TC06069

Appeal number: TC/2014/03531
TC/2017/00859

VALUE ADDED TAX – exemption for management of special investment funds - Item 9 Group 5 Schedule 9 Value Added Tax Act 1994 and Article 135.1 (g) Principal VAT Directive – reverse charge - supply of services delivered by means of a computerised fund management platform – whether supply exempt – whether consideration for a single supply consisting of predominantly non-exempt services can be "apportioned" between non-exempt and exempt use - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BLACKROCK INVESTMENT MANAGEMENT (UK) LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN

Sitting in public at the Royal Courts of Justice, Strand, London on 5-8 June 2017

Andrew Hitchmough QC and Laura Poots instructed by Simmons & Simmons, for the Appellant

Raymond Hill instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This appeal concerns the scope of the exemption from VAT for the management of special investment funds ("SIFs").

2. In short, the appellant ("BlackRock") is the UK representative member of a UK VAT group that includes two other fund management companies. BlackRock receives the supply of services from a US affiliated company called BlackRock Financial Management Inc ("BFMI"). During the hearing, BlackRock and these two fund management companies were conveniently referred to as "the Aladdin Recipients" and I shall use the same terminology.

3. There are two main issues in this appeal. The first issue, ("**the exemption issue**") is whether BlackRock needs to account for VAT under the reverse charge mechanism on a supply of services to it by BFMI. The services in question are comprised in an investment management computer platform called "Aladdin" which is used by the Aladdin Recipients. BlackRock's case is that it does not need to do so because the services supplied by BFMI are exempt from VAT under Item 9 of Group 5 Schedule 9 Value Added Tax Act 1994 ("VATA") and/or Article 135.1(g) of the Principal VAT Directive (Council Directive 2006/112/EC) ("PVD") in so far as those services are used by the Aladdin Recipients in the management of SIFs.

4. The exemption contained in Article 135.1(g) ("the exemption") applies to services which constitute the "management of special investment funds". SIFs are investment funds which, broadly speaking, are aimed at small investors.

5. Initially, there was a dispute between the parties as to the nature of the supply made by BFMI to BlackRock. This concerned the question whether certain functions referred to as "Other Services" were part of an overall composite supply with the Aladdin platform. In the respondents' ("HMRC") skeleton argument it was accepted that the "Other Services" constituted separate supplies. Consequently, the dispute in this appeal concerns only the provision of the Aladdin platform – which I shall, for convenience, refer to as "Aladdin", the "Aladdin Services", as the context requires.

6. In relation the second issue in this appeal, I should explain that BlackRock accepts that BFMI did not make a separate supply of Aladdin Services in respect of each fund managed by the Aladdin Recipients, but rather that the Aladdin Services constituted a single supply made by BFMI to BlackRock as a representative VAT group member and used by the Aladdin Recipients. Consequently, this gave rise to the second issue. If the services supplied by BFMI and reverse charged by BlackRock were exempt insofar as they were used for the purposes of SIFs, because they formed part of a single supply which was predominantly used for the management of non-SIFs (which would be standard rated), could the single supply be taxed at different rates and the consideration be apportioned? I shall, for convenience, refer to this as "**the apportionment issue**".

The appeal

7. BlackRock has accounted for VAT under the reverse charge procedure (section 8 VATA). On 2 May 2012, BlackRock requested a ruling from HMRC that it was not liable to account for VAT under the reverse charge in relation to the supply of the Aladdin Services. The ruling was requested on the following grounds:

(1) When the Aladdin Recipients use the Aladdin Services for the purpose of managing SIFs, the Aladdin Services are exempt under Item 9 of Group 5 Schedule 9 VATA and/or Article 135.1(g) PVD; and

(2) When the Aladdin Recipients use the Aladdin Services in the management of non-SIFs, any tax for which the Aladdin Recipients would be liable to account under the reverse charge mechanism would be directly attributable to onward taxable supplies, so that any such VAT would be fully recoverable by BlackRock as input tax.

8. I should make clear that the second point in relation to direct attribution was not directly in issue before me.

9. This was followed, on 24 July 2013, by a claim made by BlackRock under section 80 VATA for repayment of VAT accounted for on the basis described above for the period 1 January 2010 to 31 March 2013.

10. On 30 August 2013, HMRC issued a decision letter which denied the exemption and rejected BlackRock's claim.

11. BlackRock now appeals to this Tribunal.

12. I should add that BlackRock subsequently lodged a further appeal on 13 January 2017 (TC/2017/00859). This further appeal raises the same issues but relates to the period from 1 April 2013 to 30 September 2016. At the request of the parties, I directed that the appeals for both periods should be consolidated and that the hearing should constitute a hearing of both appeals.

The evidence

13. I was supplied with two ring binders of documents. Also, Mr Jonathan Kirby-Tibbits of BlackRock supplied a witness statement and was cross-examined. In addition, as part of his evidence, Mr Kirby-Tibbits gave a helpful demonstration of Aladdin at BlackRock's offices.

The law

14. Article 135.1(g) PVD requires Member States to exempt "the management of special investment funds as defined by Member States".

15. The exemption for the management of special investment funds is incorporated into UK domestic law by Schedule 9 Group 5 Item 9 VATA. This provision exempts the management of a number of specified types of special investment funds, including

authorised open-ended investment companies and authorised unit trust schemes. In addition, item 10 exempts the management of closed-ended collective investment undertakings, such as investment trust companies.

16. In *Abbey National plc v Customs & Excise Commissioners* (Case C-169/04) [2006] STC 1136, the CJEU explained at [62] that the purpose of the exemption is:

> "to facilitate investment in securities for small investors by means of investment undertakings. [The exemption] is intended to ensure that the common system of VAT is fiscally neutral as regards the choice between direct investment in securities and investment through undertakings for collective investment."

17. 16. In *JP Morgan Fleming Claverhouse v Revenue & Customs Commissioners* (Case C-363/05) [2008] STC 1180, Advocate General Kokott at [30] gave the following explanation:

> "The objective of the exemption of the management of special investment funds from VAT is in particular to avoid making access to that form of investment more difficult for small investors. If the exemption did not exist, the owners of units in investment funds would have a greater tax burden than investors who invest their money directly in shares or other securities and do not have recourse to the services of a fund manager. It is precisely small investors for whom investment in investment funds is particularly important. Because of the small volume of investment available to them, they have only a restricted opportunity of investing their money directly in a wide spread of securities. In addition, they often do not have the necessary knowledge for comparing and selecting securities."

