[2022] UKUT 00149 (TCC)

Appeal number:
UT/2021/000024
UT/2021/000076

VAT— local authority providing sports and leisure facilities – whether engaging as public authority - Article 13 PVD – appeal dismissed – not necessary to consider cross-appeal on Note 3 Group 10 Sch 9 VATA 1994, but if it were, cross-appeal would be dismissed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Appellant Respondents in cross-appeal**
-and-	
CHELMSFORD CITY COUNCIL	**Respondent Appellant in cross-appeal**

TRIBUNAL: MRS JUSTICE JOANNA SMITH
JUDGE SWAMI RAGHAVAN

Sitting in public in London, on 9 and 10 March 2022

Raymond Hill, counsel, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Appellants /Respondents in cross-appeal

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DECISION

Introduction

1. The appellants each appeal against the decision of the First-tier Tribunal ("**FTT**") published as *Chelmsford City Council v Commissioners for HM Revenue & Customs* [2020] UKFTT 432 (TC) ("**the Decision**").

2. The central issue in the appeal is the VAT liability for admissions charges for sports and leisure facilities (the "**Facilities**") provided by the local authority, Chelmsford City Council ("**Chelmsford**"). In particular, whether, as HMRC contends, Chelmsford was acting as a taxable person when providing the Facilities (and so was subject to VAT) or whether, as Chelmsford argues, it was acting as a public authority pursuant to Article 13(1) of the Principal VAT Directive 2006/112/EC (the "**PVD**"). Under the relevant case-law on Article 13 of the PVD, that question turns on whether the body providing the facilities was acting pursuant to a "special legal regime" applicable only to the public authority and not to private operators. The FTT agreed with Chelmsford, that its services were provided under a special legal regime and that, accordingly, the supplies did not bear VAT. HMRC appeal against the Decision on that issue ("**the Special Legal Regime Issue**") with the permission of the FTT.

3. If the FTT was wrong on the Special Legal Regime Issue, a further issue arises regarding the interpretation of a domestic VAT provision (Note 3, Group 10, Schedule 9 of the Value Added Tax Act 1994 (the "**VAT Act**")) ("**the Note 3 Issue**"). That turns on whether (as Chelmsford contends) the terms of Note 3 operated as an exercise of the discretion permitted under Article 13(2) of the PVD so as to treat the relevant supplies made by Chelmsford as carried out by it as a public authority. The FTT rejected Chelmsford's interpretation of Note 3. With the FTT's permission, Chelmsford cross-appeals against the Decision on the Note 3 Issue.

Procedural Background

4. By a voluntary disclosure submitted in December 2010, Chelmsford claimed repayment of VAT allegedly overpaid in VAT accounting periods between 2006 and 2010, totalling around £0.9 million. The claim was rejected by HMRC and Chelmsford appealed to the FTT. In circumstances where similar issues had arisen across the UK,

this case was designated a "lead case" for England and Wales. Lead cases were also designated for Scotland and for Northern Ireland. The same three judge FTT panel was convened to hear all of these lead cases. The lead cases for Scotland (*Midlothian District Council v Revenue & Customs* [2020] UKFTT 433 (TC)) and Northern Ireland (*Mid-Ulster District Council (formerly Magherafelt District Council v Revenue & Customs* [2020] UKFTT 433 (TC)) considered the legislation relevant to those jurisdictions. The FTT found in the relevant local authority's favour on the Article 13 Special Legal Regime Issue in both. HMRC have not appealed *Midlothian*. They have appealed *Mid-Ulster* but on different grounds not relevant to this appeal.

5. Before the FTT, Chelmsford's first argument was that the supply of the Facilities to members of the public was not an "economic activity" such that Chelmsford was not a "taxable person" within the meaning of Articles 2 and 9 of the PVD and hence not subject to VAT. The FTT found against Chelmsford on this point but granted permission to appeal. Chelmsford withdrew this aspect of its appeal shortly before the hearing before us. HMRC's appeal on the Special Legal Regime Issue, and Chelmsford's cross-appeal on the Note 3 Issue, are discrete issues and were argued sequentially before us. In dealing with those two issues in the same manner, we first address the Special Legal Regime Issue. We will set out the background law and summary of the parts of the Decision relevant to that issue before moving on to a more detailed discussion of the legal principles to be applied and whether the FTT applied those correctly.

Background law on Special Legal Regime Issue

6. Despite Chelmsford's withdrawal on the issue of "economic activity", Articles 2 and 9 of the PVD remain relevant in that they provide the general rule against which the derogations and exemptions at issue in this case apply. Article 2 subjects the supply of services for consideration by a "taxable person" acting as such to VAT. Article 9 defines "taxable person" as meaning any person who "carries out…any economic activity". Any activity of an economic nature may thus be subject to VAT.

7. Article 13(1) of the PVD derogates from that general rule in providing for circumstances in which local government authorities will not be regarded as taxable persons in respect of certain activities in which the authority engages:

> Article 13
>
> "1. States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.
>
> However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.
>
> …"

8. CJEU case-law on Article 13(1) highlights two conditions that need to be fulfilled in respect of "the activities". First, the activities must be carried out by a body "governed by public law" (references in this judgment to the "**first condition**" will be references to this requirement). There is no dispute here that Chelmsford meets the first condition. Second, the activities carried out by that body must be "activities…in which they engage as public authorities" (references in this judgment to the "**second condition**" will be references to this requirement). This second condition is the focus of HMRC's appeal.

9. According to the case-law, and as is common ground between the parties, the issue arising under the second condition turns on whether the activity is engaged in under a "special legal regime". As explained in *Fazenda Pública v Câmara Municipal do Porto* (Case C-446/98) ("***Fazenda***"), which we will discuss in more detail later in this judgment, this requires the national court to:

> ".analyse all the conditions laid down by national law for the pursuit of the activity at issue in the main proceedings, to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators."

10. Pursuant to the last paragraph of Article 13(1), and even assuming a special legal regime, an activity may still be treated as taxable if treating the body carrying it out as a non-taxable person would lead to significant distortions of competition. That is an issue which, by agreement of the parties, the FTT did not determine and which remains before the FTT. It does not arise on this appeal.

FTT Decision – Summary in relation to the Special Legal Regime issue

11. After setting out the relevant European VAT legislation and corresponding UK legislative references, the FTT referred to various excerpts from Local Authority legislation, including (at [13] of the Decision) s19 Local Government (Miscellaneous Provisions) Act 1976 ("**LGMPA**") **("s19")**:

> **Section 19 LGMPA**:
>
> "Recreational facilities.
>
> (1)A local authority may provide, inside or outside its area, such recreational facilities as it thinks fit and, without prejudice to the generality of the powers conferred by the preceding provisions of this subsection, those powers include in particular powers to provide—
>
> (a) indoor facilities consisting of sports centres, swimming pools, skating rinks, tennis, squash and badminton courts, bowling centres, dance studios and riding schools.
>
> (b) outdoor facilities consisting of pitches for team games, athletics grounds, swimming pools, tennis courts, cycle tracks, golf courses, bowling greens, riding schools, camp sites and facilities for gliding;
>
> (c) facilities for boating and water ski-ing on inland and coastal waters and for fishing in such waters.
>
> (d) premises for the use of clubs or societies having athletic, social or recreational objects.
>
> (e) staff, including instructors, in connection with any such facilities or premises as are mentioned in the preceding paragraphs and in connection with any other recreational facilities provided by the authority.
>
> (f) such facilities in connection with any other recreational facilities as the authority considers it appropriate to provide including, without

> prejudice to the generality of the preceding provisions of this paragraph, facilities by way of parking spaces and places at which food, drink and tobacco may be bought from the authority or another person;
>
> and it is hereby declared that the powers conferred by this subsection to provide facilities include powers to provide buildings, equipment, supplies and assistance of any kind.
>
> (2) A local authority may make any facilities provided by it in pursuance of the preceding subsection available for use by such persons as the authority thinks fit either without charge or on payment of such charges as the authority thinks fit.
>
> (3) A local authority may contribute—
>
> (a) by way of grant or loan towards the expenses incurred or to be incurred by any voluntary organisation in providing any recreational facilities which the authority has power to provide by virtue of subsection (1) of this section; and
>
> (b) by way of grant towards the expenses incurred or to be incurred by any other local authority in providing such facilities.
>
> and in this subsection "voluntary organisation" means any person carrying on or proposing to carry on an undertaking otherwise than for profit.
>
> …"

12. The FTT identified the general duty for "best value" mandated by section 3(1) of the Local Government Act 1999: "A best value authority must make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness". It also identified (i) that section 221 of the Public Health Act 1936 gave a power to local authorities to "…provide public baths" and to make charges for the use of those baths; and (ii) the subsidiary powers of local authorities as set out in section 111 Local Government Act 1972, including (at section 111(1)) that "…a local authority shall have power to do anything…which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions"). See paragraphs [14]-[16] of the Decision.

13. The FTT then examined at some length (at paragraphs [21] and [22] of the Decision) the evidence from Chelmsford's two witnesses, its Leisure and Heritage

Service Manager, Mr Jonathan Lyons, and its Principal Accountant, Mr Philip Reeves. Their evidence described in detail how Chelmsford has exercised its discretion to provide fee-generating sport and leisure facilities, and its objectives in providing those facilities. The FTT accepted that evidence in its entirety (at paragraph [100]). The documentary evidence before the FTT included Chelmsford's policy and corporate strategy documents.

14. By way of background, the evidence explained that the main fee generating leisure activities were swimming, ice skating, various racquet and team sports, gym and exercise classes, athletics and children's soft play, which were provided at four leisure centres and in Chelmsford's parks (paragraph [21(3)]). Apart from gym facilities, offered on a membership basis, the services were "pay for play" meaning users simply pay for access upon arrival. Price concessions were in operation for various categories of users (paragraph [21(4)]). Chelmsford does not act as a business would because it does not aim to make a profit in its provision of leisure services. Chelmsford cannot provide leisure services as a trading activity as it does not have power to do so – a local authority can only undertake a trade through a subsidiary company (paragraph [21(11)]). The evidence identified in detail the provision of similar leisure facilities by other (private) providers (21[10]).

