TC03104

Appeal number: TC/2010/0691 & TC/2010/0686

VAT – SINGLE AND MULTIPLE SUPPLIES – Talacre – zero rating of new houses – appellant selling retirement flats with the benefit of the use of furnishing in common areas – whether zero rating of single supplies encompasses matters outside the express words of Group 5 Sch 8 VATA- meaning of premium in Note(14)

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) McCARTHY & STONE (DEVELOPMENTS) LIMITED **Appellants**
(2) MONARCH REALISATIONS NO1 PLC in administration

- and -

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

TRIBUNAL: JUDGE CHARLES HELLIER
SHEILA CHEESMAN

Sitting in public at Bedford Square WC1B 3DR on 25 and 26 September 2012

Andrew Hitchmough, counsel, instructed by Deloitte for the Appellant

Andrew MacNab, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the extent of the zero rating afforded to the sale by a builder of an interest in land. A central issue is the effect of the decision of the ECJ (as was, and as we shall continue to call, the Court of Justice of the European Communities) in *Talacre Beach Caravans Ltd v Customs & Excise Commissioners* C-251/05 [2006] STC 1671 in the context of the zero rating of the supply of new housing when the provision of accommodation is accompanied by the provision of the use of furniture.

2. The appeal arises in this way. Companies in the VAT group of the first appellant ("M& S") (the second appellant is the assignee of the first appellant's claim) built and sold retirement accommodation. It would build a set of separate apartments with communal areas such as a residents' lounge. It would furnish the communal areas. It granted new leases of the apartments to purchasers. By the leases it gave the purchasers the right to use the communal areas. Under the contract of sale a purchaser of an apartment paid: a premium for his or her lease together a sum of £500 (or £1000) "towards the communal fittings"; and under the lease agreed to pay rent, and to pay an annual service charge. The issue on this appeal is whether M & S can get credit for input VAT on its purchase of the furnishings for the communal areas. If M&S made a single zero rated supply is entitled to credit that VAT.

3. Although HMRC have a subsidiary argument to which we will come at the end of decision, their principal argument is this. They say that a single supply was made to the purchaser of an apartment. The nature of that supply was a supply of land and such a supply was generally exempt by schedule 9 VAT Act 1994 or its predecessors. They agree that if a supply is zero rated then the zero rating takes precedence over exemption and agree that what is now Schedule 8 VAT Act 1994 zero rates a supply of new residential accommodation, but say that this zero rating applies only to the extent of elements within that supply which fall within schedule 8 (because they say that even if the supply as a whole is properly described as being a single of residential accommodation, any part of that supply which does not fall within the express terms of Schedule 8 is not zero rated on the basis of the decision of the ECJ in *Talacre*). Having thus carved out a part of the single supply as being zero rated by Schedule 8 they say that the balance remains an exempt supply. That balance was the supply of the use of furniture. Accordingly the input VAT on that furniture is not recoverable since it was used in making an exempt supply (namely the single, otherwise exempt, supply of land).

4. M & S by contrast say that *Talacre* cannot be applied thus. They say that this was a single supply which fell as a whole within schedule 8 and was zero rated. They say that in the case of a composite supply, the effect of *Talacre* is that only those components of that supply which are expressly excluded by the domestic legislation are deprived of zero rating, and that there is no such exclusion in the domestic legislation.

5. The appeal relates to supplies made by M&S in the quarters ending January 1980 ("01/80") to 04/97, and 01/06 to 03/09. As we shall explain the detail of the relevant statutory provisions changed in the period encompassing those quarters.

6. The remainder of the decision has the following form. After setting out the factual and documentary background, we consider the history of the relevant domestic zero rating provisions. Then we turn to the development of the case law on when the supply of a package of items is to be treated as a single supply or multiple supplies. Next we discuss the ambit and consequences of *Talacre*. Here we address the parties' competing arguments and set out our conclusion on how *Talacre* applies. Then we consider the arguments on the interpretation and application of the UK provisions (construed in accordance with our conclusion as to the effect of *Talacre*) to the facts. Lastly we discuss HMRC's subsidiary argument.

The facts, the contractual documents and the nature of the agreements.

7. We heard no oral evidence. Among others the following facts were agreed between the parties:

(1) M & S constructed retirement developments comprising a number of self-contained one and two-bedroom apartments.

(2) The sale of each apartment to a purchaser was affected by the grant of a 125 year lease;

(3) furniture and other equipment was provided in the common areas for the use and enjoyment of the residents;

8. We were provided with examples of documentation for the sale of the flats which we understood to be representative of the relevant transactions. These included: a purchaser's information pack, a contract of sale (including Conditions of Sale), a lease and a Completion Statement.

9. The lease made no express provision for the furnishing of, or the use of furniture in, the common areas. It granted to the tenant rights of access in relation to parts retained by the seller, rights in relation to the passage of services to his or her apartment, and the right to use the community guestroom, the residents' lounge, and other common facilities. The use of the guestroom was subject to an additional charge. The landlord was obliged to provide services which included the maintenance of common parts (including the guestroom) and was given a discretion to vary the services it provided. No express mention was made in the lease for the provision or maintenance of the furniture in the common parts. The tenant was obliged to pay a service charge for the services the landlord was obliged to provide and any other services provided by the landlord for the general benefit of tenants. There was a provision for a contingency fund for capital repairs to be funded by a fee of 1% of the sale price of any subsequent sale of a flat.

10. The purchaser's information pack described the communal areas - the residents lounge, the guest suite, the laundry and the gardens: they were described as places where the residents were "free to enjoy the company of friends and family". We

conclude that any person acquiring a flat from M&S would have seen this pack or something similar.

11. The contract of sale required : the payment of a Price (in the example we saw of £233,950), the payment of £100 for documents, and a separate Capital Contribution of £500, explained in the purchaser's information pack and in the conditions of sale as a one-off charge for the initial provision of communal furniture and equipment. The contract of sale provided that the lease would be granted "at the Price ... in accordance with the Conditions of Sale". Those Conditions provided that on completion the buyer should pay the Capital Contribution "towards the capital cost of purchasing equipment and other items intended to be used in connection with the provision by the seller of communal services and furniture at the Development". There was also a requirement to pay amounts on account of ground rent and service charge for the then current year. The conditions of sale incorporated the Standard Conditions of Sale (Fourth Edition) which provide that the purchase price in the case of a lease is the premium to be paid on the grant of a new lease. The completion Statement described the Capital contribution (of £500 or £1000) as "Agreed sum for Communal Fixtures."

12. In our view the agreement between the Landlord and the tenant did not give the tenant any right of ownership in the furnishings. The conferring of such a right would have been inimical to the concept of common use. There was no conferring on the tenant of a right to dispose of them as owner. We concluded that in relation to the furnishings the only thing that could have been be provided to the tenant by the landlord on the acquisition of an apartment was the right to use that furniture and the right to require that the landlord maintain it.

13. Despite the absence of express provisions in the lease for the provision of furniture in areas such as the communal lounge, for the granting rights to use the furniture or for requiring the landlord to maintain it, we concluded that both landlord and tenant would, at the time of the contract have understood and intended that these areas were to be furnished and kept furnished, that the furnishings were to be maintained by the landlord, and that those furnishings were to be available to the tenant. The communal areas would have been of little benefit to the tenants without furniture. In our view the lease and the contract of sale are properly be read as imposing upon the landlord the obligation to provide and maintain the furnishings and granting the tenant the right to use them.

