hotels, including, of course, the Sponsor itself). But each Participating Hotel, in paying monies to MR, qua Sponsor, or receiving monies from MR, qua Redeemer, is paying money to a separate operator (who is not a "cipher"), which makes the relevant money-flows identical, we consider, to those in the separate operator model in *LMUK SC*. The Members who obtain points may or may not redeem those points against the sponsors and to that extent the model in this case cannot be aptly described as a sub-contractor model. Further we do not detect anything in the judgments of any of Lord Reed, Lord Hope or Lord Walker to suggest that the presence or absence of a commercial or corporate group relationship is relevant to the analysis of the VAT treatment of the payment by an operator to a redeemer.[41]

53. This case is also different from the type of simple own customer model loyalty scheme operated in *Kuwait Petroleum*, where a trader simply issues points to its own customers on acquiring (in that case) petrol, which points are subsequently redeemed for other goods. It is easy to see why the CJEU saw that no part of the purchase price paid by the points-earning customer in

[41] Unless this cast some sort of doubt, in the light of "economic reality" or "abuse" on the true nature of the loyalty scheme in question, which does not feature in any of the submissions in this appeal.

Kuwait Petroleum was paid for the points, since exactly the same amount would be paid by a non-points-earning customer who was simply buying petrol, and the subsequent redemption of points was simply goods supplied free of charge by the trader to the customer. Equally the Program is not a sub-contractor model as in *Baxi CJEU*. MR is not paying a sub-contractor to implement a rewards scheme for MR's customers (MR does not have hotel customers, MR is not a Participating Hotel).

54. Applying the principles of VAT we have set out above at paragraph 21:-

i) As to VAT being a tax on consumption, proportional to the price paid for a supply (principles (i) and (ii)), Issue 1 requires us to identify precisely what, on the redemption of points by Members, against Redeemers, is being supplied and consumed: a service of the redemption of points, hotel room accommodation, or both? This we must do by applying further principles below.

ii) In relation to principle (iii), that the final consumer should bear the burden of VAT as "sticking tax", MR (like the promoter in *LMUK SC*) has an economic activity for VAT purposes; the absence of a profit motive is irrelevant; to the extent that MR incurs VAT on payments to Redeemers as a cost component of its business, MR is not in the position of a final consumer. On the other hand, the Member who obtains points having purchased hotel rooms from Sponsors incurs irrecoverable sticking tax, albeit that the Member does not suffer

further sticking tax on redeeming points against a Redeemer which supplies hotel accommodation to the Member on redemption.

iii) In relation to principle (iv) (consideration must be a function of a reciprocal relationship between payment and supply), we consider that the payments made by MR to the Redeemers have a clear reciprocal relationship to the redemption of points by Redeemers on presentation of a Certificate and cannot be described as consideration for the supply of hotel accommodation by Redeemers to Members. Under the Participation Agreement, the management company (GHL) procures ("causes") the Participating Hotels, qua Redeemers, to accept the points (on the presentation of Certificates) to supply (in this case) hotel rooms to the Members. The obligation is for Redeemers to participate in the Program and accept the redemption of points, not to supply particular hotel rooms. We find that the payments by MR to Redeemers and the Redeemers' participation in the Program had a clear relationship of reciprocity. This is in contradistinction to *Baxi CJEU*, where, when @1 acquired goods to be supplied to Baxi's customers, on the redemption of points, @1 knew that it would get the retail value of those goods (and thus make a profit). In this case, just like *LMUK SC*, Participating Hotels have to pay money to MR (qua Sponsors) without any guarantee that they will have any amounts paid to them (qua Redeemers); MR, in the course of its economic activity, which comprises operating the Program and receiving (via GHL) and

paying monies to Participating Hotels, pays Redeemers (based on occupancy rates). It follows that the payment to Redeemers by MR is a cost component of that economic activity.

iv) As a cross check, we note that MR is not discharging an obligation owed by MR to Members by paying Redeemers. Members are not (absent payment by MR) liable to the Redeemers. Members simply, as we understand it, redeem points. If MR defaulted on payments to the Redeemers, we do not understand that the Redeemer could make any claim against the Member. Thus we consider that the payments by MR to Redeemers are consideration for the redemption of points, which MR, via GHL under the Participation Agreement "causes" the Participating Hotels to implement and not third party payment of a liability otherwise owed by Members to Redeemers.

v) Principle (v) (VAT is properly charged on the value added in the chain of production and distribution of services) would be properly applied if payments by MR to Redeemers were treated as cost components of MR's economic activity. MR makes supplies on the issue of points to Members (albeit that MR has no UK place of belonging and the charge to VAT arises on the Sponsors who acquire the points under the reverse charge provisions). Marriott International Inc undertakes contractual obligations to Members under the T&Cs, in respect of the program which is operated by MR, and (via GHL) causes Redeemers to accept the redemption of points, on presentation of a certificate,

under the Program. MR makes payments once points have been redeemed in the course of operating the Program (MR's economic activity). Whether or not there is a contractual obligation for MR to make such payments, these payments are a direct and immediate quid pro quo to the redemption of points by Redeemers.

vi) Principle (vi) (the same transaction may yield two or more supplies) is illustrated in these appeals, just as in *LMUK SC*. There is one supply (the redemption of points) by Redeemers to MR and another (the supply of hotel accommodation) by Redeemers to Members. For the reasons we give above, the payments by MR have a direct and immediate link to the former but not the latter.