15. The evidence upon which the FTT particularly relied in its later reasoning (at paragraph [141]) is summarised below:

> (1) All decisions provided by Chelmsford in relation to the Facilities, including key decisions such as pricing and capital investment took into account the social benefits of participation: health and wellbeing, education, reduction in crime and tackling social exclusion. These social objectives were reflected in Chelmsford's Corporate Plan, its Community Plan "Chelmsford Tomorrow 2021" and its strategy documents relating to the Facilities, including "A Strategy for Sport & Recreation in Chelmsford 2006-2010" ([21(6)] and [7])).
>
> (2) Chelmsford did not expect a market return on its capital funding which was considered by reference to a wide range of factors including social benefit. It would fund capital projects in areas where public demand was not met by private operators and it recognised that siting a leisure centre

in an area of deprivation was likely to bring higher social benefits (21[13]).

(3) Chelmsford ran its leisure department in a way which actively promoted other organisations, for instance the remit of its staff was, amongst other things, to support local sports clubs and to work with schools to implement schemes promoting health or increasing participation amongst vulnerable groups (21[14]).

(4) Chelmsford also had regard, in providing the Facilities, to statutory obligations, undertaking "best value" reviews to meet these. It also now has regard to obligations arising under the Health and Social Care Act 2012. Chelmsford recognises that the promotion of health is one of the key benefits to be derived from participation in sport and leisure pursuits, putting in place various initiatives that focus on improving the health and wellbeing of the population (21[16]).

(5) There was always a balancing exercise between cost of provision and charges made. The overriding factor had always been to encourage participation with charges being "held" if it was felt an increase would deter participation. The same considerations, regarding not compromising the objective of providing the facilities, applied in financial appraisal of any new facilities and new capital expenditure. Financial considerations are generally regarded as secondary – thus Chelmsford would not agree to increase fees to reduce expenditure on a service if the result of that increase was expected to exclude vulnerable groups from accessing the services ([21(20)(e)] and [22(9)] and [13]).

16. The FTT set out the parties' respective arguments on the Special Legal Regime Issue (at paragraphs [49] –[63] and [85] –[91]) and then turned to address its reasoning on the issue at paragraphs [116]-[146].

17. It decided (at paragraph [142]) that any private sector business providing sports and leisure facilities in Chelmsford's area "…would be doing so not under the s19 regime but instead under the general legal regime applicable to all facility operators" and thus that Chelmsford's provision of facilities was being engaged in under a special legal regime applicable to a body governed by public law. We will set out the legal

principles upon which the FTT relied, together with its application of those principles, later in this decision.

The Special Legal Regime Issue

Grounds of appeal and summary of parties' submissions

HMRC's ground of appeal: FTT failed correctly to apply relevant case-law

18. HMRC submits that the FTT erred in law by failing correctly to apply the test laid down by case law for the identification of a special legal regime under Article 13(1) of the PVD. In its Grounds of Appeal, HMRC focused on the approach of the CJEU in Case C-554/07 *Commission v Ireland*, contending that the "generic conditions" under which Chelmsford operated were not sufficient to put it in a different position to the Irish local authorities considered by the CJEU in that case and that if any of those conditions was enough to transform the power in s 19 LGMPA into a special legal regime, then the same would equally be true of all local authority powers, an outcome which would be directly contrary to the decision in *Commission v Ireland*.

19. In written and oral submissions for the hearing, HMRC sought to advance an additional argument. It now contends that in various cases in which the issue of a special legal regime has arisen, the CJEU has drawn a distinction between use of a statutory power simply to authorise the public body to carry on the activity (e.g. making parking one of the areas which fall within the remit of the local authority) and the use of a power specifically to exercise the activity. Thus, a correct interpretation of those cases leads to the conclusion that a special legal regime arises only where the relevant activities require use of "sovereign" powers, for example rule-making or penalty imposition (e.g. giving a council power to demarcate and charge for parking spaces in the public highway). HMRC says that the identification of a dividing line by reference to this criterion is consistent with the requirement that Article 13(1) of the PVD is a derogation and so must be interpreted strictly.

20. Chelmsford agrees that authorisation to exercise a power provided by statute is not, in itself enough to give rise to a special legal regime and it accepts that the focus must be on the use of the power for the exercise or carrying on of the relevant activity. However, it contends that the existing case-law establishes that the emphasis is on the

way and manner in which the activity is carried out under the legal regime and whether that regime is different from the regime under which private operators carry out the same activity. It disagrees that the case-law limits the existence of a special legal regime to circumstances in which the powers used or exercised are "sovereign" type powers. It took no point on HMRC's failure to raise this issue in its Grounds of Appeal.

21. Although the FTT spent some time in its Decision considering the possible distinction between powers and duties, that was not an issue between the parties at this hearing. It is common ground that it is possible for both powers and duties to fall within Article 13(1) in the right circumstances, although HMRC contends that it is more likely that duties will do so.

22. The key points of contention between the parties to this appeal therefore concern (i) what is encompassed by the "use or exercise" of public power and in particular whether HMRC is correct that the second condition in Article 13(1) only applies where the public body has to actually use its public – "sovereign" – powers to carry out the relevant activity, and (ii) whether the FTT failed to apply the test laid down in *Commission v Ireland*.

23. We begin by summarising the key authorities to which we were referred by the parties, together with the undisputed principles to be derived from them.

Case-law

24. *Ufficio distrettuale delle imposte dirette di Fiorenzuola d'Arda (Piacenza) v Comune di Carpaneto Piacentino (Piacenza),* and *Comune di Rivergaro and 23 other local authorities v Ufficio provinciale imposta sul valore aggiunto di Piacenza (Piacenza)* Joined Cases C-231/87 and 129/88 *("**Carpaneto 1**")* concerned whether various transactions engaged in by the local authorities, including concessions in respect of graves, cemetery vaults and chapels, met the second condition. The CJEU explained that analysis of the second condition (paragraphs [15] and [16])

> "…in the light of the scheme of the directive shows that it is the way in which the activities are carried out that determines the scope of the treatment of public bodies as non-taxable persons. In so far as that provision makes such treatment of bodies governed by public law conditional upon their acting 'as public authorities', it excludes therefrom

> activities engaged in by them not as bodies governed by public law but as persons subject to private law. Consequently, the only criterion making it possible to distinguish with certainty between those two categories of activity is the legal regime applicable under national law.
>
> It follows that the bodies governed by public law referred to in the first subparagraph of Article 4(5) of the Sixth Directive engage in activities 'as public authorities' within the meaning of that provision when they do so under the special legal regime applicable to them. On the other hand, when they act under the same legal conditions as those that apply to private traders, they cannot be regarded as acting 'as public authorities'."

25. The Court had explained earlier that subject matter and purpose were irrelevant to this question as those matters were covered elsewhere in the Directive ([13]).

26. In *Carpaneto Comune di Carpaneto Piacentino v Ufficio Provinciale Imposta Sul Valore Aggiunto di Piacenza* Case C-4/89 *("**Carpaneto 2**")* the court affirmed the principle that it was "the manner" in which activities were carried out which determined the scope of the second condition ([10]). We do not consider there to be any distinction between the use of the words "way" and "manner" in *Carpaneto 1* and *Carpaneto 2* and none was suggested to us.

27. In *Fazenda*, where the relevant activity was the provision of car parking, the CJEU elaborated on how the legal regime provided the relevant distinction. After emphasising, by reference to *Carpaneto 1* and *Carpaneto 2*, that it was "the way in which the activities are carried out that determines the scope of the treatment of public bodies as non-taxable" ([16]), the CJEU explained the task of the national court was to:

> "…analyse all the conditions laid down by national law for the pursuit of the activity at issue…to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same conditions as those that apply to private economic operators" (paragraph [21])

28. At [22] the CJEU found that:

> "the fact that the pursuit of an activity such as that at issue in the main proceedings involves the use of public powers such as authorising or restricting parking on a public highway or penalising by a fine the

> exceeding of the authorised parking time, shows that this activity is subject to a public law regime"

29. In answer to the referring court's question, the CJEU viewed the special legal regime requirement as being satisfied "where the pursuit of the activity involves the use of public powers" ([24]). This is a formulation of the test which has been picked up in various subsequent cases.

30. Car parking provision by local authorities also featured in *Revenue and Customs Commissioners v Isle of Wight Council and others* (Case C-288/07) ("***Isle of Wight***"). On the basis of the court's ruling in *Fazenda*, the local authorities considered their provision of off-street parking was not subject to VAT. The point at issue was the distortion of competition condition (which followed on from the second condition) in Article 13(1) and the interpretation of particular words in the statutory formulation. The court noted, pursuant to the second condition, that activities pursued as public authorities within the meaning of that condition were those engaged in by bodies governed by public law under the special legal regime applicable to them and did not include activities pursued by them under the same legal conditions as those that applied to private economic operators. The analysis of this was for the national court ([21] and [22]). That issue was not referred to the court though so, subject to verification by the national court, the CJEU proceeded on the hypothesis that the second condition had been fulfilled ([23]).

31. Nonetheless, the Court's analysis on why the competition condition was not subject to evaluation at a local market level (one of the issues in the case) is instructive for the light it throws on the philosophy behind Article 13. In particular, that the general rule that activities of an economic nature are subject to VAT, and that it is only by derogation that activities engaged in by a body governed by public law acting as a public authority are not to be subject to VAT. At [31], the CJEU explained that such activities "while fully economic in nature, **are closely linked to the exercise of rights and powers of public authority**" (**emphasis added**). The absence of VAT was not potentially anti-competitive inasmuch as the activities were "generally engaged in exclusively, or almost exclusively by the public sector." The competition condition, and an Annex (which listed various activities such as telecommunications and other utilities as subject to VAT unless negligible - now in Annex 1 of the PVD) which operated as exceptions to the derogation were:

> "subject to the same logic by which the Community legislature intended to limit the scope of the treatment of bodies governed by public law as non-taxable persons, so that the general rule…under which any activity of an economic nature is, in principle, to be subject to VAT, is observed" ([38]).