The facts - introduction

18. The clients of the Aladdin Recipients divide into two broad groups – institutional investors and collective investment schemes (funds). The Aladdin Recipients manage a range of different collective investment schemes which qualify as SIFs and a range of other such schemes and investment funds that do not qualify as SIFs. In the course of the hearing, I was informed that the majority of funds and investment schemes managed by the Aladdin Recipients were not SIFs.

19. The individuals responsible for managing the funds are the portfolio managers ("PMs"). Aladdin has the capability to support SIFs and non-SIFs.

20. BFMI also supplies Aladdin to third-party fund managers outside the BlackRock group.

21. In general terms, Aladdin provides the PM with performance and risk analysis and monitoring to assist in making investment decisions, monitors regulatory compliance and enables the PMs to implement trading decisions.

22. The functions performed by Aladdin are set out in more detail later in this decision ("*The facts - Aladdin's Functions*").

23. The Aladdin Services are provided by BFMI to the Aladdin Recipients under the "Aladdin License and Services Agreement" ("the Aladdin Agreement") dated 1 January 2010, an agreement governed by New York law. Under the Aladdin Agreement, the Aladdin Recipients obtain from BFMI a licence for the Aladdin software, together with, according to the recitals in the Aladdin Agreement, "the benefit of the functionality comprised within the Aladdin Software, the hosting of the Aladdin Software and ancillary services". The Aladdin software is described in the recitals as:

> "an integrated trading, portfolio management, and risk reporting software application, including improvements and new systems that may be developed from time to time, (the "Aladdin Software") to capture, execute, process and settle securities transactions and facilitate securities trading, and to assist in portfolio management and construction, investment analysis, securities lending and other aspects of [BlackRock]'s business".

24. The recitals also state:

> "[BlackRock] wishes to obtain and [BFMI] desires to provide a license for the Aladdin Software, the hosting of the Aladdin Software and ancillary services further described in the Schedules hereto, for the enjoyment of the functionality of the Aladdin Software (the foregoing functionality, hosting and ancillary services, together with the Aladdin Software collectively the "Aladdin System")…."

25. Under Section 1 of the Aladdin Agreement, BFMI grants BlackRock a licence to use the Aladdin Software.

26. In Section 3 of the Aladdin Agreement, under the heading "Risk Considerations", BlackRock acknowledges to BFMI that:

> "(i) [BFMI]'s sole responsibility in connection with this Agreement is to provide the Aladdin System as described herein, (ii) [BFMI] is not serving as an investment adviser or fiduciary or making any recommendations or soliciting any action based on its risk measurement analyses for provision of analytic tools, and (iii) [BlackRock] will be solely responsible for any judgements as to the valuation, hedging of, or purchase and sale of its portfolios or any securities in which it transacts. Accordingly, [BFMI] will not be responsible nor have any liability for any actions, inactions or conclusions drawn by the client with respect to any matter, whether or not based to any extent on the Aladdin System."

27. In Schedule A to the Aladdin Agreement is entitled "Aladdin Software and System Functionality Summary" provides:

> "The Aladdin Software provides a range of functionality throughout the investment life-cycle. The Aladdin System enables [BlackRock] to capture, execute, process and settle transactions. [BlackRock] will also use the Aladdin System [BlackRock]'s on-going management and operation of its asset management activities. The Aladdin System

> reduces operational risk by helping to achieve a paperless office while providing users with access to portfolio and transaction data at both the highest and lowest levels of detail."

28. The Schedule then divides the functionality encompassed in the Aladdin software into five broad "trade processing and routing categories, plus a suite of supporting monitoring and reporting categories and ancillary improvement and bespoke enhancements."

29. In his submissions, Mr Andrew Hitchmough QC (leading Ms Laura Poots), for BlackRock, drew attention to certain aspects of the Schedule. In particular under the heading "Nightly Production", he referred to the following:

> "[BFMI] is responsible for managing and maintaining the nightly production cycle required to operate the Aladdin System. This process includes:
>
> - Preparing the Aladdin database for the next Business Day.
> - Gathering new and updated Third Party Data and integrating it into the [BlackRock] dedicated database server (where appropriate).
> - Producing trade reports, risk reports, and analytics.

30. Under the heading "Daily Risk Reporting", BFMI agreed to provide BlackRock "with a suite of portfolio and risk measurement reports based on [BFMI]'s standard reports for all assets maintained on the Aladdin System." BFMI agreed to review the information contained within these reports on a daily basis.

31. The Schedule also referred to BFMI providing Value-at-Risk ("VaR") Reports. In particular, BFMI agreed to provide an analytic VaR measuring expected risk based on the linear sensitivity of the portfolio to a complete set of market risk factors. In addition, BFMI agreed to provide historical VaR measuring "expected risk based on current parametric exposures and actual observed historical daily market changes".

32. Mr Kirby-Tibbits's evidence was that Aladdin's software was "populated" with information from two different sources. First, Aladdin contained information from third parties (such as pricing information) from, for example, Bloomberg or Thomson Reuters or other sources. Secondly, Aladdin also contains information programmed into it by staff who were either employed by or who acted on behalf of BFMI.

33. Mr Kirby-Tibbits accepted that the terms of the Aladdin Agreement did not suggest that the Aladdin Recipients were outsourcing fund management and administration to BFMI.

34. Aladdin can only be accessed by employees involved in what Mr Kirby-Tibbits described as the investment management cycle (see below).

35. Fees charged by BFMI for the Aladdin Services are based upon:

(1) The quantity of assets under management with a particular entity (i.e. the specific Aladdin Recipient), calculated on a quarterly average basis;

(2) A component fee for a pre-agreed number of portfolios (currently 1,473); and

5 (3) A fixed charge per individual Aladdin user.

The facts - role of a Portfolio manager (PM)

36. Collective investment allows retail investors to benefit from the advantages of investing as part of a group including (1) the ability to engage a professional asset manager, (2) lower transaction costs and other economies of scale, and (3) the ability 10 to spread investment risk across a more diverse pool of assets than would otherwise be possible.

37. The role of a PM in relation to collective investment schemes can be summarised as follows. Essentially, a PM has two broad roles. The first is to be responsible for investment decision-making and, secondly, operational and 15 administration functions including portfolio administration, portfolio accounting, regulatory reporting, reconciliation and performance calculations.

