TC02857

Appeal number: LON/2007/01844

VAT – recovery of input tax on professional fees relating to the sale of shares in subsidiary companies* – Skatteverket v AB SKF – *whether sale of shares constituted an economic activity – yes – if so, whether an exempt supply – yes – if an exempt supply, whether input tax recoverable – no – whether sale of shares a transfer of a going concern – no – if so, whether input tax recoverable – no – whether discharge of indebtedness by subsidiary companies on completion of sale comprised part of consideration for the supply of the shares – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TLLC LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE EDWARD SADLER
MICHAEL SHARP

Sitting in public at Bedford Square on 31 January, 1 February and 26 – 27 March 2013. Final written submissions made 17 June 2013

Kevin Prosser QC, instructed by Deloitte LLP, for the Appellant

Kieron Beal QC, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

The appeal in summary

1. This is an appeal by the company TLLC Limited ("the Appellant") against an assessment to VAT made by The Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") and dated 5 July 2007. That assessment was made to recover certain input tax which the Appellant had claimed as a credit against its output tax for its VAT quarterly accounting periods 12/04 and 03/05. The amount of VAT so assessed is £723,627.21.

2. The Appellant delivered its notice of appeal on 31 October 2007. By agreement of the parties the appeal was stood over for a number of years awaiting the delivery of the judgment of the Court of Justice of the European Union ("the CJEU") in Case C-29/08 *Skatteverket v AB SKF* [2009] ECR I-10413 ("the *AB SKF* case"). Following that judgment the Appellant delivered a revised notice of appeal, specifying further grounds of appeal, on 10 August 2011.

3. At the hearing of the appeal the parties were aware that a further case was before the CJEU, the decision in which could be relevant to certain of the submissions made at the hearing. A decision in that case was released on 30 May 2013, and following its release the parties made further written submissions to the tribunal with reference to that decision (Case C-651/11 *Staatssecretaris van Financiën v X BV* [2013] ECR I-0000 ("the *X BV* case")).

4. The Appellant is the representative member of a VAT group carrying on a business of providing hotel accommodation under the Travelodge trade name. The supplies made in the course of that business are taxable supplies for VAT purposes. In late 2004 and early 2005 members of the Travelodge group of companies entered into a complex sale and leaseback transaction with an unrelated third party in relation to certain of the group's hotel properties. In the course of that transaction the group sold 16 hotel properties directly, and sold the shares in 18 subsidiary companies which between them held 119 hotel properties. The subsidiary companies in question were substantially indebted to other (retained) Travelodge group companies, and on completion of the sale of the subsidiary companies the purchaser procured each subsidiary company to discharge its indebtedness to the Travelodge group.

5. The Travelodge group incurred substantial fees from its professional advisers in relation to the sale of the subsidiary companies (and also in relation to the sale of the 16 hotel properties sold directly, but that is not a concern of this appeal). Those advisers charged VAT on the supply of the services they had made (which, by virtue of the VAT group registration were all treated as made to the Appellant). The Appellant claims, on a number of alternative grounds, that it is entitled to a credit for such VAT charged to it as input tax. The Commissioners deny that claim, principally on the ground that the supplies in question are directly linked to an exempt transaction entered into by the Appellant (that is, the sale of the shares in the subsidiary companies).

The issue for determination

6. Simply stated, therefore, the issue for determination is whether the Appellant is entitled to recover (by way of credit) the input tax it has paid on the supplies made to it by its professional advisers in relation to the sale of the subsidiary companies.

7. As matters were refined by the parties during the preliminary stages of the appeal proceedings, and in particular as the parties developed their respective arguments in the light of the judgment in the *AB SKF* case, they together posed six questions for our decision:

(1) Question 1: Did the sale of the shares in the subsidiary companies constitute "an economic activity" for VAT purposes? The Appellant argues that it did not (it therefore being a transaction outside the scope of VAT); the Commissioners argue that it did.

(2) Question 2: If the sale of the subsidiary companies is not an economic activity, is the Appellant entitled to recover the input tax paid on the professional fees? The Appellant argues that in such a case the costs of its input supplies are overhead costs of its taxable business and the VAT is therefore recoverable; the Commissioners argue that the professional fees are directly and immediately linked with the sale of the subsidiary companies, and not with the group's hotel business, and therefore the input tax paid on the professional fees is not recoverable.

(3) Question 3: If the sale of the subsidiary companies is an economic activity, is it nevertheless outside the scope of VAT because it is within the terms of the VAT provisions which relate to the transfer of a business or of part of a business as a going concern? The Appellant argues that this is so; the Commissioners argue that it is not the case.

(4) Question 4: If the sale of the subsidiary companies is a transfer of a business or of part of a business as a going concern for VAT purposes, is the Appellant entitled to recover the input tax paid on the professional fees? The Appellant argues that the input tax is recoverable as VAT on overhead costs of its taxable business; the Commissioners, as in Question 2, argue that it is not because it is VAT on fees directly and immediately linked with a transaction outside the scope of VAT.

(5) Question 5: If the sale of the subsidiary companies is an economic activity which is an exempt supply (and is not a transfer of a business as a going concern), is the Appellant nevertheless entitled to recover the input tax paid on the professional fees? The Appellant argues that since the input costs (that is, the fees) were not incorporated in the prices agreed for the sales of the subsidiary companies they are not directly and immediately linked with such sales, and that the input tax is therefore recoverable since the costs of its input supplies are overheads of its taxable business; the Commissioners argue that there is a direct and immediate link between the professional fees and the exempt supply comprised by the sales of the shares, so that the input tax is not recoverable.

(6) Question 6: Did the consideration for the sale of the shares in the subsidiary companies comprise the amount paid for those shares pursuant to the share sale agreement, or that amount together with the (much larger) amount of the indebtedness of the subsidiary companies due to the retained Travelodge group, repayment of which the purchaser of the subsidiary companies agreed to procure on completion of its purchase of those companies? This question is relevant to calculate the amount of input tax which can be deducted if an apportionment has to be made between exempt and other output supplies. The Appellant argues that the amount received in discharge of the indebtedness of the subsidiary companies is not part of the consideration for the sale of the shares in those companies; the Commissioners argue that such amount should for VAT purposes be treated as part of such consideration.

The decision in summary

8. For the reasons given below it is our decision that the Appellant is not entitled to recover (by way of credit) the input tax it has paid on the supplies made to it by its professional advisers in relation to the sale of the subsidiary companies.

9. Taking each of the specific questions which the parties posed to us for our decision:

(1) Question 1: The sale of the shares in the subsidiary companies constitutes an economic activity for VAT purposes, and is an exempt supply for those purposes;

(2) Question 2: If we are wrong in our answer to Question 1 (so that the sale of the shares in the subsidiary companies does not constitute an economic activity), the Appellant cannot deduct the input VAT as the input supplies are directly and immediately linked to the sale of the shares, which on this premise is a transaction outside the scope of VAT;

(3) Question 3: The sale of the shares in the subsidiary companies is not a transaction which, for VAT purposes, is the transfer of a business, or of part of a business, as a going concern;

(4) Question 4: If we are wrong in our answer to Question 3 (so that the sale of the shares in the subsidiary companies is the transfer of a business, or of part of a business, as a going concern), the Appellant is not entitled to recover the input tax paid on the professional fees, since those supplies are directly and immediately linked to the sale of the shares, which on this premise is a transaction outside the scope of VAT;

(5) Question 5: If we are right in our answer to Question 1 (so that the sale of the shares in the subsidiary companies is an exempt supply for VAT purposes), the Appellant is not entitled to recover the input tax paid on the professional fees;

(6) Question 6: The consideration for the sale of the shares in the subsidiary companies does not include the amount received in discharge of the indebtedness of the subsidiary companies.

10. We therefore dismiss the Appellant's appeal.

The relevant EU and domestic legislation

The provisions of the Sixth Directive

11. The transactions with which this appeal is concerned took place in late 2004 and early 2003, at which time the relevant EU legislation was the Sixth Council Directive of 17 May 1977, 77/388/EEC ("the Sixth Directive"). References in this decision to an Article are references to that Article in the Sixth Directive.

12. Article 2(1) provides for a charge to VAT on "the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such".

13. Critical to this appeal is the nature of the supply made by the Appellant (as the representative member of the Travelodge VAT group) on the sale of the shares in the subsidiary companies, and for that purpose it is necessary to know whether, in relation to that transaction, the Appellant is a "taxable person". Article 4 deals with that matter in these terms:

> *1. 'Taxable person' shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.*
>
> *2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.*

14. Article 5(8) deals with what in the UK legislation (see below) is referred to as a transfer of a business as a going concern. It is permissive, rather than mandatory (and the UK has chosen to adopt such an arrangement). Article 5(8) provides:

> *In the event of a transfer, whether for consideration or not ..., of a totality of assets or part thereof, Member States may consider that no supply of goods has taken place and in that event the recipient shall be treated as the successor to the transferor.*

15. Article 6(1) specifies that:

> *"Supply of services" shall mean any transaction which does not constitute a supply of goods within the meaning of Article 5.*

16. Article 13 specifies supplies which are to be exempt from VAT. So far as relevant to this appeal Article 13B provides as follows:

> *Without prejudice to other Community provisions, Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of*

the exemptions and of preventing any possible evasion, avoidance or abuse;

(d) the following transactions:

... ;

5 transactions, including negotiation, excluding management and safe-keeping, in shares, interest in companies or associations, debentures and other securities, excluding –

- documents establishing title to goods,

- the rights or securities referred to in Article 5(3)

17. Article 17 concerns the scope of the right to deduct VAT. So far as relevant to this appeal it provides as follows:

1. The right to deduct shall arise at the time when the deductible tax becomes chargeable.

2. In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) value added tax due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person;

... .

5. As regards goods and services to be used by a taxable person both for transactions covered by [paragraph 2], in respect of which value added tax is deductible, and for transactions in respect of which value added tax is not deductible, only such proportion of the value added tax shall be deductible as is attributable to the former transactions.

This proportion shall be determined, in accordance with Article 19, for all the transactions carried out by the taxable person.

However, Member States may:

...

(c) authorise or compel the taxable person to make the deduction on the basis of the use of all or part of the goods and services;

... .

The provisions of the Value Added Tax Act 1994

18. The Sixth Directive provisions are given effect in the UK's domestic legislation in the provisions of the Value Added Tax Act 1994 ("VATA 1994") and the Regulations made under VATA 1994. In this decision any reference to a statutory provision is a reference to that provision in VATA 1994 unless otherwise indicated.

19. Section 1 provides for the charge to VAT on the supply of goods or services in the UK, and the scope of the charge is set out in section 4:

> *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.*

It is now well-established in case law that the concept of "carrying on a business" for section 4 purposes is entirely consonant with the concept of "carrying on an economic activity" within Article 4.

20. Sections 24, 25 and 26 deal with input tax and output tax, and the rules by which, and the extent to which, input tax is allowable as a credit and thereby deductible against output tax. VAT on the supply to a person of any goods or services is input tax where the goods or services are used or are to be used for the purpose of any business carried on by that person. Where goods or services are used or are to be used partly for the purposes of a business and partly for some other purposes, the tax on such goods or services must be apportioned so that only the portion of tax referable to the person's business purposes counts as input tax: section 24(5).

21. Section 25 sets out the right for a taxable person to claim credit for his input tax and to deduct input tax from output tax due from him. The amount of input tax which a taxable person can recover in this way is determined by section 26: it is the amount which is allowable under the Value Added Tax Regulations 1995(SI 1995/2518) as being attributable to the taxable supplies made by that taxable person in the course or furtherance of his business. It is provided in section 26(3) that the regulations made by the Commissioners (that is, the Value Added Tax Regulations 1995) shall secure a fair and reasonable attribution of input tax to the taxable supplies so made by the taxable person.

22. Regulation 101 of the Value Added Tax Regulations 1995 provides that there shall be attributed to taxable supplies made by a taxable person all the input tax on those goods or services supplied to him which are used or to be used by him exclusively in making taxable supplies. Correspondingly, input tax on goods or services supplied to him which are used or to be used by him exclusively in making exempt supplies, or in carrying on any activity other than the making of taxable supplies, cannot be attributed to taxable supplies. In the case of "residual input tax" (that is, input tax incurred by a taxable person on goods or services which are used or to be used by him in making both taxable and exempt supplies), an apportionment is made to determine the portion of input tax to be attributed to the taxable supplies made by the taxable person. In broad terms, the apportionment is made by reference to the proportion which the value of taxable supplies made by the taxable person bears to the value of all supplies made by him in the relevant period. This is generally referred to as the "standard method" of apportioning residual input tax between taxable and exempt supplies to determine the amount which may be deducted from output tax. Regulation 102 permits the Commissioners to approve or direct the use by a taxable person of some other method for the attribution of input tax to taxable supplies, provided it is within the ambit of section 26.

23. Section 31 is concerned with exempt supplies, and introduces Schedule 9 which describes those supplies which are to be treated as exempt. Item No 6 of Group 5 of Schedule 9 includes the following as exempt supplies:

> *6 The issue, transfer or receipt of, or any dealing with, any security or secondary security being –*
>
> *(a) shares, stocks, bonds, notes (other than promissory notes), debenture, debenture stock or shares in an oil royalty;...*

24. Finally, there is provision for the case where a business (or part of a business) carried on by a taxable person is transferred to another person as a going concern. Section 49 gives the Commissioners powers to make regulations "for securing continuity in the application of [VATA 1994] in cases where a business, or part of a business, carried on by a taxable person is transferred to another person as a going concern and the transferee is registered under [VATA 1994] in substitution for the transferor". Those regulations are found in article 5 of the Value Added Tax (Special Provisions) Order 1995 (SI 1995/1268). Article 5 provides:

> *5(1) ..., there shall be treated as neither a supply of goods nor a supply of services the following supplies by a person of assets of his business –*
>
> *(a) their supply to a person to whom he transfers his business as a going concern where -*
>
> *(i) the assets are to be used by the transferee in carrying on the same kind of business, whether or not as part of any existing business, as that carried on by the transferor, and*
>
> *(ii) in a case where the transferor is a taxable person, the transferee is already, or immediately becomes as a result of the transfer, a taxable person ... ;*
>
> *(b) their supply to a person to whom he transfers part of his business as a going concern where –*
>
> *(i) that part is capable of separate operation,*
>
> *(ii) the assets are to be used by the transferee in carrying on the same kind of business whether or not as part of any existing business, as that carried on by the transferor in relation to that part, and*
>
> *(iii) in the case where the transferor is a taxable person, the transferee is already, or immediately becomes as a result of the transfer, a taxable person ....*

The evidence and the findings of fact

The evidence

25. We had in evidence before us a joint bundle of documents (three lever-arch files) relating to "Project Kylie", the sale and leaseback transaction by which

companies in the Travelodge group disposed of hotel properties and the Travelodge group disposed of companies holding hotel properties to a third party (together with documents relating to the prior transfer and reorganisation of properties within the Travelodge group).