32. A dispute over VAT on parking provision also lay at the root of *Commission v Ireland* (Case C-554/07), although by the time the issue got to the CJEU, in the form of infraction proceedings, it concerned the wider question of compatibility of Irish legislation (under which, state and local authorities were not treated as taxable persons unless a ministerial order was made in respect of a specified category of goods or services) with the Directive. The Commission's case was that Ireland's legislation failed to require taxation of activities of local authorities otherwise than in their capacity as public bodies. Ireland's response (at ([38]) was that it was clear from a constitutional provision and "more specifically the provision of the Local Government Act 2001 that, in so far as they engage in activities, local authorities in Ireland did so uniquely pursuant to powers conferred upon them under the specific legal regime applicable to them by statute including the exercise of public powers, in accordance with the Court's case-law". Ireland's argument, in essence, was that its legislation was not at odds with the Directive, because local authorities acted only pursuant to powers conferred on them by statute and therefore necessarily acted in their capacity as public bodies such that their activities were not subject to taxation (subject to a ministerial order in respect of a specified category of goods or services).

33. Given the reliance placed by HMRC on this case, the findings of the Court are worth setting out in detail.

34. At [39]-[42], the Court affirmed the effect of the first paragraph of Article 13(1) as a derogation from the general rule that activity of an economic nature was taxable. The first subparagraph, as an exception to that rule, had to be strictly interpreted. At [41] the Court said:

> "As the Court has held on numerous occasions, two conditions must be cumulatively fulfilled in order for [the derogation] to apply: the activities must be carried out by a body governed by public law and they must be carried out by that body acting as a public authority…"

35. It followed that bodies governed by public law were "subject to VAT in respect of economic activities in which they engage otherwise than as public authorities" (para [43]).

36. The Court found (at [46]) that Ireland's legislation in respect of VAT did not satisfy the requirement for an express provision requiring bodies governed by public law to be treated as taxable, noting (at [47]) that "[i]t follows that activities in which Irish public authorities engage are not, as a rule, regarded as being taxable".

37. At [49] the Court observed that its conclusion was not affected by Ireland's argument that, in so far as they engage in economic activities, local authorities in Ireland do so uniquely pursuant to powers conferred upon them under the specific legal regime applicable to them by statute, saying this:

> "Apart from the fact that such argument concerns only activities engaged in by local authorities and not those engaged in by the State, **it is to be noted that bodies governed by public law act as public authorities when they engage in activities which, while fully economic in nature, are closely linked to the exercise of rights and powers of public authority** (*Isle of Wight Council and Others*, paragraph 31). Moreover, the mere fact that a body governed by public law acts within the framework of a special legal regime and in accordance with powers conferred upon it by statute does not mean that engaging in its activities necessarily involves the exercise of rights and powers of public authority" (**emphasis added**).

38. In *Saudaçor - Sociedade Gestora de Recursos e Equipamentos da Saúde dos Açores SA v Fazenda Pública* (Case C-174/14) ("***Saudaçor***"), a company (Saudaçor) providing planning and management services to the health service of the Autonomous Azores Region (the "**RAA**") was created by a Regional Legislative Decree (the "**Decree**") of the RAA which set out its various functions. The Decree identified Saudaçor's functions and provided that it should be "governed by that instrument", by its articles of association, "by the legal regime for public undertakings [as provided for in another decree] and by private law". The Decree also required Saudaçor to respect the rules governing the organisation and operation of the regional health service of the RAA and provided (in Article 10) that Saudaçor held the same powers conferred by public law as the RAA, "including the power to carry out expropriations" ([15]).

39. The underlying dispute concerned whether Saudaçor was liable to VAT on the services it provided. The CJEU, in dealing with the referring court's questions, considered the provision of services was economic in scope and that it could not be ruled out, in light of an overall assessment taking account of the provisions of national law applicable to Saudaçor, that it met the first condition ([68]). As to whether it was acting as a public authority for the purposes of the second condition, the Court affirmed (at [[70]-[71]) the tests applicable to the existence of a special legal regime as laid down in *Fazenda* ("pursuit of the activity…involves the use of powers conferred by public law"), and *Isle of Wight* (the "activities engaged in…are closely linked to the exercise of powers conferred by public law").

40. At [72], the CJEU explained that the second condition would not be satisfied (subject to verification by the national court) if, as the Portuguese Government argued:

> "…the powers conferred by public law available to Saudaçor under [Article 10 of the Decree] did not amount to an instrument that could be used by Saudaçor in order to carry out activities at issue in the main proceedings, namely the activities concerning the planning and management of the regional health service, the liability of which to VAT is disputed, since they are used for carrying out other activities."

41. *National Roads Authority v The Revenue Commissioners* (Case C-344/15) ("***NRA***") concerned whether an Irish authority, set up by statute, which was empowered to establish a road toll scheme, and which provided road infrastructure in return for tolls, was a taxable person. In relation to the activity in question, it was common ground before the referring tribunal, that the body was governed by public law and was acting as a public authority ([22]). Although the Commission considered it "far from clear" that was the case ([30]), the CJEU did not revisit the issue, noting it was for the national court to define the legislative and factual context of the dispute together with the questions to be submitted to the European Court ([31]-[34]).

42. *Gmina Wroclaw v Dyrektor Krajowej Informacji Skarbowej* (Case C-604/19) ("***Gmina Wroclaw 2021***") concerned a municipality's activity of transformation of leasehold type rights (referred to as perpetual usufruct) which existed under the former communist regime as between the occupier and authority, into ownership rights, in return for payment of a fee. The referring court described the tasks undertaken by the municipality as "tasks of an administrative nature" and explained how the process took

place "solely by operation of law…and that the [municipality] cannot take any action which would have an impact on the personal, material or economic scope of that transformation" ([40]).

43. One of the questions referred concerned whether the municipality pursued the activity as a public body. Before going on to recite the well-established principles by reference to *Saudaçor* at [70] together with the case law there cited, the CJEU explained (at [78]) that:

> "it is the manner in which the activities at issue are carried out that determines the scope of treatment of public bodies as non-taxable persons. Thus, activities carried out as public authorities for the purposes of the first subparagraph of Article 13(1) of the VAT Directive are those engaged in by bodies governed by public law under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private traders…"

44. Whilst the CJEU considered the first condition to apply ([80]), it expressed the view that, subject to verification by the referring court, several factors seemed to indicate that the municipality did not exercise powers conferred by public law ([82]). At [83] it noted that the municipality appeared to have no decision-making power as regards the personal scope and detailed rules of application of the transformation. At [84] it pointed out that the municipality's role "consists, in essence, in verifying the facts, issuing a certificate confirming the transformation of the right of perpetual usufruct into full immovable property ownership rights and informing the new owner of the obligation to pay a transformation fee". It noted that, as the Advocate General had observed, the municipality did not fix the fee "in an administrative procedure as a public authority under a special public law regime applicable to it" ([82]–[84]).

45. Although nothing turns on the point, it was common ground between the parties to these proceedings that *Gmina Wroclaw 2021* (which arose from a reference from the Polish court, and in respect of which judgment was given in 2021 after the end of the transition period for the UK's withdrawal from the EU), is not retained EU case law which this Tribunal is bound to follow but that we "may have regard" to the judgment "so far as it is relevant" to the matters before us.

46. The decision of the Upper Tribunal (Warren J) in *R. (on the application of the Durham Company Ltd (trading as Max Recycle)) v Revenue and Customs Commissioners* [2017] STC 264 ("***Durham Company***"), together with Nugee J's decision refusing permission to appeal in relation to it, published under [2018] UKUT 188 (TCC), were the only domestic authorities on Article 13(1) to which we were referred. Neither party submits that *Durham Company* extends the CJEU jurisprudence, however we mention it given that the FTT referred to it in its reasoning and the parties relied upon it in their submissions before us.

47. One of the preliminary issues, raised in the context of a judicial review application by a commercial company waste collector against HMRC, who was seeking to challenge the lawfulness of local authorities not charging VAT on trade waste collections, was whether the authority was engaged as a public authority under Article 13(1). The relevant statutory provision was s45(1)(b) of the Environmental Protection Act 1990 ("**EPA**") which put the authority under a duty to collect the trade waste. The Upper Tribunal expressed the view (at [103]) that the provision was capable of being a special legal regime, a point which appears to have been conceded. However, whether a local authority was in fact providing its services under the provision was a matter to be determined on the facts of each case.

48. In refusing the applicant permission to appeal, Nugee J agreed (at [13]–[14]) that, if local authorities operated under the section, then it was a special legal regime applicable to them in their capacity as public authorities exercising public duties, which was different from the legal regime which applied to private sector businesses. This was because, as Warren J had set out, the section 45 power is "hedged around by a number of constraints" namely, the obligation to collect waste from premises in its area, that collection charges had to be reasonable, and that there are obligations in relation to disposal together with environmental obligations. The key distinction identified by Nugee J (at [15]) was "that the legal conditions under which the local authorities are providing services are different, because of their function as public authorities, from the legal conditions under which their private sector counterparts are providing what may…from the point of view of the consumer, be indistinguishable services."

Discussion on legal principles

49. It is common ground that the above CJEU jurisprudence establishes the following propositions:

> (1) Article 13(1) of the PVD derogates from the general rule in providing for circumstances in which local government authorities will not be regarded as taxable persons. Given that it is a derogation, it must be interpreted strictly (*Isle of Wight* at [60]);
>
> (2) the task of the national court is to "analyse all the conditions laid down by national law for the pursuit of the activity in issue…to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same conditions as those that apply to private economic operators" (*Fazenda* at [21]);
>
> (3) The subject matter and purpose of the activity are not relevant (*Fazenda* at [19]).
>
> (4) Authorisation by statute alone is not enough. Something more is required (*Commission v Ireland* at [49]).

50. In support of his submission that the second condition in Article 13(1) only applies where the public body uses "sovereign" powers to carry out the relevant activity, Mr Hill, acting on behalf of HMRC, relied upon six main points drawn from the decisions of the European Court and related Advocate General opinions, which we deal with in turn (taking them slightly out of the order presented to us). For reasons we shall explain, we disagree that any of these points confirms or establishes that the CJEU jurisprudence envisages the existence of a special legal regime only where "sovereign powers" (in the sense that this term is used by Mr Hill – i.e. powers providing for the making of rules or the imposition of fines) are used to carry out the activity.

51. First, Mr Hill relies on the CJEU's reference in *Fazenda* to "the use of public powers" such as authorising or restricting parking on the public highway or imposing fines ([22] and [24]), pointing out that the Court was here referring to the use of public powers, not to authorisation by public powers. He also relies on the Advocate General's indication in his Opinion (at [41]) that "What matters is the legal way in which the activity is carried out" and (at [42]) that it might be significant "whether exceeding the

parking time is punishable by a fine or provision is made merely for an additional payment or a contractual penalty (under civil law)".