38. Typically, an investment fund would also employ a third-party custodian (usually the subsidiary of the bank). The third-party custodian's role was to hold and safeguard the fund's assets, to collect the income from investments, to maintain the 20 official books and records and to facilitate settlement of trading in securities. The custodian does not have access to Aladdin. BlackRock provides information to the custodian, which is responsible for performing the task of updating its books and records. Aladdin, however, maintains its own records as well.

39. It is also relatively common for a PM to outsource some of its functions such as 25 order management and trade execution systems, accounting systems and risk analytics systems. There is a diverse range of providers of these services.

40. Mr Kirby-Tibbits noted, however, that analytical processes and investment decisions were two related and essential aspects of managing any collective investment scheme. Aladdin focused on the analytical processes by performing 30 continuing performance attribution (see [78] below) and risk analysis functions for each individual portfolio. The PMs focused on making investment decisions: Aladdin did not take investment decisions for the PM and was not a substitute for the PM's expertise. Aladdin performed core analytical functions that in the past might have been:

35 (1) carried out by the PMs or their assistants ("PMAs");

(2) purchased from third parties; or

(3) too complex to perform.

41. Mr Kirby-Tibbits said that Aladdin took all the data to which it had access and performed the calculations which identified the issues that the PM should be

considering. Aladdin shaped the PM's thinking and guided him or her in making investment decisions in relation to each individual product portfolio. He considered that this aspect of Aladdin's functionality was a distinct but integral part of the investment decision-making process.

42. A SIF can be actively or passively managed. A passively-managed SIF will aim to replicate the performance of a "Benchmark", such as the FTSE 100 Index. Thus the PM will aim to replicate the Benchmark's performance, rather than seeking to outperform it. The assets held by the fund would largely mirror the make-up of the Benchmark. This did not necessarily mean that a passive SIF would hold every asset that is a constituent of the Benchmark but rather a representative selection of assets through which the performance of the overall Benchmark could be tracked. The selection of assets held by a passive fund would be the result of the exercise by a PM of his or her expertise, assisted by Aladdin.

43. Mr Kirby-Tibbits accepted that Aladdin did not take over the entire function of selecting a representative sample of assets from the PM. Nonetheless, he said that Aladdin helped the PM to make the selection of the representative sample because otherwise the PM would be faced with a very large volume of information which would require analysis. His evidence was that a PM would need to do a "tremendous amount of analysis" in order to be able to confirm that the passive portfolio was in line with the Benchmark "that could have 13,000 holdings within it and be fixed income in nature." He considered that whilst the PM could "technically" use his or her skill and judgment this would be very difficult in practice and the PM would need to assimilate a vast amount of information. Mr Kirby-Tibbits emphasised the sheer volume of information which, without Aladdin, a PM would be required to know (including a knowledge of all the securities in which a portfolio was invested). The clear implication of his evidence, which I accept, was that it would be very difficult for a PM to keep track of all this information effectively.

44. An actively-managed SIF, on the other hand, will be designed to obtain a particular return, often stated in terms of a return in excess of a Benchmark. The intended return will often be specified as, for example, 2% above the performance of the FTSE 100 Index. In both cases (i.e. passive and actively managed funds), deviation from the Benchmark is known as the "tracking error".

45. Collective investment schemes such as SIFs are subject to regulatory rules ("the Regulatory Rules"), such as those set out in the UCITS Directives. The UCITS Directives apply in different combinations depending on the type of investors investing in the fund and the type of investments being made by the fund. Typical rules imposed by the UCITS Directives can include:

(1) Restrictions on the types of assets into which the collective investment scheme can invest. Investment schemes that are subject to the UCITS Directives must invest in "eligible assets" which are generally transferable securities or other liquid assets such as company stocks.

(2) Restrictions on investing in financial derivative instruments such as options, futures or swaps.

(3) Restrictions on investing in assets that are not listed or traded on a recognised stock exchange, such as direct investment in real estate, venture capital, private equity or other non-traditional investments such as wine or art.

(4) Required levels of investment diversity. An example would be the “5/10/40 rule” which states that:

(a) no more than 10% of the net assets of the collective investment scheme can be invested in securities of a single issuer; and

(b) investments of more than 5% of net assets with a single issuer cannot make up more than 40% of the whole portfolio of the collective investment scheme.

46. The applicable Regulatory Rules will depend upon the jurisdiction in which the scheme is constituted, so there may be different rules for different funds managed by the Aladdin Recipients. The rules can include restrictions on the types of assets in which the SIF can invest or the diversity of the assets within the SIF.

47. In addition to the Regulatory Rules, a SIF can have its own rules, designed to attract specific types of investor (“the Product Rules”). Thus, BlackRock also designs collective investment products that give investors exposure to particular industry sectors, currencies or regional markets. For example, a fund may be designed to:

(1) provide exposure to large or mid-sized companies based in the UK;

(2) incorporate prohibitions on holding e.g. tobacco or gaming company stocks or restrictions on investments in emerging markets; and

(3) limit the proportion of the total assets of the fund that can be exposed to certain currencies or industries.

48. These Product Rules are applied by BlackRock alongside the Regulatory Rules to create the framework within which the different BlackRock collective investment schemes were required to be managed.

49. Thus, the Aladdin Recipients use Aladdin to ensure that the BlackRock portfolios are managed and administered in a manner that reflects the relevant Regulatory Rules (e.g. UCITS rules) and Product Rules. This process involves the BlackRock Portfolio Compliance Group (“PCG”), which is a global BlackRock function with employees based worldwide. PCG is not part of Aladdin, and the individuals working for PCG are employed typically by the local investment management company in the relevant jurisdiction, for example, one of the Aladdin Recipients in the United Kingdom. Members of the PCG team are not employed by BFMI.

50. PCG takes (a) the Product Rules that have been identified at the product design stage to reflect investor demand and (b) the relevant sets of Regulatory Rules (e.g. the UCITS rules), and ‘codes’ these rules against the individual portfolios within Aladdin. Every portfolio managed by the Aladdin Recipients is programmed into Aladdin in this manner by PCG. Thus, if Aladdin is told that the fund is a SIF, the UCITS rules contained in Aladdin’s “rule library” would be applied. In this way, Aladdin is able to

analyse each individual fund in a “bespoke” manner. Aladdin then applies the Regulatory and Product rules for the PM, thus relieving the PM of the need to refer constantly to the relevant Regulatory and Product Rules on an ongoing basis. Mr Kirby- Tibbits considered (and I accept) that Aladdin enables the management of a wider range of portfolios within a more complex set of investment parameters than would be possible for a human PM operating without Aladdin.