14. The effect of the Agreement for Sale was that the tenant would not obtain the Lease unless both the Price and the Capital Contribution were paid at completion.

The legislation and the case law.

15. For reasons which will become apparent later, the history of the legislation and of the UK Courts' approach to it (in particular the approach of the UK Courts to the question of whether there were single or multiple supplies before the decision of the ECJ in *Card Protection Plan v Customs and Excise Commissioners* ("CPP")) is in our view central to the determination of this appeal.

16. When VAT began in 1972 Group 8 of Schedule 4 Finance Act 1972 brought within the zero rate:

> "The granting by a person constructing a building of a major interest in, or in any part of, the building or its site."

17. This formulation, which zero rated all construction services, and not just the construction of housing, was preserved in Group 8 Schedule 5 of the VAT Act 1983.

18. In 1989 as a result of infraction proceedings brought by the European Commission (to which we shall return later) the scope of this zero rating was restricted to housing. The Finance Act 1989 limited the zero rating to:

> "1. The grant by a person constructing a building --
>
> (a) designed as a dwelling or a number of dwellings; or
>
> (b) intended for use solely for a relevant residential… purpose
>
> of a major interest in, or in any part of, the building or its site."

19. That Act also added a restriction in relation to leases to which we will return. That restriction is in the form of what is now Note (14) to Group 5 of Schedule 8 VATA 1994.

20. Group 5 of Schedule 8 VAT Act 1994 preserved the words of the amended Group 8 of Schedule 5 VAT Act 1993 and the restrictions of Note(14), adding only the word "first" in the opening line of Item1 so that it read: "The first grant ...".

21. Section 96 VATA 1994 provides that a "major interest in relation to land means the fee simple or a tenancy for a term certain exceeding 21 years, and in relation to Scotland means the interest of the owner, or the lessee's interest under a lease for a period of not less than 20 years". (A similar definition applied from 1972 (see section 5(6) FA 1972)).

22. The UK legislation must be seen against the background of the relevant European directives which imposed the requirement upon the UK to adopt a system of VAT. In 1972 the Second Directive (of 1967) applied. Article 17 of that Directive provided that member states might:

> "provide for reduced rates or even exemptions with refund, if appropriate, of the tax paid at the preceding stage [i.e. zero rating], where the total incidence of such measures does not exceed that of the reliefs supplied under the present system. Such measures may only be taken for clearly defined social reasons and for the benefit of the final consumer, and may not remain in force after the abolition of the imposition of tax on importation and the remission of tax on exportation in trade between member states."

23. In 1977 the Sixth Directive subsumed the Second. In its original form Article 28 (2) of the Sixth Directive provided:

"Reduced rates and exemptions with a refund of the tax paid at the preceding stage [zero rates] which are in force on 31 December 1975, and which satisfy the conditions stated in the last indent of article 17 of the Second Council Directive of 11 April 1967, may be maintained until a date which shall be fixed by the Council, acting unanimously on a proposal from the Commission, but which shall not be later than that on which the charging of tax on imports and the remission of tax on exports in trade between member states are abolished…..

"On the basis of a report from the Commission, the Council shall review the above-mentioned rates and exemptions every five years and, acting unanimously on a proposal from the Commission shall where appropriate, adopted the measures required to ensure the progressive abolition thereof."

This language was changed by Directive 92/97 of 19 October 1992 – see below

24. In 1981 the European Commission concluded that the scope of the zero rating provided for by Finance Act 1972 and its successor, the VAT Act 1983, was wider than permitted by the Directives (which limited the permitted zero rating to measures for social reasons for the benefit of the final consumer). It brought proceedings before the ECJ (*Commission v United Kingdom* [1990] 2 QB 130). In those proceedings the UK argued that the width of the exemption for construction was justified on social grounds and for the benefit of the final consumer. The ECJ held that:

"36. With regard to building intended for housing, the Commission's argument cannot be upheld. The measures adopted by the United Kingdom to implement its social policy in housing matters, that is to say facilitating house ownership for the whole population, fall within the purview of "social reasons" for the purpose of the last indent of article 17 of the Second Directive.

"37. By applying a zero rate to the activities comprised in group 8 with regard to housing constructed both by local authorities and by the private sector, the United Kingdom has not, therefore, contravened the last article indent of article 17 of the Second Directive.

"38. However the activities included in group 8 in relation to the construction of industrial and commercial buildings and to community and civil engineering works cannot be considered to be for the benefit of the final consumer."

25. In 1972 the form of Art 28(2) quoted above was replaced by Directive 92/77 and became:

" exemptions with refund of the tax paid at the preceding stage [zero rating] and reduced rates lower than the minimum rate laid down in article 12 (3) in respect of the reduced rates, which were in force on 1 January 1991 and which are in accordance with the Community law, and satisfy the conditions stated in the last indent of Article 17 of the second Council Directive of 11 April 1967, may be maintained ... "

The effect of this was to change the stand still date from 31 December 1975 to 1 January 1991.

Single and Multiple supplies.

26. In the years after 1972 the UK courts started to grapple with the question as to whether, when several things were provided by a trader at the same time, that should be treated as a single supply (with a rate of tax and a place of supply determined by the nature of that single supply) or instead as multiple supplies taxed separately.

27. The UK courts did this at first as a matter of domestic construction of domestic legislation without assistance from the ECJ. Thus in *British Railways Board v Customs & Excise Commissioners* 1977 FTC 221, the payment of £1.50 for a student Railcard was regarded as "a part payment in advance of the supply of transport by rail" and not as a supply a separate supply: liability depended upon "the legal effect of the transaction considered in relation to the words of the statute." And per Brown LJ: "the question is whether, on the true construction of the Finance Act 1972 as applied to the undisputed facts documents, this was a zero rated supply. That is a question of law."

28. In *Customs & Excise Commissioners v Automobile Association* [1974] STC 192 the Divisional Court held that a subscription to the AA was apportionable over the services received. And in *Customs & Excise Commissioners v Scott* 1978 STC 191 the Court of Appeal held that the provision to clients who were the owners of the mares and sent them to the taxpayer for the purpose of service was a single supply notwithstanding that as part of the same contract the trader undertook to keep the mare, to feed and look after it and to call the vet if required. Cumming-Bruce LJ said:

> "Asking a simple question: what did the taxpayer supply in consideration of money that he charged clients per week in respect of the mare in respect of the service that he provided? The answer, as a matter of common sense to my mind, is that what he supplied was the keep of the mare for a week with everything that was involved in order to maintain the mare in reasonable condition and safety for week on the farm ... I find it artificial to describe what the taxpayer was supplying as being a supply of a number of different things as compared to the supply of one service for a week, namely the service of keeping the mare. ... it may be that this is largely a matter of first impression"

29. Lord Widgery CJ agreed and said:

> "Otherwise I would only wish to repeat what I said in one of the earlier cases, and that is to hope that when answering Lord Denning MR's question in the future in this type of case people do approach the problem in substance and reality.... once one has got to the question posed, the answer should be supplied by a little common sense and concern for what is done in real life and not what is, as Cumming-Bruce LJ put it, too artificial to be recognised in any context."