52. However, whilst it is clear that the Court viewed the use of powers in this case (which did involve the imposition of fines) as "showing" that an activity "such as that at issue" in the proceedings was subject to a public law regime ([22]), nowhere did the Court suggest that only use of "sovereign" powers to carry out the relevant activity was sufficient for the existence of a special legal regime. The test articulated by the Court at [21] required the national court to analyse all the conditions laid down by national law for the pursuit of the activity to determine whether "that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators". The more restrictive interpretation for which Mr Hill contends is nowhere to be found in the Court's reasoning. The Court did not expressly pick up on the points raised by the Advocate General.

53. Second, Mr Hill highlights that the CJEU in *Saudaçor* emphasised the concept of "use of" public powers in a similar fashion (at [70]), that the Court specifically mentioned Saudaçor's power to carry out expropriations (at [15]) and that the Court referred (in [72]) to the use of powers as "an instrument" to carry out the relevant activities, thereby emphasising the distinction between being authorised to carry out an activity and using the power to carry it out.

54. The similarities between *Fazenda* and *Saudaçor* are unsurprising given that paragraph [70] of *Saudaçor* expressly cites *Fazenda* (including paragraph [22]). The point takes Mr Hill no further than it did in relation to *Fazenda*. Furthermore, there is nothing in the Court's judgment in *Saudaçor* to suggest that it was the existence of the expropriation power that made the difference to its analysis. The existence of that power appears in any event to have been a point that was relied upon by the Court when it discussed the first condition of Article 13(1) (whether Saudaçor was a body governed by public law) not the second condition (see [59]).

55. When it came to the second condition, the Court expressly referred both to the tests identified in *Fazenda* and *Isle of Wight* (at [70] and [71]), the latter involving a "close linkage" between the activities engaged in and the exercise of powers conferred by public law, a test that does not appear to us to admit the restrictive interpretation urged upon us by Mr Hill. As Ms Brown QC, on behalf of Chelmsford, pointed out, it is

difficult to see how the expropriation power could impact on planning and management of health services in any event. If Mr Hill's submissions were correct, the Court would surely have made it clearer that (subject to verification by the national court) the provision of planning and management services was incapable of satisfying the second condition. Instead it focused (at [72]) on the question of whether the powers conferred on Saudaçor had been conferred by public law in such a way as to enable them to be used by Saudaçor in carrying out its planning and management activities. We cannot see that the CJEU's use of the term "instrument" in this paragraph has the significance attached to it by Mr Hill in circumstances where that term appears to have been used merely as a reference to the Decree (see [14] and [65]).

56. Third, having regard to *Gmina Wroclaw 2021*, Mr Hill asks us to note that the CJEU placed significance, in line with Advocate General Kokott's opinion, on the fact that the fee was not fixed by the authority "in an administrative procedure as a public authority" in other words, according to Mr Hill, it was not fixed in a sovereign type bye-law making power rather than a less formal administrative procedure ([84]). Mr Hill points out that the authority carried out its tasks in accordance with the Polish Law on Municipalities (i.e. its activities were authorised by a statutory power), but those tasks were not found to fall within Article 13(1).

57. It is true that the Court noted the municipality's lack of decision-making power and its limited role ([82])-[84]), and also that (notwithstanding that the municipality was authorised to act by statutory power) this led to the Court's decision that the second condition was not satisfied in that the activities being carried out by the municipality did not involve the exercise of powers conferred by public law. This case appears to be a clear example of a situation in which the mere existence of a statutory power is not, without more, sufficient to give rise to a special legal regime. However, that outcome is perhaps unsurprising in circumstances where the tasks being carried out were "only tasks of an administrative nature" and the municipality lacked all decision-making power as to the transformation process.

58. The reference by the CJEU at [84] to the fee not being fixed by administrative procedure, is plainly intended to distinguish between a fee that is already fixed by law (see the background facts at ([32]) and a fee that would otherwise have been fixed by an administrative procedure (which might then have involved an act as a public authority under a special public law regime). In addition the CJEU made the point it

did at [84] by reference to paragraph [61] of the Advocate General's opinion in which she noted that the fee was not fixed "…as a public authority". That paragraph must be read in conjunction with the next paragraph [62], where the Advocate General contrasted fee fixing under an administrative procedure "as a public authority under a special legal regime applicable to it" ([61]) on the one hand with payment of the fee to the authority "…in its capacity as previous owner of land" on the other. She went on to explain that the latter payment had its basis in civil law as it was "connected with the surrender of the perpetual usufruct of the municipal land". Neither of these explanations for the absence of a special legal regime in the circumstances of this case supports Mr Hill's suggestion that it was the lack of a sovereign type power (such as bye-law making) which was relevant.

59. Fourth, Mr Hill relies on Advocate General Mischo's opinion in *Carpaneto 1* where, in relation to the concept of powers vested in a body as a public authority, the Advocate General recommended that the Court adopt the definition proposed by Advocate General Mancini in *Commission v French Republic* Case 307/84 ([1986] ECR 1725 at p 1732) which referred to "acts of will which affect private individuals by requiring their obedience or, in the event of disobedience, by compelling them to comply".

60. We note however that the Advocate General's suggested definition was not adopted by the CJEU (whether in *Carpaneto 1* or any other case) and has no binding effect on us. The fact that nothing similar has ever been said by the Court itself, tends in our view to militate strongly against the interpretation for which Mr Hill contends.

61. Fifth, Mr Hill relies on Advocate General Maduro's explanation in *Isle of Wight* of the rationale for derogating from the rule that activities are subject to taxation. The Advocate General described the derogation as: "founded on the weak presumption that activities engaged in by public bodies as public bodies are activities of an essentially regulatory nature that are linked to the exercise of rights and powers of public authority" ([15]). This did not have an anti-competitive effect with private sector activities "inasmuch as [the activities] are generally undertaken exclusively or almost exclusively, by the public sector".

62. The proposition that the activities contemplated by the second condition were essentially of a regulatory nature was however not adopted by the CJEU. In any event, the Advocate General went on to explain (at [16]) that the presumption was a weak one

because of the strong probability that certain of the activities engaged in by public bodies were also entrusted to the private sector. He specifically acknowledged that activities of an essentially economic nature where the national law makes the body act under a "special legal regime applicable to it" could fall within the derogation.

63. Sixth, and finally, Mr Hill relies on Advocate General Szpunar's doubt in *NRA* (at [24] of his Opinion) that Article 13(1) applied to all of the National Road Authority's activities. The Advocate General pointed out (at [23]) that when collecting road tolls, the NRA was bound by its own bye laws applicable to a specific toll scheme in the same way as private bodies. He then went on at [24] to say: "It is not therefore inconceivable that the NRA is acting as a public authority only when it decides to make a toll scheme on a specific section of road and makes bye laws relating to that scheme, whereas when it collects those tolls, it is acting under the same legal conditions as a private body".

64. The doubt expressed by the Advocate General may have prompted the Court's observation that it was far from clear that in operating the toll roads and collecting tolls the NRA was to be regarded as acting as a public authority. However, the Court made no further statement of principle and the Advocate General's views ("not therefore inconceivable") are equivocal at best. Further and in any case, the underpinning of the distinction he drew between toll collection and toll scheme creation was that, as regards the latter, the private bodies, who managed toll roads under agreements with the authority, operated on the basis of the same act and bye-laws made by the authority (see [23]). Thus it was not the sovereign nature of the power but the fact it applied both to public and private operators which he considered to be relevant.

65. On close analysis, we are not persuaded that the CJEU jurisprudence in fact supports the proposition that a special legal regime only arises where "sovereign powers" in the sense identified by Mr Hill are used to carry out the activity. If the Court was seeking to lay down a hard-edged test, along the lines for which Mr Hill contends, it is to be expected that it would do so explicitly. The need for Mr Hill to emphasise and interpret particular words within the CJEU's judgments (without always having regard to the particular facts of the case) and to focus so much attention on Opinions of the Advocates General which have not been adopted by the Court or which might be said to be equivocal at best, was not a promising basis on which to make out his argument.

66. Mr Hill also took us to two references pending before the CJEU: *Gmina O v Dyrektor Krajowej Informacji Skarbowej* (Case C-612/21) (lodged on 30 September 2021) and *Gmina L v Dyrektor Krajowej Informacji Skarbowej* (Case C-616/21) (lodged on 5 October 2021). These references, particularly the latter, have the potential to engage with the issue of whether Mr Hill is correct in his interpretation of the second condition. But neither party seeks a stay behind either of them, and given what we have said above about the lack of support in the current case-law for Mr Hill's interpretation, there is no reason, as Ms Brown pointed out, to suppose that the CJEU will depart from its consistent formulation of the test for special legal regime. We must proceed on the basis of the law as it appears in the CJEU decisions to which we have referred.

67. Mr Hill also submitted that it is important not to overlook the accepted principle that a strict interpretation ought to be taken to construing exemptions. That provides the context for the restrictive reading of the derogation but, more than that, it is an interpretative principle which is capable of having real effect by itself. Mr Hill took us in detail through *Isle of Wight* in which the CJEU deployed the interpretive principle. Ms Brown does not dispute a strict interpretation must be taken but points out that the formulation with respect to exemptions is that they should be construed "strictly but not restrictively".

68. We do not consider the strict interpretation principle sheds light on the question of interpretation that we must decide. The issue for us on Mr Hill's argument as to the exercise of a sovereign power is how the CJEU's decisions are to be interpreted and where the dividing line has in fact been drawn. For the reasons already explained, we do not consider the CJEU has adopted any "sovereign power" restriction in its interpretation of the second condition to Article 13.

69. The strict interpretation principle continues to have resonance, however, in relation to the argument HMRC identified in its Grounds of Appeal. In particular, HMRC's case that the approach adopted by the Tribunal cannot be reconciled with the CJEU's decision in *Commission v Ireland*. We return to that submission in a moment. For present purposes, however, we observe that we do not consider this argument to support Mr Hill's "sovereign powers" interpretation. Mr Hill relies on the Court's statement (at [49]) that the mere fact that a body governed by public law acts within the framework of a special legal regime and in accordance with powers conferred upon it by statute does not mean that engaging in its activities necessarily involves the exercise of rights

and powers of public authority. However, as Ms Brown submits, the CJEU, in that passage, does no more than confirm that mere authorisation by statute is not enough - a legal proposition that is not in dispute. As discussed later in this decision, Chelmsford does not, in any case, rely on statutory powers or legal features which apply across the board to all local authority activities or accept that a finding of special regime in their case would entail the activities of all local authorities falling within Article 13(1).