51. The extent to which individuals within BlackRock are able view information contained in Aladdin depends on their individual permissions and confidentiality restrictions. Access to information is controlled by the Aladdin Dashboard – the screen to which all users of Aladdin have access.

52. Mr Kirby-Tibbits explained that investment management was not limited to “populating” each new investment fund with assets that matched the framework of Regulatory and Product Rules and the particular fund’s objectives (and which the PM believes will produce the desired targeted return on investment). Instead, investment management follows a cycle of analysis, decision making, trade execution and post trade settlement and reconciliation. Once a trade is confirmed, settled and reconciled, the portfolio reporting is updated and the cycle begins again with the PM monitoring and analysing the exposure, performance and risk across the portfolio. In addition, throughout this investment management cycle it was important that the cash position of the fund was constantly monitored because the fund’s cash position could influence trading decisions.

53. As I have explained, these processes are carried out against the background of the applicable Regulatory and Product Rules, which must be considered and adhered to by the PM at each stage of the investment management cycle.

(a) Portfolio Analysis and Monitoring

54. The value of a fund’s assets can be affected over time by a variety of factors. This means that once a strategy has been devised and the initial portfolio of assets acquired – the PM of an actively managed portfolio needs to monitor continually how the assets are performing (i.e. how their value is changing) and seek to predict how they will perform in the future. This monitoring drives the decisions that the PM must make about whether to hold the assets or trade them. Even where the PM is seeking to replicate a particular Benchmark using a passive strategy, the Benchmark itself is still subject to change over time (for instance, the constituent companies can change, as can the relative market capitalisations of the companies in the Benchmark), and it is therefore equally important for the PM to monitor the portfolio and assess whether the assets are tracking the Benchmark correctly. The goal is ultimately to have fully informed decision-making over which assets should be kept and which should be traded.

55. The PM’s analysis also involves assessing the risk associated with the assets. In investment terms, risk describes the chance that an investment’s actual return will differ from the expected return.

56. Monitoring starts with being able to see at any given point precisely which assets are being held and in which proportions. The PM of the actively managed fund also needs to be able to calculate what impact each asset, held in that proportion, is having on his or her plan to meet the portfolio's objective. This principally means the ability to calculate, based on the precise asset price at a particular time, what value the specific holding is contributing to the overall value of the portfolio. It also requires an assessment of the historical performance of the holding. Certain holdings may have increased in value to such an extent that the portfolio is on track to meet the objective, but this could mask the fact that other holdings have decreased in value, thus creating a "drag" on the overall performance.

57. The evaluation of risk is important for a number of reasons:

(1) The fact that a holding has increased in value over a specified period of time is not the only relevant measure of its success. Risk is essential to understanding the sustainability of the performance. If the increase in value involved taking a high degree of risk, this indicates that there was a high likelihood that the investment could have gone down in value instead of going up in value.

(2) An investment portfolio traditionally has guidelines, and can have strict limits, on the amount of variability in investment returns that holdings can experience. This is known as risk tolerance. If the risk associated with a particular holding were to change over time, this could require the PM to sell the holding, or at least reduce the proportion of the portfolio invested in the asset so as to reduce the amount of risk it is contributing to the portfolio as a whole.

(3) The ability to assess the risk associated with particular assets also allows the PM to test how individual assets, or the entire portfolio of assets, would perform under various market conditions if they were to arise in the future.

58. The proportion of certain assets in the portfolio versus other assets can also be crucial to the overall performance of the portfolio for the following reasons:

(1) An active PM's strategy for achieving the targeted return is likely to involve having a particularly high or low proportion (or weighting) of one asset or type of assets (e.g. assets associated with the energy sector or shares in companies based in the UK) compared with the make-up of assets in the Benchmark. This is how the PM differentiates the investment portfolio from the Benchmark, and how it aims to outperform the Benchmark.

(2) It is likely also that the PM will have various investment views (e.g. to hold a particular stock also in addition to holding a higher weighting of one type of asset) that will need to be balanced against each other in determining the make-up of the portfolio.

(3) As a result, knowing how much of one asset or asset type the portfolio holds relative to another asset or asset type is important to a PM. It is also important for the PM to be able to monitor changes in the desired proportions as

the value of individual holdings can change over time, so that the PM may determine whether steps need to be taken to maintain those desired proportions.

59. Mr Kirby-Tibbits accepted that the PM would have both a broad strategy to achieve a particular investment objective for a particular fund and would also have specific investment views in relation to individual investments (e.g. which specific oil company's shares should be bought or sold).

60. A PM following a passive management strategy, as I have described, will ensure that the balance of assets of the portfolio gives a good representation of the portfolio's Benchmark, and that the investment performance of the assets in the portfolio does not deviate unduly from the performance of the Benchmark. Where changes occur in the Benchmark, the PM is likely to want to 'rebalance' the portfolio to track the activity in the Benchmark more closely. Even if the PM is only able to hold a sub-set of the constituent assets of the Benchmark, it is necessary to monitor and assess whether the assets held in the portfolio are the most appropriate (in terms of the number of different securities, and the proportions they are held in) for mirroring the performance of the overall Benchmark.

61. The Aladdin Recipients would also typically talk to companies into which a fund either had invested or might invest. The Aladdin Recipients would then enter the results of that research into Aladdin so that other fund managers within the BlackRock group could benefit from it.

(b) Deciding whether to trade

62. Changes in outlook for particular holdings or changes in risk may prompt the PM to sell or buy certain holdings. However, the trading that the PM will look to carry out is unlikely to be just a matter of selling one particular asset and buying another asset as a replacement. This is because expressing a different view on a particular asset, by selling the whole or part of the holding of that asset, may well end up having a knock-on impact on the holdings of other assets, as follows:

(1) Using the proceeds for corresponding purchases will need to be done in a way that seeks to maintain the PM's overall strategy (if the PM wants to maintain it), or perhaps in a way that contributes to a change in the strategy (if the change in view on the one asset affects the whole strategy).

(2) This could mean increasing the proportion of the portfolio held in other existing assets, whether alone or in combination with buying an entirely new asset.

(3) The PM must consider what he or she wants the new portfolio to look like and model what trading activity is needed to achieve that – which, as noted, could mean multiple trades in multiple assets having to be placed.