26. Those documents included the following: extensive correspondence between the parties beginning in April 2005 and concluding in July 2011; reports and financial statements for the relevant years of the various companies in the Travelodge group which carried out the transactions relevant to this appeal; invoices for professional services, the VAT on which is the input tax for which the Appellant claims a credit; minutes of board meetings of the Appellant and other companies in the Travelodge group relating to the disposal of the hotel properties and the disposal of subsidiary companies holding hotel properties; corporate structure diagrams showing the group structure of the Travelodge group at various stages before and at the time of the Project Kylie transactions; a summary of the transaction steps in the Project Kylie transactions; a Preliminary Information Memorandum distributed in July 2004 by CB Richard Ellis on behalf of the Travelodge group to interested parties in connection with Project Kylie, and subsequent presentation material prepared for interested parties; sample transaction documents relating to the transfer of properties within the Travelodge group with purchase consideration left outstanding; sample transaction documents relating to the outright sale and leaseback of properties in the course of Project Kylie; and sample transaction documents relating to the sale of property-holding subsidiaries in the Travelodge group in the course of Project Kylie.

27. One witness appeared for the Appellant, Mr Jon Mortimore. Mr Mortimore is a member of the Chartered Institute of Management Accountants, and is the Chief Financial Officer and a director of Travelodge Hotels Limited, the principal trading company of the Travelodge group of companies. He has held that position since November 2003. Mr Mortimore is also a director of all the companies in the Travelodge group, including those involved in the Project Kylie transactions. He was the executive at Travelodge who had principal responsibility in the group for the Project Kylie transaction, and he appointed and instructed the various advisers engaged by the Travelodge group to structure and implement that transaction (it is the VAT charged on the supplies made by such advisers which is the subject of this appeal). Mr Mortimore had prepared a witness statement, and he gave further evidence at the hearing. He was cross-examined by Mr Beal, who appeared for the Commissioners.

28. Mr Mortimore's evidence dealt with the following matters: the business of the Travelodge group of companies; the acquisition in 2003 by the Appellant of Travelodge Hotels Limited and its subsidiary companies; the debt arrangements put in place to fund that acquisition; the property transactions and loan arrangements within the Travelodge group of companies in advance of the transactions comprising Project Kylie; the implementation of Project Kylie to effect, on sale and leaseback terms, the disposal of 135 hotel properties (directly and by the sale of subsidiary companies) to a third party, Prestbury Hotels Limited; the reasons the Appellant entered into the Project Kylie transactions, and the benefits which accrued to the Travelodge group as a result of those transactions; the nature of the services supplied by the professional

and other advisers to the Travelodge group in connection with Project Kylie and the fees and VAT charged for such services; the extent and nature of services provided by the Appellant and Travelodge Hotels Limited to other group companies and whether or not consideration was given for such services; and the accounting treatment adopted by group companies in relation to intra-group services.

29. We found Mr Mortimore to be an entirely credible witness, and accept his evidence in full.

30. The Commissioners had one witness, Mr Peter John Bennett. Mr Bennett is an officer of the Commissioners employed in The Large Business Service group. From 2004 to July 2007 he had responsibility within that group for the VAT affairs of the Appellant. Mr Bennett had prepared a witness statement of his evidence. His evidence was not challenged by the Appellant, and he was not called as a witness at the hearing. His evidence relates to the detail of the investigation which he and his colleagues carried out with respect to Project Kylie and the Appellant's claim to recover input tax charged on the fees of advisers engaged by the Appellant in that transaction, and the assessment raised by the Commissioners for what in their view was over-claimed input tax.

31. We accept Mr Bennett's evidence in full.

The findings of fact

32. From the evidence before us we find the facts set out in paragraphs 33 to 65.

33. The Appellant is the representative member of a VAT group which includes the Appellant, its only direct subsidiary company, Travelodge Hotels Limited ("THL"), and THL's subsidiary companies (together, "the Travelodge group").

34. Prior to February 2003 THL and its subsidiaries were owned by the Compass group of companies. THL was at that time (and has remained subsequently) a trading company which provides budget hotel accommodation under the trade name "Travelodge". The supplies made by THL in the course of its business are fully taxable for VAT purposes.

35. In December 2002 (that is, whilst the Travelodge group was part of Compass group), Compass carried out a restructuring of the Travelodge group, by transferring from THL to newly-incorporated subsidiaries of THL its hotel properties, with those subsidiaries granting back to THL occupational leases or licences at a rent or licence fee enabling THL to continue using the hotel properties for the purposes of its trade. Those transactions ascribed substantial value to the hotel properties, and the respective property holding subsidiaries (which included the companies referred to below as the "PropCos") remained indebted to THL on intercompany account for the consideration given for the hotel properties they had acquired. In the case of hotel properties sold to the A Sold PropCos (as referred to below) interest was paid on the debt due to THL. These restructuring transactions were carried out to meet the requirements of the prospective purchaser of the Travelodge group, by separating

operational activities from property-holding activities (which facilitated the use of the properties for securing borrowings and also facilitated the realisation of the value of the properties on any possible future sale) in a way which was effective for the capital gains tax planning purposes of the Compass group, and to reduce the stamp duty land tax payable by any subsequent purchaser of the hotel properties.

36. In February 2003 the Appellant acquired the Travelodge group by purchasing the whole of the share capital of THL. The Appellant was at that time (and remained so at all times material to this appeal) a company (held through holding companies) owned by funds managed by Permira, the European private equity firm, and Dubai International Capital. Sophisticated debt financing, of a kind commonly found in substantial highly-leveraged private equity acquisitions, with different tranches and rankings of debt, was put in place to enable the Appellant to purchase the Travelodge group with appropriate recourse to the hotel properties and other assets of that group. The debt financing included a range of different bank borrowings (commercial mortgages, secured senior loans, mezzanine loans and junior loans) and deep discounted bonds issued for debt provided by the funds ultimately owning the Travelodge group. Certain borrowings were taken by companies in the Travelodge group as part of the arrangements for the debt financing of the acquisition of the group. In addition, THL had trade credit and other loan facilities required to finance the operation of its business.

37. The Travelodge group included 18 companies (the "PropCos") which held in aggregate 119 hotel properties leased back to THL. The PropCos were divided into two groups: the A Sold PropCos held properties which were subject to commercial mortgages and the B Sold PropCos held properties (of lesser commercial quality) which were not subject to commercial mortgages. (There were also other property-holding subsidiaries in the Travelodge group – referred to as the "Retained PropCos" – which are not relevant to this appeal.)

38. In July 2004 the Appellant, under the direction of Permira, began to seek a third party purchaser for certain of the Travelodge group hotel properties and the PropCos, with a view to realising the full value of the hotel properties whilst retaining THL's rights, as a trading company, to continue to use the hotel properties for the purposes of its trade. In this way the Appellant and the Travelodge group could reduce the indebtedness incurred to acquire the group from Compass and thereby reduce the interest cost to the group of servicing such debt. The promotional material produced for the prospective sale identified the sale as primarily a sale of shares in property-holding companies (with a 0.5% stamp duty cost – rather than a higher stamp duty land tax cost – but no VAT cost, for any purchaser of the shares).

39. The series of transactions whereby the group was restructured in advance of the sale of the property interests, and such sale was then effected, is referred to as "Project Kylie". In essence, and in broad effect, Project Kylie comprised the sale of 135 hotel properties by the Travelodge group to Prestbury Hotels Limited ("Prestbury"), an unrelated party, each of the hotel properties being subject to a lease or licence on arm's length terms to THL. Prestbury purchased 16 hotel properties directly and 119 hotel properties were, as mentioned, held by the PropCos, with

Prestbury purchasing the shares in the PropCos. Prestbury agreed to procure the PropCos to discharge their indebtedness to THL and other companies in the retained Travelodge group.

40. In advance of the sale to Prestbury a number of transactions were undertaken to gather together those hotel properties which the Travelodge group wished to sell, to grant leases to THL to enable it to continue using the hotel properties for its business, and to avoid a "clawback" of relief from stamp duty land tax which had been claimed in relation to the December 2002 sales of the hotel properties to the PropCos. For the purposes of this appeal the following pre-sale transactions are relevant:

(1) The A Sold PropCos and the B Sold PropCos incorporated wholly-owned direct subsidiary companies (the "SubPropCos");

(2) The A Sold PropCos agreed to grant a new lease to THL for each hotel property held. The new leases were to be on open market terms agreed between Prestbury and THL, such leases to come into effect only upon the completion of the sale of the PropCos to Prestbury;

(3) The A Sold PropCos and the B Sold PropCos sold their respective hotel properties to the SubPropCos (subject to existing leases and, in the case of those properties held by the A Sold PropCos, the new leases referred to in (2) above). The consideration given by the SubPropCos was market value, and payment was left outstanding; and

(4) The SubPropCos which had acquired hotel properties from the B Sold PropCos agreed to grant a new lease to THL for each such hotel property. The new leases were granted on open market terms and came into effect immediately on grant.

41. On 15 October 2004 THL and certain subsidiaries in the Travelodge group entered into agreements with Prestbury for the sale of the shares in the PropCos (at that point holding the SubPropCos, which together then held 119 hotel properties) and for the sale of 16 hotel properties. Completion of the sale took place on 19 October 2004, except in relation to certain hotel properties, and in relation to certain PropCos, where the disposal of the relevant hotel properties required third-party consent. All sales were completed in the course of 2005.

42. The vendor of the shares of the A Sold PropCos was TLLC PropHoldCo2 (a wholly-owned indirect subsidiary company of THL). The vendor of the shares of the B Sold PropCos was THL.

43. The agreement for the sale of the shares of each PropCo specified an amount by way of purchase price to be paid for the shares of the PropCo in question. The aggregate amount paid by way of purchase price for the shares of the A Sold PropCos was £19,480,000. The aggregate amount paid by way of purchase price for the shares of the B Sold PropCos was £4,929,000. No VAT was charged on the sale of the shares of the PropCos.

44. The amount paid by way of purchase price for the shares of the PropCos was determined by deducting from the market value of the underlying hotel properties (as negotiated and agreed with Prestbury) the amount of debt due from the PropCos to creditors (for the most part creditor companies in the retained Travelodge group).

45. The vendors of the 16 hotel properties were the Retained PropCos and THL. The aggregate consideration for the hotel properties (after adjustments for rent apportionments) was £26,208,000. VAT was charged on the sale of those hotel properties.

46. It was a term of the agreement for the sale of the shares of each PropCo that on or after completion of the sale, and on the demand of the vendor of such shares, Prestbury would procure that the PropCo would repay to the vendor (as trustee for the relevant creditor company in the retained Travelodge group) an amount equal to the net aggregate indebtedness due at that time from that PropCo to all such creditor companies. (The indebtedness so repaid was, in substance, the indebtedness which the PropCos incurred in December 2002 when they acquired hotel properties in the course of the structuring carried out when the companies were in the ownership of the Compass group – see paragraph 35 above). THL knew in advance of entering into the share sale agreements with Prestbury that Prestbury had obtained a loan facility for the purpose of funding the PropCos to enable them to repay the creditor companies in the retained Travelodge group on completion of the share sales, but Prestbury was not required to do so as a term of its agreement with THL.

47. The amount of net aggregate indebtedness repaid by the PropCos following completion pursuant to these arrangements was £328,964,000.

48. It was also a term of the agreement for the sale of the shares of each PropCo that at completion the leases back of the hotel properties would be varied to conform to the terms agreed between Prestbury and THL (to the extent that this was not achieved in the September 2004 transactions).

49. On completion of the sale of each PropCo directors and a company secretary appointed by Prestbury replaced the directors and the company secretary appointed by the Travelodge group (and similarly for each SubPropCo). Prestbury also appointed to the PropCos its own auditors, bankers and lawyers.

50. The proceeds of the sale of the hotel properties and of the sale of the shares in the PropCos, and the amounts received on repayment of the indebtedness of the PropCos were predominantly used to repay borrowings of the retained Travelodge group (including borrowings undertaken in connection with the acquisition of the Travelodge group) and borrowings of the Appellant and its direct and indirect holding companies, including repayment of commercial mortgages secured on the hotel properties held by the A Sold PropCos and partial repayment of the senior debt and the deep discounted bonds. Part of the proceeds was used in payment of transaction fees and costs.

51. The effect of the Project Kylie transactions was to reduce the annualised interest cost to the retained Travelodge group by approximately £32,000,000, effectively replacing that cost by an annualised rental charge for use of the hotel properties of approximately £23,500,000, a net annual saving of approximately £8,500,000. There was also an improvement to the Travelodge group's balance sheet (rental obligations being perceived as more favourable to a group's financial standing than interest obligations).

52. Following completion of Project Kylie the number of hotel sites used in THL's business expanded from 252 in 2004 to 457 in 2010, and over that period annual turnover grew from £151,000,000 to £331,000,000.

