[2013] UKFTT 444 (TC)

TC02836

Appeal number: TC/2010/06359

Value added tax – whether input tax recoverable – tax incurred on non-business investment activity raising income used by University to facilitate and support its other activities both taxable and exempt – whether fees incurred on management of fund an overhead for input tax to be treated as residual - yes - tax recoverable under Appellant's partial special exemption

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE CHANCELLOR, MASTERS AND SCHOLARS OF THE UNIVERSITY OF CAMBRIDGE — **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Respondents**

TRIBUNAL: **JUDGE MICHAEL S CONNELL**
JAMES MIDGLEY

Sitting in public at 45 Bedford Square London WC1 on 15 October 2012

Mr Andrew Hitchmough for the Appellant

Mr Sarabjit Singh, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Appeal

1. This is an appeal by the University of Cambridge (full legal name, The Chancellor, Masters and Scholars of the University of Cambridge) against HMRC's decision to refuse its claim for recovery of a proportion of input tax incurred on the payment of professional fees for the management of its endowment fund.

2. The claim is in respect of :

(a) under-recovered input tax for the period between 1 April 1973 and 1 May 1997 following the *Fleming/Condé Nast* [HL 2008] decision and HMRC's Brief 07/08 and

(b) under-recovered input tax for the period between 1 May 2006 and 31 January 2009 pursuant to SI 1995/2518 Regulation 29.

Background

3. As a charity, the Appellant is a non-profit making body in the business of education, research, academic publishing and consultancy. It receives donations which are invested in The Cambridge University Endowment Fund. The fund invests in a range of securities including equities, property, bonds, cash deposits and other investments. The Appellant uses professional fund managers in both the United Kingdom and the United States. It incurs fees on the management of its investments and some of these are liable to input tax, depending on the nature of the investment. The fund produces over £40m of income per year, which contributes to the Appellant's group income of £1.26b. The income is distributed across the University in support of all of its activities. Income provided by its investment activities cover around 6% of the Appellant's operational expenditure. As a charity the Appellant is required to expend all of its income in the deliverance of its chargeable aims. This includes taxable, exempt and non-taxable activity.

4. The University of Cambridge and the associated Cambridge Colleges (collectively) have separate functions. The University provides the infrastructure and staff for research: it delivers teaching through lectures: conducts examinations and awards degrees. The Colleges recruit students, provide accommodation, catering, pastoral care and guidance. So whilst the University and Colleges have a common purpose, they fulfil different roles in delivering that purpose.

5. The University's main activity, that of providing education, is an exempt supply. Its principle taxable activity relates to commercial research, sales of publications, consultancy and the hiring of facilities and equipment. The Colleges generate taxable supplies through bars, external catering and provision of non term time accommodation.

6. The Appellant therefore has a combination of both taxable and exempt supplies and is partially exempt. Input tax is accordingly attributed to taxable supplies where possible, leaving the balance as exempt input tax.

7. Where a business makes partially exempt supplies the method used to calculate the taxable input tax can either be the standard method which is the default option or a special method agreed with Revenue and Customs. Input tax can only be attributed if the whole of the supply to which the input relates is used for either exclusively taxable or wholly exempt supplies and there is a direct and immediate link. Where this is not possible the related input tax is treated as residual input tax which must be apportioned between exempt and taxable supplies. The amount applicable is added to the total attributed or exempt.

8. The Appellant's residual input tax was agreed with HMRC using an agreed methodology known as the CVCP Agreement (the Committee of Vice Chancellors and Principals), the purpose of which was to avoid the need for the University to maintain detailed systems for VAT accounting purposes.

9. Although the Appellant incurs input tax on some of its professional investment advice, it does not regard the investment activity as a specific business activity, on the basis that its investment income is outside the scope of VAT. Historically VAT incurred on investment management fees was not included in the CVCP arrangement and the Appellant had not recovered any VAT incurred as input tax.

10. By a letter of claim of 30 March 2009 the Appellant proposed that the input tax incurred on the professional management fees during the claim periods should be treated as residual, and recoverable in accordance with the special partial exemption method agreed with HMRC. The value of the claim is £182,501.

11. The Appellant had previously submitted a similar claim to HM Customs & Excise in February 2002, seeking to recover VAT incurred on fund management charges for the years 1998-99 and 2000-01. HMC&E provisionally rejected the claim citing the case of *NSPCC* (VTD 9325), and requesting further information. In *NSPCC* the VAT Tribunal decided that input tax incurred on supplies used in carrying on charitable investment activities were not referable to its taxable supplies. The University did not pursue its claim which HMRC say was "left to lie".

12. The House of Lords in *HMRC v Michael Fleming* (T/A BodyCraft [2008] UKHL2, [2008] STC324) held that the three year cap on claims for repayment of under-claimed input tax must be disapplied until an adequate transitional period had been applied.

13. Following the *Fleming* case, the Appellant submitted the current claim for the capped period from 1 May 2006 to 31 January 2009, and a proportion of the input VAT incurred on investment management fees, which were previously treated as irrecoverable in the period 1 April 1973 to 31 March 1997. The Appellant's advisors KPMG, who submitted the claim, said that the decision in *NSPCC* was not relevant to the claim and that the case could be distinguished for a number of reasons :

(1) In the *NSPCC* case, the charity sought to recover a proportion of the VAT attributed specifically to its investment activities. It argued that its investments represented a business activity and that [because it made some supplies of securities to non-EU entities] it was entitled to input tax credit in respect of a proportion of its supplies under SI 1999/3121. The Tribunal disagreed and decided that it was not appropriate to treat the Charity's investment activities as constituting a business activity.