30. In *British Airways plc v Customs & Excise Commissioners* [1990] STC 643 the question was whether the provision of in-flight catering provided on a flight for which a single price was paid was a supply of catering separate from the supply of air travel Lord Donaldson MR said:

" although the tribunal stated the right question, viz, 'was the supply of food and beverages incidental ["integral" might perhaps be a better word] to the air transportation?', this passage shows that it was in fact answering a different question, viz, "was the supply of food and beverages a necessary or essential adjunct the air transportation?", the answer to which is clearly that it was not. ...

The reality is that transportation by air can be of different classes or qualities. Air carriers can and do provide alternative services which give the passengers …The air passenger chooses from what is on offer and pays for, whichever degree of luxury he requires, but the choice is between grades of air transportation not between grades of transportation and separate grades of in-flight catering.

"This is to be contrasted with domestic rail travel, where …[t]he two do not go together. They are distinct and separate supplies…The answer to the question which we have to consider - was there one supply or two - may well be one of first impression, but for my part, despite the persuasiveness of counsel for the commissioners, it has proved a lasting and indeed indelible impression. There is a single supply and it is of air transportation."

31. And Stuart-Smith LJ said:

" The test, as both Lord Grantchester QC and Otton J recognised, is "in substance and reality is the in-flight catering an integral part of the transport?" ... catering facilities are part of or integral to the transportation in that degree of comfort which British Airways have decided is commercially appropriate and indeed necessary to attract passengers. "

32. We also note the comments of Parker LJ in the same case that the concept of two supplies would lead to a result which Balcombe LJ in the *CPP* case, *Card Protection Plan Ltd v Customs & Excise Commissioners* (in the Court of Appeal:[1994] STC) at 207 b called "bizarre", and was unlikely to have been intended by Parliament:

"The results to which I refer stem from the fact that the ticket price is the same whether the passenger is provided with nothing at all or with coffee and biscuits, or a continental breakfast or a main meal with drinks. In the result, the cost to the passenger for his flight, if the commissioners are right, will be at maximum when British Airways provides nothing and at a minimum when they provide most. I regard this as being quite absurd. The absurdity is increased by the fact that a business passenger would, on the commissioners' basis, be entitled to demand a tax invoice in respect of every drink, cup of coffee, or meal with which he was provided. Thus the passenger who received a meal valued at a £10 and drinks at £3 would pay £13 less for his transport than one who was provided with nothing and would in addition have the benefit of the input tax.."

33. Thus by 1999 and before the ECJ's judgement in *CPP* the following principles guided the Courts in construing the ambit of the zero rating provisions:

(1) Whether a supply was single or multiple was very much a question of impression;

(2) The answer required the application of common sense and the avoidance of artificiality;

(3) The test to be applied was: in substance and reality was A an integral part of, or incidental to, B

(4) Parliament should be taken not to have intended an absurd result.

34. It seems to us that the nature of the UK legislation before CPP, reinforces a conclusion that that legislation should be construed, not with the CPP principles in mind, but the on domestic approach we have outlined. Thus the terms of the note to the group zero rating the supply of static caravans (group 11 schedule 5 VAT Act 1983) said that "This group does not include ... removable contents". That drafting presupposed that such contents were not part of the supply of a caravan and could not be: it was therefore on the basis that the CPP principles did not apply. Likewise Group 8 VAT Act 1983 and its predecessors contained three items. The second was the supply in the course of construction of a building of any services. The third was "the supply by persons supplying services with item 2 and in connection with the services, of materials or builders' hardware or other articles of a kind ordinarily installed by builders". It seems to us that if builders provided a building service that service would under CPP principles almost always include the materials he supplied in connection with the supply of services. Thus in a post-CPP world item 3 appears otiose. But it seems to us that that was not how it appeared to Parliament in 1972. Mr Hitchmough suggested that item 3 of Group 8 was included by the draftsman out of an abundance of caution, but its words suggest to us that the legislature approached the nature of the tax in a manner not wholly aligned to the CPP principles

35. But it was not long before the issue of single and multiple supplies was understood to be a question of European law - because the uniform application of VAT across the Community required a uniform understanding of whether there was one supply or many. In a *Faaborg Linien v Finanzamt* [1996] STC 774 the ECJ indicated that the provision of a restaurant meal was characterised by a cluster of features and acts which must be regarded as a (single) supply of services. There were similar indications in *Customs & Excise Commissioners v Madgett and Baldwin* [1998] STC 1189.

36. Then came the Card Protection Plan case ("CPP"). This concerned the provision of a package of some 15 individual constituent parts (the "15 points") some of which gave insurance cover against the loss of a credit card.

37. In that case the Court of Appeal, having recourse only to domestic precedents and methods of construction, concluded that there was a single supply of convenience services. Balcombe LJ, having quoted Parker LJ in British Airways in the passage set out at [XX] above, and noted the bizarre result his approach avoided, said at 207:

> "The case is different where the contract is a big commercial contract clearly involving the provision of goods and services of various kinds ... I would

therefore be very reluctant to be forced to reach the conclusion to which Popplewell J came: that there are here two supplies for which the consideration must be apportioned, with VAT chargeable on one part and not on the other.

"Accordingly I approach this case on the basis that the 15 points contain elements of both "convenience" ... and insurance ... and the primary question to ask is whether the supply of insurance is incidental to, or an integral part of, the supply of convenience or vice versa.

".I have come to the ... conclusion that this is a contract for the supply of a card registration service -- what the judge termed a supply of services of convenience -- and that the insurance elements are incidental to that primary element.

It was thus a supply of "convenience services" on the basis of the "incidental" or integral test.

38. Sir John McGraw, at 209f, said:

"Special difficulties arise, in the mystic twilight of the VAT legislation, where there is what in modern jargon is called 'a package' of services, some of which may, and others of which may not, be within a VAT exemption. Of the 15 points ... .2 and 3 are insurance services ... .1, 4, 5, 6, 7, 13, and 14 are not the subject matter of any insurance cover in the insurance policy as issued. Some of them have an indirect bearing on insurance cover: for example services registration of credit cards in point 1 coupled with the obligation of CPP under point 4 to notify the card issuers of the loss of registered cards, may well have a bearing on the willingness of the insurer to issue a policy and may affect the amount of premium. But that is not enough to bring these points within the category of insurance services for the purposes of entitlement to exemption. Other points contain an element of insurance but this is included amongst other services (and goods) supplied under the second point.

"Looking at the "package" as a whole -- or, to use the word used in some of the authorities, the "totality" -- I agree with Balcombe LJ that it would be wrong to treat the whole, or the totality, as being an arrangement, or arrangements, for the supply of insurance services. Can the package, then, as a matter of principle can be divided into two parts: one being insurance supply including points 2 and 3 and some proportion (how estimated, I know not) or some other of some of the other points; and the other being the VAT rated supply company to include the remainder of the package? I think that as a matter of principle it would, at best, be rare that such a division be required where, as here, payment for the whole of the supply is given in the package is one single, undivided, sum. It would, indeed, been impossible task, on any other basis that a guess made without any reason for confidence that it would represent a fair practical answer."

39. Thus immediately before the House of Lords heard the appeal, the Courts were applying the principles described at [33] above, with the same emphasis on the practicality of division and absence of a principle/ancillary test.