53. In order to plan, prepare for, and implement Project Kylie companies in the Travelodge group engaged a number of advisers and professional firms, including solicitors, accountants, valuers and surveyors. The principal advisers, and (in summary) the services which they respectively provided to the Travelodge group are as follows:

(1) CB Richard Ellis: agents acting in the marketing and sale of the hotel properties;

(2) Aldrington Investments Ltd: consulting services in connection with the terms of sale and leases back;

(3) WSP Environmental Limited: carrying out environmental surveys to identify if any of the sites that were being sold were on or near contaminated land;

(4) Ray Parker & Co Limited Property Consultants: property consultancy services;

(5) Deloitte and Touche LLP: advising in relation to the financial and tax structuring and consequences of the transactions and in relation to tax warranty and other tax-related provisions in the transaction documents;

(6) Clifford Chance LLP, Addleshaw Goddard LLP, DLA LLP, and Tods Murray LLP: legal services.

54. All of the advisers rendered invoices to the Travelodge group in respect of the services provided, and charged VAT on the supplies made. Most of the invoices were addressed to THL, but some were addressed to TLLC Group Holdings Limited, the parent of the Appellant. The parties have agreed the amounts of advisers' fees which are attributable respectively to the direct sale of the 16 hotel properties to Prestbury and to the sale of the shares in the PropCos and related transactions. The amount of VAT charged on fees in relation to the sale of the shares in the PropCos and related transactions (being input tax of the Appellant as the VAT group representative member) is £723,627.21.

55. In the period prior to, and as at, the sale of the PropCos to Prestbury, the only assets of the PropCos were the hotel properties they respectively held (until the September 2004 restructuring, when the hotel properties were transferred to the

SubPropCos, at which point the PropCos held shares in the SubPropCos and the debt due to them from the SubPropCos). Their only income was rental or licence income from the leases or licences back of the hotel properties to THL. The A Sold PropCos paid interest on their intra-group borrowing out of rental income received, but the B Sold PropCos did not. Hotel properties held by the A Sold PropCos were charged as security for commercial mortgage borrowings by the Appellant or its immediate parent company. THL guaranteed the obligations of the A Sold PropCos to third party claimants.

56. The PropCos had no employees. No employees of other Travelodge group companies were seconded to the PropCos. The PropCos had directors, but the PropCos paid no directors' fees. All the directors, such as Mr Mortimore, were directors and employees of other group companies and were remunerated for their duties as directors out of the salaries they received from their employing company. Mr Mortimore's salary was not reduced when he ceased to be a director of the PropCos on their sale to Prestbury.

57. The PropCos had no premises other than the hotel properties leased or licensed back to THL. With regard to the hotel properties, THL as lessee maintained the properties and paid all outgoings. Rents were reviewed according to a formula based on the increase in the Retail Prices Index, and not according to an open market rental valuation.

58. The PropCos had no bank accounts, and payments and receipts were recorded by entries in the books of account of the PropCos.

59. The audited financial statements of the PropCos for the 59 weeks ended 31 December 2003 show no management or administration charges made to, or paid by, the PropCos.

60. The activities of the directors of the PropCos were limited to approving the accounts annually, and authorising any transactions entered into by the PropCos.

61. Audit fees in relation to the PropCos were paid by THL as part of the group audit fee rendered by the group's auditors for their audit services provided to the group as a whole. The financial statements of each PropCo state: "The audit fee is borne by a fellow group company". The work involved in the audit of the PropCos was insignificant in relation to the work involved in the audit of the group as a whole.

62. If any PropCo surrendered losses to other group companies by way of group relief, no payment was made to the PropCo for the surrender of such losses. Correspondingly, if any group company surrendered losses to a PropCo by way of group relief, no payment was made by the PropCo for the benefit of such surrender.

63. In addition to the staff it employed for its trading activities, THL employed the "group headquarters" staff, that is, those engaged in the management and administration of the group as a whole (including those engaged in senior management, and those engaged in the provision of accounting, human resources, IT, marketing, company secretary and legal facilities).

64. Although costs incurred by THL in relation to the management of group companies were not normally re-charged to other group companies, some of the transaction costs of Project Kylie (including internal staff costs) were, because of their materiality, re-charged to the group companies which sold the shares in the PropCos.

65. In the case of each PropCo the financial statements for the 59 weeks ended 31 December 2003 state: "As a subsidiary of TLLC Group Holdings Limited, the company has taken advantage of the exemption in FRS 8 'Related Party Transactions' not to disclose transactions with other members of the group". The PropCos recorded in their respective profit and loss accounts the rents received from THL and, where interest was charged on intra-group borrowings, the interest paid.

Question 1: Did the sale of the shares in the subsidiary companies constitute "an economic activity" for VAT purposes?

66. The first question posed by the parties in the course of determining whether the Appellant is entitled to recover as input tax the VAT charged to it by its advisers on the supplies made by them in relation to the sale of the shares in the PropCos is whether the sale of those share constituted "an economic activity" for VAT purposes. Rather as at the start of a flowchart, the answer to this question does not determine conclusively the issue of the Appellant's entitlement to recover the VAT, but it is a necessary precursor to the subsequent questions which have to be answered in order to determine that issue.

67. The question arises by reason of Articles 2 and 4. A charge to VAT arises on a supply of goods or services for a consideration only where that supply is made by "a taxable person acting as such", and Article 4 defines "taxable person" to mean any person who independently carries out any economic activity, whatever the purpose or results of that activity. The "economic activity" must be of a kind specified in Article 4(2). In the UK legislation section 4(1) provides that the charge to VAT arises on a supply of goods or services where that supply is "a taxable supply made by a taxable person in the course or furtherance of any business carried on by him". It is well-established that the UK legislation is entirely congruent with the Directive.

68. In summary, the Appellant's case, as set out for us by Mr Kevin Prosser QC, is that the mere acquisition, holding and disposal of shares in a company, even if the shareholder is a taxable person, does not constitute the carrying out of any economic activity provided there is no involvement in the management of the company in question. The Appellant argues that, on the facts, THL and the other shareholders in the PropCos were not involved in the management of the PropCos.

69. Mr Kieron Beal QC appeared for the Commissioners. His case, in summary, was that the sale of the PropCo shares was not the sale of shares held as an investment, but the disposal of a financial holding in each PropCo where there had been involvement in the management of that company or where the holding and the sale of the shares was an extension of the group's taxable business. As such the disposal of the shares in each PropCo was an economic activity.

70. Both parties relied particularly on the decision of the CJEU in the *AB SKF* case.

The Appellant's submissions

71. The Appellant argues that it is uncontroversial, and confirmed in the *AB SKF* case, that "the mere acquisition, holding and sale of shares do not, in themselves, constitute economic activities within the meaning of the Sixth Directive": *AB SKF* at [28]. The reason that such circumstances and transactions are not an economic activity is because there is no exploitation of an asset with an intention of producing revenue – there is simply a sale of the asset for a consideration.

72. However, there are three circumstances where the acquisition, holding and sale of shares do constitute economic activities: where those transactions are carried out in the course of a share-dealing activity (not relevant to the Appellant); where those transactions are accompanied by direct or indirect involvement by the shareholder in the management of the company in which it holds the shares; and where those transactions "constitute the direct, permanent and necessary extension of the taxable activity" of the taxable person who is the shareholder: *AB SKF* at [30] – [33].

73. In the *AB SKF* case the parent company which sold (or proposed to sell) shares in its subsidiary company supplied a variety of administrative, accounting and marketing services to the subsidiary for a consideration, and in respect of which it was liable to pay VAT, and for that reason was held to be involved in the management of the subsidiary, so that the holding of the shares was a taxable activity. The CJEU therefore concluded that the holding of the shares was an economic activity which was brought to an end by the sale of the shares, that sale being an extension of the taxable activity of holding the shares. The Court's decision on this point was re-affirmed in the *X BV* case (at [37]).

74. In the Appellant's case, neither THL nor any other company provided management or other services to the PropCos beyond the bare minimum required for the PropCos to function. Thus audit services were provided as part of the group audit, and the group made available the services of the directors for the minimal functions they were required to carry out. But the evidence from the accounts and from Mr Mortimore is that no consideration was given by the PropCos for any such services. THL and the other group companies were not therefore carrying on an economic activity in relation to their holding of shares in the PropCos, and the disposal of those shares could not therefore be an extension of a taxable activity and hence was not an economic activity. The Appellant relies on Case C-16/00 *Cibo Participations SA* [2001] ECR I-6663 for the proposition that a holding of shares accompanied by involvement in management where there is no consideration (for example, where administrative services are provided for no charge) is not an economic activity. The Appellant also relies on the recent decision of the Court of Appeal in the case of *BAA Limited v HMRC* [2013], where the Court of Appeal held that a holding company was not carrying on an economic activity at the relevant time when it acquired shares on the take-over of a company.

75. Finally, the holding of the shares in the PropCos is not an economic activity in terms of constituting a "direct, permanent and necessary extension of the taxable activity" of the group (that is, as an extension of the economic activity of providing hotel accommodation). In the *AB SKF* case the taxable activity was the provision of management services by the parent company to the subsidiaries for a consideration, and the sale of the shares in the subsidiaries was an extension of that activity. That was not the case in the Appellant's circumstances.

76. Nor can it be said that the sale of the shares in the PropCos was an extension of the group's taxable activity of providing hotel accommodation. The PropCos held hotel properties, but they were leased or licensed back to THL on commercial terms, and THL's business continued on exactly the same basis after the PropCos had left the group on their sale to Prestbury. It must therefore follow that the sale of the shares was not an extension of any economic activity.

77. Whilst the Appellant accepted that the sale of the PropCos benefitted the group's economic activity of providing hotel accommodation, that did not mean that the holding of the shares was an economic activity – such a conclusion is contrary to the approach set out in the case of *Kretztechnik AG v Finanzamt Linz* Case C-465/03 [2005] ECR I-4359. In the *Kretztechnik* case (which concerns the issue of share capital), although the issue of shares was for the economic benefit of the company issuing the shares, such issue was not an economic activity. In the same way, if the holding of shares is not an economic activity, the disposal of those shares is not an economic activity by reason of that disposal benefitting the economic activity of the shareholder or group making the disposal.

78. For these reasons the Appellant argues that the sale of the shares in the PropCos by THL and the other group holders of those shares was not an economic activity for the purposes of the Sixth Directive.

The Commissioners' submissions

79. Before dealing with the specific issue of whether the sale of the shares in the PropCos was an economic activity, Mr Beal referred to the broader scope of the Appellant's case in the appeal: the Appellant contends that the sale of the shares was either a supply outside the scope of VAT or an exempt supply, but that nevertheless it is entitled to recover in full the input tax on supplies directly and immediately connected with that sale. Such an outcome is contrary to the scheme of VAT.

80. As to the question of whether the sale of the shares was an economic activity, Mr Beal emphasised that the context of the transaction is a group of companies which, by virtue of the VAT grouping, is a single taxable person for VAT purposes. This demonstrates the financial, economic and organisational links between all group companies, and the VAT group is clearly engaged in significant economic activity so that the sale of the shares (treated for VAT purposes as a sale by the Appellant as the representative member of the group) is an aspect of that economic activity.

81. Those financial, economic and organisational links are apparent from the facts: common directors for all group companies, including the PropCos; the provision of services co-ordinated at group level for the benefit of each individual group company, including audit, taxation, banking, legal, personnel and IT services, with the costs of those services met by the Appellant or THL; the use of certain fixed assets held by the A Sold Propcos as security for group borrowings; borrowings undertaken at group level for the benefit of the group as a whole, including the leveraged borrowings made to purchase the Travelodge group, and the interconnection of financings and security between group companies; and the leases between the PropCos and THL, including the variation of lease terms on the occasion of the sale of the PropCos to Prestbury.

82. Even if no actual charge was rendered by THL or the Appellant for the services provided at group level for the benefit of the PropCos, that does not establish that there were no supplies of such services for VAT purposes – VAT would have been chargeable on the value of those services were it not for the fact that they are disregarded because of the effect of VAT grouping.

83. Having regard to the European case law, the group's holding of shares in the PropCos was far more than a merely passive investment over which the group exercised no control other than by reason of exercise of the rights it held in its capacity as a shareholder. Rather, THL and the Appellant were directly and indirectly involved in the management of the PropCos, which the cases clearly identify as the test by which it is established that the sale of shares is an economic activity. The Appellant acquired the PropCos as part of the hotel business it acquired when it purchased the Travelodge group, and it managed the PropCos in the course of carrying on that hotel business. By this means the Appellant was clearly engaged in an economic activity. It follows that the sale of the shares in the PropCos was part of, or an extension of, that economic activity.

84. In making these submissions Mr Beal relied on the *AB SKF* case, and the earlier cases of Case C-60/90 *Polysar Investments Netherlands BV* [1991] ECR I-3111; Case C-4/94 *BLP Group plc* [1995] ECR I-983; Case C-155/94 *Wellcome Trust Ltd v CCE* [1996] ECR I-3013; Case C-306/94 *Régie Dauphinoise* [1996] ECR I-3695; Case C-142/99 *Floridienne SA v Belgium* [2000] ECR I-9567; Case C-16/00 *Cibo Participations SA* [2001] ECR I-6663; and Case C-77/01 *EDM* [2004] ECR I-4295.

85. The Commissioners also relied on the recent decision of the CJEU in Case C-259/11 *DTZ Zadelhoff* [2012] ECR I-0000, which concerns the question of whether the transfer of shares in companies formed for the purpose of holding land is an exempt supply (the transfer of the shares being an indirect transfer of the land). It was decided that the transfer was a transfer of shares and not a transfer of the underlying property and that the transfer of the shares in question was an exempt supply, (as were the services supplied by way of negotiation of the transfer).

Discussion and conclusions

86. On this issue we are persuaded by the case advanced by the Commissioners, and conclude that the sale of the shares in the PropCos was "an economic activity" for the

purposes of the Directive, and, in the terms of the domestic legislation, a supply made by a taxable person in the course of a business.