(2) Historically *NSPCC* had only reclaimed approximately 5% of its input tax. It sought to include its investment income in its partial exemption calculation to significantly boost its residual VAT recovery rate. The Tribunal decided that, given that the income was derived from a non-business activity, it had to be left out of account and could not be included in the partial exemption method.

14. KPMG said that unlike *NSPCC* the Appellant did not assert that its investment activities constituted a business activity. It did not seek to attribute the VAT incurred to those activities and recover a proportion. It accepted that the supplies made by the fund were not made in the course or furtherance of a separate investment business and therefore it would be inappropriate to include such income within an income-based pro-rata calculation. They said that the income generated each year from the investment activities was used solely to provide funds to support the normal activities (taxable and exempt) and non-business activities of the various departments within the University. The purpose of the fund was therefore not to run a parallel and distinct investment activity, but to generate funds that facilitated and supported the overall operation of the University. On that basis the University proposed that because the VAT could not be directly attributed to either taxable supplies or exempt supplies it should be treated as residual and recoverable in accordance with its partial exemption special method. The Appellant therefore seeks to recover residual input tax in the same proportion as its taxable activities form of its total activities.

15. The Appellant says that its present claim is supported by two decisions of the CJEC. In *Kretztechnik* v *Finanzamt Linz* (C465/03), the Court decided that costs in relation to a share issue leading to a listing and to raise capital should be treated as part of the company's overheads and are therefore recoverable to the extent that its economic activities were taxable. In *Securenta Gottinger v Finanzant Gottingen* (C-437/06) the tax-payer reclaimed input tax on professional fees relating to the issue of shares and "silent partnership" arrangements for the purpose of raising capital. The ECJ held that "where a tax-payer simultaneously carried out economic activities taxed or exempt, and non-economic activities outside the scope of (the Sixth Directive), the deduction of VAT relating to expenditure connected with the (capital raising) is allowable to the extent that the expenditure is attributable to the tax-payer's economic activities within the meaning of article 2(1)". *Kretztechnik* and *Securenta* are considered in more detail later in this decision.

16. In rejecting the earlier 2002 claim, HMC&E stated that the Commissioners did not consider the Appellant's investment activities to be in the course of furtherance of its business and therefore the University could not recover any input tax on management fees relating to a non-business activity. Following *Kretztechnik* and

Securenta the Appellant says that when a tax-payer simultaneously carries out economic activities which are taxable or exempt and uneconomic activities, input tax on investment management services was an "overhead" cost which related to raising funds to support all of its activities and that the tax is recoverable to the extent that its activities are carried out for taxable purposes, using the methodology previously agreed with HMRC as applying during the relevant period of the claim.

17. HMRC's stated decisions for refusing the current claim were:

(1) that the input tax incurred related to a non-business activity and was of too considerable a size to be regarded as "incidental".

(2) HMRC said that the University's endowment fund invested in a range of securities and was actively managed for the best return. The cases of *Kretztechnik* and *Securenta* were not relevant as they related to transactions involving the issue of shares in companies to obtain fresh capital finance as opposed to the Appellant's broader and freestanding investment activities (the purpose of which was to provide income and capital).

18. Following *Kretztechnik,* HMRC issued BB12/05 to explain its view on how the ruling in the case affected the position where securities were issued in return for investment capital. Until *Kretztechnik,* HMRC's treatment of shares issued by a company for the purpose of financing its business was an exempt supply under item 6 of Group 5 of Schedule 9 VATA. Any input tax that was attributable to the costs of making the issue was generally therefore not deductible. *Kretztechnik* established that this treatment was incorrect. Business brief 12/05 confirmed that companies that make a first issue of shares in circumstances that were the same as in *Kretztechnik* were entitled to recover the input tax on the costs of the issue to the extent that they made taxable supplies. Consequently, companies which have both taxable and exempt outputs, became entitled to recover a proportion in accordance with the partial exemption method. Business brief 21/05 subsequently advised that the same principles applied to other types of shares and the issuing of other forms of security where the issuing companies' motivations were, like *Kretztechnik*, the raising of capital.

19. The Appellant lodged its Notice of Appeal with the Tribunal on 3 August 2010. Its stated grounds of appeal were:

(1) "The NSPCC case addresses different questions to those posed by the University. The NSPCC case had substantial investments and had argued:

(a) that the buying and selling of investments was carried out at such a substantial level that it should be regarded as a business activity,

(b) that input tax incurred in the course of carrying on the charity's business should be apportioned to its investments supplies,

(c) that the income from its investment activities should be included in its partial exemption/non-business calculation.

(2) Although the Tribunal decided against the NSPCC on all three points. Points (b) & (c) have no relevance to the University's case and point (a) was only relevant if the impact of Kretztechnik is ignored. The University therefore believes that HMRC have placed undue reliance on a case which does not address the points put by the University.

(3) HMRC indicate that the principles in Kretztechnik can only be applied to share issues and that the University cannot apply the principle to investment income. The fact that the case has wider application can be discerned, not only by analysing the case itself, but also looking at the case of Church of England Children's Society v HMRC [2005] STC 1644 which applies the principles established in Kretztechnik to fundraising".

20. Following the Appellant's appeal to the Tribunal, there was a further exchange of correspondence between its advisors and HMRC in which, for the purposes of determination of this appeal, it was agreed that:

(1) The operation of the endowment fund is not an economic activity in its own right, (and therefore is outside the scope of VAT.)

(2) The issue for the Tribunal to decide is whether the Appellant has a right to deduct, in part, input tax incurred on the cost of operating the endowment fund on the basis that it should be characterised as overhead expenditure.