40. The House of Lords referred to the ECJ the question of what was the proper test to apply in deciding whether a transaction consisted of a single composite supply or

two or more independent supplies. On the basis of the answer obtained to that question it later held that there was a dominant supply of insurance services to which the other supplies were ancillary: it was thus taxed as a supply of insurance. The difference between the decision of the Court of Appeal and the eventual decision of the House of Lords marks to our mind the difference of approach which came with CPP.

41. The kernel of the ECJ's response to the question posed by the House of Lords was in paragraphs 28 to 31 of its judgement:

> "28. However, the Court held in [Faaborg] concerning the classification of restaurant transactions, where the transaction in question comprises a bundle of features and acts, regard must first be had to all the circumstances in which that transaction takes place.
>
> "29. In this respect, taking into account, first, that it follows from art 2(1) of the Sixth Directive that every supply of a service must normally be regarded as distinct and independent and, second, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of transaction must be ascertained in order to determine whether the taxable person is supplying the consumer, being a typical consumer, with several distinct principal services or with a single service.
>
> "30. There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as anciliary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplier ...
>
> "31. In these circumstances, the fact that a single price is charged is not decisive. Admittedly, if the service provided to customers consists of several elements for a single price, the single price may suggest there is a single service. ..."

42. In later cases and in *Levob Verzekeringen BV and OV Bank NV v Staatccesretaris von Financien* C 41/04 [2006] STC 766 the ECJ made clear (as anticipated by the House of Lords in *College of Estate Management* (and by Laws LJ in *FDR*)) that "in particular" in paragraph 30 of its judgment in CPP meant what it said, so that:

> "22. The same is true where two or more elements or acts supplied by the taxable person to the customer, being a typical customer, are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split."

43. These principles (we shall call them the CPP principles) have since been applied in many domestic cases (see eg *Kimberley-Clark c C&E Comms* [2004] STC 472, and *David Baxendale, Salon 24, and Purple Parking*, cited below).

44. There was no dispute before us as to the nature of the principles now to be applied in determining whether M&S made a single supply. Neither was there any dispute as to the application of those principles in the present appeal. The formulation of the reasons why M&S made (on the application of those principles) a single supply were set out in paragraph 28 of Mr. MacNab's skeleton argument with which Mr Hitchmough thoroughly agreed:

> "In HMRC's primary submission, the equipment supply is ancillary to the lease. From a prospective tenant's point of view M&S's developments would be less attractive were M&S not to provide decorations, furniture and equipment in communal areas. The main selling point of the apartments within developments is that they are attractive and comfortable places for retired persons to live in the company of others with the minimum of fuss. Having regard to the objective features of the transaction, the "typical consumers," who purchase an apartment do so in order to keep some independence in their own apartment, while having the possibility of socialising with others in the communal areas and having someone else take care of the provision of decorations, furniture and equipment in those communal areas. In this case the relevant "typical customers" positively want a "package" of the leasehold of the flat together with the relevant equipment, as they do not want to be responsible for organising the sourcing of that equipment themselves."

45. We agree that under CPP principles what was supplied was a single supply of the lease to which the other features were ancillary, being, for a typical customer, a way of better enjoying the principle service.

46. But this is not the end of the story.

Talacre

47. *Talacre* related to the supply of caravans and their removable contents. The relevant group of the UK's zero rating schedule provided for the zero rating of the supply of a static caravan but said that this did not include its removable contents. The ECJ held, having regard to the fact that the UK legislation excluded (or did not include) removable contents from the zero rating permitted by the derogation in Art 28(2), that even if the supply of a caravan and its removable contents were a single supply on a proper application of the CPP principles, that supply should be zero rated only to the extent of that part of it which was the supply of the caravan.

48. Most of the argument before us revolved around this case and we shall consider it in some detail. But the essence of HMRC's case is that *Talacre* applies to the zero rate in group 5 of schedule 8, and that M&S' supply of the use of the furniture in the common parts is not covered by that zero rating.

49. The question referred to the ECJ was this

> "Where a member state has, pursuant to article 28 (2) (a) of the Sixth Directive, by its domestic legislation exercised its right to derogation so as to zero rate a supply of specified goods but in the same legislation has identified items that

should not be included in the scope of zero rating ("excluded items"), does the fact that there is a single supply of goods (together with the excluded items) preclude the Member State from charging VAT at the standard rate on the supply of the excluded items?"

50. Mr. Hitchmough notes the nature of this question. The ECJ is told that in its domestic legislation in the UK "has identified items that should not be included in the scope of the zero rating". The ECJ's judgement is therefore on the basis of an interpretation of the domestic legislation which accepts that the UK had excluded certain items. Mr. Hitchmough puts the point more highly. He said that this case was in the context of a specific exclusion and the Court's reasoning is dependent upon the existence of such an exclusion in the domestic legislation.

51. Talacre had submitted to the ECJ that the Court's case law on single and multiple supplies showed that the CPP principles trumped provisions requiring a particular rate to be applied to a component of a single supply. It relied on cases such as *Skatteministeriet v Henriksen* [1990] STC 768. That case related to article 13B(b) of the Directive which specifically exempted land but "excluding the letting of premises and sites for parking vehicles". In that case the ECJ had held that where the letting of parking sites was closely linked to the letting of land for another exempt use "so that the two lettings constitute a single economic transaction" the exemption applied to the whole transaction despite the express words of exclusion in the directive. In *Talacre* the ECJ said at paragraph 24 that that case law "does not relate to [zero rating) with which article 28 ... is concerned": in other words although the CPP principles trumped the exclusions in the scheme of the Directive, they did not trump provisions pursuant to derogations from that scheme.

52. In paragraph 17 and 18 of its judgement the court explained that article 28 was a derogation and applied only where zero rating had been in force on 1 January 1991 and had been established with clearly defined social reasons and for the benefit of the final consumer. It then said:

> "19. In the present case, it is not disputed that in so far as the VAT Act exempts, with refund of the tax paid, caravans of the kind supplied by Talacre, those conditions are fulfilled. Specifically it is acknowledged that the zero rate was in force on one January 1991 and that it was established for social reasons.
>
> "20. It is also common ground that the VAT Act specifically excludes some items supplied with the caravans from [zer rating]. It follows that, so far as those items are concerned, the conditions laid down in article 28(2)(a) of the Sixth Directive, in particular the condition that only exemptions in force on 1 January 1991 can be maintained, are not fulfilled.
>
> "21. Therefore, an exemption with refund of the tax paid in respect of those amounts would extend the scope of the exemption laid down for the supply of the caravans themselves. That would mean that items specifically excluded from the exemption by the national legislation would be exempted nevertheless pursuant to article 28(2)(a) of the Sixth Directive."

53. Mr. Hitchmough fastened on the words "it follows that" in para 20 and "therefore" at the beginning of para 21 as indicating that the court's conclusion followed from the specific exclusion of the removable contents of the caravan in the National legislation. The court's reasoning he said was only in the context of a specific exclusion in domestic legislation and there was no such specific exclusion in the provisions of what is now Schedule 5 Group 8.

54. Mr. MacNab says these passages simply set the scene. The court he says is simply indicating and explaining the extent of the derogation expressly provided for by the UK legislation in 1991.