87. The most recent, and detailed, decision on this issue is to be found in the *AB SKF* case, and it is necessary to consider that decision at some length. The case is concerned with the parent company of an industrial group which was proposing to restructure the group by disposing of the business of one of its wholly-owned subsidiaries by means of the transfer of all of the shares in that subsidiary (additionally, it proposed to dispose of its remaining (minority) shareholding in another company under its control). The company was seeking a ruling on the VAT consequences of those transactions in advance of carrying them out.

88. As to the facts, the CJEU mentions the following:

> "[20] ....SKF plays an active role in the management of its subsidiaries and supplies to them, for consideration, services, including management, administration and marketing policy. Those services are invoiced to the subsidiaries and SKF is liable to VAT on them.
>
> [21] ....The reason for [the] disposals is to obtain funds to finance other activities of the group. ...."

89. The first question the court had to decide (as we mention below, it also dealt with other questions which are pertinent to certain of the other issues in this appeal) was stated in these terms:

> "[26] By its first question, the referring court asks, in essence, whether Article 2(1) and Article 4(1) and (2) of the Sixth Directive ... must be interpreted as meaning that, when a parent company disposes of all the shares in a wholly-owned subsidiary and of its remaining shareholding in a controlled company which was previously wholly owned by it, these being companies to which it has supplied services subject to VAT, that disposal is an economic activity coming within the scope of those directives."

90. The CJEU then set out the principles to be derived from previous decisions of the court:

> "[28] According to settled case-law, the mere acquisition, holding and sale of shares do not, in themselves, constitute economic activities within the meaning of the Sixth Directive [reference to authorities]. Those transactions cannot amount to 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 (see, to that effect, *EDM*, paragraph 58).
>
> [29] The Court has stated that only payments which are the consideration for a transaction or an economic activity come within the scope of VAT and that such is not the case in respect of payments which arise simply from ownership of the asset, as in the case of dividends or other yields from a shareholding [reference to authorities].

> [30] However, the Court has held that the position is otherwise where a financial holding in another company is accompanied by direct or indirect involvement in the management of the company in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder [reference to authorities] in so far as involvement of that kind entails carrying out transactions which are subject to VAT by virtue of Article 2 of the Sixth Directive, such as the supply of administrative, accounting and information-technology services [reference to authorities].
>
> [31] Moreover, it is clear from the Court's case-law that transactions relating to shares or holdings in a company are subject to VAT when they are carried out as part of a commercial share-dealing activity or in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired, or where they constitute the direct, permanent and necessary extension of the taxable activity [reference to authorities].
>
> [32] In the present case , it is clear from the order for reference that SKF, as the parent company of an industrial group, was involved in the management of the subsidiary and the controlled company by supplying to them, for consideration, a variety of administrative, accounting and marketing services, in respect of which it was liable to pay VAT.
>
> [33] By the disposal of all its shares in the subsidiary and in the controlled company, SKF brought to an end its holdings in those companies. That disposal, carried out in order to enable the parent company to restructure a group of companies, can be regarded as a transaction that consists in obtaining income on a continuing basis from activities which go beyond the compass of the simple sale of shares (see, to that effect, [the *Kretztechnik* case], paragraph 20, and the case-law there cited). That transaction has a direct link with the organisation of the activity carried out by the group and constitutes accordingly the direct, permanent and necessary extension of the taxable activity of the taxable person within the terms of the case-law cited in paragraph 31 of this judgment. Such a transaction consequently comes within the scope of VAT."

91. As we understand this passage, the CJEU first makes the distinction between those cases where there is "the mere acquisition, holding and sale of shares" on the one hand, and those where the holding and sale of shares in a company entails taxable transactions or is otherwise part of a taxable activity.

92. In the former case, none of those activities constitute economic activities for the purposes of the Sixth Directive. This is so because there is no active exploitation of the shareholding asset, but simply receipt of the fruits of ownership (dividend income and a possible profit on eventual sale), none of which is consideration for an economic activity. The "mere acquisition, holding and sale of shares" does not therefore involve, nor is it part of, a taxable activity.

93. In contrast, in the latter case, the acquisition, holding and sale of shares is an economic activity because such activities involve, or are a part of, a taxable activity.

94. Having made this distinction, the CJEU identifies the different circumstances in which the acquisition, holding and sale of shares comprises an economic activity.

95. The first of these circumstances is where those activities are carried out as part of a commercial share-dealing activity. We need consider that no further, as clearly that was not the case with regard to the Appellant and the PropCos.

96. The second of these circumstances is where those activities are related to the direct or indirect involvement by the shareholder in the management of the company whose shares it holds "in so far as involvement of that kind entails carrying out transactions which are subject to VAT by virtue of Article 2 of the Sixth Directive, such as the supply of administrative, accounting and information-technology services".

97. The third of these circumstances is where those activities "constitute the direct, permanent and necessary extension of the taxable activity" carried on by the shareholder or the group of which it forms part in the sense that they are linked with the organisation of the group's taxable activity.

98. In AB SKF's particular case the CJEU found that the sale of the shares in the two companies was an economic activity because the holding of the shares was related to its making of taxable supplies to those companies by way of management services by which it was involved in the management of those companies. It also found that the holding and sale of the shares was directly linked to the organisation of the group's taxable business activity and so was an economic activity because it was a direct, permanent and necessary extension of that business activity.

99. Turning now to the Appellant's case, the Appellant argues that neither it nor the companies which sold the PropCos were directly or indirectly involved in the management of the PropCos in that they provided no management services, or if they did provide management services, they did so for no consideration, and hence made no taxable supplies, to those companies. It cannot therefore be said that the holding and sale of the shares was in that manner related to taxable activities. The Appellant points to the evidence of Mr Mortimore in this regard, and to the accounts of the relevant companies, which show no charges paid for management services received. It argues that THL provided only the minimum necessary for the PropCos to maintain their corporate standing (that is, the services of an auditor and of directors to sign the accounts).

100. We reach a different conclusion from the evidence before us and the inferences which may reasonably be drawn from that evidence. Our conclusion is that THL (and, possibly, the Appellant) provided management services to the PropCos. The PropCos were (as we refer to below) of prime significance to the Travelodge group as the entities which held the hotel properties from which THL carried on its business of providing hotel accommodation. The PropCos not only made those hotel properties available to THL, but in certain cases charged those properties as security for group borrowings. THL had every interest in ensuring that the PropCos did all that was

necessary to carry out the functions which they had within the group and were provided with such services and facilities as were required for those purposes.

101. It is true that the PropCos were not vigorously active companies: once they had acquired the hotel properties and granted the leases or licences back to THL they were (at least until the restructuring for Project Kylie) largely passive, receiving rent and (in some cases) paying interest. Rent reviews took place according to a formula, and THL as tenant or licensee bore all the costs and burden of maintenance, insurance and so forth which might otherwise fall upon the owner of the hotel properties. It is also the case that the essential arrangements – the acquisition by the PropCos of the hotel properties and their lease or licence back – were put in place before the Appellant acquired the Travelodge group (albeit in anticipation of that acquisition).

102. For the most part, therefore, the PropCos were not in need of much by way of management services. What is clear, however, is that to the extent that they were in need of management services (if only to the limited extent of undertaking an audit or to ensure that they had directors and a company secretary for the limited compliance requirements imposed on them by law) they looked to THL to provide them.

103. It is not available to the Appellant to argue that such services were *de minimis* and should therefore be disregarded. As and when the PropCos were required to take a more active role, as they were in order to ensure the implementation of Project Kylie, there is no evidence that they engaged directly and at their cost the services of the staff, lawyers and accountants required for them to form the SubPropCos, to transfer the hotel properties to the SubPropCos, to vary the terms of those leases which had to be varied on the effective transfer of the hotel properties to a third party, Prestbury, and the related transactions including the discharge of the charges over certain of the properties. Those were services which were, we assume, made available to the PropCos (and to their subsidiaries, the SubPropCos) by THL or by the Appellant. The accounts of the PropCos disclose no payment for any such services, but the PropCos could not have carried out those transactions without them.

104. The Appellant argues that the *AB SKF* case (affirmed by the *X BV* case) shows that for there to be involvement in the management of a company it must be involvement in terms of supplying taxable services, that is, services supplied for a consideration, which was not the case with THL and the PropCos. What is clear, however, is that the nature of the services supplied was such that they were taxable. It is also the case that the companies in question were within a group registration for VAT purposes (which appears not to be the circumstances in the *AB SKF* case, and therefore the consequences of such registration are not considered in that case). We agree with Mr Beal that in considering whether there is involvement in management in terms of supplying taxable services it is necessary to take account of the VAT group registration applying to the Appellant and all relevant companies in the Travelodge group: the effect of that registration is that supplies of goods and services between group members are disregarded for VAT purposes. Had there been no group registration the question would have arisen as to the nature of any consideration given for those services, and the value of any such consideration.

105. The Appellant relies on the decision of the Court of Appeal in the *BAA Limited* case. In that case the taxpayer company, ADIL, suffered VAT on input supplies made by professional advisers in relation to its acquisition of shares in the BAA group. The principal questions for decision were whether ADIL was carrying on an economic activity; and whether there was a direct and immediate link between the input tax on the supplies made to ADIL and the output services attributed to ADIL following its subsequent joining in the BAA group registration. After ADIL acquired the BAA group, but before it became a member of the BAA group registration (a period of three months) ADIL provided management services to members of the BAA group, but did not made charges for those services. At the time of its acquisition of the BAA group there was no evidence that ADIL intended to join the BAA VAT group, nor was there an intention that it would charge for its services. At that time it was not entitled to be registered as a taxable person.

106. It was held that since ADIL was not, at the time of the input supplies, making, or intending to make, taxable supplies, it was not then carrying on an economic activity. Mummery LJ said (at [98]):

> "To start at the beginning with the relevant date. That was the date on which ADIL incurred the liability to VAT on the services supplied to it. ADIL's only evident and proven intention at that time was to take over BAA by acquiring the shares in it. Acquiring the BAA shares was an *act* which would have economic consequences, but that is not the same as carrying on an *economic activity* for VAT purposes: ADIL's activities at that time neither involved the making of, nor even the intention of making, taxable supplies of goods or services."

107. Those circumstances seem very different from the circumstances of the Appellant and the Travelodge group, where management services were provided throughout the period in which the shares in the PropCos were held. It is true that an aspect of the *BAA Limited* case is that, in the period prior to ADIL joining the BAA VAT group, it provided management services, but for no charge, and so in that period was making not taxable supplies, but the essence of the decision is that at the time at which the input supplies were made to ADIL it was not carrying on an activity, but was merely engaged in the act of acquiring shares. The case is not concerned with an established group of companies within a group registration, where management services – even if of limited scope – have been provided throughout the period of ownership.

108. We therefore conclude that the holding of the shares in the PropCos, and their sale (whether such holding and sale is regarded as that of the Appellant as the group representative member, or as that of THL and the other group company which was the immediate shareholder) should be regarded as an economic activity, since the holding was accompanied by direct or indirect involvement in the management of the PropCos entailing the supply of services which were taxable or could have been so if the group registration had not been in place.

109. Furthermore, we conclude that the shareholding and the sale of the shares in the PropCos is rightly to be regarded as the direct, permanent and necessary extension of

the taxable activity of the Appellant since it has a direct link with the organisation of the group's business activity. It is for that reason also the case that, applying the *AB SKF* decision, the holding of the shares and their sale constitutes an economic activity for the purposes of the Directive.

110. The structure of the Travelodge group, whereby the operational activities (providing hotel accommodation services) were segregated from the property-holding activities was established to facilitate the funding of the Appellant's acquisition of the group and to enable the value of the property-holding activities to be fully realised (thereby enabling part of the acquisition funding to be paid down, as eventually happened). It is clear, however, that for so long as all those activities were carried out by companies within the same group, they were integrated and interdependent, operationally, in terms of financing, and as to management.

111. In relation to operations, THL could not carry on its business in the way it carried it on without occupying the hotel properties held by the PropCos. The only tenant which the PropCos had for their hotel properties were THL and (possibly) other group companies. There was no evidence that THL sought hotel properties leased by other companies, or that the PropCos sought other tenants. The terms of the leases were arranged to provide a certain financial cost to THL and a financial return to the PropCos (rent reviews were by reference to an indexation factor, not market rents for hotel properties), and when the PropCos were sold out of the group it was necessary to vary at least some of the leases to ensure that they were on true arm's length terms, or at least to meet the requirements of THL and those of the third party investor.

112. In relation to financing, the group's borrowing and financing arrangements were complex, much of that complexity stemming from the highly-leveraged private equity terms on which the Appellant acquired the Travelodge group. Such financing arrangements were made on a group basis, including for the benefit of the PropCos, and with the properties of the PropCos facilitating the borrowings indirectly as a group balance sheet asset and in some cases directly in terms of providing security for mortgage borrowings. Certain of the PropCos did not pay interest on their inter-group borrowings, others did, when such borrowings reflected or represented borrowings at group level – thus the payment of interest was based on what suited the group, not on the independent financial relationships between individual companies in the group. Finally, the PropCos were sold to enable part of the acquisition debt to be repaid and thereby to improve the financial position of the retained group.

113. As for management matters, we have already mentioned the way in which THL provided to the PropCos such management services as they required. Looking at the group as a whole, management was integrated in that THL provided a "head office" function which supported all group companies, reflecting the way in which the group was operated as an integrated business. It is indicative of the integration of the PropCos in this group management arrangement that on the sale of the PropCos to Prestbury it was a requirement of the parties that all aspects of management (the directors, company secretaries, auditors, lawyers etc) appointed for each company should be changed to release the THL appointees and replace them with Prestbury

appointees. We also observe that the invoices with which this appeal is concerned for the Project Kylie transaction were rendered to either THL or to TLLC Group Holdings Limited. THL was the shareholder of some of the PropCos, but TLLC Group Holdings Limited was not a shareholder of any of the PropCos.