Hearing bundle

21. The hearing bundle included copy correspondence between the parties, including HMRC's decision, its review and the Notice of Appeal, relevant legislation, case law authorities and witness statements by Mr Andrew Reid and Mr Kerry Sykes. the director and deputy director of finance of the Appellant University.

Relevant legislation

22. Article 2(1) of EC Council Directive 2006/112 provides so far as material that:

(The following) transactions shall be subject to VAT;

a) The supply of goods for consideration within the territory of a member of state by a taxable person acting as such

b) The supply of services for consideration within the territory of a member of state by a taxable person acting as such.

23. Article 9(1) provides so far as material that:

> "(1) "Taxable person" shall mean any person who, independently, carries out in any place any economic activity whatever the purpose of that activity.
>
> (2) Any activity of producers, traders or persons supplying services… shall be regarded as an economic activity. The exploitation of tangible

or intangible property for the purpose of obtaining income there from on a continuing basis shall in particular be regarded as an economic activity..”

24. Article 168 provides so far as material that:

“..insofar as the goods and services are used for the purposes of the taxed transaction of a taxable person, the taxable person shall be entitled…to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid…in respect of supplies to him of goods or services carried out or to be carried out by another taxable person.

……

25. Article 173 provides so far as material that:

“..in the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to article 168…and in respect of which VAT is not deductible only such proportion of the VAT as is attributable to the former transactions shall be deductible”

26. Article 13B(d)(5) exempts

“transactions, including negotiation, excluding management and safe keeping, in shares, interests in companies or associations, debentures or other securities”,

27. VATA 1994 provides so far as material as follows:

“4(1) VAT shall be charged on any supply of goods or services made in the United Kingdom where it is a taxable supply made by a taxable person in the course or furtherance of any business carried on by him.

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

5(1) Schedule 4 shall apply for determining what is or is to be treated as a supply of goods or a supply of services.

(2) subject to any provision made by that Schedule..

(a) “supply” in this act includes all forms of supply, but not anything done otherwise that for a consideration:..

24(1) Subject to the following provisions of this section “input tax”, in relation to a taxable person means the following tax, that is to say-

(a) VAT on the supply to him of any goods or services:..

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

(2) Subject to the following provisions of this section “input tax” in relation to a taxable person, means VAT on supplies which he makes…

(5) Where goods or services supplied to a taxable person…are used or to be used partly for the purposes of a business carried on or to be carried on by him and partly for other purposes VAT on supplies…shall be apportioned so that only so much as is referable to his business purposes is counted as his input tax…..

28. Section 101 of the Value Added Tax Regulations 1995 states :

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

and Regulation 102 states :

(2)"… the Commissioners may approve or direct the use by a taxable person of a method other than that specified in Regulation 101."

29. Group 5 - Finance - of Schedule 9 VATA 1994 contains a list of exempt supplies of goods and services which includes:

item 6 "..the issue, transfer or receipt of, any dealing with, any security or second security being-

(a) shares, stocks, bonds, notes….debentures…

The Appellant's case

30. Mr Hitchmough referred us to *Mayflower Theatre Trust v HMRC* [2007] STC 880 where the notion of "overhead expenditure" was considered. Carnwath LJ said (at [26]) that:

"Input tax on services may fall within the partial exemption rules, first, where it has a direct link, and is therefore attributable, to both taxable and exempt supplies; or, secondly, where it has a direct link to neither, in other words it is 'non-attributable'. Both may be described as 'residual'. The second category, also well established in the case law, appears to be more usually (and more helpfully) described by the term 'overheads'."

He then went on to explain (at [28]) that,

"in relation to 'overheads' which cannot be attributed to particular supplies, it is enough [in order to found a right of deduction] to establish the appropriate link with the 'whole economic activity' of the taxable person.",

before concluding (at [33]) that,

> "The special treatment of 'overheads' or 'general costs' serves a particular and limited purpose in the VAT system, for those inputs which would not otherwise be brought within the [right to deduct]".

31. *Kretztechnik*, Mr Hitchmough says, provides an illustration of the application of these principles. In that case it was decided that the share issue was not a "supply" for VAT purposes but that the inputs on associated costs could nonetheless be regarded as "part of the overheads of the company" and thus "components of the price of the products marketed by it" (Judgment [32]). The ECJ said :

> "34. The deduction system is meant to relieve the trader entirely of the burden of VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT …
>
> 35. It is clear from the last-mentioned condition that, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction. Thus, the right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them was a component of the cost of the output transaction that gave rise to the right to deduct …
>
> 36. In this case, in view of the fact that, first, a share issue is an operation not falling within the scope of the Sixth Directive and, second, that operation was carried out by Kretztechnik in order to increase its capital for the benefit of its economic activity in general, it must be considered that the costs of the supplies acquired by that company in connection with the operation concerned formed part of its overheads and are therefore, as such, component parts of the price of its products. Those supplies have a direct and immediate link with the whole economic activity of the taxable person …"

32. Thus in *Kretztechnik*, the ECJ held that although the share issue was itself a non-economic activity, the associated costs formed part of the company's overheads, having a direct and immediate link with the whole economic activity of the company. The company had the right to deduct the proportion of the VAT on those costs which could be attributed to its taxable economic activities.

33. The Appellant says the ECJ recognised that, although the expenditure on the services in question might have been incurred for the purposes of "an operation not falling within the scope of [VAT]", provided it could be established that "that operation was carried out … for the benefit of [Kretztechnik's] economic activity in general" the expenditure was overhead expenditure and, "as such", a cost component of Kretztechnik's taxable and exempt outputs.