55. The court continued:

> "22. Clearly, such an interpretation of article 28(2)(b) of the Sixth Directive would run counter to that provision's wording and purpose, according to which the scope of the derogation laid down by the provision is restricted to what was expressly covered by the national legislation on 1 January 1991. As the Advocate General observed paragraphs 15 and 16 of her opinion, article 28 (2) (a) of the Sixth Directive can be compared to a "stand-still" clause, intended to prevent social hardship likely to follow from the abolition of exemptions provided for by the national legislature but not included in the Sixth Directive. Having regard to that purpose, the content of the national legislation in force on 1 January 1991 is decisive in ascertaining the scope of the supplies in respect of which the Sixth Directive allows an exemption to be maintained for the transitional period.

56. In the paragraphs of the Advocate General's opinion here approved by the ECJ she had said this:

> "15. Article 28(2)(a) of the Sixth Directive authorises the member states to maintain, as a transitional measure, exemptions which were in force on 1 January 1991. The directive thereby refers to the relevant national rules. The form of these rules therefore determines which supplies are exempt from VAT. According to the relevant rules of the United Kingdom, the caravan itself is taxed at a zero rate but not its removable contents.
>
> "16. This determination under national law should, in principle, be strictly observed, and according to the clear wording of article 28(2)(a) of the Sixth Directive, not be extended, ... this is because article 28(2)(a) of the Sixth Directive is a kind of stand-still clause. The provision was already contained in the original version of the directive and at that time permitted the maintenance, on a transitional basis, of exemptions existing on 31 December 1975. It is intended to prevent the immediate abolition of exemptions not included in the directive from leading to social hardship."

57. Mr. Hitchmough says that the reasoning paragraph 22 of the court's decision is that "such an interpretation" is one which will bring the specific exclusions within the direction within the derogation; paragraphs of 15 and 16 of the advocate general's

opinion show the court's deference to the form of the exclusion taken by the national legislature. It is to that specific exclusion to which the court is giving effect.

58. Mr. MacNab says that the reasoning is not dependent upon a specific exclusion. The test is that described in paragraph 22: the derogation is restricted to what is "expressly covered by the national legislation".

59. In paragraph 23 the ECJ also prays aid the strict construction of exemptions on general principles. It says:

> "…For that reason as well, [the zero rate] referred to in article 28(2)(a) of the Sixth Directive cannot cover items which were, as at 1 January 1991 excluded from such an exemption by the national legislature."

60. Mr. Hitchmough says that this could only be a contributing factor to the court's decision. Strict construction of an exemption would not be enough on its own to lead to exclusion from the zero rate. Strict construction of the insurance exemption did not lead the ECJ to bifurcate a single supply in CPP itself. The passage, in relying upon the specific exclusion, again shows the reasoning of the ECJ. Mr. MacNab says that this passage indicates that an even stricter construction is to be applied to derogations than to a exemptions because the derogation lies outside the harmonised system; that is all.

61. The court continued:

> "24. The fact that the supply of the caravan and of its contents may be characterised as a single supply does not affect that conclusion. The case law on the taxation of single supplies, relied upon by Talacre and referred to in paragraph 15 of this judgement [the *Henriksen* cases], does not relate to the exemptions with refund of the tax paid with which article 28 of the Sixth Directive is concerned. While it follows, admittedly from the case law, that a single supply is, as a general rule, subject to a single rate of VAT, the case law does not preclude some elements of that supply from being taxed separately where only such taxation complies with the conditions imposed by article 28(2)(a) of the Sixth Directive on the application of [zero rating].
>
> "25. In this connection, as the Advocate General rightly pointed out in paragraphs 38 to 40 of her opinion referring to paragraph 27 of CPP ... there is no set rule for determining the scope of a supply from the VAT point of view and therefore all the circumstances, including the specific legal framework must be taken into account. In the light of the wording and objectives of article 28(2)(a)of the Sixth Directive, recalled above, a national exemption authorised under this article can be applied only if it was in force on 1 January 1991 and is necessary, in the opinion of the member state concerned, for social reasons and for the benefit of the final consumer. In the present case, the United Kingdom ... has determined that the only the supply of the caravans themselves should be subject to the zero rate. It did not consider that it was justified to apply the rate also to the supply of the contents of those caravans."

62. In this passage the court is clear that the CPP principles are trumped by a requirement to restrict the derogation in article 28. It is clear that the aim of limiting the derogation (as Mr. MacNab says, an aim applied more strictly than for an exemption) trumps the CPP principles.

63. In summary Mr Hitchmough says that these passages show that the court's reasoning is limited to the situation in which there is a specific exclusion in national legislation; and MacNab says that the reasoning shows that a specific exclusion is a sufficient condition for the bifurcation supply but not a necessary one. He says that the necessary condition is that the supplies are not expressly included in the derogating measure.

64. Mr. McNab says that the exclusion of removable contents from the domestic zero rating of caravans was a specific circumstance of Talacre that was not decisive in its reasoning. The basis of the judgement in *Talacre* was only on the basis that (1) national law at 1 January 1991 was decisive in determining the extent of the zero rating provision, and (2) the zero rating provision as a derogation had to be construed strictly. The question is whether the equipment falls within the express zero rating provided for at 1 January 1991.

Talacre -Discussion and conclusions

65. It seems to us that the reasoning of ECJ is not dependent upon a specific exclusion in the domestic legislation nor what was only expressly included in it, but hinges on what was intended to be encompassed in the domestic legislation so far is apparent from the legislation. The Advocate General said that "the form of the [domestic] rules determines which supplies are exempt from VAT" and added that that determination should be strictly observed. At paragraph 21 she noted that there are non-harmonised concessions that these non-harmonised concessions "depend on political decisions by member states" and at paragraph 25 that "the intensity of the court's examination [of them] is restricted" as a result. These phrases look at the intention of the national legislature as expressed in legislation, not the words of the legislation. At paragraph 38 she says "in determining the scope of a supply all circumstances must be taken into account, including the specific legal framework [and] it is necessary to have regard to the particularity that the UK has established exemption in a particular way in accordance with its socio political evaluation." That again points to reasoning which depends, not on the specific semantic form of a national measure, but on the intention of the state expressed in the measures it enacted.

66. The ECJ reflects this in paragraph 25: the "specific legal framework" - not the specific words – "must be taken into account"; and the determination of the UK "that only the supply of the caravans themselves should be subject to the zero rate" determines what was in force in 1991. The final words of paragraph 25 look again to the UK's intention: "[the UK] did not consider that it was justified to apply that rate also to the supply of the contents ...".

67. The task we have to address therefore is what was "the content of the national legislation in force on 1 January 1991" (see judgement [22])? This appeal however encompasses VAT periods before 1991, namely those from 01/80 to 01/91 as well as those after 1 January 1981. However in our view the change in the provisions of Article 28(2) by directive 92/77 (see para 25 above) does not affect the reasoning of the ECJ: the difference is in the relevant date from which the standstill applies: until 92/97 it was 31 December 1975, thereafter it was 1 January 1991. We address below therefore in relation to each relevant time what was the purpose and effect of the zero rating provisions at that time.

Construing the domestic legislation without reference to CPP

68. During the hearing we asked whether there was an element of circularity which could be inherent in this process: (1) we had to consider the extent of the zero rating; (2) EU law in relation to what constitutes a single supply is part of domestic law; (3) the CPP principles therefore apply in considering UK legislation; (4) under those principles a single supply of land would be treated only as such; (5) is therefore "the content of the national legislation" to be seen through CPP principles; and (6) if there is under those principles a single supply there is no room to say that the purpose and meaning of the domestic legislation is to bifurcate that supply.