Disposal of Issue 1

55. We therefore reject HMRC's challenge on Issue 1.

ISSUE 2

Place of Supply – are the supplies by Redeemers supplied in connection with immoveable property, or supplies of advertising or of some other description?

56. Having ascertained that the payment by MR to the Redeemers is, indeed, a payment in consideration of supplies (of accepting points) by the Redeemer to MR, we must ascertain the place of supply. We note that in *Baxi CJEU*, the CJEU, having found that a portion of the sums paid by the VAT trader (Baxi)

to the sub-contractor (@1) was consideration for the supply of accepting the redemption of points by @1, the CJEU did not investigate further whether that supply of services was to be categorised for VAT purposes by means of a deeper investigation or analysis by reference to the supply made by @1 to Baxi's own customers. If the CJEU's approach in *Baxi CJEU* requires, as a matter of principle, the supply of accepting the redemption of points to be treated as just that, with no further investigation, it follows that the supply of services by Redeemers to MR in this case is equally a supply of accepting points (and no more) so, therefore, not supplies made with either a "connection" to immovable property, as submitted by MR, or of advertising, as submitted by Whitbread. But even if we are required to look further at the supplies made by Redeemers to Members, to ascertain the nature of supplies made by Redeemers to Members, like the FTT, we do not consider that the supplies are those with a connection to immovable property or of advertising.

Supplies by redeemers are not supplies "in connection with immoveable property"

57. MR contended that the supplies had a "connection with immovable property". MR relied on *Minister Finansow v RR Donnelley Global Turnkey Solutions Poland sp zoo* (Case C-155/12) ("*Donnelley*") and *RCI Europe v HMRC* (Case C-37/08) ("*RCI Europe*"). The test is that there is specific immovable property and the supply must "relate" to that specific immovable property, so that the property is a constituent element and essential element in the supply (*Donnelley*, [34], [35]. So, in *RCI Europe*, timeshares in properties which were "pooled" were treated as being supplies made in "connection" of land.

MR observed that it was only once a particular hotel room had been provided that MR would make a payment to a Redeemer.

58. We disagree. The Redeemers are accepting the redemption of points under the Program (in particular under the International Franchise Agreement or the International Services Agreement, as the case may be, which requires all Participating Hotels to pay MR under the Program and to accept the redemption of points) by undertaking to provide *a* hotel room, either free or at a discounted rate. The Redeemers are not undertaking to provide a specific hotel room. And although payment from MR follows (obviously) after the provision of a specific hotel room to a specific Member, the payment is for the Redeemer to accept points from a Member for a hotel room. We consider the FTT to have expressed the analysis very well in describing the services provided by the Redeemer as the provision of "generic service of agreeing to provide Reward Stays generally." (FTT Decision [172]). We observe that the reason why the payments by MR to Redeemers are consideration for supplies made by Redeemers to MR and not third party consideration for supplies of hotel rooms by Redeemers to Members is also the reason why the supplies are not made "in connection with" immoveable property.

Supplies by Redeemers are not supplies of advertising

59. Ms Brown, for Whitbread, submitted that the supplies made by a Redeemer to MR were those of advertising, being "the dissemination of material to inform consumers of the existence and qualities of a product or service with a view to

increasing sales" (*EC v French Republic* (Case C-68/92) [16]) ("*French Republic*"). Whitbread, in the course of oral submissions, said that HMRC had treated the payments made by Sponsors to MR as payments for supplies of advertising (and further, that the nature of the Program as a whole was clearly that of promotion and advertising in the *French Republic* sense); Whitbread submitted that the roles of Participating Hotels as both Sponsors and Redeemers were necessarily part of that advertising and hence the supplies by Redeemers to MR were supplies of advertising.

60. Again, like the FTT, we disagree, although we have found this point more difficult to resolve than that relating to immoveable property. The FTT found that the purpose of the Program was to attract more customers, and to increase revenue (FTT Decision [13]), which is clearly "advertising" in the *French Republic* sense. The FTT also found that the Program was designed to encourage hotels to launch Marriott brands rather than competitor brands (FTT Decision [13]). And that Members who redeemed points would be fairly treated to avoid adverse publicity (FTT Decision [20]), which is again consistent with the Program having an advertising objective.

61. We have no difficulty in finding that the objective of the Program as a whole was to advertise the Marriott brand. We also recognise that the provision of free goods and services can constitute "advertising". A greengrocer may give away free oranges to advertise his or her fresh fruit to customers who like oranges and are perfectly aware that the oranges are excellent. The role of Participating Hotels as Sponsors and Redeemers (obligatory under the

International Service Agreement and International Franchise Agreement) was fundamental to the Program and must take their colour from the nature and object of the Program. Equally, however, it is self-evident that a trader which sells goods or services to a consumer is not "advertising" in any relevant sense, even if the trader ensures that the goods or services are of good quality and hopes that this good quality will lead to further sales.