34. Mr Hitchmough says that it follows from *Kretztechnik* that the issue of deductibility can be resolved by asking a relatively straightforward question; for what

purpose has the operation not falling within the scope of VAT been carried out? Examples of this approach can be found in a number of subsequent cases. For example:

(1) In *Church of England Children's Society v. HMRC* ([2005] STC 1644), the issue was whether input tax could be deducted on charges levied by face-to-face professional fundraising organisations and on newsletters (activities out of scope of VAT) to the extent that they are attributable to the tax payers general economic activities. Following *Kretztechnik* Blackburne J held (at [28]) that,

> "What matters … is the link, if any, which the output supplies made by the Society have with the fundraising services and, if there is such a link, whether that supply is taxable or exempt. In other words, were the funds that were raised, ie the donations, used to any extent for the purposes of any taxable output transactions by the Society? If and to the extent that they were, the input tax on those services is deductible."

The Court therefore followed *Kretztechnik* and held that input tax on fundraising, where fundraising was outside the scope of VAT, was partly recoverable as the fundraising related to the Society's wider activities, which included the making of taxable supplies.

(2) In *University of Southampton v HMRC* [2006] STC 1389 the question was whether publicly-funded research carried out by that University formed part of its overall economic activity. In the course of giving judgment Warren J referred to *Kretztechnik*. He observed that,

> "26 ….raising capital by issuing shares cannot sensibly be viewed as being carried out, even in part, for its own sake. The costs of the operation (of issuing shares) were in those circumstances part of the company's overheads and 'therefore, as such, component parts of the price of its products". This makes perfectly good sense. If the company were asked 'why are you spending this money on fees etc?' the answer would come 'In order to increase the capital, issue more shares and become listed'. That could prompt another question 'Why are you increasing capital, issuing more shares and becoming listed?' to which the answer would be 'Because we see that as the way to benefit our business' where the business referred to is the economic activity (in the sense of producing outputs) within the Sixth Directive. The answer would not be along the lines 'Because we see doing so as a worthwhile activity in its own right'. The position is really no different, in that sense, from internal marketing costs, for instance, the production in-house of advertising brochures. Although there is, in one sense, a separate activity – the production of brochures – that production is effected for the benefit, and only for the benefit, of the business; the cost of production is an overhead cost and therefore 'as such as component part' of the product's production. The advertising brochure is not something which is prepared for its own sake.
>
> 27 I do not read the decision in Kretztechnik as establishing any general proposition which goes further than this: that a cost will be an overhead where it is incurred solely (as was the case on the facts) for the benefit of the trader's economic activity in general. I add that, in principle, it should be possible to

> treat in the same way an apportioned part of a cost incurred partly in connection with business activities and partly in connection with non-business activities."

35. The guidance provided by Warren J, says the Appellant, is directly relevant to these proceedings. The University's investment activity, which it undertakes through the Fund, is (as is common ground) not "an operation … falling within the scope of [VAT]". Accordingly, one must enquire whether the investment activity is an activity carried out "*for the benefit of [the University's] economic activity in general*", or whether it is, instead, an activity carried out for its own sake?

36. The answer, submits Mr Hitchmough, is clear. The investment activity is carried out not for its own sake, but for the benefit of the University's activity generally. It follows that the expenditure on fund management fees is overhead expenditure of the University and "as such" a cost component of its taxable and exempt outputs. Moreover, as Warren J noted in *University of Southampton* at [27] above, this conclusion would in no way be affected as a result of part of the capital and income generated by the University from the fund being used to support its non-business activities, such as publicly funded research. As Warren J observed, this simply means that some form of apportionment is necessary, as was carried out by the University in quantifying the claim.

37. The same point is made by the ECJ in its judgment in *Securenta Göttinger v. Finanzamt Göttingen* (Case C-437/06) [2008] STC 3473 where it held (at [31])

> "where a taxpayer simultaneously carries out economic activities, taxed or exempt, and non-economic activities outside the scope of the Sixth Directive, deduction of the VAT relating to [overhead] expenditure … is allowed only to the extent that that expenditure is attributable to the taxpayer's economic activity within the meaning of art 2(1) of that Directive".

38. Mr Hitchmough says that the Commissioners resist the above analysis and conclusion, on the grounds that in both *Kretztechnik* and *Church of England Children's Society*, the capital raising activity to which the costs initially related did not involve the making of supplies whereas in the [University's] case, the investment activity does involve the making of supplies (disposals of investments) for a consideration, albeit that the University does not make such supplies as a taxable person acting as such.

39. The Appellant says this interpretation and the Commissioners' analysis is flawed, supported by neither principle nor authority. Mr Hitchmough says that that in its judgment in *Kretztechnik* the ECJ used neutral language, referring simply to "operations" falling outside the scope of VAT irrespective of the reason. The Commissioners' approach cannot be reconciled with the use of such neutral language.

40. Mr Hitchmough referred us to *Skatteverket v AB SKF* (Case C-29/08), where the ECJ had to consider whether the principles which it identified in *Kretztechnik* should be applied in the case of share disposals. The facts of the case were that SKF in the context of restructuring, the parent company of an industrial group, proposed to

dispose of a number of shares in subsidiary companies. The reason for the disposals was to obtain funds to finance other activities of the group. In order to carry out the disposals SKF required a share valuation, assistance with negotiations and specialist legal advice, all of which were subject to VAT. The issue was whether SKF could recover the VAT on associated fees. The ECJ held that it could, stating (at [68]) that:

> "disposals of shareholdings are considered to form part of the taxable person's general costs in cases where the disposal itself is outside the scope of VAT".

41. Mr Hitchmough observed that the ECJ did not confine its language to a mere issue of shares before concluding (at [72]) that:

> "… there is a right to deduct input VAT in respect of services carried out in connection with financial transactions if the capital acquired by means of those transactions is used in connection with the economic activities of the person concerned".