69. It seems to us how however that this knot is cut by Talacre. What is required is an understanding of what in 1991 would have been understood at that time to be the purpose and effect of the domestic provision. That is because (1) otherwise the premise (the exclusion of certain supplies from zero rating) of the Talacre decision would be wrong; (2) the emphasis of that decision (and the decision on in the infraction proceedings) is on the policy of the state which is given voice in the domestic legislation and that legislation can only be taken to be in interpreted in accordance with the principles used by domestic courts at the time that legislation was adopted.

70. Accordingly it seems to us that in construing the UK's zero rating provisions we need to approach them as a UK court would have done before the decision of the ECJ in CPP. It is for that reason that earlier in this decision we have dealt at greater length with the decisions of the UK courts in relation to single and multiple supplies before CPP.

71. The application of *Talacre* to tax what would otherwise have been a zero rated single supply by reference to some of its elements has been considered by the tribunals in three cases although in two its comments were obitur.

72. The first was *David BaxendaleLtd v HMRC* VAT Decision 20757, and ChD [2009] STC 818, and CA [2009]STC 2578. There the tribunal asked, in the context of the hypothetical question whether a single composite supply of food might be split on *Talacre* lines, whether it mattered that there were no specific exclusions in the domestic schedule which exempted from “food”, services ancillary to, or indisociable from the food supplied with them. The tribunal suggested that if the zero rating for caravans in group 8 had said "the shell of Caravan and all things afixed thereto" it

would have had the same effect as it did when it said "Caravans" with a note that this did not include their removable contents; and that if the zero rating provisions had said “dogs”, that necessarily excluded cats.

73. Mr. Hitchmough criticised the tribunal's reasoning in this case. He said that the contrast between dogs and cats did not help where one supply was anciliary to another, and that the issue is whether Talacre means that an anciliary item can never be part of a zero rated supply, or whether it means that an anciliary item is to be part of the zero rated supply unless specifically exempted - so that the general CPP rule applies unless there is a particular exclusion.

74. In the High Court in *Baxendale* neither party supported the tribunal’s approach. Morgan J said:

> "It seems to me that such an approach is not required by the decision of the ECJ in Talacre and is not appropriate see also International Masters Publishers Ltd v Revenue & Customs Commissioners [2007] STC 153 at [14] commenting on Talacre.”

75. In the passage referred to Arden LJ had said:

> "The Court of Justice held, although there was a single supply of the caravan and contents, the consideration that is for the supply could be apportioned between the contents of the shell and VAT levied on the consideration for the contents. In my judgement this case demonstrates that, as the law on multiple supplies is derived from the jurisprudence of the Court Justice, and not from any specific provision of the Sixth VAT directive, it is open to the Court of Justice to develop and refine its jurisprudence as it thinks appropriate in the light of the principles and purposes of that Directive in new situations which come before it."

76. Neither Mr. McNab nor Mr. Hitchmough offered an explanation as to how Arden LJ's comments supported Morgan J’s conclusion. However Morgan J’s conclusion was, like that of the tribunal, obitur because he had concluded that there was a single supply of standard rated services rather than the zero rated supply of which could possibly be split on *Talacre* lines. In the light of that decision no issue arose as to whether what would otherwise be a single zero rated supply of food could be split. Given that conclusion it was unsurprising that he found the *Talacre* question inappropriate.

77. The second case was *Purple Parking* [2009] SSTD 444. In that case the issue was whether there was one supply of long-term airport parking or separate supplies of parking and bus transport to the airport terminal. The tribunal held that there was a single composite supply in which parking was dominant. The FTT commented on a third analysis in paragraph 37 of its decision. That analysis was that there was a single supply of transport and that *Talacre* might then apply to require it to be divided:

> "... counsel for the Appellants might have suggested that there was only one supply and that was of transport. Counsel for the Appellants did not particularly

advance this case, and we indicated that we thought that it would not have been promising to do so. Counsel also pointed out correctly that even if that case had been advanced, and indeed accepted, the outcome would still have been that there should be dissected from, and removed from, the reserved category of zero rated service, the parking element. This was because under the decision in Talacre Beach, the reserved category of zero rated services should be construed strictly, and not extended, even within something that ranked as one the single supply, beyond the element of that supply that was properly zero rated. We consider that this assumption is correct even though, in the Talacre Beach case, the excluded element was something that was very specifically excluded from the zero rated category, rather than an element that, viewed on its own would be standard rated, such as parking."

78. We would have reached the same conclusion as the tribunal in that case. The provisions of item 4 group 8 schedule 8 (transport) are:

> "4. Transport of passengers --
>
> (a) in any vehicle ship or aircraft designed or adapted to carry not less than 10 passengers;
>
> (b) by a universal service provider;
>
> (c) on a scheduled flight; or
>
> (d) from a place within to a place outside the UK or vice versa ...".

79. It seems to us that as a matter of domestic construction the provision of the supply of long-term airport parking (which the tribunal found was clearly the dominant element of the service provided in that appeal) could not be considered to be part of a supply of transport on the basis of the law in 1991. If the supply of parking had been a minor incidental benefit of a supply transport the position might have been different. But it was not. [That may also reflect the earlier decision of the tribunal in 1985*: Courtlands Car Services Ltd v C & E Commissioners* 1985 VAT TR1 1778].

80. The third case was *Harrier LLC v Revenue and Customs Commissioners* [2011] UK FTT 725. In this case the tribunal concluded that items supplied by Harrier which included the incorporation of images chosen or provided by the customer into a particular form of a photobook was a single supply of goods, namely of books. That supply was claimed to be zero rated by item 1 group 3 schedule 8 VAT Act 1994. HMRC argued that *Talacre* required the zero rating provisions to be construed strictly and some of the services provided by Harrier should be treated as falling outside the zero rating. The tribunal said:

> "42. In *Talacre Beach* the taxpayer was relying on the terms of the principles, those regarding single supplies, of the Sixth Directive. In this case we are not concerned with the construction of the terms of what is now the Principal VAT Directive, but with the meaning of the domestic legislation which is permitted under the terms of the derogation. It is right for the exemptions ... in the Directive fall to be construed strictly ... but what we are concerned with here is the construction of the UK domestic provision, which will fall to be construed

in accordance with ordinary principles of statutory construction. Nor is this case concerned with any items that are specifically excluded from the zero rating treatment."

81. In paragraph 43 the tribunal went on to say that if it concluded that the UK domestic legislation went too far, i.e. went beyond the derogation permitted by the directive, that would not assist HMRC because the taxpayer could place reliance upon the domestic registration. That of course it is subject to the duty to construe domestic legislation enacting a Directive consistently with community law so far as such a construction goes with the grain of the domestic legislation. The tribunal continued:

> "Nor can the domestic provisions be construed so as to reflect only the circumstances applicable at the relevant date of 1 January 1991 ... technological advances in printing may mean that products which in 1991 would not have been conceived of are now a reality and fall to be classified for VAT purposes. If the construction of the domestic provisions encompasses those new products they will fall to be zero rated…"

82. The tribunal then went on to consider the domestic authorities on the meaning of book or booklet for the purposes of item 1 and to conclude that the photo book was a book.