FTT's identification of legal principles

70. The FTT set out the parties' respective detailed submissions on the law and extracted the relevant provisions of Article 13. At [116] onwards it dealt with the legal principles. It explained the cases from which the requirement for a "special legal regime" derived setting out extracts from *Carpaneto 2* (which in turn referred to *Carpaneto 1*), *Fazenda, Commission v Ireland,* and *Saudaçor* and stated that it was clear from these and other authorities that the application of Article 13(1) was highly fact specific. It also set out extracts from *Durham Company* (both in the Upper Tribunal and on the application for permission to appeal) and explained why *NRA* did not assist, as the conclusion that a special legal regime was present in that case was accepted as common ground by the parties. At paragraph [127], the FTT stated that it was adopting the approach set out in *Fazenda* (at [16],[17] [19] and [21]).

71. Pausing there, it is sufficient for the purposes of this ground, that the FTT directed itself by reference to the correct test, as set out in *Fazenda.*

72. The FTT then went on, as part of its analysis of national law conditions, to consider the Council's policy documents. Whether it was correct to do so is the subject of the next alleged error. However, what is plain from that additional consideration is that it did not view the mere fact that the activity has statutory authorisation under s19 LGMPA to be sufficient. Furthermore, it follows from our analysis above, that the FTT made no error, contrary to the case advanced by HMRC, in not interpreting the CJEU case-law as restricted to the use or exercise of "sovereign power" only (as opposed to the authorisation to act). In our judgment, the FTT identified the correct legal test.

HMRC's further grounds – error in application of test

73. Mr Hill contends that, in seeking to satisfy itself that this case involved the necessary additional element to a bare statutory authorisation, the FTT was wrong to rely on conditions which Chelmsford had set for itself, not in law, but in policy documents. To the extent the policies were adopted in relation to general duties, those did not transform Chelmsford's powers into a special legal regime, as that would have the consequence that all local authority powers would amount to a special legal regime. This would be contrary to the principle in *Commission v Ireland*.

74. Chelmsford agrees that, as set out in *Fazenda*, the relevant legal conditions are those set out in national law. It says, however, that the FTT was entitled to rely on the policy documents. The policy set out in those documents was created as a consequence of national law provisions. It reflected within it the statutory constraints and "hedges" that exist around Chelmsford's discretion and the exercise of its powers. Those were relevant because they were part of all the circumstances of national law which made up the "way and manner" in which the power was exercised. The pursuit of the activity in question thereby involved the use of public powers and so was distinguishable from similar activities carried out by private economic operators.

FTT Decision

75. The FTT (rightly) expressed the view (at [129]) that the first step in its analysis was to identify the applicable legal regime under which Chelmsford engages in the activities. The FTT identified at [130] that Chelmsford provides the sports and leisure facilities pursuant to s 19 LGMPA and went on:

> "Section 19 confers wide powers on local authorities to provide the facilities … The witness evidence (which we accept) was that the Council's provision of the sports and leisure facilities arose from the Council's social objectives in its formal strategies (see Mr Lyons at [21(6-7)] above and Mr Reeves at [22(8)] above), and that the Council has regard to its statutory obligations (see Mr Lyons at [21(16)] above). Mr Lyons's evidence (see [22(11)] above) was that the Council could not provide leisure services as a trading activity as it did not have power to do so, and a local authority could only undertake a trade through a subsidiary company. That is confirmed by the requirements of s 95 Local Government Act 2003 and s 4 Localism Act 2011."

76. Thus, it concluded that s19 LGMPA was the source of the power to undertake the activity in question and therefore that s19 was "the applicable legal regime" ([132]). It then went on to consider whether s19 constituted a "special legal regime".

77. The FTT set out Warren J's reasoning and Nugee J's endorsement of the same in *Durham Company* in relation to the statutory provision relevant there (s45 EPA) being a special legal regime ([133]). That prompted a diversion into whether powers rather than duties were sufficient to find a special legal regime, during which the FTT expressly considered the guidance in *Fazenda*, *Saudacor* and *Isle of Wight*. Having concluded that the existence of a power was sufficient, the FTT went on at [140] to direct itself and decide the special legal regime question as follows:

> "140. …we must (in the words of *Fazenda Pública*) analyse all the conditions laid down by national law for the Council's provision of sports and leisure facilities, to determine whether that activity is being engaged in under a special legal regime applicable to bodies governed by public law or under the same legal conditions as those that apply to private economic operators. The conditions under which the Council exercises its s 19 powers to provide the facilities include the Council's policy documents described by Mr Lyons (see [21(7)] above); the Sport and Recreation Strategy for Chelmsford for 2006-2010 sets these main objectives:
>
> "Objective 1: Provide a range of new and improved sporting facilities by working with partners where appropriate and in response to the identified needs of the local community.
>
> Objective 2: Ensure that the whole of the community is able to access and participate in sport and recreation and that sport is used as a vehicle for promoting social inclusion.
>
> Objective 3: Develop initiatives with partners where appropriate, to ensure that physical activity and exercise makes a valuable contribution to the health and wellbeing of the local community.
>
> Objective 4: Ensure that co-ordinated, sustainable sports development frameworks are supported and developed within sports centres and through partners to enable those with an interest and ability in sport to reach their full potential.

> Objective 5: Provide education and training opportunities for volunteers, coaches and staff wishing to get involved in or progress in, coaching, administering and officiating within sport.
>
> Objective 6: Ensure that resource is are (sic) used effectively & efficiently and that new funding streams are maximised and utilised through creative means."
>
> 141. We accept the witness evidence that in providing the facilities the Council acts to achieve those objectives, as refined by the Council's Corporate Plans, including aspects such as pricing (including setting of concessions) and location and scope of facilities – see Mr Lyons's evidence generally (but in particular at [21 (6, 7, 13, 14, 16 & 20e)] above), and Mr Reeves at [22(9 & 13)] above.
>
> 142. Any private sector business providing sports and leisure facilities in the Council's area – even ones indistinguishable to the consumer from the Council's facilities – would be doing so not under the s 19 regime but instead under the general legal regime applicable to all facilities operators. Accordingly, the legal conditions under which the Council is providing services are different, because of its function as a public authority, from the legal conditions under which its private sector counterparts are providing perhaps indistinguishable services. Thus, the Council's provision of the facilities is being engaged in under a special legal regime applicable to a body governed by public law."

78. Thus, the FTT concluded that the second condition in the first paragraph of Article 13 was satisfied ([144]). In addition, dealing with the formulation of the special legal regime test as expressed in *Isle of Wight*, the FTT considered it "self-evident" that the provision of the leisure facilities was "closely linked to the exercise of rights and powers of [the] public authority" as they were "the subject matter of s19 itself" ([143]).

79. The FTT's analysis at [141] referred back to the detailed evidence which the FTT had heard from Mr Lyons, and Mr Reeves (which we have already addressed), including that Chelmsford's decision making in relation to the Facilities takes account of various social objectives linked to increased sports and leisure participation and certain statutory obligations.

80. Ms Brown highlighted paragraph 21(11) of the Decision (also referred to at [130]), which mentioned that Chelmsford's interest in its financial performance and so its net

expenditure had to be weighed against the social benefits achieved from participation in sport. (It was accepted by HMRC that the FTT's cross-reference to [22(11]) in [130] was in error and should have referred to [21(11)] given the context referred to in [130]). Paragraph 21(11), in Ms Brown's submission, spoke to Chelmsford's fiduciary duties to ratepayers.

81. The FTT also identified (i) that Chelmsford had no power to carry out trading activities ([21(11)] and [130]); (ii) that Chelmsford had a general duty for best value under s3 LGA 1999 [15] and [29]; and (iii) Chelmsford's argument that its exercise of s19 LGMPA was subject to its general duties as a local authority to act "both within the width of the power and also for the purpose for which that power was conferred" ([58][59]).

The Parties' submissions

82. HMRC argue that there is no real conceptual difference between s19 LGMPA and the general statutory powers which Chelmsford concede would not be enough to form the basis of a "special legal regime". Both simply authorise the activity. The conditions the FTT relied on at [140] and [141] were conditions that Chelmsford had set for itself; they were not imposed by law. The FTT in those paragraphs, which HMRC say represent the operative part of its decision, did not suggest that the special legal regime was made up of anything other than s19 LGMPA, combined with Chelmsford's policies and strategies.

83. Chelmsford acknowledge that some powers are so generic that they would not, even when combined with other generic constraints, such as fiduciary duty, amount to a special legal regime (the powers in *Gmina Wroclaw 2021* being one example). They contrast, for example, s111 Local Government Act 1972, which gives a local authority power to do anything "which is calculated to facilitate, or is conducive or incidental to, the discharge of their functions" with s19 LGMPA, which provides a specific power related to the activity in question. Although that section enables provision of the activity as the authority "thinks fit" (thereby imposing no specific duties), the power so provided carries with it certain public law obligations. The authority could not simply do nothing.

84. In considering what it "thinks fit" the authority is subject to a variety of constraints deriving from statute and case law. Chelmsford's skeleton referred to a multitude of statutes. We pressed Ms Brown at the hearing to identify which ones were relevant and relied upon. She referred in her submissions, which were clarified and corrected by a follow up note sent to the tribunal and copied to HMRC shortly after the hearing, to:

> (1) s17 of the Crime and Disorder Act 1998 which imposes a duty on local authorities to exercise their functions with regard to the likely effect of those functions on, and the need to do all that they reasonably can to prevent crime and disorder including anti-social behaviour and other behaviour adversely affecting the local environment;
>
> (2) s4 of the Local Government Act 2000 which requires local authorities to prepare strategies for promoting or improving the economic, social and environmental well-being of their area, including the requirement to consult in respect of those strategies; and
>
> (3) s11 of the Children Act 2004 which imposes an obligation on local authorities to make arrangements for ensuring that their functions are discharged having regard to the need to safeguard and promote the welfare of children.