42. The ECJ therefore confirmed that a taxable person had a right to deduct not only where there was a direct and immediate link between a particular input transaction and an output transaction or transactions, but also where the costs of the services in question were part of the taxable person's general costs (overheads), and were, as such, components of the price of the goods or services that were supplied, thereby having a direct and immediate link with the taxable person's economic activity as a whole (para 58).

43. Mr Hitchmough says that the Respondents will rely on the case of *BLP Group v Customs & Excise Commissioners* [1995] STC424. In that case a holding company provided management services to a group of subsidiary trading companies. It disposed of 95% of the shares in a subsidiary company to raise capital. It was accepted that the disposal was an exempt supply, but the holding company reclaimed input tax in respect of professional services supplied in relation to the disposal. The ECJ upheld the VAT and Duties Tribunal decision, that the input tax was not deductible as it related entirely to the making of an exempt supply and that input tax was only deductible under Article 17 of the EC Sixth Directive if the goods or services in question had a direct and immediate link with the taxable transactions. The fact that the ultimate aim of a taxable person was the carrying out of a taxable transaction was irrelevant.

44. Mr Hitchmough says that in *BLP* the Court was looking at whether there was a direct link, but that in this case the Appellant does not seek to apply that test. The Appellant applies a different test, which was not based on a subjective intention as to whether the money was raised for an economic activity but an objective test. If the funds have been raised and employed in the Appellant's economic activity, the input tax is an overhead and is deductible. This point, he says, was recognised in *Kretztechnik* and *AB SKF*.

45. Mr Hitchmough submits that it is clear that the ECJ's approach in *AB SKF* is identical to that adopted and applied by it in *Kreztechnik*; the issue was resolved by

posing the simple question, "for what purpose has the operation not falling within the scope of VAT been carried out?". The argument advanced by the Commissioners is totally inconsistent with the approach and conclusion of the ECJ in *AB SKF*.

46. It is he says accepted by the Appellant that where services are used by a taxable person both for taxable transactions and for non-taxable transactions, Article 173 of the Principal VAT Directive provides that only such proportion of the VAT as is attributable to the taxable transactions shall be deductible. The Appellant undertakes both taxable research activity and exempt educational activity and has agreed a special method of attributing residual input tax to its taxable and exempt supplies with HMRC. The Appellant therefore says that the input tax on the investment activity is an overhead and deductible, despite the fact that there may be no immediate and direct link between the investment activity and its overall economic activity for which the investment fund generated income.

The Respondents case

47. Mr Singh, for the Respondents, says that if the investment activity of the Appellant had been an economic activity in its own right it would be an exempt supply and input tax incurred on management and other associated fees would not be deductible. However, as referred to in paragraph 19 above, it is agreed by the Respondents that the Appellant's investment activity is not an economic activity in its own right. The Appellant says however that it is necessary to determine the reasons why the investment activity is not an economic activity because the reasons dictate the consequences that follow.

48. Article 168 of Directive 2006/112/EC provides that the right of deduction of VAT in respect of services supplied to a taxable person only arises insofar as those services *"are used for the purposes of the taxed transactions"* of that taxable person. Under Article 13B(d)(5) transactions in share interests in companies and other securities must be exempted from the scope of VAT and are exempted under Group 5 VATA 1994. There are occasions when transactions in shares and interests in company and other securities may fall within the scope of VAT and in particular where such transactions are effected as part of a commercial share dealing activity. Mr Singh says that the Appellant's investment activity although agreed not to be an economic activity is nonetheless a "supply" capable of taxation or exemption within the VAT system and on that basis the facts of this appeal are fundamentally different and can be distinguished from those in *Kretztechnik.*

49. Mr Singh argues that because the Appellant's investment activity is not an economic activity, the Appellant must demonstrate that it is nonetheless permissible to reallocate the VAT incurred on the costs of the investment activity to their economic activities. He submits that it is only where there is no supply *capable of taxation or exemption* within the VAT system that it becomes necessary to consider whether costs can be directly and immediately linked to the tax-payer's economic activities as whole. In the Appellant's case, there are supplies capable of taxation or exemption, but they are not taxable or exempt because *they are not made by a taxable person acting as such.* Mr Singh says that the Appellant must demonstrate that the

costs burden their economic activities alone and do not also burden the cost of the non-economic activities. He asserts that the Appellant is unable to demonstrate this.

50. In the *Kretztechnik* case, AG Jacobs at paragraph 9 of his opinion said :

> ".. because the right to deduct arises only in respect of supplies used for the purposes of tax transactions, there is no such right if they are used only for the purpose of other output transactions, such as the exempt transactions listed in article 13, or of supplies which would fall outside the scope of VAT because, for example, they are not effected for consideration or are not made by a taxable person acting as such, in the context of an economic activity within the meaning or article 4.."

51. If input tax was attributable to supplies made as part of the Appellant's investment activity, that would be because there was a *direct and immediate link* between the costs relating to the activity and those supplies. In *BLP Group* when considering the right to deduct input tax under Article 17(2) of the EC Sixth Directive the ECJ said :

> *"… the goods or services in question must have a direct and immediate link with the taxable transactions .. the ultimate aim pursued by the taxable person is irrelevant."*

52. Mr Singh argues that there is no direct and immediate link between the costs associated with the Appellant's non-economic investment activity and its taxable or exempt supplies. Nor is it possible to look through an objective analysis of those costs to the ultimate intentions of the tax-payer.