63. Trading decisions are also prompted by the flow of investment into and out of the fund:

(1) The cash available to the PM to invest in assets is dependent (in the case of a portfolio for a collective investment scheme) on the funding provided by the unit-holders of the scheme.

(2) If an investor buys new units in the scheme, the relevant cash will be made available to the PM, who must then determine what assets should be bought with it. It may be that the PM wishes to maintain the current set of assets and in their current proportions – this is likely to mean that small additional holdings in each of the existing assets will need to be bought. Alternatively, the PM may want to invest in a new asset – but in doing so all the ways in which this will impact the existing holdings (as noted above) will need to be considered.

(3) Existing unit-holders may instead decide to sell their units back to the fund, meaning that assets in the portfolio will need to be sold. Again, the PM must consider what overall changes are needed to maintain the desired strategy with a lower value portfolio.

64. As regards making changes to the assets in the portfolio, the PM is not completely unconstrained in deciding how to act. The Regulatory and Product Rules that apply to the fund, discussed above, must be complied with. For example, in many cases the applicable rules will prevent the scheme's portfolio assets becoming concentrated in particular stocks or asset classes. This means that the PM may not be entitled to replace assets that are to be sold with a higher proportion or weighting of existing assets if that would increase the concentration in those assets or associated asset classes beyond the permitted limits.

65. Mr Kirby-Tibbits accepted that it was the PM who made the decision what to buy and sell in relation to a particular portfolio, using information provided by Aladdin. The ultimate decision rested with the PM exercising his or her experience and judgement. Aladdin was helping the PM with investment decisions but was not taking over the whole of that function.

(c) Trading

66. The PM will need to ensure that any trading to be carried out is done as efficiently as possible, so that the costs of selling certain assets and buying others are kept to a minimum. This prevents the portfolio's value being unduly affected by trading.

67. Where the assets being traded are company shares and bonds, one way to increase the efficiency of trading is to establish whether there are opportunities for "sell" trades to be matched internally with corresponding "buy" trades, i.e. without having to use an external broker (which will involve a brokerage fee). This process, which is known as "crossing", has the potential to create a conflict of interest between the PM's clients and therefore must be properly authorised. It is therefore important for the PM and the trader to be aware of which clients have authorised crossing.

68. Once a certain pattern of trading has been decided upon, checked for compliance with the restrictions on the portfolio and traded as efficiently as possible,

the PM will need a confirmation that the change in assets has been effected. In practice, this means that the trades will need to be confirmed with the end counterparty and then all of the portfolio records updated and reconciled to ensure that the PM has a clear picture of the new make-up of the portfolio. Only then can the cycle of monitoring and decision-making start again.

The facts - Aladdin's Functions

69. The Aladdin Services are used by the Aladdin Recipients in the day-to-day management of both SIFs and non-SIFs. In the case of any particular SIF, Aladdin draws on both the "coding" of the relevant UCITS rules and other investment characteristics of the SIF, as well as a broad range of security specific and market data which is held within Aladdin. Aladdin also monitors the composition of the SIFs managed by the Aladdin Recipients and the activities carried out in relation to the assets comprising the SIFs on a continuous basis. Mr Kirby-Tibbits accepted however, that Aladdin was a "tool" which the Aladdin Recipients interrogate and then take investment decisions based on the information so derived.

70. Regardless of whether a SIF is a passive or an active fund, the Aladdin Recipients' PMs monitor the performance and composition of their funds throughout the day, to identify risks and returns and to understand how the composition of the portfolio is affecting not only the investment performance of the funds, but also the application of the Regulatory and Product Rules relevant to the funds.

71. Aladdin contains two performance attribution applications (see below at [78]) called PRISM and IMPACT which analyse which stocks, industry sectors, regions and currencies:

(1) have generated positive returns for the fund;

(2) have given rise to negative returns or detractions from an applicable Benchmark; and

(3) are giving rise to the greatest level of tracking error or risk within the portfolio.

72. Aladdin performs the following specific functions in relation to each fund.

73. **The "Green Package"**. Aladdin produces an electronic report called the 'Green Package' (a reference to the time before Aladdin when reports were printed on green paper) for the PM to use at the start of each day. The Green Package gives a 'snapshot' of the fund. It includes:

(1) A summary of the portfolio, including a summary of the risks and sectors to which the portfolio is exposed.

(2) An analysis of the portfolio's performance compared with the Benchmark, showing whether the portfolio has a tracking error. This analysis identifies the impact that specific assets have on performance, in order to determine (i) the

cause of any tracking error and (ii) how the different assets are contributing to risks in the portfolio.

74. As I have described, the information contained in Aladdin comes from two main sources. First, Aladdin contains information from third parties (such as pricing information) from, for example, Bloomberg or Thomson Reuters or other sources. Secondly, Aladdin also contains information entered by staff either employed by or who act on behalf of BFMI. In addition, the Aladdin Recipients also add information obtained from meetings and discussions with companies into which their funds have invested or intend to do so.

75. Aladdin holds detailed information relating to every individual security that any BlackRock or other fund might hold; in other words, it holds detailed information relating to every security or financial instrument in, what Mr Kirby-Tibbits described as, “the investable universe”. It is this security specific information that is programmed into Aladdin (and then kept up to date) by BFMI employees or persons acting on behalf of BFMI based in various locations around the world. These members of staff also check exceptions that Aladdin highlights.

76. The security specific data is held within an Aladdin application called Security Master. Security Master is an application that is programmed to associate all financial instruments with the relevant industry sectors, countries, currencies and other markets that might affect the performance of the financial instrument in question. It enables Aladdin to make connections between financial instruments and particular markets that are not immediately apparent from the overt characteristics of the investment and which a PM and his team might not be able to identify with any degree of consistency. An example given by Mr Kirby-Tibbits was the way in which a fall in the oil price might affect a certain brewing company’s shares because that company had significant interests in Russia, which was an economy that was significantly dependent on the price of oil. In addition, a PM would have to be aware of the location of the company’s subsidiaries, the company’s debt and, for example, the nature of the listing of the company’s shares. Mr Kirby Tibbits considered, and I accept with his unchallenged evidence, that this would require a PM to remember a very great deal of information indeed.

77. Mr Kirby-Tibbits accepted that the BFMI staff referred to in [74] and [75] above did not instruct the PM to buy or sell securities but gave the PM information that was important to the PM’s investment decisions. He also accepted that the PM was constantly monitoring the portfolio of each fund. Aladdin provided the PM with up-to-date information and the PM used Aladdin as an aid in monitoring the portfolio in conjunction with the PM’s own experience. As Mr Kirby-Tibbits put it, the PMs “will be using their own brains as well….”