114. We agree with Mr Beal that the fact of VAT group registration for the group is an indication of the integrated nature of the group for the purposes of the group's business – the purpose of such registration is, in effect, to allow the group to operate as a single business for VAT purposes, and to avoid individual VAT reporting and compliance, including for the many supplies between group companies which are working with each other together in the common endeavour of a business.

115. Taking all these factors together we reach the conclusion that the holding of the shares in the PropCos and their disposal is directly linked with the organisation of the business carried on by the group and therefore, in the terms of the *AB SKF* decision, is the direct, permanent and necessary extension of the group's taxable activity.

116. Mr Prosser's argument to the contrary is that nothing changed in THL's business, nor in the business of the PropCos, on the sale of the PropCos to Prestbury – this was not a case where a segment of a composite business was disposed of such that one could say that the disposal of shares was an extension of the taxable business which was thereby reduced in its scope or extent.

117. That argument, in our view, fails on two counts. First, in order to dispose of the PropCos to Prestbury it was necessary, as a term of such disposal, for THL as tenant and the PropCos (or certain of them) to enter into new leasing arrangements, and therefore the disposal did to some degree affect directly THL's business. Secondly, and more significantly, if one looks at the business carried on by the group as a whole, which we consider is the proper approach, it was undoubtedly changed by the disposal of the PropCos: the business no longer had resort (other than as occupying tenant or licensee) to the assets held by the PropCos and the security they provided for group borrowings. What (in group terms, and in broad VAT terms, having regard to the group registration) was a business which encompassed providing hotel accommodation where the hotels were within group ownership was, after the sale of the PropCos, a different (and perhaps reduced) business of providing hotel accommodation using hotels in third party ownership.

118. What is clear is that we do not have in the Appellant's case "the mere acquisition, holding and sale of shares", for the reasons we have given. We conclude that the sale of the shares was an economic activity for the purposes of the Directive and a transaction which was a supply in the course of the carrying on of a business for the purposes of the domestic legislation.

119. We therefore decide Question 1 in favour of the Commissioners.

120. The question then arises as to the nature of the supply for VAT purposes where the sale of the shares is an economic activity. This is clear and is not in dispute: the supply is an exempt supply, falling within Article 13B(d)5 as a transaction in shares

or interests in companies, and within the corresponding provisions in the domestic legislation at Item No 6 of Group 5 of Schedule 9. That is confirmed in the *AB SKF* case at [50] and [52] of the decision.

Question 2: If the sale of the subsidiary companies is not an economic activity, is the Appellant entitled to recover the input tax paid on the professional fees?

121. As will be apparent, this question requires to be answered only if we are wrong in holding that the sales of the shares in the PropCos is an economic activity for the purposes of the Directive.

122. In summary, the Appellant argues that if the sale of the PropCos is not an economic activity (and is therefore outside the scope of VAT), the VAT charged to it on the supplies made by its advisers in relation to the sale of the PropCos should nevertheless be deductible in that the input supplies are directly and immediately linked to the supplies of its taxable business generally, in the nature of overhead costs. The Commissioners argue that since the input supplies relate directly and immediately to the sale of the shares, input tax on those supplies cannot be recovered if the sale of the shares is not an economic activity. This is so even if it could be said that the sale of the shares was for the ultimate benefit of the taxable business.

The Appellant's submissions

123. Mr Prosser accepted that for input tax to be deductible it must have a direct and immediate relation to those taxable output transactions which give rise to the right of deduction. That is well-established by the case of *Midland Bank plc v Customs and Excise Commissioners* Case C-98/98) [2000] STC 501. If the transaction with which the input supplies are most directly linked is a transaction outside the scope of VAT, that transaction is disregarded for the purposes of establishing deductibility, and instead the question is whether the input supplies are directly linked to the taxable business as a whole. If so, the VAT on the input supplies is deductible as VAT on overhead costs.

124. This was the case in the *Kretztechnik* case (where the transaction was the issue of shares for the benefit of the business) and also in Case C-408/98 *Abbey National* [2001] ECR I-1361, where the input supplies related to the transfer of a business as a going concern which was found to be for the benefit of the company's business.

125. Applying that proposition to the Appellant's circumstances, Mr Prosser argued that since the shares in the PropCos were sold in order to raise funds for the benefit of the group's taxable business, the supplies made by the advisers in respect of that transaction have a direct and immediate link with the taxable business of the group as overhead costs of that business. He argued that such direct and immediate link is established notwithstanding that it cannot be demonstrated that the costs of the input supplies are incorporated within the price of the particular services and goods supplied by the Appellant. Mr Prosser referred us to the decision of the First-tier Tribunal in *Volkswagen Financial Services (UK) Limited v HMRC* [2011] UKFTT 556 at [64] – [68].

The Commissioners' submissions

126. The Commissioners argue that in the Appellant's case there is a direct and immediate link between the cost of the input supplies and the sale of the shares in the PropCos, and if that transaction is not an economic activity there is no link with a taxable output transaction and the VAT on the input supplies therefore cannot be recovered.

127. The Commissioners accept that input tax may be recovered where there is a direct and immediate link between the input supplies and the economic activity of the business as a whole, provided that the costs of the input supplies are a general overhead of the business or a cost component of the taxable business, but that can be the case only where the link cannot be established with any specific transaction.

128. In making his submissions Mr Beal relied on a number of decisions of the CJEU, including those in Case C-4/94 *BLP Group plc* [1995] ECR I-983; Case C-435/05 *Investrand* [2007] ECR I-1315; Case C-437/06 *Securenta v Finanzamt Göttingen* [2008] ECR I-1597; Case C-515/07 *Vereniging Noordelijke Land- en Tuinbouw Organisatie v Staatssecretaries van Financiën* [2009] ECR I-839; and *AB SKF*.

129. In the case of the supplies made to the Appellant with which this case is concerned, all the costs were incurred specifically for the transaction comprising the sale of the shares in the PropCos (any costs which were more general in nature had been identified and excluded from the present claim). Those costs cannot therefore be said to be directly and immediately linked to the business of the Appellant, even if it can be established that the business of the Appellant ultimately benefits from the receipt of the share sale proceeds.

Discussion and conclusions

130. The issue here is whether the Appellant has a right under Article 17 (and the corresponding domestic law provisions) to deduct the VAT charged on those input supplies made in relation to the sale of the shares in the PropCos if that sale is not an economic activity and is therefore a transaction outside the scope of VAT. As is evident from the list of cases cited to us, this is an issue which, in one form or another, has been considered by the CJEU on a number of occasions and yet there is sufficient uncertainty for the parties in this case to argue their opposing cases at length and with conviction.

131. Article 17(2) gives the taxpayer the right to deduct VAT on input supplies in so far as the input supplies are used for the purposes of his taxable transactions. It is now well-established that, for the taxpayer to deduct the tax on input supplies, there must be a direct and immediate link between the input supplies and the taxpayer's taxable transactions. In the *Midland Bank* case the Court states the position as follows (at [24]):

> " ... Article 17(2) ... must be interpreted as meaning that, in principle, the existence of a direct and immediate link between a particular input

> transaction and a particular output transaction or transactions giving rise to entitlement to deduct is necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement."

132. The Court goes on to state (at [30]) that it follows from this rule that:

> " ... the right to deduct the VAT charged on [input] goods or services presupposes that the expenditure incurred in obtaining them was part of the cost components of the taxable transactions. Such expenditure must therefore be part of the costs of the output transactions which utilise the goods and services acquired...."

133. The essential dispute between the parties in the Appellant's case is that the Commissioners say that the relevant input supplies have a direct and immediate link with the sale of the shares (which for the purpose of this part of their dispute is assumed to be a transaction outside the scope of VAT) and so there is no such link with a taxable transaction; and the Appellant says that there is instead a direct and immediate link with the general (taxable) business activity of the Appellant (taking account of the group registration), and that entitles it to deduct the VAT charged on the input supplies.

134. This area was reviewed by the CJEU in the *AB SKF* case (at [54] to [73]). The Court had concluded, as we have already mentioned, that the taxpayer, in selling shares in a subsidiary company and another company which it controlled, would be carrying out an economic activity which would be exempt from VAT. The Court was then required to consider whether the taxpayer would have a right to deduct input VAT on the supplies of services it required for the disposal of the shares. The case argued for the taxpayer was that the costs of such services formed part of its general costs and should be linked to its overall economic activity.

135. Although the case is concerned with a transaction which is an exempt supply, rather than a transaction which is outside the scope of VAT, the decision makes it clear that in both those circumstances the right to deduct VAT on input supplies is subject to the same principles, since otherwise there would be an infringement of the principle of fiscal neutrality (see [66] to [68]).

136. The court sets out the general principles of deductibility in these circumstances as follows:

> "57 According to settled case-law, the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (see *Midland Bank*, paragraph 24; *Abbey National*, paragraph 26; and *Inverstrand*, paragraph 23). 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 cost of the output transactions that gave rise to the right to deduct (see *Cibo*

Participations, paragraph 31; *Kretztechnik*, paragraph 35; *Inverstrand*, paragraph 23; and *Securenta*, paragraph 27).

58 It is, however, also accepted that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person's economic activity as a whole (see, inter alia, *Midland Bank*, paragraphs 23 and 31; *Abbey National*, paragraph 35; *Kretztechnik*, paragraph 36; and *Investrand*, paragraph 24).

59 On the other hand, where goods or services acquired by a taxable person are used for purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (see, to that effect, Case C-184/04 *Uudenkaupungin kaupunki* [2006] ECR I-3039, paragraph 24; Case C-72/05 *Wollny* [2006] ECR I-8297, paragraph 20; and *Vereniging Noordelijke Land- en Tuinbouw Organisatie*, paragraph 28).

60 It follows that whether there is a right to deduct is determined by the nature of the output transactions to which the input transactions are assigned. Accordingly, there is a right to deduct when the input transaction subject to VAT has a direct and immediate link with one or more output transactions giving rise to the right to deduct. If that is not the case, it is necessary to examine whether the costs incurred to acquire the input goods or services are part of the general costs linked to the taxable person's overall economic activity. In either case, whether there is a direct and immediate link will depend on whether the cost of the input services is incorporated either in the cost of particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities."

137. The Court continues by stating 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 acquire by means of those transactions is used in connection with the economic activities of the person concerned."

138. The Court also states (at [73]) that it is for the national court to determine from all the circumstances surrounding the transaction in question whether the input costs incurred are incorporated in the cost of the output transaction or in the cost of the goods or services supplied in the general business activity of the taxpayer.

139. This issue was re-visited by the CJEU in the *X BV* case (at [55] to [57]), but the Court went no further than summarising its conclusions in the *AB SKF* case.

140. It would appear, therefore that, to determine whether VAT on input supplies is deductible on a sale of shares which is either within the scope of VAT (and exempt) or outside the scope of VAT, the initial enquiry which must be made is whether the input supplies have an immediate and direct link to the output transaction under

examination, that is, to the sale of the shares. That is determined by whether or not the cost of those input supplies is a component of the cost of the output transaction. If that is the case, the input VAT cannot be deducted.

141. If it cannot be established that the input supplies have an immediate and direct link to the output transaction, an enquiry must be made as to whether the input supplies have an immediate and direct link to the taxable person's economic activity as a whole. That is determined by whether or not the cost of the input supplies are part of the taxable person's general costs (and therefore components of the price of the goods or services supplied by the taxable person in the course of his general economic activity). If they are part of the overhead costs of the business, and the supplies of that business are taxable supplies, the input VAT can be deducted.

142. Mr Prosser argued that if the transaction is one which is outside the scope of VAT (so that it is not an "output transaction", because for VAT purposes there is no supply) that initial enquiry is not made – the only enquiry is whether there is an immediate and direct link between the input costs and the taxable person's economic activity as a whole. In support of that proposition he cites the *Abbey National* and *Kretztechnik* cases. That, however, is contrary to the reasoning in the *AB SKF* case, where the case of the transaction which is exempted and the case of the transaction which is outside the scope are specifically held to be treated in the same manner in order to comply with the principle of fiscal neutrality. This is so notwithstanding the acknowledgment of the decisions in the *Abbey National* and *Kretztechnik* cases.

143. Therefore we need to consider whether, in the Appellant's case, the supplies in question of the professional advisers have an immediate and direct link to the sale of the shares in the PropCos – were those costs a component of the cost of the sale of the shares.

144. We conclude that the costs incurred by the Appellant on the supplies by the relevant professional advisers were immediately and directly linked to the sale of the shares in the PropCos. They relate to such matters as advising on the legal and accounting consequences of all aspects of Project Kylie; marketing the shares and seeking prospective purchasers; assessing the value of the underlying properties and therefore the value of the shares in the PropCos; proving title to those properties; revising the terms of the leases to which those properties were subject; advising upon and negotiating the terms of the sale of the shares, including the legal, tax and accounting provisions in the sale agreement; and providing environmental surveys to enable appropriate warranties to be given to the purchaser of the shares.

145. Mr Prosser argued that the shares had an inherent value reflecting the valuation of the underlying properties, and that the services of the professional advisers did nothing to increase the value of the shares, but merely enabled that value to be identified and then realised in the sale terms. That is too narrow an approach. The costs of those services were a cost to the Appellant of the sale of the shares. It is fair to say (applying an alternative expression used in the *AB* SKF case) that they were costs incorporated in the price at which the shares were sold (see [62]), in the sense that they contributed to the value of the shares – the Appellant would not have been

able to negotiate the price it negotiated for the shares had it not had the benefit of the services in question. No doubt the properties had a value (although establishing an agreed value was presumably achieved only on the basis of valuations and negotiation), but the Appellant sold the shares with the benefit of warranties and indemnities (in turn supported or verified by a range of specialised advice and reports) as to a range of key matters which enabled the Appellant to sell the shares in the manner in which, and at the price at which, it sold them. That is also the case in relation to the tax planning advice as to how the sale should be structured, where, for example, a reduced stamp duty charge for the prospective purchaser enabled the shares to be sold at a higher price.