85. Ms Brown submitted that the existence of a special legal regime was not therefore solely reliant upon the constraints imposed on the s19 LGMPA power by the generic fiduciary and best value obligations (although those constraints were, in Ms Brown's submission, nevertheless relevant and added to the picture of the way and manner in which the s19 power is used). On the contrary, the s19 power was in reality constrained in the manner of its execution by a variety of additional statutory obligations.

86. Ms Brown developed her case as to the FTT's entitlement to look at the Chelmsford policy documents in assessing whether there was a special legal regime by taking us through the two policy documents on which the FTT relied, highlighting particular aspects of those documents which she submitted were derived from national law requirements.

87. The first policy document is entitled "*A Strategy for Sport & Recreation in Chelmsford 2006-2010*". It is a summary of strategy which appears in a series of bullet

points addressing health, best value and increase in participation. The chapter on "Strategy Themes" mentioned, amongst other things, the following topics:

> (1) It described how changes in legislation through the Race Relations (Amendment) Act 2000 and Disability Discrimination Act (DDA) 2005 (more details of which were provided in an Appendix) meant service providers in England were obliged to take steps to make access (including to sport) fair, just and equal. Ms Brown explained that although this text referred to service providers generally, the legislation was more stringent on local authorities by making them subject to a specific duty.
>
> (2) The theme of "Health" included the heading "Every Child Matters: Change for Children December 2004" and referred to the "statutory duty on local authorities" to deliver five outcomes for all children and young people: health, safety, enjoyment and achievement, positive contribution to community and not engaging in anti-social or offending behaviour, and economic well-being. It explained that sports and recreation could make a significant contribution to some or all of these outcomes. Ms Brown submitted that these linked to obligations under s11 of the Children Act 2004.
>
> (3) The theme of "Crime and Disorder" explained how sport and recreation programmes could promote social inclusion and diversionary activities to help reduce crime and vandalism. This theme linked the activity to obligations under s17 of the Crime and Disorder Act 1998.
>
> (4) The theme of "Consultation" linked through to the local authority's obligation to consult under s4 of the Local Government Act 2000.

88. The document went on to describe specific priorities for action to fulfil the objectives of the strategy. Ms Brown took us through the Health Improvement Objectives and submitted that these linked to duties to cooperate and deliver public health services under the Children Act 2004 together with s6 of the Care Act 2014 and s12 of the Health and Social Care Act 2012 (these, she told us, had equivalent predecessor provisions in s116 Local Government and Public Involvement in Health Act 2007).

89. The other key document the FTT relied on was Chelmsford's corporate plan entitled "*Community Plan – Chelmsford Tomorrow 2021*". This set out themes

including health, social inclusivity and nurturing the environment and explained that "each theme is supported by a number of specific properties, which are in turn reflected in action plans."

Discussion

90. As we have noted, there is no dispute that the relevant legal test only permits national law requirements to be taken into account in identifying whether there is a special legal regime for the purposes of Article 13(1). If the FTT relied on the policy documents by virtue of their status as policy, then that would be an error. The real issue raised by this ground is whether the FTT appreciated that only national law conditions were relevant and accordingly relied on the policy documents as expressions of national law conditions, and further, whether if they did that, they were correct to arrive at the view that those expressions of national law conditions (when seen in context) would give rise to a special legal regime.

91. The FTT did not specifically direct itself only to look at national law requirements. However, for a number of reasons we are not persuaded this means they overlooked the point.

92. The FTT expressly included the relevant national law requirement as set out in *Fazenda* in its direction to itself at [140].

93. The FTT had earlier referred extensively to extracts from *Durham Company*. In particular, at the beginning of its discussion of what constituted a special legal regime, its first port of call was the approach in *Durham Company.* It referred at [133] to Nugee J having set out the constraints at [14] of his decision which hedged the statutory provision, s45 EPA, relevant in that case. The FTT did not list those constraints but must be taken to have looked at them. The constraints listed at [14] of Nugee J's permission decision refer to matters arising from s45 and to "environmental obligations" none of which gives the impression that an authority's policy would be relevant in its own right.

94. The above analysis took place against the backdrop of Chelmsford's arguments as set out in the Decision at [57]-[61] identifying s19 LGMPA as the relevant power ([57]) and explaining the various limitations on that power including (i) the need to act within the scope and purpose of the power ([58]), and (ii) the need to comply with fiduciary

duties ([59]) - in relation to which, Chelmsford advanced evidence before the tribunal, which the FTT accepted as fact, that there was a legal obligation, when selecting services and setting prices, to consider both financial cost and social return ([60]). Chelmsford had also identified the relevance of "best value" rules regarding economy, efficiency and effectiveness – and submitted on the latter that "effectiveness" referred to the legitimate social benefits that derive from the activity ([61]).

95. Furthermore, the analysis took place in light of the accepted evidence from Chelmsford that it had regard to its statutory obligations in providing the services ([20(16)]). This sub-paragraph was referred to among the particular provisions the FTT mentioned both in identifying the legal regime ([130]) and its reasoning as to why that regime was a special legal regime ([141]).

96. Although Mr Hill points to paragraphs [141] and [142] of the Decision as representing its operative part and highlights that s19 LGMPA is the only legal provision mentioned there, we agree with Ms Brown that the decision needs to be read as a whole. As Ms Brown pointed out, the FTT referred in [142] to the "s19 regime". That was consistent, particularly in view of its preceding discussion, with it not looking at s19 alone, but rather in conjunction with other powers and obligations pursuant to which Chelmsford was exercising its s19 powers.

97. It is correct that the FTT did not make explicit the basis upon which the objectives and policy it mentioned were derived from national law provisions. But the above features, taken together, and in particular the FTT's acceptance of evidence which did make that link, indicate, in our judgment, that the FTT did not regard the policy as part of the content of the regime under consideration simply because it was Chelmsford's policy, but rather because the policy was an expression of relevant national law requirements operating on Chelmsford in the context of the exercise of its s19 powers. In our judgment the FTT did not misunderstand the legal test required of it.

98. Further, given that the ultimate purpose of the enquiry was to see if the legal conditions were different as between the authority and private operators, once it became apparent that there was enough of a difference for a special legal regime to apply (as there plainly was), little purpose would be served in exhaustively dissecting all of the objectives and policy to trace each element back to a legal source. It is not apparent from any of the documents we were taken to that the legal provenance of the policy was highlighted to the FTT as being a contentious issue.

99. We disagree with HMRC therefore that the FTT erred in principle in taking account of the policy. It was entitled to do so as an expression of other legal conditions and constraints which applied in the context of the exercise of the s19 power.

100. Working through the matters covered in the evidence before it, which it accepted, the FTT was aware of the following national law conditions which applied to Chelmsford but not to private sector operators: fiduciary obligations, s3 Local Government Act 1999 ("best value obligation") and the Health and Social Care Act 2012 (s12 of which provides for duties as to improvement of public health – including taking steps to provide services or facilities designed to promote healthy living) and whose provisions, so far as the relevant period in consideration here is concerned were reflected, Ms Brown submitted, in the Local Government and Involvement in Public Health Act 2007, a submission which Mr Hill did not gainsay.

101. S17 of the Crime and Disorder Act 1998, s4 Local Government Act 2000 and s11 Children Act 2004, which Ms Brown referred us to in the event we were in the situation of needing to remake the FTT Decision, were not constraints, so far as we can see, that were highlighted to the FTT – certainly there is no reference to them in the Decision. However, it is apparent from Ms Brown's submissions before us in relation to Chelmsford's policies, how those provisions are capable of shaping such policies in relation to the exercise of Chelmsford's powers under s19 LGMPA. The FTT accepted that Chelmsford was subject to those policies when exercising its powers under s19 (at [140]). Those policies impact the way and manner in which the Facilities are provided in terms of what sorts of services are provided, how and where they are provided and to whom.

102. That this was so was borne out by the FTT's findings on the evidence. Perhaps the clearest example is the obligation under s17 of the Crime and Disorder Act 1998 which is directly reflected in the policy theme of "Crime and Disorder" (identified above) which explained how sport and recreation programmes could promote social inclusion and diversionary activities to help reduce crime and vandalism. The FTT's findings referred (in respect of reduction of crime) to a range of activities that Chelmsford provided on a Sunday night to 12-18 years costing £1 to attend ([21(13)]). With respect to the obligations under s11 of the Children Act 2004, and s4 Local Government Act 2000, it is apparent that the way and manner in which Chelmsford provided the Facilities necessarily took account of the arrangements it was obliged to put in place

regarding safeguarding children and their welfare, together with the obligation to prepare an economic and social well-being strategy.

103.Returning to the FTT Decision, the particular features which the FTT relied on in making the regime "special" were indicated at FTT [141] where the FTT referred to "pricing (including setting of concessions) and location and scope of facilities". The evidence accepted by the FTT had explained how these matters were impacted by intersecting statutory obligations relating, for instance, to the need for economy, efficiency and effectiveness in achieving best value, governance and health. Read in conjunction with that evidence, the FTT's reasoning was that, in providing its services, the authority was (through the policies which in turn derived from legal obligations) subject to different requirements when deciding what services to provide, at what price, where to provide them and to whom, by comparison with a private sector operator. In other words, the FTT, rightly in our judgment, considered the way and manner in which Chelmsford provided the Facilities was subject to different legal obligations to those under which private sector operators provided similar facilities. The provision of the Facilities involves the use of public powers and is subject to a public law regime.

104.We consider that even if we are wrong in the above analysis, such that the FTT erred, either in relying on Chelmsford's policies, oblivious to the need for the obligations to stem from national law, or in not explicitly linking the material parts of the policies back to national law conditions, neither error would, if corrected, result in a different outcome. If we were to set aside the FTT decision and remake it there would, in our judgment, be sufficient elements deriving from national law reflected in the policies to reach the same result. The best value obligation, the fiduciary obligations and the other statutory obligations to which we have referred (the obligations under s17 Crime and Disorder 1998 Act, s11 Children Act 2004 and s4 Local Government Act 2000) – which together impact (and "hedge") Chelmsford's decision-making on what, where and to whom to provide services and at what cost, would result in the conclusion that the legal conditions under which Chelmsford provides the Facilities amount to a special legal regime because private operators providing such facilities are not subject to those same conditions.