78. **Real-time analysis.** Aladdin continuously analyses and updates the performance and risk level of the portfolio throughout the day. This analysis is very detailed, and identifies the factors and investments affecting both the performance and risk levels within the portfolio. This analysis, known as “performance attribution” enables the PM to understand why and how the performance of the particular portfolio is differing (either positively or negatively) from its Benchmark (see [71]).

79. Although Mr Kirby-Tibbits agreed that the ultimate decision in respect of risk always lay with the PM, he said that the PM now, with Aladdin, had more information available upon which to base his or her decisions.

80. **Trade modelling.** If a PM decides to buy or sell investments, Aladdin can model the specific trading orders required to achieve the desired outcome, and can also model the effect of the proposed trade using its pre-trade analytical tools. Aladdin, using its inbuilt pre-trade analytical tools, will show the PM the impact of the proposed trade on the tracking error and on the overall risk of the portfolio.

81. **Compliance and Risk Monitoring: Trading.** If a PM decides to buy or sell assets, the proposed trade will be run through Aladdin's compliance engine, against the Regulatory and Product Rules which have been set for the particular fund. The compliance engine will identify any relevant risk management or compliance issues that need to be considered and will give a warning of any such issues. If Aladdin identifies the proposed asset as ineligible for the portfolio (for example, due to a Regulatory Rule or a Product Rule), Aladdin may place a total block on the trade.

82. If the PM wishes to go ahead with a blocked trade, Aladdin will alert the PCG and the PCG team will consider the proposed trade in the light of the relevant Product and Regulatory Rules (e.g. the UCITS rules).

83. Aladdin will continue to block the trade until the PCG team have confirmed whether or not it can go ahead.

84. **Compliance and Risk Monitoring: Ongoing.** Aladdin monitors the portfolios continuously for active and passive compliance issues. An active breach is one that results from an action taken by the PM, such as a trade which breaches a concentration limit. A passive breach is one that results from movements in the market that affect the relative weightings of securities and/or the risk exposures within the portfolio. Aladdin alerts the PM to any potential breach and informs the PM of the need to take corrective action, within a given time frame. Thus, Aladdin facilitates the process of correcting a breach in a way which was not available before Aladdin's introduction.

85. Mr Kirby-Tibbits accepted that, although Aladdin made it easier for PMs to comply with the relevant Regulatory and Product Rules, the ultimate responsibility for compliance lay with the PM. Aladdin was a tool which assisted the PM (and the compliance and legal teams within BlackRock) but it did not take over the whole of the compliance function because each of the PM, the compliance and legal teams retained their functions in that regard.

86. **Corporate Actions.** Aladdin monitors "corporate actions" in relation to any particular investment. A corporate action is an event initiated by the issuer of the security which might require action to be taken by the owner. This would include stock splits, takeovers and rights issues. Aladdin will alert the PM to the corporate action, identify the options available to the PM and identify whether any of the options might breach a Regulatory Rule or a Product Rule. Aladdin will also model

the impact of participating in the corporate action, in the same way as it would do for a trade proposed by the PM. Aladdin will, as appropriate, restrict any trading on the securities until the "ex-date" i.e. the date until which the portfolio needs to hold a particular security in order to benefit from the corporate action, thus ensuring that the fund does not lose its entitlement.

87. Mr Kirby-Tibbits accepted that, although Aladdin helped the PM to decide what action to take in relation to a corporate action, it did not take over the whole of this function because the PM was also using his or her own judgement.

88. **Trading.** If Aladdin and the PM are satisfied that sufficient resources are or will be available to fund the trade, and Aladdin has not blocked the trade for compliance reasons, the PM uses Aladdin's trade execution tools to place the order. Aladdin communicates the order to one of BlackRock's dealing teams. Those teams are not part of Aladdin, but they use the Aladdin Platform to 'pick up' the order placed by the PM.

89. In relation to trading, set out above, Mr Kirby-Tibbits accepted that it was the PM, using Aladdin combined with his or her own judgement, to decide which investments to buy or sell and that the ultimate decision lay with the PM.

90. The dealing teams have access to the Aladdin Platform (with the information available to them being tailored to their role as dealers). Aladdin enables the dealers to execute trades in accordance with BlackRock's "best execution" policies. The best execution regime is set out in the Financial Conduct Authority Handbook at Conduct of Business Sourcebook 11.2. This requires asset managers such as the Aladdin Recipients to take all reasonable steps when executing orders to obtain the best possible result for the investors. This involves not just obtaining the best price but might include aggregating dealing instructions from different PMs on the same stock, or matching a sale order from a BlackRock PM to a buy order from another BlackRock PM (i.e. "crossing"), where this is permitted. Finally, Aladdin tracks the progress of trading orders until they are completed, enabling the dealing team (on the instructions of the PM) to reverse a transaction in the event of unforeseen circumstances.

91. As regards aggregation and "crossing", Mr Kirby-Tibbits again agreed that Aladdin was a tool providing the dealing team with information but Aladdin was not taking over the whole function. For example with "crossing" Aladdin merely informed the dealing team of a "crossing" opportunity but the dealing team, using its own judgement, would decide whether to take up that opportunity. Similarly, as regards the tracking of orders, the PM could reverse the order if the situation changed but ultimately the decision was that of the PM.

92. **Post-trade portfolio administration.** After a trade has been made by the dealing teams, the trade is settled by the third-party custodian. Settlement is the process of delivering title to the financial instrument to the buying party and payment to the selling party. The custodian takes custody of the financial instruments and

makes payment from the portfolio assets. This service is performed by the third-party custodian.

93. The Aladdin Recipients must maintain their own accurate and up-to-date records in order to allow the detailed portfolio and risk analysis processes, described above, to be carried out. This includes keeping records of the details of trades that have been executed but not yet settled. Aladdin uses records of trades that have been executed to reconcile cash and securities balances in real-time with third-party custodians.