62. The FTT found that "[a] Member obtaining a reward stay at a particular hotel cannot have been unaware of the existence of that hotel not least since the Member would have made a positive choice to obtain the reward stay at that very hotel" (FTT Decision [182]). If the FTT is saying that the redemption of points which leads to the hotel room being supplied to the Member takes place after the dissemination of information etc. has been already made to the Member (that is consumed by the Participating Hotels qua Sponsors) and therefore the supplies by Redeemers cannot be advertising, we disagree with the FTT. As we have observed, the supply of goods or services free can be advertising, whether the consumer knows subjectively of their quality or not. However, the FTT further found that "[the FTT was] not satisfied on the evidence…that Whitbread agreed to make rewards available to Members without charge in order to inform the Member of the existence or qualities of its goods or services" (FTT Decision [183]). Indeed the FTT found that "…the purpose Whitbread had in making reward rooms available was simply that it was contractually obliged to do so" (ibid).

63. The FTT also found, as a finding of fact, that there was insufficient evidence that Redeemers accepted the redemption of points to advertise the Marriott brand (FTT Decision [183]) and that "[MR] is receiving the "raw material" (Redeemers' agreement to provide services rewards to Members without payment in cash) which is central to its business [and] that the services from Redeemers therefore enable MR to perform obligations associated with its business, not to promote or advertise it" (FTT Decision [184]).

64. As a matter of principle, it is specifically the supplies by the Redeemers to MR (as we have found there to be) which we have to analyse, albeit taking into account "economic reality" and their clear and undoubted place in the context of the Program. The FTT has concluded as a function of its findings on the basis of the evidence (which we cannot disturb unless the FTT has misdirected itself or those findings are otherwise perverse) that subjectively the Redeemers are merely fulfilling contractual obligations. The FTT was entitled to find that Redeemers were merely subjectively fulfilling contractual obligations (since the FTT at [183]) had observed the obligatory participation of Participating Hotels in the Program and was entitled to find that such participation was viewed by them as a mere cost rather than as advertising the Marriott brand). After all, Members may redeem points against Redeemers who had nothing to do with the Participating Hotels who had paid as Sponsors and in which Members had stayed to earn the points in the first place.

65. The question for us is whether the objectives of the Program as a whole mean that the FTT was wrong to find that payments by MR to Redeemers were not

for supplies of advertising. We consider the answer to be "no". The FTT expressly found that there was no evidence on the part of Redeemers that the redemption of points had an advertising objective (FTT Decision [183]). Just because Redeemers are accepting points under the Program which has an advertising objective as a whole, this does not mean that it is axiomatic that the redemption of points under the Program is of itself advertising, even looked at objectively. The acceptance of points on redemption by Members may be the fructification of a completed advertising process. Whether it is or not is a function of objective assessment in the light of relevant evidence. The FTT has found that the acceptance of points by Redeemers was exclusively the fulfilment of a contractual obligation and not part of the advertising process under the Program and it was entitled to so find. We cannot disturb this on the basis of either the FTT having failed to consider the relevant evidence, or having otherwise misdirected itself, since the FTT clearly had the *French Republic* test in mind and considered the evidence and the Program as a whole in identifying the nature of the Redeemers' supplies to MR .

66. There is a more fundamental objection to recovery by Whitbread for the VAT element of supplies by the Redeemers to MR. Even if the FTT was wrong and ought to have concluded that, so far as the Redeemers were concerned, the acceptance of points from Members was indeed advertising, the supplies by the Redeemers to MR can only be intelligibly categorised as supplies of "advertising" by Redeemers to MR if MR has a business of advertising. The FTT at FTT Decision [184] held that MR does not have a business of

advertising. We revisit the FTT's observation at FTT Decision [184] that "[MR] is receiving the raw material (Redeemers' agreements to provide rewards to Members without payment in cash) which is central to its business. The services from Redeemers therefore enable MR to perform obligations associated with its business, not to promote or advertise it." It is implicit in this statement by the FTT that it is no part of MR's business to promote or advertise the Marriott brand or Participating Hotels, despite being the operator of the Program. Otherwise the "obligations" of which the FTT speaks would necessarily include "promotion" and "advertising" of the Marriott brand as necessary components of MR's business. As in our analysis of the Program from the perspective of the Redeemers, the objective of the Program does not mean that MR, as operator of the Program, axiomatically has a business of advertising. MR may, for example (the evidence simply does not permit us to conclude one way or the other) carry on a business of merely mechanically operating the Program (rather like a group treasury company which undertakes, often large, financial transactions within a particular group, without sharing the specific commercial objectives of that group, so that the treasury company will not, in an advertising group, itself have advertising objectives). The nature of the Program to promote the Marriott brand is not sufficient for us to displace the finding of fact made by the FTT that MR did not have any such purpose in its own business.

Disposal of Issue 2

67. We dismiss the appeals of MR and Whitbread on Issue 2.

Conclusion

68. For the reasons given above, this appeal is dismissed.

Mr Justice Henry Carr

Deputy Judge Ghosh

Judges of the Upper Tribunal

Released 30 April 2018