105.The FTT in *Midlothian* found that the legal conditions under which the local authority was providing services were different from the legal conditions under which their private sector counterparts were providing the same or similar services. It

considered that sports and leisure facilities were provided pursuant to a special legal regime where, amongst other things, that provision was subject to the "further and not inconsiderable statutory constraint" ([134]) of the duty to secure best value under section 1 of the Local Government Scotland Act 2003, which included the requirement that the local authority should have regard to "sufficiency, effectiveness, economy and the need to meet equal opportunity requirements". Mr Hill clarified during his oral submissions that HMRC had not sought to appeal this decision because the sports facilities there were provided under a statutory duty rather than a power. That, he said, was significant because European case-law (to which we were not referred given that Chelmsford's provision of facilities was made under a power) suggests that activities carried out pursuant to duties fall outside the ambit of tax under Article 13. This was a rather different explanation from that provided in the Grounds of Appeal and we were not addressed in any detail on the facts of *Midlothian* or the reason why the best value obligations in Scotland may be regarded differently from those applicable in this jurisdiction. However, we observe that the same broad reasoning, regarding a statutory provision not being considered in isolation but together with other legal conditions which intersect with it, applies also in this case.

106. Standing back and having regard to the cases to which we have already referred in detail, this outcome appears to us entirely consistent with those cases. The activities undertaken by Chelmsford pursuant to its powers under s19 LGMPA go very far beyond the mere "administrative tasks" identified in *Gmina Wroclaw 2021*. In the exercise of their powers to provide the Facilities, Chelmsford has established and managed such Facilities, having regard to its fiduciary duties and its (statutory) "best value" obligations, which inevitably place constraints on the exercise of its powers. The evidence shows that this has required the making of numerous decisions as to the manner and way in which the Facilities should be run. Those decisions have included how best to achieve objectives to which Chelmsford must have regard by reason of other statutory obligations to which it is subject. We do not consider that it is possible to view the s19 power in isolation in this context.

107. No private operator would be obliged to run leisure facilities in this way or to have regard to the various considerations to which we have referred. To paraphrase Nugee J in the *Durham Company* case, the legal conditions under which Chelmsford is providing the Facilities are different, because of Chelmsford's function as a public authority, from the legal conditions under which its private sector counterparts are

providing what may, from the point of view of the consumer, be indistinguishable services. Chelmsford exercised its power to provide facilities as it considers "fit" within the context of its wider statutory obligations. In common with the FTT we consider that the activities engaged in by Chelmsford are plainly closely linked to the exercise of their rights and powers of public authority.

108. We disagree with HMRC's argument that this conclusion will result in all activities of local authorities necessarily being non-taxable and that it thereby offends against the principle which HMRC submit was established in *Commission v Ireland* that the special legal regime analysis must mean this result is avoided.

109. As the CJEU case law repeatedly emphasises, the national court must analyse the relevant conditions laid down by national law in each particular case and reach a view on whether that constitutes a special legal regime.

110. The observations made by the CJEU in *Commission v Ireland* must be seen against the background of the statutory regime adopted by Ireland, which did not, as the CJEU held was required, adopt the starting point that economic activities engaged in by bodies governed by public law otherwise than in their capacity as a public authority were subject to tax. The regime instead envisaged that <u>all</u> acts of local authorities were acts carried out in their capacity as public bodies. The CJEU rejected that proposition, emphasising the need for strict interpretation and confirming that meant that merely acting in accordance with public law powers will not necessarily be sufficient to establish that those activities are performed pursuant to a special legal regime. However, owing to the nature of the case, the Court did not engage with the circumstances in which a public authority might satisfy the test laid down in existing case law, a test which it expressly referred to by reference to paragraph [31] of *Isle of Wight* (at [49]) – as HMRC itself recognises in its Grounds of Appeal at paragraph 11(d).

111. *Commission v Ireland* therefore says nothing that is not already clear from the existing case law and, as we have said, it is in any event common ground in this appeal that for an activity to fall within Article 13(1) of the PVD, there has to be an additional element beyond the mere authorisation of a statutory power to a public authority to carry on the relevant activity. The particular matrix of legal conditions to which we (and, we believe, the FTT) have referred in this case goes beyond mere authorisation for the reasons we have already identified. This is not a case in which the legal

conditions or obligations are purely "generic", as suggested by HMRC. Furthermore, it is plainly a case where, as we have said, it is clear that the legal conditions operating upon Chelmsford are different from those operating upon a private sector competitor.

112.Chelmsford suggested that if HMRC's argument was correct, the outcome would be inconsistent with HMRC's treatment of the consideration local authorities pay to third party providers to whom the authorities have outsourced provision of the relevant activities. Chelmsford highlight that here, HMRC accept the VAT incurred is attributable to the local authority's non-business activities. There is, Chelmsford submits, no rational basis for treating the local authority's activities differently depending on whether it is undertaken by the local authority or by a third-party provider. Ms Brown rightly, in our view, did not press this argument in her oral submissions. Even if there were an inconsistency in HMRC's treatment (which is in any event disputed) HMRC's view on how such payments to third party providers are to be treated, which is not before us, and which may or may not be correct, does not help us on the question of the correct VAT liability on the provision of the Facilities.

The Note 3 issue

113. Strictly this issue does not arise in circumstances where we have dismissed HMRC's appeal in relation to the Special Legal Regime Issue. However, as we heard full argument on the Note 3 Issue we shall deal with it as briefly as possible.

114.The complexity of the Note 3 Issue means that in order to provide context for the parties' arguments we need first to start with the legal background.

115.Note 3, emphasised below, is a Note to Item 3 of Group 10 of the VAT Act which exempts supplies as follows:

> "Sport, sports competitions and physical education
>
> Item No …
>
> 3 The supply by an eligible body to an individual of services closely linked with and essential to sport or physical education in which the individual is taking part.
>
> NOTES
>
> …

(2A) Subject to Notes (2C) and (3), in this Group "eligible body" means a non-profit making body …

…

(3) In Item 3 "an eligible body" does not include (a) a local authority; …"

116.Note 3 thus excludes local authorities from the VAT exemption for supplies of sporting services made by eligible bodies, by providing that local authorities are not eligible bodies.

117.The EU Directive provision requiring the exemption is Article 132 of the PVD which provides so far as relevant:

> "Exemptions for certain activities in the public interest
>
> 1. Member States shall exempt the following transactions:
>
> …
>
> (m) the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education; …"

118.Article 133 of the PVD gives discretion to Member States discretion as follows:

> "Member States may make the granting to bodies other than those governed by public law of each exemption provided for in points … (m)… of Article 132(1) subject in each individual case to one or more of the following conditions:
>
> (a) the bodies in question must not systematically aim to make a profit, and any surpluses nevertheless arising must not be distributed, but must be assigned to the continuance or improvement of the services supplied.
>
> (b) those bodies must be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned.
>
> (c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT;

(d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT.

Member States which, pursuant to Annex E of Directive 77/388/ EEC, on 1 January 1989 applied VAT to the transactions referred to in Article 132(1)(m) and (n) may also apply the conditions provided for in point (d) of the first paragraph when the said supply of goods or services by bodies governed by public law is granted exemption." (**emphasis added**)"

119.Article 133 thus allows Member States to circumscribe the Article 132 exemption with further conditions as regards bodies which are not governed by public law. The second sub-paragraph of Article 133, emphasised above, also allows Member States to apply condition (d) to bodies, such as local authorities, which are governed by public law.

120.The UK, in *London Borough of Ealing* (Case C-633/15), argued that the exception to the exclusion from exemption in Note 3 was permitted under Article 133(d). The CJEU agreed however with the local authority that a Member State could only exclude local authorities using that provision if it also excluded non-profit making bodies other than those governed by public law (which the UK had not done).

121.The result of the Court's decision, as submitted by HMRC according to its public briefing (Revenue & Customs Brief 6/2017), with which the FTT agreed (at [153]), was that the exemption under Article 132(1)(m) applied through direct effect. Local authorities could rely on this direct effect to claim exemption, if they wished.

122.Chelmsford accept that the effect of *Ealing* is that Note 3 cannot be viewed as a valid implementation of Article 133(d), but they do not want to claim exemption on their supplies of Facilities. As we explain in more detail below, they argue instead that Note 3 must be viewed as implementing the Member State discretion in Article 13(2) (emphasised below):

"Article 13

1. States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public

> authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.
>
> However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition. …
>
> **2. Member States may regard activities, exempt under Articles 132, …,**
>
> **engaged in by bodies governed by public law as activities in which those bodies engage as public authorities.**"

123.Article 13(2) is a key provision to Chelmsford's alternative case in this appeal because it allows Member States to deem certain activities engaged in by public authorities as fulfilling the second condition of Article 13(1), and therefore as carried out by a non-taxable person, even if there the local authority is not providing the relevant facilities under a special legal regime.

124.The central issue therefore is which Directive provision is Note 3 to be viewed as implementing? If it is, as Chelmsford argue, Article 13(2), that means the supply would be a deemed supply by a non-taxable person. If, as HMRC argue, the Note is an implementation of Article 133(d) - albeit a failed one, following the CJEU's decision in *Ealing* - then Chelmsford's supplies, if they so elect, are exempt.

125. Although both interpretations ultimately achieve the same result, namely that VAT would not be chargeable on the supply of the Facilities, the difference in interpretation matters to Chelmsford because of the way refund provisions, which the UK's legislation enables for local authorities, distinguish between supplies which are exempt for VAT purposes and supplies which are not for the purpose of business, for instance because they are made by non-taxable persons. These refund provisions are set out in s33 of the VAT Act.

126.Pursuant to that provision, local authorities can claim a refund of the VAT on supplies of goods and services made to them where the supply "is not for the purpose of any business carried on" by them (s33(1)). HMRC may, for this purpose, attribute VAT between supplies that are not for the purpose of business. The refund for non-business purpose supplies may include VAT attributable to exempt supplies (which would otherwise be irrecoverable), provided HMRC consider the exempt proportion to

be “insignificant”. In practice HMRC interpret this as 5% of the total VAT incurred by the local authority for its non-business activities. If the VAT attributable to exempt supplies is not insignificant, then all exempt input tax is disallowed, not just that incurred over the 5% threshold.

127.If HMRC’s interpretation is correct and the sports supplies are exempt, even though no tax is payable on Chelmsford’s supplies, there would be significant adverse knock on effects for refunds in respect of capital expenditure associated with exempt supplies. This is because in Chelmsford’s case the 5% limit is breached,

128.The FTT summarised Chelmsford’s arguments at [64] to [74], HMRC’s at [92] – [99], and gave its *obiter* view, rejecting Chelmsford’s case at [147] to [158].