83. We would have come to the same conclusion as the tribunal in *Harrier*. The relevant question in our view is whether the domestic zero rating of "Books, booklets, brochures, pamphlets and leaflets" would, when enacted, have been considered to cover all the elements of the supply of the photobooks. In our view it would. As a result of the answer to the question of what the domestic legislation zero rated in 1991 would be such that the photobooks fell within it and so would be zero rated post *Talacre*.

84. For completeness we should say that we reject the suggestion that *Talacre* requires *any* ancillary element of a composite otherwise zero rated supply to be dissected and taxed separately. Were that the case the jar in which honey comes, the plastic wrapper of a pack of biscuits, or the bag for potatoes should all be separately taxed. Our conclusion is that recourse must be had to what would have been treated as part of the zero rated supply on a domestic construction of the relevant provision without regard to the CPP principles. On that basis we believe that all these examples would have been wholly zero rated.

The Domestic legislation

85. In addressing this question the assessments under appeal break down into three periods: (1) 1980 – 1989, when the domestic legislation was not limited to relief for residential construction, and Art 28(2) of the Directive was in the form which related to provisions in force on 31 December 1975; (2) 1989 – 1990, when the domestic legislation was in the form restricting the relief to housing, and Art 28(2) of the Directive grandfathered provisions in force on 31 December 1975, and (3) 1991 –

2009 when the domestic legislation was of the limited housing form and Art 28(2) grandfathered provisions in force on 1 January 1991.

86. It seems to us that the second two periods can be dealt with together. That is because the question in each of them is, what did the domestic legislation (which was the same in both periods) zero rate? Given that the 1989 legislation did not extend zero rating but reduced its ambit, what was eligible to be zero rated after 1989 was a subset of what was zero rated on 31 December 1975 and thus the 1989 zero rating may be taken to have been "in force" for the purposes of Art 28(2) at that date; and what was zero rated by the 1989 legislation was clearly in force when Art 28(2) was replaced. Thus for each period the question is the same: what was the scope of the zero rating provided for by the 1989 legislation?

(1) 1980 -- 1989.

87. Article 28 (2) of the Second Directive applied to national provisions in effect on 31 December 1975 which satisfy the article 17 conditions. The very broad zero rating provisions in relation to construction services in the Finance Act 1972 were in force on that date (and were "in force" in the UK even if in part if they did not satisfy the conditions of article 17 of the second directive). It seems to us that the effect of the judgement of the ECJ in Commission v UK is that to the extent such provisions were satisfied the condition in article 17 they are to be treated as satisfying Art 28.. In other words the over extensiveness of the provisions did not make them ineligible for the purposes of article 28(2) .

88. Bearing the principles set out in [33] above in mind, we consider the UK legislation in force before 1989. It seems to us that the matters which were intended by that legislation to be zero rated were not limited solely to the delivery of a major interest in land:

> (i) the grant of an easement of access across retained land as part of the sale of a freehold, or the grant by a lease of rights to use, common parts of a block of flats in the grant of a lease were in our view capable of being found to be incidental to or integral with the conveyance of the major interest, and would be absurd or nonsensical to divide from it;
>
> (ii) the provision of a key to the door of a dwelling would clearly fall within the provisions. That would be incidental to or integral with the supply of the land, would contribute only a minor part of what was sold, and would be absurd to divide from it.

89. The supply of the right to use furniture in common parts seems to us to be at least as incidental to the supply of the flat as the supply of the right to use the common parts themselves. Even if separate charges were made which might be said to relate to the use of furniture, it is our clear impression that the right to use of the furniture was incidental to, or integral with, the right to the land obtained by a purchaser.

(2) 1989- 2009.

90. In this period the restricted form of the UK provision was in force. Its particular words were not in force on 31 December 1975, but it is clear that the 1989 provision was a subset of the 1972 zero rating. That provision included what is now Note (14):

> "(14). Where the major interest referred to in item 1 is a tenancy or lease -
>
> (a) if a premium is payable, the grant falls within that item only to the extent that it is made for consideration in the form of the premium; and
>
> (b) if a premium is not payable, the grant falls within that item only to the extent that it is made for consideration in the form of the first payment of rent due under the tenancy or lease."

91. Mr. McNab says that in this appeal the leases were granted for a premium. Thus note (14) has the effect of reducing the scope of the zero rating to that part of the supply which was in consideration for that premium. The supply is zero rated "only to the extent of the premium". This is an express exclusion of part of the supply. This restriction in the scope of zero rating was in force in 1991 and is thus required by Talacre to trump any zero rating which might otherwise be applied to any single composite supply made by M & S to its tenant.

92. In this context he says that the "premium" given for the lease of an apartment was the Price described as such in the contract and did not include the £500 Capital Contribution towards the furnishings. He says that "premium" can only be the amount identified by the purchaser as paid for the grant of the lease, not something paid in addition to the price.

93. He says that "premium" should have its ordinary meaning. That meaning is shown by the way it is used in the National Conditions of Sale (see para [11] above). In this case the price paid was the £233,950, not that amount plus the £500.

94. Mr. McNab says that the task of the tribunal is to classify the actions whose identification follows from an examination of the contract (see *A1 Lofts v Revenue & Customs Commissioners* [2010] STC 214). In this case the amount paid for the lease (£233,950 in our example) is clear, and the £500 is paid for something else. The parties to the lease agreed that the equipment charge was not part of the premium for the lease. That was the real deal. "Premium" in Note (14) had its normal conveyancing meaning - the price paid for the lease. That was £233,950, not that some plus £500. Thus the zero rating extended only to the extent of the £233,950.

95. Mr. Hitchmough says that the Capital Contribution (the equipment charge) was a contribution towards the cost of purchasing the equipment which the landlord was to provide, and not a separate charge for the use or maintenance of that equipment. The tenant could not have obtained the lease without paying it.

96. He says that the labels at the parties attached to a payment in the documentation cannot be determinative of their proper description for tax purposes. "Premium" must be given the meaning the context requires.

97. Before 1989 regulation 19 of the 1985 VAT regulations provided that the supply occasioned by the grant of a lease:

> "shall be treated as taking place when each payment is received, or a tax invoice ... is issued ... [if] earlier."

98. In 1989 this was amended at the same time as Note (14) was introduced. The new regulation 19 provided that supplies should be:

> "treated as separately and successively supplied on the earlier of the following times:
>
> (a) when a part of the consideration was received,
>
> (b) whenever the supplier issues a tax invoice."

99. This, Mr. Hitchmough says, puts Note (14) in context. Prior to 1989 there was a single continuous zero rated supply; after that date there were separate supplies and only the first was to be zero rated. The object of Note (14) was simply to limit the zero rating to the first payment, not to restrict the nature of the zero rated supply to only part of the congery of items making up the single supply. Seen in that light "premium" in Note(14) was not to be identified as the sum the parties described as a premium or the sum attributable to the land element in the transaction, but meant the first payment.

100. Mr. MacNab says that the object of Note(14) was to restrict the zero rating to the construction of buildings so as to exclude the provision of services after construction had finished (with the consequent limitation in some cases of the input VAT creditable) . The object was to set a tax point at which input tax exclusively applicable to the construction and grant could be recovered, so that thereafter input tax (relating for example to services provided by the landlord) would not be recoverable.