146. The input costs were in this manner immediately and directly linked to the sale of the shares in the PropCos. That link is to a transaction for which no output tax can be collected, and correspondingly no input tax can be deducted. No further enquiry needs to be made, and in particular it is not necessary to enquire whether the costs of the input supplies are part of the Appellant's general costs (although it is implicit in our finding that they were costs of the sale of the shares in the PropCos that they were not overhead costs of the Appellant's general business activity). Even if we were to accept that the sale of the shares in the PropCos resulted in a benefit to the Travelodge group, in terms of reduced debt and a consequent reduction in interest costs and also an improvement to its balance sheet in the perception of the market (and as we mention below in relation to Question 4, that is not necessarily established where much of the sale proceeds was used to repay the leveraged debt incurred to acquire the Travelodge group), that is not a relevant factor where, as is the case, specific costs are linked directly to a specific transaction.

147. We therefore decide Question 2 in favour of the Commissioners.

Question 3: If the sale of the subsidiary companies is an economic activity, is it nevertheless outside the scope of VAT because it is within the terms of the VAT provisions which relate to the transfer of a business or of part of a business as a going concern?

148. If we are right in our answer to Question 1, so that the sale of the shares in the PropCos is an economic activity, the supply thereby made is, as we have stated, an exempt supply. However, the UK, as permitted by the Directive (Article 5(8)), has provisions (in article 5 of the Value Added Tax (Special Provisions) Order 1995) ("the TOGC provisions") which treat the transfer of a business or of part of a business as a transaction which is outside the scope of VAT where certain conditions are fulfilled. The most significant of those conditions where part of a business is transferred are that the part of business transferred is capable of separate operation; the assets transferred should be used by the transferee in a business of the same kind as that carried on by the transferor; and that the transferee should be a taxable person with regard to the business transferred. Thus, in effect, the business or part of the business in question is transferred as a going concern, and its VAT status is unaffected by the transfer.

149. The Appellant argues that even if the Commissioners are right with regard to Question 1, the sale of the shares in the PropCos is nevertheless outside the scope of VAT because it is the transfer of part of the Appellant's business (taking the group as a whole) in circumstances which satisfy the conditions of the provisions concerning the transfer of a business as a going concern. If the Appellant is right, it still has to establish that it is entitled to deduct the VAT on the relevant input supplies, but that is Question 4 below.

150. The Commissioners argue that the sale of the shares in the PropCos is not a transfer as a going concern, principally on the ground that what is sold is shares and not the business owned by the company whose shares are sold. The Commissioners also argue that, on the facts, the PropCos held assets as an investment and not as a business or part of a business.

151. Since the hearing of the appeal the CJEU has given its decision in the *X BV* case, where the principal question for its decision was whether the disposal of a 30% shareholding in a company, where the disposing shareholder provided management services to that company, was the transfer of part of a business outside the scope of VAT by reason of Article 5(8). Following the release of that decision, as mentioned, both parties made written submissions to us on that decision and its application to the Appellant's case.

The Appellant's submissions

152. The Appellant submits that a sale of shares in a company where the company carries on a business can be a transfer of that business, and therefore in principle can be a transfer within the TOGC provisions. The Appellant refers to the decision in the *AB SKF* case where it is clearly contemplated (at [38] and [40]) that this is so. The Appellant also finds support in the decision in the *X BV* case, where the CJEU rejected the argument that a transfer of a 30% shareholding in a company could be the transfer of the business held by the company, and also rejected the argument that if all the shareholders in that company together transferred their shares, that would be the transfer of the business. The CJEU, so the Appellant argues, considered that the size of the shareholding was relevant, implicitly acknowledging that the transfer by a shareholder of the entire share capital of a company could be a transfer within the TOGC provisions.

153. On the facts, the Appellant argues that since the PropCos owned properties which were let on commercial terms, it was carrying on a letting business which was continued under the ownership of Prestbury on the sale of the shares. All the conditions were satisfied for the transfer to qualify as the transfer of a business as a going concern within the TOGC provisions.

The Commissioners' submissions

154. The Commissioners argue that when a person transfers shares in a company he is transferring the company, and not the business held and carried on by the company – there is no transfer of the business, which at all times is in the ownership of the

company. Therefore, as a matter both of logic and reason, a transfer of shares cannot come within the TOGC provisions, which extend only to the transfer of a business or part of a business.

155. Mr Beal pointed to the basis or reason for the TOGC provisions, as explained in Case C-497/01 *Zita Modes* [2003] ECR I-14393 (at [39]): when a taxable person sells a business and its assets to another taxable person the resulting VAT (absent the TOGC provisions) on what is likely to be a sizeable transaction presents a significant cashflow cost to the purchaser until that VAT is reclaimed, when in the overall scheme, the purchaser is simply continuing to operate a taxable business. There is a corresponding credit risk for the revenue authority on the vendor, who may fail to account for the substantial amount of VAT it has collected. The TOGC provisions eliminate the need for that extraordinary VAT payment in what, overall, is a VAT-neutral transaction. As is made clear in the *X BV* case, that reasoning does not apply in the case of the transfer of shares, which is either an exempt supply (if it is an economic activity) or is outside the scope of VAT (if it is not an economic activity). It is therefore rational within the scheme of VAT that the transfer of shares should not be treated as the transfer of a business as a going concern.

156. The Commissioners accept that in the *AB SKF* case the question is posed by the CJEU as to whether a sale of shares in a subsidiary can be a transfer of a business as a going concern, and that question is left open. It is important to note that it is not a question referred to the Court for a decision, nor is a decision on the point required to enable the Court to reach its final decision on the questions before it – the matter is discussed because it was raised in argument before the Court by the Commission of the EC. In any event, in the Commissioners' view the matter is dealt with decisively by the CJEU in the *X BV* case, which confirms that neither a transfer of a 30% holding nor a transfer of a 100% holding of shares in a company can, in itself, be a transfer of a business, since the holders of those shares do not own the business or the assets of the business. This decision is therefore consistent with decisions in cases including *Zita Modes* and Case C-444/10 *Schriever* [2011] ECR I-0000.

157. In any event, the Commissioners argue that, on the facts, the Appellant's sale of the shares in the PropCos does not satisfy the conditions of the TOGC provisions. The Travelodge group, of which the PropCos formed part, had a business of providing hotel accommodation. Following the sale of the shares Prestbury was carrying on the different business of a commercial landlord. Even if it is argued that part of the group's business has been transferred, the reality is that assets – commercial properties subject to leases – have been transferred, not a business or part of a business capable of independent operation.

Discussion and conclusions

158. First we consider whether in principle a sale of shares can be a transfer of a business, or of part of a business, as a going concern and hence potentially within the scope of the TOGC provisions.

159. On this issue the arguments of the parties were focused on statements included in the decisions in the *AB SKF* and *X BV* cases, as we have indicated.

160. Mr Beal is right to point out that this was not an issue on which the CJEU was required to reach a decision on the facts of the *AB SKF* case or to answer the question referred to the Court. Nevertheless, in its comprehensive review of the question of the deductibility of input VAT on the sale of shares, the Court made a number of observations.

161. Having explained the submissions of the Commission on the point (at [35]), and (at [36]) the effect of Article 5(8) (the Directive provision setting out the scope of what individual Member States may introduce to take transfers of business out of the scope of VAT), and having confirmed (at [37]) that such provisions do not apply to the transfer of mere assets which do not constitute an undertaking (or part of an undertaking) capable of being carried on as an independent economic activity, the decision continues as follows:

> "38 In the present case, it is not possible, on the basis of the case-file submitted to the Court, to determine whether the effect of the sale of shares in the subsidiary and in the controlled company was the total or partial disposal of the assets of the undertakings concerned. Furthermore, SKF stated at the hearing that the possible application of Article 5(8) of the Sixth Directive to the present case had not even been broached before the national court.
>
> ....
>
> 40 In any event, even if Article 5(8) of the Sixth Directive ... could be applied to a transaction such as that at issue in the main proceedings, a matter which it is for the national court to determine, it must be observed that both SKF and the Swedish Government stated at the hearing that the Kingdom of Sweden has chosen to exercise the option, provided for by those provisions, of treating the transfer of a totality of assets as not coming within the scope of the Sixth Directive. That being the case, a disposal of shares which amounts to a transfer of a totality of assets does not constitute an economic activity subject to VAT."

162. Although these statements, given in the context of a question which was not, in terms, referred to the Court for its decision, do not decisively establish that the transfer of shares may be treated as the transfer of the underlying business of the company whose shares are transferred, we can see that they are at least sufficient to encourage the Appellant to argue the point.

163. The question was squarely before the CJEU in the *X BV* case, although the decision of the Court, as it applies to the particular facts of the case, leaves some area for uncertainty, as is apparent from the respective submissions made to us on the decision by the parties.

164. In *X BV* the Netherlands taxpayer, X, held 30% of the shares in a company which carries on a business. The remaining shares were held individually by three

other companies. X, and two of the other shareholders provided management services to the company for consideration. X (together with all the other shareholders) sold its holding in the company (all selling to the same purchaser), and it and the other shareholders ceased to provide management services to the company.

165. X claimed a deduction for the VAT charged to it on the supplies made to X in conjunction with the sale of its holding in the company. This was refused by the Netherlands tax authorities on the grounds that the sale by X of the shares was an exempt supply. The Netherlands has enacted "transfer as a going concern" provisions as permitted by Article 5(8).

166. The first question referred to the Court was whether X's sale of its 30% shareholding in the company was equivalent to the transfer of part of a business and its assets within Article 5(8). The second question was whether X's sale of its shareholding was such a transfer of a business in the circumstances where (as was the case) all the other shareholders sold their holdings in the company at the same time and to the same purchaser.

167. Having stated the scope and conditions of Article 5(8), and the requirement that what must be established is a transfer of an undertaking capable of being carried on as an independent economic activity, and not merely a transfer of assets, the Court continues as follows:

> "33 As the referring court states, it is indeed apparent from paragraphs 38 and 40 of the judgment in *SKF* that the Court did not rule out that the disposal of a 100% shareholding may, in certain circumstances, be regarded as equivalent to a transfer of a totality of assets or part thereof in so far as the effect of such a disposal is the total or partial disposal of the assets of the undertakings concerned. However, in the case giving rise to that judgment, the Court did not have the information necessary to express a view on the applicability of Article 5(8) of the Sixth Directive to a transaction such as the transaction at issue in that case, and left it to the referring court to consider that point.
>
> 34 In paragraph 25 of the judgment in *Schriever*, the Court emphasised that, in order to find that there has been a transfer of a business, or of an independent part of an undertaking, for the purposes of Article 5(8) of the Sixth Directive, all of the elements transferred must, together, be sufficient to allow an independent economic activity to be carried on.
>
> 35 In that regard it must be stated that, unlike the holding of the assets of an undertaking, the holding of shares in an undertaking is not sufficient to allow an independent economic activity to be carried on."

168. The Court then states that it is established that the mere acquisition, holding and sale of shares in a company do not, in themselves, amount to an economic activity, but that if the holding is accompanied by involvement in the management of the company held (entailing the supply of taxable management services) that is an economic activity. The decision then continues:

> "38 Therefore, as the German government submits, the transfer of shares in a company cannot, irrespective of the size of the shareholding, be regarded as equivalent to the transfer of a totality of assets or part thereof within the meaning of Article 5(8) of the Sixth Directive, unless the holding is part of an independent unit which allows an independent economic activity to be carried out, and that activity is carried on by the transferee. The mere disposal of shares, unaccompanied by the transfer of assets, does not allow the transferee to carry on an independent economic activity as the transferor's successor.
>
> 39 Shareholders are not owners of the assets of the undertaking in which they hold their shares; they are owners of the shares and, as such, are entitled to a dividend and to the communication of information, and are involved in the adoption of important decisions for the management of the undertaking. As regards a 30% shareholding in a company, it must be observed that that represents only a limited entitlement in respect of that company.
>
> 40 It follows from the foregoing that the transfer of 30% of the shares in a company cannot be regarded as equivalent to the transfer of a totality of assets or part thereof within the meaning of Article 5(8) of the Sixth Directive."

169. The Court then proceeds to justify its decision as being in accordance with the aim of Article 5(8), whose purpose is to avoid the problems of a disproportionate VAT charge in a VAT-neutral transaction, a situation which does not arise in the case of a person acquiring shares in what is an exempt or "outside the scope" transaction (as we have mentioned in paragraph 154 above).

170. The Court then considers the second question. It notes that Article 5(8) is in terms of "transferor", in the singular, and therefore where there are a number of transferors, the transaction of each must be considered individually and independently (see [46] and [47]). On the second question the Court concludes:

> "51 Accordingly, the disposal to a single person of all the shares in a company by all the shareholders of that company cannot be regarded as equivalent to the transfer of a totality of assets within the meaning of Article 5(8) of the Sixth Directive."

171. The Court considers whether it is significant that X and the other shareholders provide management services to the company, and concludes that it is not – they ceased on the transfer of the shares, and are not an autonomous part of X's own undertaking which could be operated independently by a purchaser. In any event if the management activities comprised an autonomous undertaking, its transfer as a going concern would be distinct from the transfer of the shares, each comprising a different undertaking (see [52] and [53]).

172. Mr Prosser argues that the decision in *AB SKF* leaves open the possibility that in some circumstances a disposal by a shareholder of all the shares in a company may be the transfer as a going concern of that company's business, and that the Court in *X BV* does not rule out that possibility. It decides that a sale of a 30% shareholding cannot

be such a transfer, nor can the sale on the same occasion of all the shares by a number of different shareholders who together own all the shares in the company be such a transfer. The decision should not be given a significance beyond the questions which had to be decided. It is instructive that the reason given for the decision on the second question (all the shareholders together transferring their shares) is not that a transfer of 100% of a company cannot be a transfer of a business, but that the transaction entered into by each shareholder individually cannot be such a transfer.