129.Before us, Chelmsford submit that the FTT made two errors of law. The FTT erred in concluding, first, that *Ealing* was authority for the proposition that Note 3 was enacted to give effect to Article 133(d), and second that Note 3 was not capable of being interpreted as an exercise of the discretion under Article 13(2).

130.HMRC, along with the FTT, read *Ealing* as confirming that Note 3 was introduced to implement Article 133(d). It points out that that was the position adopted by the parties upon which the reference was put to the CJEU.

131.Chelmsford submit, however, that the decision in *Ealing* simply held that Article 133(d) was not available to back up the domestic legislation. *Ealing* therefore said nothing on the issue of whether Note 3 was to be regarded as seeking to implement Article 133(d) as opposed to another Directive provision.

132.Chelmsford’s case that the correct Directive basis is instead Article 13(2) and that the supplies are therefore deemed to be made by a non-taxable person, relies on drawing a number of strands together: 1) the underlying statutory purpose for Note 3 in view of the extra-statutory material; 2) the declaratory case-law effect of *Ealing;* 3) the domestic principle of interpretation that Parliament legislates rationally introducing provisions for a purpose and not in vain, together with 4) the EU law principle of conforming interpretation.

133.The steps in Ms Brown’s analysis are as follows:

(1) *Statutory background Note 3:* The extra statutory materials indicated the outcome sought by Parliament, following representations from local authorities, namely that local authorities should not be subject to the sports exemption. The reason for the local authorities' concerns was explained by Ms Brown as follows. If exempt, input tax on the supplies would not be recoverable. Not only that, (echoing the reasons exemption is not a result favourable to Chelmsford as we have discussed above) amounts of input tax in respect of other exempt supplies that would otherwise be recoverable through the refund under s33 of the VAT Act for "insignificant" exempt input VAT (because the total of exempt input tax was less than 5%) might no longer be recoverable. This non-recoverability increased "the cost base" for the local authority. That either meant increasing costs for users, which was not possible given the way pricing was determined, or the local authority bearing the loss of recoverability. It was this concern, that the local authorities' "cost base" would be increased, that was the mischief the exclusion in Note 3 sought to address. There were in principle two routes to address the mischief: making the supplies taxable by excluding them from exemption under Article 133(d) (so input tax on them could be relieved), or Article 13(2), which deemed the supplies to be made by a non-taxable person (so the authority could get its input tax under s33 of the VAT Act as the supplies were for a non-business purpose).

(2) *Declaratory effect of Ealing*: *Ealing* revealed the first route (exclusion from exemption under Article 133(d)) was not possible. The principle that case-law has declaratory effect meant that must be taken always to have been the case and knowledge of *Ealing* was to be imputed to reasonable persons (*Prudential Assurance Co Ltd v HMRC* [2013] EWHC 3249 (Ch) ("*Prudential*")). That position applied equally to Parliament, who must be presumed to be a reasonable person, and to be taken to have known that an Article 133(d) route– which addressed the mischief through making the supplies taxable – was not available.

(3) *Principles i) that Parliament legislates for a purpose ii) Conforming construction to give EU directive provisions full effect*: Parliament cannot be taken to have enacted a provision that had no effect. The provision must be construed so as to give it effect. Together with the principle that

> domestic legislation must be read so as to give EU law directive provisions full effect and consistently with the Directive, Note 3 must be read as implementing Article 13(2), and consistent with the objective of addressing the cost base mischief of deeming the supply as made by a non-taxable person.

134. HMRC submits that Chelmsford's interpretation is wrong. It does not reflect the direction Parliament headed (which, in line with the timing of Note 3 and where it sits within the domestic legislation, was plainly towards implementing Article 133(d), not Article 13(2)). Nor does it reflect the CJEU's decision in *Ealing*, which was that the supplies were exempt. Rather it is an entirely new direction which would entail the opposite of what Parliament intended. There is no need to rely on any interpretative presumption of rationality as there is no doubt what the words of Note 3 mean. The principle on conforming construction is not relevant and Chelmsford's interpretation offends the limits of construction because it is "*contra legem*" (meaning literally "against the law" i.e. "an interpretation that contradicts the very wording of the national provision at issue"[1]). Furthermore Article 13(2) would have needed the Member State to make a specific choice otherwise legal certainty and non-retroactivity principles would be infringed.

135. We consider, in large part for the reasons HMRC submit, that Chelmsford's construction of Note 3 is wrong and, had it been necessary to do so we would have upheld the decision of the FTT. Our reasons do not depend on *Ealing* being read as an authority for the proposition that Note 3 sought to implement Article 133(d), albeit unsuccessfully, and we do not express a conclusion on that question.

136. We consider that Chelmsford's argument of statutory purpose is not borne out by the materials relied upon. Those do not support the proposition that Parliament had the general outcome in mind of removing local authority concerns over increases to their costs base arising out of irrecoverable exempt input VAT by excluding local authorities from exemption but then leaving open the question of whether recoverability was achieved through taxation or through deeming the supply to be one which was made by

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[1] Advocate General Bot in *Dansk Industri (DI) v Estate of Karsten Eigel Rasmussen* (Case C-441/14) at [68]

a non-taxable person (Article 13(2)). There is in addition an unresolved question of the extent to which Custom and Excise's understanding, as expressed in its briefing documents, some of which post-date introduction of the provision introducing Note 3, can be imputed to Parliament.

137.If anything, although Mr Hill's case did not seek to rely upon the extra-statutory materials, we consider that there was material to point to the exclusion from exemption being made on the understanding that the supplies would then be taxed. For instance, the concluding paragraph of the 18 May 1995 Business Brief 9/95 which was referred to in 2017 House of Common briefing explains:

> "It has been decided not to extend the existing exemption to supplies by local and other public authorities. Such supplies accordingly continue to be standard rated."

138. That Parliament intended Note 3 to implement Article 133(d), and the consequence that the supplies were taxable, rather than deem the supplies to be those of a non-taxable person under Article 13(2) is also plainly apparent from the wording and context of Note 3 itself.

139.Item 3 only exempts supplies by "eligible bodies". Note 3 expressly removes local authorities from the definition of "eligible bodies". The wording of Note 3 is a straightforward exclusion from exemption in Item 3, which puts the supplies made by local authorities in the same position as supplies made by other non-eligible bodies, namely that the supplies are taxable. Chelmsford agree that, but for the effect of *Ealing,* (and presumably their argument regarding Note 3 being construed as an implementation of Article 13(2)) the effect of Note 3 is that the supplies are taxable.

140.As HMRC point out, Item 3 appears in a provision dealing with exemption introduced in 1994. The relevant provision implementing Article 13 is Section 41A of the VAT Act which was enacted in 2012. Had Parliament intended Note 3 to implement Article 13(2) it would have made sense to move it to s41A, but Parliament did not do that.

141.Moreover, a conclusion that Note 3 implements Article 13(2) is not consistent with the principles laid down by the CJEU in *Finanzamt Düsseldorf-Süd v SALIX Grundstücks-Vermietungsgesellschaft mbH & Co. Objekt Offenbach KG* (Case C-

102/08), ("*SALIX")*. There, the Court held that the Member State must make a specific choice when exercising a Member State discretion, but that "a general legal context" might be adequate to show the choice had been made (at [40]). That case, which also concerned Article 13(2), went on however to give examples of how the Member State could show that choice by either incorporating the Directive wording, or an equivalent expression, or drawing up a list of activities of bodies exempted which are considered to be activities of the public authority ([56]). Although these were only examples, they indicate the level of specificity envisaged. Note 3, effectively a bare exclusion from exemption, which gives no clue that the activity is to be considered to be an activity of a public authority under Article 13, does not in our judgment amount to a specific choice that the option in Article 13(2) is being exercised.

142.It is not in dispute that the effect of *Ealing* is that Note 3, must be regarded as an ineffective implementation of Article 133(d), insofar as it was that article which the UK sought to advance in that case as the Directive basis for the Note. On that basis, Note 3, unless Chelmsford's case is accepted, had to be disapplied. Chelmsford rely on the principle that legislation is presumed to have a purpose and Parliament should not lightly be taken to legislate in vain. But where legislation is disapplied under EU law that is exactly what Parliament has done. The legislation had a particular purpose but the purpose failed for want of consistency with EU law. There was no authority we were taken to which suggests that when a domestic provision is disapplied by a provision of EU law, a court must strive to see if that domestic provision can be given effect under the guise of another EU directive provision. Even if that were what the domestic presumption of purpose and rationality required, then this would not overcome the EU law obstacle presented by the principles in *SALIX* that the words used do not show that the UK made a specific choice to implement Article 13(2).

143.As to the principle of conforming interpretation, both parties ultimately agreed that there were limits to a conforming interpretation and that a court could not adopt an interpretation "*contra legem*", although each party differs on the precise extent of the limit and whether Chelmsford's interpretation of Note 3 goes beyond such limit. Chelmsford, for instance, highlight the conforming interpretation need only "go with the grain of the legislation" (*Prudential* at [37]). HMRC says an interpretation is "*contra legem*" where it "…contradicts the very wording of the national provision at issue" (see [95] of the Court of Appeal's discussion in *Ampleward Ltd v Revenue and Customs* [2021] EWCA Civ 1459 of the expression *contra legem* in the context of the

principle of conforming interpretation as explained by Advocate General Bot in *Dansk Industri (DI) v Estate of Karsten Eigel Rasmussen* (Case C-441/14) at [68]).

144.We do not need to express a view on whether Note 3 is *contra legem* as we consider Chelmsford's reliance on the EU principle of conforming interpretation, as regards Article 13(2), is misplaced. That reliance fails to recognise that Article 13(2) does not impose obligations, but gives Member States an option. The relevant interpretative principles for options are set out in *SALIX* and concern whether the Member State has exercised a specific choice. As we have said we do not consider those principles are met.

145.If the issue arose for consideration, we would therefore dismiss Chelmsford's appeal on the Note 3 issue.

Decision

146.HMRC's appeal on the Special Legal Regime Issue is dismissed.

Signed On Original

MRS JUSTICE JOANNA SMITH

JUDGE SWAMI RAGHAVAN

Release Date: 15 June 2022