101. Mr Hitchmough says that if Mr MacNab is right then there would be a difference between the sale by a builder of a residential leasehold and a freehold: the latter would be wholly zero rated and the former only partially so if any of the consideration for the supply could not be described as “premium”: thus for example the £100 documentary charge would fall within the zero rate for a freehold but not a leasehold. Mr MacNab says that such a difference would arise because of the way the deal is structured, but it seems to us that if a freehold sale were structured in this way Mr MacNab’s argument would still occasion a difference between the taxation of a leasehold and the freehold sale.

Discussion

102. We accept that the words "only to the extent that" in note (14) restrict the scope of the zero rating and that the ambit of the domestic legislation was reduced by the enactment of this note.

103. Paragraph (b) of Note (14) deals with the situation in which only a rent is payable. But the word "rent" seems to us to be an apt and normal description for: a periodic payment for the use of an asset, periodic payments under a lease for less than 21 years or periodic consideration for an easement. If that is the case then on Mr MacNab's approach the situation would differ according to whether a premium or a rental was paid for a composite supply: for if a rent was paid the whole of the supply to the extent of the rent would be zero rated, but if a premium only that attributable to the grant of the land interest. That indicates to us that "premium" may not have the restricted meaning for which Mr. MacNab contends.

104. On the other hand if Note (14) had simply been intended to zero rate only the first payment of consideration made under or for lease, why did the draughtsman take the trouble of distinguishing between premium and rent? After all the formulation "consideration for the grant" is used in regulation 19. One reason may be that the draughtsman had in mind the payment of the premium by instalments or the payment of a deposit for a premium and was seeking to ensure that the whole of the supply referable to such a premium was zero rated.

105. We were not shown any, and we found no, particularly helpful definition of "premium" in any of the case law. In *King v Earl Cadogan* [1915] 3KB485 Warrington LJ said:

> "I need not say anything about the meaning of the word rent, but "premium" as I understand it, used as it frequently is in legal documents, means a cash payment made to the lessor, and representing, or supposed to represent the capital value of the difference between the actual rent and the best rent that might otherwise be obtained."

106. This might suggest that any charge for the use or maintenance of the furnishings was in place of a rent for them and thus could be a premium.

107. But it seems to us that the essential difference between a premium and rent is that rent is payable under the lease whilst the lease is extant, while a premium is paid for the grant of the lease, and is dependent on the grant of the lease but independent of the continuing existence of the lease: so that a premium payable by instalments over a number of years would be a premium and not rent if the buyer's liability to pay it was not affected by the fate of the leasehold interest.

108. We agree with Mr Hitchmough that the words the parties attach to a payment will not be determinative of its nature for the purpose of Note(14). And we agree with Mr MacNab that our task is to classify the actions identified in the contract.

109. The contract specifies a Price of £233,950 and a Capital Contribution of £500 That was explained in the purchaser's information pack as a one-off charge for the initial provision of communal furniture and equipment. The Conditions which formed part of the contract provided that on completion the buyer should pay the Capital Contribution "towards the capital cost of purchasing equipment and other items

intended to be used in connection with the provision by the seller of communal services and furniture at the Development".

110. It does not seem to us that the use of the words "towards the cost" have any effect on whether the sum is part of the premium. If the lease was to be granted in consideration of "£233,950 towards the cost of providing the buildings", the £233,950 would clearly be premium.

111. The £500 is not paid for any transfer of ownership in the furnishings. The most that can be said is that it is a sum paid in connection with the obligation to make the furnishings available. As an alternative to rent for the use of the furnishings it would fall within Warrington LJ's description of the meaning of premium.

112. But whatever it is described as being payable for, it is plainly part of the consideration for the grant of the lease which must be read as incorporating an obligation on the landlord to provide and maintain such furnishings. The liability to pay the sum is independent of the continuance of the lease. It seems to us that it is properly classified as a premium.

113. If Mr MacNab is right and the object of Note(14) and Reg 19 was to restrict the input tax which could be credited to that exclusively attributable to the grant of the lease, it seems to us that a conclusion that the £500 is part of the premium does not fall outside that object: the input tax on the furnishings is part of the expense of providing the lease and is thus attributable to its grant. If Mr Hitchmough is right and the object is to limit the zero rating of the first payment of consideration, a conclusion that the £500 is premium is not at odds with that purpose.

114. We conclude that the premium payable included the £500 and the zero rating should accordingly not be limited by excluding from it the £500.

Scotland

115. Mr Hitchmough suggested that in Scotland M&S sold a freehold interest rather than a leasehold. There was no evidence before us that this was the case. Given our conclusions in relation to Note (14), we do not consider this further.

HMRC's subsidiary position: A single supply with multiple rates of tax or distinct supplies?

116. HMRC's subsidiary position is that the equipment charge is to be treated as consideration for a separate supply of services by M&S not linked to the upkeep of the communal areas. That, Mr. McNab says, is the only other conclusion consistent with *Talacre* and with the general principle that VAT is to be levied on all supplies for consideration by a taxable person. On that basis the equipment charge would represent a taxable supply.

117. Mr. MacNab was, we understood, not intending to submit that the supply made by M&S was not a single supply on CPP principles (if he had we would have rejected that submission for the reasons he advanced and we accepted at [45] above), but

rather, saying that where T*alacre* required the zero rating of only part of a single CPP supply, the remaining part was taxed according to its own nature and not as part of the single supply. Thus he says that *Talacre* requires a single CPP supply to be taxed, not at multiple rates (zero rated and exempt this case), but as separate supplies. Therefore the equipment supply made by M&S which would remain, on HMRC's approach to *Talacre*, after excising the zero rated accommodation should be standard rated as a supply of equipment use rather than exempt as a supply of land.

118. We have decided that the whole of M&S' supply is zero rated, so this argument is not necessary to our decision, but we offer our views on it.

119. At paragraphs 44 and 45 her opinion in *Talacre* the Advocate General put aside the possibility that the caravan and its removable contents might be two separate supplies. In doing so it may be suggested that she intended that such a conclusion would not be the result of her proposed answer to the question put to the Court. The language of the Court at [24] is ambivalent: "While it follows, admittedly, from that case law that a single supply is, as a rule subject to a single rate of VAT, the case law does not preclude some elements of their supply from being taxed separately ...". The words "being taxed separately" could mean being a single supply taxed at different rates or being taxed as separate supplies. But the Court, at [25], accepts the Advocate General's view that "there is no set rule for determining the scope of a supply" and, at [27], that VAT might be levied "at the standard rate on the supply of the excluded items".

120. It seems to us that the court was limiting the CPP principles rather than preserving them with a codicil permitting a single supply to be taxed as multiple rates. That is because the CPP logic is "based on the consideration that splitting transactions too much could endanger the functioning of the VAT system" (Advocate General [37]), and once it is accepted that part of a supply should be separated taxed the pragmatic logic for regarding that part as influencing the taxation of the other parts disappears, so that a departure from the CPP principles is not illogical and is in keeping with the scheme of the Directive.

Conclusion

121. We allow the appeal.

Rights of Appeal

122. 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.

CHARLES HELLIER
TRIBUNAL JUDGE

RELEASE DATE: 6 December 2012