173. Faced with the statement in [38] that, "the transfer of shares in a company cannot, irrespective of the size of the shareholding, be regarded as equivalent to the transfer of a totality of assets", Mr Prosser argues that the Court did not mean that a transfer of shares – even if the size of the shareholding is 100% - cannot ever be the transfer of a business: rather, he says, the Court was making the point that the question of whether the transfer of shares is equivalent to the transfer of a business is a question which can be considered only with regard to the size of the shareholding ("irrespective of" meaning "without paying regard to" in this instance).

174. Despite the ingenuity of Mr Prosser's arguments, we cannot agree with his conclusions. We have quoted at some length from the decision in the *X BV* case because it is necessary to have a sense of the balance of the decision and the reasons and explanations which form part of it.

175. Thus it is made clear (at [35] and [39]) that the holding of shares is not the holding of the underlying business, and it is for that reason that the transfer of shares in a company cannot be regarded as equivalent to the transfer of the underlying business which the company carries on. This is without qualification, even though the matter to be decided concerns a shareholding of 30%. In no sense is it suggested that a 100% shareholding might, contrary to the position stated, be regarded as a holding of the underlying business.

176. This is reinforced, as Mr Beal points out, by the Court's explanation as to why its finding in this respect accords with the aim of Article 5(8) (see [41] to [43]). The special treatment which Article 5(8) affords is not relevant to a transfer of shares, where the purchaser pays no VAT on that transfer (because the transfer is either exempt or outside the scope of VAT). This is so whether the transfer is of a shareholding of a minority interest or of the entire interest in the company. If the Court considered that there are circumstances where the transfer of shares could be regarded as the transfer of the underlying business of the company as a going concern it could not justify its decision as resulting in an outcome which is consistent with the aim of Article 5(8). Indeed, given that the basis of the Article 8(5) provisions and the TOGC provisions in the domestic legislation is that a transfer within those provisions is VAT-neutral, it would be anomalous if they could be applied to what might otherwise be an exempt supply.

177. As regards the statements made on this issue by the CJEU in the *AB SKF* case, the Court in *X BV* neither expressly confirms nor refutes them, although it takes the opportunity on two occasions to mention that the Court in the *AB SKF* case "did not have sufficient information to decide whether Article 5(8) of the Sixth Directive was

applicable to the transaction at issue", and was able to decide the question before it on different grounds. That suggests to us something of an intent to downplay the significance of those statements.

178. Taking these points together we conclude that the Court's decision in the *X BV* case is authority for the proposition that where there is a transfer of shares alone, including the case where the transfer is of the entire holding in a company, that cannot be treated as the transfer of a business as a going concern, even in a case where the company whose shares are transferred is carrying on a business. The transfer of the shares cannot be treated as the equivalent of the transfer of the company's business. We would add that in the Appellant's case there was a further degree of "remoteness" as between the transferring shareholders and the actual business, in that the assets of the PropCos were not the hotel properties, but the shares in the SubPropCos, which in turn held the business.

179. If we are wrong in this conclusion, and in principle the transfer of a 100% shareholding can be treated as equivalent to the transfer of the underlying business, we have to decide on the facts of this case whether there is such a transfer by reason of the sale of the shares in the PropCos to Prestbury.

180. The conditions which must be satisfied if the TOGC provisions are to apply are that (in the Appellant's circumstances) there must be a supply by way of transfer of a business (or part of a business) as a going concern; if the transfer is part of a business, it must be capable of separate operation; the assets transferred must be used by the transferee in carrying on the same kind of business as that carried on by the transferor (and that may be as a new business begun on the transfer by the transferee, or as an accretion to his existing business); and if the transferor is a taxable person, the transferee must also be taxable or become taxable as a result of the transfer.

181. It is clearly established (see, for example, the *Zita Modes* case) that there must be more than the mere transfer of assets – that which is transferred must be sufficient to enable a business to be operated as a separate and independent enterprise.

182. The business which the Appellant (as group representative member) carried on was the provision of hotel accommodation, and the letting and licensing of the hotel properties by the PropCos to THL were part of that business. The Appellant has to show not only that that part of the business was capable of separate operation, but also that the assets transferred are used by the transferee "in carrying on the same kind of business ... as that carried on by the transferor in relation to that part".

183. Taking this second requirement (carrying on the same kind of business) first, the business carried on by Prestbury on its acquisition of the PropCos was the business of letting hotels on commercial terms. That is not the same kind of business as providing hotel accommodation. However, to qualify it must be the same kind of business as that carried on by the transferor in relation to the part of the business transferred. The TOGC provisions therefore seem to envisage that a business may be, so to speak, sliced horizontally as well as vertically, that is, with different components of a larger overall business transferred (provided those components are capable of

separate operation as a business), and the benefits of the TOGC provisions are available provided that the transferee carries on, as a business, operations of the kind which the transferor carried on in utilising and operating the assets and undertaking when they formed part of his overall business.

184. Applying this to the Appellant's circumstances we conclude that this second requirement is met. The letting of hotel properties on commercial terms was an undertaking which formed part of the Appellant's business of providing hotel accommodation, and when that particular part of the business was acquired by Prestbury, Prestbury carried it on in the same terms – it carried on the same kind of business as that carried on by the Appellant in relation to the part of the business transferred.

185. The first requirement (the part of the business transferred was capable of separate operation) is perhaps an aspect of the question of whether what was transferred was a business or simply assets.

186. We have already noted that the PropCos carried no management capability themselves, but looked to THL to provide that. We have also noted that when the PropCos were sold the management capability supplied by THL was terminated and Prestbury appointed its own directors, bankers, auditors and so forth to the PropCos. The PropCos themselves had no staff or other capability to operate a letting business, nor did they have in place arrangements which secured any such capability through the change of ownership. They lacked the apparatus that differentiates what is a business from what is a mere holding of assets as an investment.

187. The Appellant's reply to this is that the PropCos had no need of staff or other apparatus: the leases were in place, the rents were reviewed by a formula, and all the property obligations were laid on THL as tenant or licensee. That reply is open to two objections. First, the PropCos were required to take action, most notably to transfer down the hotel properties to the SubPropCos, and to vary certain of the leases, all in advance of the sale of the shares in the PropCos to Prestbury. They themselves lacked the resources to implement that action. Secondly, if it is true that the PropCos required no staff or other apparatus, that in itself is a strong indication that what we are looking at is not a business (or part of a business capable of separate operation) – which connotes a dynamic, changing state of affairs, an activity – but the holding of assets, which is essentially a passive and static state of affairs.

188. We therefore conclude that on the sale of the shares in the PropCos to Prestbury there was no transfer of a business as a going concern within the terms of the TOGC provisions.

189. We therefore decide Question 3 in favour of the Commissioners.

Question 4: If the sale of the subsidiary companies is a transfer of a business or of part of a business as a going concern for VAT purposes, is the Appellant entitled to recover the input tax paid on the professional fees?

190. This question, of course, requires to be answered only if we are wrong in our answer to Question 3.

The Appellant's submissions

191. The Appellant argues that its circumstances are covered by the decision in the *Abbey National* case. In that case the costs of the services supplied to the transferor of part of a business whose transfer fell within the TOGC provisions were held to form part of its overheads, being cost components of the products of its business, and as such had a direct and immediate link with the whole economic activity of the transferor. The transferor's economic activity comprised taxable supplies, and in consequence all the VAT charged on the services were recoverable.

192. The Appellant is in the same position. The sale of the shares in the PropCos was carried out for the benefit of the business of the Travelodge group, in that it reduced the group's indebtedness and interest cost and improved its balance sheet. The costs of the supplies received in connection with the sale of the shares therefore have a direct and immediate link with that business (which is a fully taxable business) and can therefore be recovered.

The Commissioners' submissions

193. The Commissioners do not question the decision in the *Abbey National* case, but they take the view that it does not apply to the circumstances of the Appellant.

194. In the *Abbey National* case the part of the business transferred comprised taxable supplies. The costs of the input supplies relating to the transfer could be said to form part of the overheads of the part of the business transferred because they had a direct and immediate link with that part of the business.

195. In the Appellant's case the part of the business transferred, viewed discretely, comprised the letting of property which, because of the group registration, had no VAT characterisation. The costs of the input supplies relating to the sale of that part of the business cannot therefore be said to be overhead costs of a taxable business. Nor can they be said to be overhead costs of the taxable business of the group (the provision of hotel accommodation), since they have no direct and immediate link with that business, notwithstanding that the proceeds of the sale were used to reduce group indebtedness – the beneficiary of the proceeds of sale was the private equity shareholder in the Travelodge group.

196. This being so, the costs of the input supplies can only be directly and immediately linked to the transfer of part of the business itself, and on the authority of the *AB SKF* case, as previously argued, the VAT on such costs cannot therefore be recovered.

Discussion and conclusions

197. As we understand the arguments put to us, the difference between the parties is as follows. The Appellant considers that the input supplies relating to what we are to assume is the transfer of part of its business can be linked directly and immediately with the taxable supplies of the retained (or continuing) business (the taxable business of providing hotel accommodation) as overhead costs of that business. The Commissioners consider that those costs relate to that part of the business which is transferred and as such are not linked to a taxable business. They can be linked only to the actual transfer itself, and since that transfer is outside the scope of VAT, they cannot be recovered.

198. In the *Abbey National* case part of a business of letting properties (where the landlord company – the transferor – had opted to charge VAT on rents charged) was sold in circumstances where it was agreed that it was a transfer within the TOGC provisions. That transfer would have been a taxable supply of the business but for the TOGC provisions, which instead rendered it a transaction outside the scope of VAT.

199. The CJEU held that the input services did not have a direct and immediate link to a taxable output supply (because of the effect of the TOGC provisions), but they were part of the taxable person's overheads and as such were cost components of the supplies it made in its business (see [34] and [35]). If all the supplies of that business are taxable supplies (as was the case in *Abbey National*) the link is with the whole business (see [36]).

200. The CJEU then proceeds to consider the position if the taxable person makes both taxable and non-taxable supplies in the course of its business (so that not all its input VAT can be deducted). In that case, VAT on overhead costs can be deducted only if they are overheads which relate to that part of the business which comprises clearly defined taxable transactions (see [37] – [39]). The Court then continues:

> "40 So if the various services acquired by the transferor in order to effect the transfer of a totality of assets or part thereof have a direct and immediate link with a clearly defined part of his economic activities, so that the costs of those services form part of the overheads of that part of the business, and all the transactions relating to that part are subject to VAT, he may deduct all the VAT charged on his costs of acquiring those services.
>
> 41 It is for the national court to determine whether those criteria are satisfied in the case in point in the main proceedings."

201. We see the force of the Commissioners' submissions. In so far as the input supplies relating to the transfer of the presumed hotel letting business have a direct link with a clearly defined part of the Appellant's economic activities, it is with the part of the business which is thereby transferred, and because of the nature of that part of the business (viewed as a discrete activity), and because no taxable supplies are made in the course of that business in any event because of the group registration, there is no right to deduct the VAT on those input supplies. The cost of the input supplies are not part of the overhead costs of the Appellant's taxable business and do not form a component part of the taxable supplies made in the course of that business.

They do not therefore have a direct and immediate link with that taxable business and cannot therefore be deducted on that basis.

202. The Appellant argues that, in the wider picture, the costs of the input supplies on the transfer benefited the taxable business of the Appellant because the proceeds of the sale were used to pay down group debt, and therefore those costs are an overhead cost of the taxable business. The Commissioners say, and we agree, that that is too remote from the taxable business, first, because, as a matter of fact, the costs were specific to the transfer and it is difficult to see that they were overheads of the hotel accommodation business; and secondly, because, in the context of the debt structure put in place to acquire the Travelodge group, the purpose of the sale of the PropCos was to reduce that debt leveraging, rather than the trade credit and loan financing historically used to finance the THL business.

203. Therefore the input costs of the transfer are not directly and immediately linked with output transactions which are taxable, and the VAT on those costs is therefore not deductible.

204. We therefore decide Question 4 in favour of the Commissioners.

Question 5: If the sale of the subsidiary companies is an economic activity which is an exempt supply (and is not a transfer of a business as a going concern), is the Appellant nevertheless entitled to recover the input tax paid on the professional fees?

205. This question requires to be answered if (as we have held to be the case) the sale of the shares in the PropCos was an exempt supply.

206. The Appellant's case in relation to this issue is founded on the *AB SKF* decision, in what Mr Prosser was almost prepared to say was a development of the law. In short the Appellant argues that the costs of the professional advisers who acted for the Appellant on the sale of the shares in the PropCos were not costs which were incorporated in the price of the shares, and therefore were not directly linked to the (exempt) transaction comprised by that sale of the shares. It follows that the input supplies were used in making taxable supplies and are therefore recoverable.

207. The Commissioners point to a line of authorities, decisions of the CJEU and of the UK courts, which in their submission establish that, for the purpose of determining whether a particular cost is a cost component of a particular supply of goods or services, it is necessary to ascertain whether, and the extent to which, that cost is used in that particular supply. It is not necessary to show that the costs are directly incorporated in the cost of the supply. Mr Beal also referred to regulations 103B and 107 of the Value Added Tax Regulations 1995 which relate to the attribution of input tax incurred on input supplies, and to Article 17(5)(c) (pursuant to which regulations 103B and 107 are made). Those provisions permit an attribution of input tax to be made on the basis of the use to which the input services are put.

208. We can dispose of this point briefly. Even if Mr Prosser is correct in saying that in order to show that the input costs incurred in relation to the sale of the shares in the PropCos are directly and immediately linked to the exempt transaction it must be the case that those costs are incorporated in the price of the shares, we have concluded that in the Appellant's case they can, on any sensible basis, be regarded as incorporated in the price of the shares, and that those costs are therefore directly and immediately linked to the sale of the shares (see paragraphs 142 to 145 above).

209. We therefore decide Question 5 in favour of the Commissioners.

Question 6: What is the consideration given for the sale of the shares in the PropCos?