94. Mr Kirby-Tibbits agreed that Aladdin provided a PM with an accurate tool to keep track of the flow of cash into and out of a fund thus enabling the PM to take investment decisions based on such accurate information. The thrust of his evidence was that without Aladdin it would be much more difficult for a PM to keep track of cash balances. Mr Kirby-Tibbits said that it needed to be borne in mind that if a single portfolio had many holdings and the PM did one or two or three transactions in different currencies that was "a lot that you would need to take into consideration and you would need to think in multiple different ways and remember everything over the day." The PM would previously have needed to keep all the cash numbers in his or her head but, after the introduction of Aladdin, Aladdin performed the cash calculation in real-time. Mr Kirby-Tibbits likened keeping track of cash balances without Aladdin as "driving in the dark with no lights." I infer from this that, bearing in mind that Aladdin allowed a PM to manage many more portfolios than before, keeping track of cash balances without access to Aladdin's functionality would be very difficult indeed.

95. Similarly, Aladdin uses the information it holds and/or receives to produce income forecasts and net asset value calculations for each portfolio, which it again reconciles with the forecasts and calculations that are held by the custodians.

96. Before Aladdin's introduction, the PMA or another individual working for the Aladdin Recipients had to log into a system operated by the custodian, access the position statements and export them into an Excel spreadsheet, before reconciling the position with the Aladdin Recipients' own post-trade records.

97. These calculations are now done by the Aladdin software, but employees working for or on behalf of BFMI will review and check the calculations. BFMI engages over 1,000 individuals worldwide to review and check the calculations and feed into the start of day reporting and performance attribution applications (see [78] above). In the first instance, an analyst will review the calculations produced by Aladdin against the figures from the previous day and identify any anomalies and investigate those further. Any exceptions that cannot be reconciled will be referred to the PM. The analysts will then look at the overall performance and composition of the portfolio and again identify any anomalies when compared with the previous day's performance.

98. The real-time information provided by Aladdin is supplied to the custodian at the end of each day and the custodian will produce on the following day (typically

between 10 AM and 5 PM) an end of day report for the previous day giving the net asset value calculation for the fund.

99. Mr Kirby-Tibbits accepted that the services provided by Aladdin were supplemental and possibly duplicative, in some cases, of those provided by the custodian. Mr Kirby-Tibbits accepted that Aladdin did not take over the whole of the post-trade portfolio administration function.

100. Mr Kirby-Tibbits clarified that the 1,000 individuals referred to at [97] above also work at keeping the information on the BlackRock servers up-to-date as well as checking for anomalies and exceptions.

101. Although end of day net asset value calculations and other reporting functions are carried out by the third party fund accountants that maintain the official books of record for the funds, it is Aladdin that provides the PMs with the start of day and real-time intra-day positions which allow the PMs to take informed investment decisions throughout the day. The end of day calculations and balances produced by the third party fund accountants are often not received by the Aladdin Recipients until early afternoon the following day. Without the real-time reporting performed by Aladdin, the PMs would be working from out- of-date positions for most of the day.

102. The individuals performing the portfolio administration and quality control services are working on behalf of BFMI from locations around the world. As with other employees working to provide the Aladdin Services, depending upon the jurisdiction in which the individual employees are based, BFMI was not always the employing entity. However, where the individuals were employed by other BlackRock group entities they were nevertheless performing services on behalf of BFMI.

103. Mr Kirby-Tibbits described the Aladdin Services as a combination of hardware, software and human input, and the employees working on the reporting and portfolio administration functions were a part of Aladdin. The hardware comprised of BFMI's computer servers that store Aladdin's data system. When an employee of an Aladdin Recipient logged in to the Aladdin system, he or she would have access to data centres which information was stored.

The facts - portfolio management before Aladdin

104. The BlackRock group began to supply and use the Aladdin Services in or around 2008. Prior to the development of the Aladdin Services, the cycle of risk analysis, decision making, trading, settlement and reporting was far less integrated and much more time consuming. Portfolio activity was uploaded into a mainframe computer system that only updated overnight. Reports were therefore not available in real time, and compliance with Regulatory and Product Rules and other investment criteria was systematically monitored after the event, once the mainframe had updated. Detailed risk analyses were produced manually using information that needed to be collated from various third party vendors and were provided to the PMs only periodically. The effect of these constraints was twofold:

(1) the ability of the PMs to understand the ongoing risks to which their portfolios were exposed was more limited and, to the extent available, very labour intensive; and

(2) the range of funds with specific combinations of rules and investment aims that could be marketed was naturally inhibited by the monitoring capabilities that were available.

105. Thus, for example, the pre-Aladdin Green Package showed the PM what investments each portfolio held at the end of the previous day. It did not provide a detailed analysis of the risks within the portfolio. Instead, risk analyses were produced periodically by a team within BlackRock known as "PARM" (Portfolio Analysis and Risk Management). These risk analysis reports were produced typically on a monthly basis. The introduction of Aladdin changed the dynamic of risk analysis and made it a real-time rather than an ad hoc periodic process.

106. Also, if a PM wished to see the impact of a proposed trade on the risk levels in the portfolio, the PM could ask PARM to check a theoretical portfolio in order to model the effect of the proposed trade. The modelling carried out by PARM was a time-intensive process and, therefore, PMs had limited opportunities to approach PARM with requests to model various scenarios.

107. Therefore, before the introduction of Aladdin, the PM was required to have a reasonable knowledge of the risks associated with the different investments that the portfolios which the PM managed might invest in or be exposed to. Acquiring and maintaining this knowledge was a very time-intensive process. A PM would work with a PMA who would assist with reading company reports and managing and applying the information as necessary.

108. Furthermore, before the introduction of Aladdin, PMs would place orders to trade assets in the portfolio using an internally built system called Fund Manager Workbench ("FMW"). FMW was not, unlike Aladdin, able to model the impact of a proposed trade on the risk levels or other exposures within the portfolio.

109. As regards the application of the Regulatory and Product Rules of the specific fund, prior to the introduction of Aladdin the PM kept a physical "rulebook" for each of the portfolios that the PM managed. A PM was typically responsible for approximately 10 individual portfolios and was required to have a clear understanding of the rules and restrictions that apply to each fund. Since introduction of Aladdin a PM is now able to manage as many as 40 fund portfolios. Moreover, the number of PMAs required has significantly reduced.

110. Some Product Rules might have been coded into the FMW system that the PM used to submit orders. However, generally, the onus was on the PM to be familiar with and apply the rules so that the rule books on the PM's desk were an essential resource. Now, Aladdin is able to identify whether proposed trades might lead to breaches of various rules before the trades have taken place and either put a block on the proposed trade or alert the PM to the need to take corrective action.