The ECJ added

> *".. moreover if BLP's interpretation were accepted the authorities when confronted with supplies which, as in the present case, are not objectively linked to taxable transactions, would have to carry out enquiries to determine the intention of the taxable person. Such an obligation would be contrary to the VAT systems objectives of ensuring legal certainty and facilitating the application of the tax by having regard, save in exceptional circumstances, to the objective character of the transaction in question.."*

53. In Case *AB SKF* it was recognised that the mere acquisition, holding and sale of shares is not in itself an economic activity (para 28) within the meaning of the Sixth Directive :

> *"[These sort of transactions] … cannot amount to the exploitation of an asset intended to produce revenue on a continuing basis, as the only consideration for those transactions consists of a possible profit on the sale of those shares."*

However, if the activity involves trading in shares or is a direct extension of taxable activities it may be economic activity (paragraph 16 of *Harnas & Helm CV*) :

> *"It is true that [the transactions referred to] … may fall within the scope of VAT where they are effected as part of a commercial share-dealing activity … and constitute a direct permanent and necessary extension of taxable activity."*

54. Mr Singh submits that the Appellant's investment activity is a freestanding activity. The management and other associated costs relate to supplies the Appellant makes in the course of investment activity that would be capable of taxation or exemption if they were made by a taxable person acting as such, i.e. as a person carrying out economic activity under Article 4(1) of the Sixth Directive (Directive 77/388/EC) (now the first paragraph of Article 9(1) of the Principal VAT Directive). The fact that they are not does not make those supplies a nullity for VAT purposes. The investment activity is not a pre-cursor activity to the University's performance of its economic activities and for that reason it is impermissible to reattribute the costs of the investment activity to its economic activities.

55. The Appellant's position, including their reliance on *Kretztechnik* and *Church of England Children's Society*, is misconceived because crucially, in both *Kretztechnik* and *Church of England Children's Society*, the capital raising activity to which the costs initially related *did not involve the making of supplies*. However, in the Appellant's case, the investment activity does involve the Appellant making supplies (disposals of investments) for a consideration, albeit that the Appellant does not make such supplies as a taxable person acting as such, and so the purpose or objectives of the investment activity is irrelevant.

56. Mr Singh says it is crucial to understand the reason why the investment activity is not an economic activity in order to decide whether the Appellant can reclaim the input VAT. He argues that the flaw in the Appellant's argument is that it ignores the fact that its investment activity involves the making of supplies and the professional fees and input tax have a direct link with the making of those supplies.

57. In *Securenta* it was held by the ECJ that if the costs of investment activity were not *solely* attributable to economic activities carried out by the tax-payer but were at least in part for the performance of non-economic activities, those costs were not among the elements which, alone, went to make up the cost of the transactions relating to economic activities. The costs of the investment activity could not therefore be regarded as an overhead and, as such, component parts of the price of the tax-payer's products, with a direct and immediate link to the whole economic activity of the tax-payer. Accordingly, there was no right to deduct (paras 23-31 of the Court's judgment and also paras 31-38 of AG Mazak's opinion).

58. In the Appellant's case, Mr Singh argues that it cannot be said that the costs of the investment activity are a cost component of the price of the Appellant's transactions relating to economic activities alone. The investment management costs burden the price of the non-economic activity of disposals of securities, not the price of the Appellant's economic activities, e.g. supplies of education, research, catering, bar sales and conferencing services. The investments simply lead to a subsidy of those economic activities. This is in contrast to the position in *Kretztechnik*, where the costs of the share issue burdened all the supplies of the business, which related to economic activities alone, as the costs had to be recovered via the price of the supplies made, in order for the shareholders to be repaid for their investment.

59. In the *Kretztechnik* case, capital was raised by the issuing of shares, but this did not involve the making of any supplies. The court concluded that an issue of new shares by a company is not a supply by the company at all, and/or that it is a transaction of a type with which VAT is not concerned. The court went on to say that it was only because the share issue by *Kretztechnik* could not be regarded as a supply capable of taxation or exemption within the VAT system, that it was necessary or possible to view in that light the referring courts finding that the costs of the disputed services were attributable exclusively to the admission to the stock market for the purpose of the issue. It was therefore open for the Court to look through to the purpose of the capital raising activity, which was to benefit the tax-payer's economic activity.

60. In this case, the investment activity is capable of being a supply. The *BLP* case made it clear that the ultimate aim of the disposal of shares is irrelevant. Only if the fiscal activity *is not capable* of being a supply falling within the scope of the Sixth Directive is it possible to consider whether the costs associated with that activity are directly or immediately linked to the tax-payer's economic activities.

61. Mr Singh argues that the position in the Appellant's case is similar to the position where a business purchases a car but does not adopt it as a business asset because there is substantial private use. If the business subsequently sells the car to raise capital for the business, there is no obligation on the business to account for output tax on the sale, because the transaction is not part of the business' economic activities. Therefore, the costs of that sale cannot be attributed to the business' economic activities, even though the capital raised is put into the business. Similarly, he says, it is not permissible to reattribute the costs of the investment management activity to the economic activities of the Appellant.

Conclusions

62. Before considering the parties' submissions, it is appropriate to consider the principles established from the relevant case law authorities.

BLP

63. In *BLP* it was *accepted* by the tax-payer that its disposal of 95% of its shares in a subsidiary company was an *exempt* supply. However, BLP claimed input tax in respect of professional services supplied in relation to that disposal. The Tribunal held that the tax was not deductible since it related entirely to the making of an exempt supply. The ECJ upheld the Tribunal's decision holding that input tax was only deductible under article 17 of the Sixth Directive if the goods or services in question had a direct and immediate link with taxable transactions. The principle recognised by the ECJ was that the ultimate aim of the taxable person, that is the carrying out of a taxable transaction, was irrelevant.

64. However, in this appeal, the input tax which the Appellant seeks to deduct does not relate to an economic activity or an exempt supply and therefore BLP can in that regard be distinguished.