210. The final question we are asked to decide concerns the amount of consideration, for VAT purposes, which Prestbury paid and the Appellant (or the relevant group companies) received for the sale of the shares in the PropCos. More specifically, the question is whether the consideration for the sale of the shares in the PropCos comprised the amount paid for those shares pursuant to the share sale agreement, or that amount together with the (much larger) amount of the indebtedness of the PropCos due to the retained Travelodge group, repayment of which Prestbury agreed to procure on completion of its purchase of the PropCos. This question is relevant for the purposes of calculating the amount of input tax which can be deducted if an apportionment as between exempt and other output supplies should be required.

211. The Appellant argues that the matter should be determined by reference to the deal struck between itself and Prestbury as that is set out in the terms of the agreement for the sale and purchase of the shares in the PropCos. On that basis the amount of consideration for the shares, for VAT purposes, is £24,409,000. The loan of £328,964,000 which Prestbury advanced to the PropCos, and which, pursuant to the share sale agreement, the PropCos used to repay a matching amount due to the retained Travelodge group on completion of the sale of the shares, should not be regarded as part of the consideration for the sale of the shares.

212. The Commissioners argue that by virtue of those loan and discharge arrangements Prestbury should, for VAT purposes, be regarded as paying in aggregate £353,373,000 for the shares in the PropCos.

213. Our findings of fact as to the terms of the sale and these matters are at paragraphs 43 to 47 above.

The Appellant's submissions

214. The Appellant's case is that, as a matter both of contract and commercial reality the amount of £329 million (in round numbers) received on repayment by the PropCos of their indebtedness was exactly that, and should not be treated as consideration for the shares in the PropCos. The terms of the contract, which accord with the commercial deal struck by the parties, should be respected: see the cases of

Fielder v Vedlynn Limited [1992] STC 553 and *Spectros International Plc v Madden* [1997] STC 114.

215. As to the commercial reality, at the time of such repayment the PropCos held the hotel properties and therefore had assets to a value which enabled them to make the repayment or to provide security against which they could borrow to make the repayment. There was nothing artificial or contrived in that situation, or in the value ascribed to the shares or in the requirement that on leaving the group the PropCos should be required to pay their debts.

216. The Appellant accepts that the question of consideration is not just a matter of contract, and must be understood as a concept of EU law. The case of *Tolsma* (Case C-16/93) [1994] ECR I-743 at [14] explains when a supply of services is effected "for consideration" for the purposes of Article 2(1). The consideration for services is the remuneration received by the provider of the service pursuant to a legal relationship between provider and recipient, being the value actually given in return for the service supplied. In the Appellant's case the repayment of the loans was in discharge of an indebtedness incurred as the consideration for the sale of the properties which the PropCos had originally acquired substantially before the sale of the shares to Prestbury, and it cannot also be the consideration for the shares.

217. The Appellant concedes that it could be said that the consideration for the shares included Prestbury's contractual obligation to procure that on completion the PropCos discharged their debts to the Travelodge group companies, but in circumstances of the assets then held by the PropCos, the value of that obligation could not be regarded as substantial.

The Commissioners' submissions

218. The Commissioners referred us to Article 11, which sets out what is to be the taxable amount for VAT purposes. The general rule is that the taxable amount for goods or services is "everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser ...for such supplies". The concept of "consideration" must be understood in its EU law context as an EU law phrase, not by reference to domestic law concepts: Case 102/86 *Apple and Pear Development Council* [1988] ECR 1443

219. The commercial reality of the transaction with Prestbury is that the Appellant sold shares in companies where those companies held hotel properties to a value of £353 million or thereabouts. £24.4 million was received from Prestbury for the shares and £329 million was received from Prestbury channelled through the PropCos as repayment of their indebtedness, all as part of the agreement for the sale of the shares and on completion of that agreement.

220. The Commissioners argue that even under domestic law the discharge of indebtedness on a sale of shares can be part of the consideration for the shares, as is apparent from the stamp duty cases of *Carlyon Estate Ltd v IRC* (1937) 16 ATC 339 and *E Gomme Ltd v IRC* [1964] 3 All ER 497.

Discussion and conclusions

221. On this issue we agree with the Appellant.

222. The agreement reached by the Appellant with Prestbury for the sale of the shares in the PropCos was an arm's length transaction negotiated and agreed between unrelated parties, each of which would have been concerned to protect its commercial interests. There was no evidence that the agreement they reached was in any way artificial or influenced by circumstances beyond those apparent from the deal as documented in the sale agreement. Nor is there any evidence that the sale agreement is not an accurate record of the commercial deal which they struck. This being so, it is right to look to the contract, and no further, to determine this question unless there is a requirement in law to do otherwise.

223. Both parties pointed out, as they were right to do, that the question of what constitutes consideration for a supply for VAT purposes is a matter of EU law, but neither party offered any guidance as to how EU law approaches this question beyond the well-known statement in the *Tolsma* case that it is the value given in return for the service provided.

224. It is important to remember that here we are concerned with the sale of the shares in the PropCos, and the consideration given for those shares. We make this point because it appeared to us that the Commissioners' arguments were at root based on the premise that what was being sold was the hotel properties held by the SubPropCos. That is a premise which is not open to them, first, because it was a sale of shares (and whatever is the EU law approach to consideration, we are clear that it does not extend to permitting such a radical change in the nature of the transaction), and secondly, because, as we have shown, in other issues in this appeal the Commissioners have strongly resisted any notion that the sale of the shares should be viewed as a sale of the underlying properties.

225. The value of shares in an investment company is essentially determined by the value of the assets held by that company less the liabilities incurred by that company. The assets may include intangibles such as goodwill, but in companies such as the PropCos the substantial value will be derived from their tangible assets – the hotel properties in their case. (We would also add, with a nod towards Questions 2 and 5, that the value of the shares, at least as it is to be established and justified on a sale, reflects the services of the professional advisers.) In the case of the PropCos the parties, after negotiation, agreed a value of £24.5 million (in round numbers) for the shares, reflecting the value of the assets of the PropCos less the liabilities of the PropCos, those liabilities being debt due to other companies in the Travelodge group. (We should make it clear that we are here speaking of the aggregate position – each PropCo was sold by separate agreement, and, we assume, the value ascribed to the shares in each company reflected the assets and liabilities of that individual company.)

226. The liabilities in question were undertaken for good reason. They represented the price paid by the PropCos for the assets they purchased for the purposes of their investment activities. That price was left outstanding and due to the vendor

companies in the group. It is not suggested that those liabilities were inflated or manipulated in any way.

227. Furthermore, the liabilities in question were relatively long-standing. In particular, they were not created specifically for the sale of the PropCos to Prestbury. The PropCos, with their assets and liabilities, were set up in December 2002, whilst the Travelodge group was in the ownership of Compass. Our findings of the relevant facts are at paragraph 35 above. Those arrangements were made in anticipation of a sale of the Travelodge group to the private equity funds (although that did not take place until February 2003), and it offered certain tax benefits for both Compass and those funds. It was also the case that those funds, as prospective owners of the Travelodge group, saw possible stamp duty benefits of the structure should they eventually decide to realise the value of the hotel properties. There is no evidence that the deal with Prestbury was, in December 2002, in any shape or form in prospect. The agreement with Prestbury was entered into in October 2004.

228. Finally, in relation to those liabilities, they were liabilities which the companies themselves were able to discharge out of their own assets, should the need arise.

229. Taking these matters into account, a figure of £24.5 million is a fair, and commercially justifiable, value to be attributed to the shares in the PropCos. That being the case it would be curious if the amount of consideration given for those shares – whether one applies English law or EU law concepts of consideration – substantially differed from that amount. That was the deal struck by the parties, it was the deal effected by the contract they entered into, and it accorded with the commercial reality.

230. It is true that the PropCos were required to repay their debts to the retained Travelodge group on completion of the sale of the PropCos, and Prestbury was obliged to procure that they did so. That is a common – even standard – arrangement when a company with intra-group indebtedness is sold out of the group. But as Mr Prosser rightly said, that payment by the PropCos was the delayed payment for the properties they purchased in December 2002, and therefore was the consideration given for those properties, and not the consideration given for the shares in the PropCos themselves.

231. As mentioned, it was a term of the sale of the shares that Prestbury should procure the PropCos to repay their indebtedness on completion. It was not a term that Prestbury should fund them for the purpose (although that was the clear expectation, in all the circumstances, and the Appellant was aware that Prestbury had in place the borrowing facilities which would enable it to ensure such funding). We agree that Prestbury's obligations to procure the repayments of the loans can fairly be regarded as part of the value given in return for the shares. Given the commercial reality that, at completion (which in most cases was four days after contract), the PropCos would not be able to realise the value of the hotel properties or themselves arrange external borrowings to the extent required, we consider that Prestbury's commitment to make funds available to the PropCos on completion can also be regarded as part of the value given in return for the shares, notwithstanding that it is not a contractual obligation

given to the vendor companies. Mr Prosser doubts whether such matters have significant value in the circumstance where the PropCos have assets whose value exceeds the amount of debt repaid. He may well be right, but it was a matter on which there was no evidence, nor was it given considered argument before us, and so we cannot decide the issue.

232. We are clear, however, that the Commissioners' case cannot be sustained. They cannot proceed on the basis that this was in truth a sale of properties. It was not: it was a sale of shares. And as a sale of shares they cannot proceed on the basis that the consideration for the shares was manifestly different from the commercial value of those shares.

233. We have read the stamp duty cases to which Mr Beal referred us, and we do not find that they are helpful to our reaching a decision in the circumstances of the present appeal.

234. We therefore decide Question 6 in favour of the Appellant.

Conclusion

235. The Appellant is not entitled to recover (by way of credit) the input tax it has paid on the supplies made to it by its professional advisers in relation to the sale of the PropCos. We dismiss the Appellant's appeal. To the extent that an apportionment is required to be made between exempt and other output supplies of the Appellant, that apportionment is to be made to give effect to our decision of Question 6.

Costs

236. The Appellant's notice of appeal was first lodged in October 2007 and, as mentioned, the appeal was stood over for a number of years pending the delivery by the CJEU of its judgment in the *AB SKF* case. These proceedings were therefore commenced in the VAT and Duties Tribunal. As such, the proceedings are within the scope of the special transitional provisions which apply to proceedings which were still current when this tribunal succeeded the VAT and Duties Tribunal on 1 April 2009.

237. Those transitional provisions, so far as relevant, are found in paragraph 7 of Schedule 3 to the Transfer of Tribunal Functions and Revenue and Customs Appeals Order 2009 ("the Transfer Order"). Paragraph 7(3) of Schedule 3 to the Transfer Order permits this tribunal to apply any provision in procedural rules which applied to the proceedings before 1 April 2009 where to do so ensures that proceedings are dealt with fairly and justly. In the present case the procedural rules which applied to these proceedings before 1 April 2009 were The Value Added Tax Tribunal Rules 1986 ("the VAT Tribunal Rules").

238. Paragraph 7(7) of Schedule 3 to the Transfer Order provides:

> An order for costs may only be made if, and to the extent that, an order could have been made before the commencement date [1 April 2009]

(on the assumption, in the case of costs actually incurred after that date, that they had been incurred before that date).

239. Rule 29 of the VAT Tribunal Rules provides, so far as relevant to the present case, as follows:

> (1)A tribunal may direct that a party or applicant shall pay to the other party to the appeal or application -
>
> (a) within such period as it may specify such sum as it may determine on account of the costs of such other party of and incidental to and consequent upon the appeal or application; or
>
> (b) the costs of such other party of and incidental to and consequent upon the appeal or application to be assessed by a taxing master of the Supreme Court or a district judge of the High Court of Justice in England and Wales by way of detailed assessment….

240. The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 which apply to these proceedings do not provide for this tribunal to make costs awards other than in special circumstances. In a case allocated to the Complex category a taxpayer has, in effect, the choice of bringing the proceedings within a costs regime or excluding them from a costs regime. Although the present appeal may well have been allocated to the Complex category of cases had the proceedings been commenced on or after 1 April 2009, it cannot be so allocated because the proceedings were commenced before that date and therefore under the VAT Tribunal Rules.

241. At the hearing the parties jointly applied to the tribunal to make a direction that Rule 29 of the VAT Tribunal Rules should apply to the proceedings in this appeal so as to give the tribunal the power to make a costs order within the terms of Rule 29.

242. Having regard to the wishes of the parties in this matter; to the fact that these proceedings were commenced well before the introduction of the changes to the costs regime on 1 April 2009 so that the parties, when embarking on the litigation, did so in anticipation that the tribunal would have the power to award costs; and to the likelihood that had the proceedings been commenced under the current procedure rules the case would have been allocated to the Complex category, we are satisfied that by making the direction for which the parties have applied we will ensure that the proceedings are dealt with fairly and justly.

243. We therefore direct, pursuant to paragraph 7(3) of Schedule 3 to the Transfer Order, that Rule 29 of the VAT Tribunal Rules shall apply to the proceedings in this appeal.

244. Accordingly the parties may apply to the tribunal for a costs award within the terms of Rule 29 of the VAT Tribunal Rules.

Right to apply for permission to appeal

245. 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.

EDWARD SADLER
TRIBUNAL JUDGE

RELEASE DATE: 3 September 2013

Authorities referred to in skeletons or included in authorities bundle and not referred to in the decision:

Staatssecretaris van Financien v Cooperatieve Aardappelenbewaarplaats (Case 154/80) GA [1981] ECR 445

Dial-a-Phone v CCE [2004] EWCA Civ 603

Banque Bruxelles Lambert (Case C-8/03) [2004] ECR I-10157

AGP (2001) Ltd v HMRC [2005] VATD 20020 (LON/05/276)

Mayflower Theatre Trust v HMRC [2006] EWCA Civ 116

WHA Ltd v HMRC [2007] EWCA Civ 278

*BLC Baumarkt*Case (C-511/10) [2012] ECR I-0000

Liverpool Institute for the Performing Arts v HMRC [2001] UKHL 28