Kretztechnik

65. In *Kretztechnik* the tax-payer was an Austrian company which, with a view to raising capital from a share issue, applied for admission to the Frankfurt stock exchange. The capital was required to assist the company's objects, which were the development and distribution of medical equipment. The issue of shares was an exempt supply under national law, and so the tax authority disallowed the company's deduction of input tax on supplies obtained in connection with the share issue. The distinction between *Kretztechnik* and *BLP* is that the company did not agree that the share issue was an exempt supply. It argued that the input tax on the costs associated with the share issue should be treated as part of its general overheads. The ECJ agreed with the tax-payer, and that because the aim of the issue was to raise capital it followed that the share issue did not constitute a supply of services within Article 2(1) of the Sixth Directive.

66. AG Jacobs in his opinion in *Kretztechnik* said that where a tax-payer sells a share, that is a supply of services in the form of an assignment of existing and tangible property within the meaning of article 6(1) of the Sixth Directive. However, when a company issues new shares, it is not selling any existing property, it is increasing its assets by acquiring capital and that such a step defies categorisation as a supply of services by the company. From its point of view, there is an acquisition of capital not a supply and thus no transaction capable of being taxed or exempted from VAT. AG Jacobs therefore concluded that an issue of new shares by a company is not a supply by the company at all and/or that is it a transaction of a type withwhich VAT is not concerned.

67. In paragraph 74 of AG Jacobs opinion he says

> " thus if the transaction with which the input is most closely linked is one which falls entirely outside the scope of VAT because it is in any event not a supply of goods or services, it is irrelevant for the purpose of determining deductibility. What matters is the link, if any, with…output supplies…"
>
> and
>
> "the question to be asked is therefore whether the capital raised by the share issue was used for the purposes of one or more taxed output transactions" (Paragraph 75)
>
> "it seems likely that the use of the capital and the services connected with the raising of that capital cannot be linked to any specific output transactions but must rather be attributed to the companies economic activities as a whole. There can be no reasonable doubt that a commercial company which raises capital does so for the purpose of its economic activity" (Paragraph 76)
>
> "it appears to be common ground that *Kretztechnik* makes only tax output supplies so that it raised the capital in its capacity as a taxable person acting as such. In that case VAT on inputs attributable as overheads to its whole economic activity would be deductible…if however, it were also to make other supplies, only a proportion would be deductible" (Paragraph 77)

68. In *Kretztechnik* the right to deduct tax charged on the acquisition of goods or services presupposed that the expenditure incurred in acquiring them was a component of the cost of the output transactions that gave rise to the right to deduct input tax. In view of the fact that a share issue was an operation not falling within the scope of the Sixth Directive, and that the operation was carried out by *Kretztechnik* in order to increase its capital for the benefit of its economic activity in general, costs of the supplies acquired in connection with the operation concerned had to be regarded as part of its general overheads and therefore component parts of the price of its products. Those supplies therefore had a direct and immediate link with the whole economic activity of the taxable person. It followed that under article 17(1) and (2) of the Sixth Directive *Kretztechnik* was entitled to deduct the tax charged on the expenses incurred for the various supplies which it acquired in the context of the share issue to the extent that such transactions constituted taxable transactions and because it only carried out taxable transactions all of the input tax was deductible.

69. As recognised in *Kretztechnik*, it is settled case law that the mere acquisition and holding of shares is not to be regarded as an economic activity within the meaning of the Sixth Directive. The mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis because any dividend yielded by that holding is merely the result of ownership of the property and not the product of an economic activity within the meaning of the Sixth Directive. Transactions that consist of obtaining income on a continuing basis from activities which go beyond the acquisition and sale of securities, such as transactions carried out in the course of a business trading in securities, could fall within the scope of the Sixth Directive, and depending on the nature of the activity may be exempted under article 13B(d)(5) of that directive. The Appellant's investment activity does not fall into that category; it is common ground that it is not an economic activity.

70. Mr Singh argues that the Appellant's investment activity could nonetheless fall within the scope of VAT and that accordingly the inputs cannot be deducted. He submits that the investment activity is a "freestanding activity" and as such a "supply", albeit not one made by a taxable person acting as such. He therefore asserts that the inputs cannot be reattributed from that non-economic supply to the Appellant's economic supplies, taxable or exempt. For the reasons outlined above we do not agree that *Kretztechnik* supports that analysis.

Securenta

71. In *Securenta* the tax-payer raised additional necessary capital by means of a share issue and silent partnership arrangements. It claimed input tax deduction relating to the associated costs. The tax authorities rejected its claim, but agreed to allow a percentage deduction of the company's residual input tax. The case was referred to the ECJ for rulings on the interpretation of Article 17(5) of the Sixth Directive. The ECJ effectively endorsed both *BLP Group* and *Kretztechnik* holding that where tax-payers simultaneously carry out economic activities, taxed or exempt,

and non-economic activities outside the scope of the Sixth Directive, a deduction of VAT relating to expenditure connected with the company's non-economic activity (the issue of shares and silent partnership arrangements) was allowable, although only to the extent that the expenditure is attributable to the tax-payer's economic activity within the meaning of Article 2(1). The ECJ said that the method of calculation for the purposes of determining an apportionment was a matter for the member state, providing the formula objectively reflected the part of the input expenditure actually attributable to the economic and non-economic activities.

72. The Appellant, as in *Securenta,* carried out three types of activity :

(1) Non-economic activities which do not fall within the scope of the Sixth Directive (that is the investment activity);

(2) Economic activities, which fall within the scope of the Directive but are exempt from VAT (such as the Appellant's provision of education); and

(3) Taxed economic activities (such as the Appellant's commercial activities).

The ECJ observed in *Securenta* that it was apparent from the documentation before the court that the costs incurred by *Securenta* for the financial transactions were at least in part for the performance of non-economic activities. Similarly, in the Appellant's case, even if the costs of professional management were for the performance of non-economic activities, that is not fatal to its claim to treat the input tax on those costs as residual and that deduction of input tax is allowable to the extent that VAT expenditure is attributable to the Appellant's economic activity.

AB SKF

73. In *AB SKF* the raising of capital involved the disposal of shares rather than issue of shares. As in *Kretztechnik* and *Securenta* the purpose of the disposals was to finance other activities of the group. The company applied for a preliminary ruling from the ECJ on whether it was entitled to reclaim input tax on the services relating to share valuations, legal advice and disposals, which would all be subject to VAT. The ECJ held that the disposal of shares was an *exempt* supply under Article 13B(d)(5). However, where a disposal of shares was "equivalent to the transfer of a totality of assets or part thereof of an undertaking", within Article 5(8) of the Sixth Directive, and where the member state concerned had chosen to exercise the option provided for by that provision, then the disposal did not constitute an economic activity subject to VAT.

74. The ECJ went on to say that there was a right to deduct input tax paid on services supplied for the purposes of a disposal of shares if there was a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person. If was for the national court to take account of all the circumstances surrounding the transactions at issue in the main proceedings and to determine whether the costs incurred are likely to be incorporated in the price of the shares sold, or if they are among only the cost component of transactions within the scope of the taxable person's economic activity.

75. The ECJ therefore recognised that the principle of fiscal neutrality required that the same tax treatment be allowed to a disposal classified as an exempted transaction (as one that was outside the scope of VAT) and it followed that there was a right to deduct input VAT paid on services supplied for the purposes of a disposal of shares, under Article 17(1) and (2) of the Sixth Directive and Article 168 of Directive 2006/112, if there was a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person.

Church of England Children's Society

76. The decision in this case followed the principles laid down in *Kretztechnik* and *Securenta*. Blackburne J held that the charities fundraising activities were "general overheads" and "cost components" of the charity's economic activities. He remitted the case to the Tribunal "to determine the extent to which the monies raised as a result of the use of the fundraising services" were used by the charity to make taxable supplies. The Tribunal were therefore asked to determine what proportion of the charity's activities were "non-business" and thus outside the scope of VAT, and what proportion was attributable to taxable supplies.

77. At paragraph 28 of his judgment Blackburne J says :

> "as *Kretztechnik* made clear, whilst it is established that the transaction with which the fundraising services are most directly and immediately linked is not a supply at all that link is irrelevant for the purpose of determining deductibility."

Blackburne J went on to say that in determining the extent to which the input tax is deductible this would involve an apportionment in order to secure a fair and reasonable attribution of the input tax as between the tax-payer's taxable and exempt supplies. His clear conclusion was that irrespective of the fact that costs of an activity fall outside the scope of VAT, if that activity funds other activities of the tax-payer, either taxable or exempt, the input tax on those costs is deductible as residual input tax.

78. The purpose of a particular activity, and in this case the Appellant's investment activity which was not by itself an economic activity, must be looked at objectively to determine whether the costs associated with that activity qualify as overheads. If the purpose of the activity is to benefit the other economic activities then the costs of the non-economic activity can be regarded as overhead costs so that the input tax is deductible wholly or in part, depending on whether outputs include exempt as well as taxable supplies. The professional management and other costs associated with the investment activity formed part of the component parts of the Appellant's supplies. Although there were separate activities, the investment activity was effected for the benefit of the Appellant's other activities. There cannot be any other conclusion if the investment activity was not something which was carried on for its own sake. The costs of the investment activity were incurred solely for the benefit of the Appellant's economic activity in general, and objectively were not incurred for the purpose and benefit of its non-economic investment activity.

79. In *BLP* the ultimate reason for the taxable supplies was the carrying out of a taxable transaction but this was only relevant because it related to an activity which the Appellant agreed was exempt. In that case the Appellant asked the court to "look through" an objective analysis of the cost of those taxable supplies to the ultimate intention of the tax-payer. Here they do not. We do not accept that it is necessary for the Appellant to demonstrate that the professional management fees burden *only* the cost of the economic activity. The investment activity was not an activity carried out for its own sake. Although the investment activity was a separate activity it was undertaken for the benefit of the Appellants other activities. Whether the investment activity operated as a subsidy or the costs thereof constituted an overhead is not in our view relevant.

80. We agree with the Appellant that *Kretztechnik* has a wider application than that asserted by the Respondents. There is clearly a link between the Appellant's investment activity and its overall economic activity. Costs associated with the investment activity were in reality components of the price of the Appellant's research and publications on the one hand and educational and other exempt activities on the other. The fact that the investment activity may have raised, primarily, income rather than capital is in our view of no relevance.

81. The VAT system achieves the greatest degree of simplicity and neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of supply. We do not accept that overheads relating to a non economic activity undertaken for the purchase of an economic activity should not be regarded as recoverable because the non economic activity may technically be capable of falling within the definition of "a supply".

82. For the above reasons we accordingly allow the appeal.

83. It follows that input tax on costs associated with the investment activity fall to be apportioned under s 24(5). Given our conclusions and that the only question which the Tribunal has been asked to decide is whether the Appellant has a right to deduct, in part, input tax incurred on the cost of operating the endowment fund on the basis that it should be characterised as overhead expenditure, any issues relating to apportionment are not matters on which we make any determination.

84. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

MICHAEL S CONNELL
TRIBUNAL JUDGE
RELEASE DATE: 19 August 2013