111. Prior to the introduction of Aladdin, rules relating to the relative weightings of particular investments within the portfolio were hard to monitor even if the PM was familiar with the relevant rule book. For example, a common restriction applicable to retail funds is that no more than 10% of net assets within the portfolio should be represented by a single issuer. The PMA calculated the percentage holdings manually from the daily portfolio data and, where this identified that the balance of assets within the portfolio was approaching a concentration limit (e.g. 10%); the PMA would bring it to the PM's attention – typically by sending an email. Aladdin can track the concentration of assets systematically and be programmed to issue a warning to the PM if the PM is proposing a trade which is close to the relevant concentration limit. This can be achieved by PCG programming Aladdin to recognise and apply an "early warning" threshold and to generate alerts once that threshold has been exceeded.

112. Similarly, before Aladdin, if a start of day report identified a breach of a concentration limit, the PMA would have to identify the cause of the breach. For example, the limit may have been infringed as a direct result of a decision by the PM to buy or sell a particular investment. Alternatively, the infringement could be a passive breach brought about by movements in the market taking place subsequent to the trading activity. Aladdin is able to perform the analysis and indicate whether a market movement or trading decision has led to the breach, without the PM or PMA having to undertake the laborious analysis described above.

113. In relation to trading, orders to buy and sell assets on behalf of the funds managed by the Aladdin Recipients are placed on the market by dealing teams working for BlackRock. Although the individuals that comprise the BlackRock dealing teams in the UK are typically employed by the Aladdin Recipients, the dealing teams are kept separate from the PMs and the investment management teams. When a PM wishes to trade the assets of a fund, it is necessary to communicate the instruction to trade to the relevant dealing team. Before the introduction of Aladdin, PMs communicated instructions to trade through the FMW system, which in turn communicated the instruction to the dealers.

114. Once the dealers had carried out the instruction and received the contract settlement dates from the brokers, they logged details of the trade into the mainframe computer system. The mainframe computer then updated itself overnight to reflect trades carried out the previous day. There was no ability to view the trading process in real-time in contrast to the current position with Aladdin.

115. Before Aladdin, opportunities for "crossing" could only be identified on an ad hoc basis, but there was no systematic way of doing this. Aladdin, however, can identify all opportunities for this form of cross-trading and whether the particular opportunity is permissible from a regulatory perspective or by reason of a client's consent.

116. In relation to corporate actions (e.g. rights issues, stock dividends, takeovers etc.), the previous mainframe computer system could not reflect any change in entitlements until the following morning. The PM had to make a note of the change

taking effect and keep it in mind when making trading decisions for the remainder of the day. Aladdin, however, updates the changes in position in real-time.

117. Also, before the introduction of Aladdin, PMs received updated cash balances for their portfolios at 11 am. The mainframe computer and FMW, which updated overnight, would not reflect updated cash balances until the following morning. Thus, if a PM was told at 11 am that, for example, a further £10 million had been subscribed by investors the PM would have manually to enter this information into FMW, overriding the start of day position. Aladdin, however, recalculates and updates cash and asset positions throughout the day.

The authorities

The exemption issue

118. For simplicity, I shall refer to the Court of Justice of the European Union and its predecessor (the Court of Justice of the European Communities) as the "CJEU" or "the Court".

119. There are two main relevant authorities of the CJEU: *Abbey National plc v Customs & Excise Commissioners Case* C-169/04 [2006] STC 1136 ("*Abbey National*") and *GfBk Gesellschaft fur Borsenkommunikation mbH v Finanzamt Bayreuth* [2013] EUECJ C-275/11 (07 March 2013) ("*GfBk*"). Both cases concerned the outsourcing of certain aspects of investment fund management.

120. *Abbey National* involved the outsourcing of administrative and accounting functions to a third party, the Bank of New York ("BoNY"), by the managers of SIFs, all of whom were members of the same VAT group. In particular, BoNY undertook to perform "a raft of services" including computing the amount of income and the price of units or shares, the valuation of assets, accounting, the preparation of statements for the distribution of income, the provision of information and documentation for periodic accounts and tax, statistical and VAT returns, and the preparation of income forecasts. The question before the Court was whether the supply of those services by BoNY to the managers of the SIFs was exempt as the supply of investment management services.

121. The Court held at [44] that the concept of "management" of SIFs for the purposes of (what is now) Article 135.1(g) PVD had its own independent meaning in Community law from which Member States could not diverge.

122. The exemption (in what is now Article 135.1(g) PVD) was an exception to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person, and should therefore, the Court held at [60], be interpreted strictly. Pausing on this point, I would simply make two observations: first, that although an exemption is to be construed strictly, that is not to say that a Court or Tribunal should adopt a restricted or the most restrictive construction, simply that "the task of the court is to give the exempting words a meaning which they can fairly and properly bear in the context in which they are used" (see *Expert Witness Institute v C&EC*

[2002] STC 42 CA at [17]- [19]). Secondly, the interpretation of the terms of an exemption must be consistent with the objectives pursued by those exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT. Accordingly, the requirement of strict interpretation does not mean that the terms used to specify the exemptions referred to in Article 135 must be construed in such a way as to deprive the exemptions of their intended effects (see *Staatssecretaris van Financien v Fiscale Eenheid X NV cs* - C-595/13 [2015] All ER (D) 93 at [68]).

123. At [63] the Court held that the transactions covered by that exemption are those which are *specific* to the business of undertakings for collective investment. Thus, services which could be used in any business would not be sufficiently specific to fall within the exemption.

124. The Court continued by concluding at [64] that, apart from tasks of portfolio management, the services of administering undertakings for collective investment themselves, such as those set out in Annex II to Directive 85/611 [the UCITS Directive], as amended, under the heading 'Administration', were functions specific to undertakings for collective investment and therefore fell within the scope of art 13B(d)(6) of the Sixth Directive [Article 135.1 (g) PVD] (see also *GfBk* at [22]). Again, pausing for a moment on this point, it is clear that the Court regarded Annex II to the UCITS Directive as being illustrative and non-exhaustive and this was common ground in the argument before me (see also *GfBk* at [25] to that effect).

125. The Court accepted at [67] (see also *GfBk* at [28]), that the exemption:

> "…does not in principle preclude the management of special investment funds from being broken down into a number of separate services which may come within the meaning of 'management of special investment funds' in that provision, and which may benefit from the exemption under it, even where they are provided by a third-party manager…"

126. In an important passage the Court held at [70] that:

> "…to be regarded as exempt transactions for the purposes of art 13B(d)(6) of the Sixth Directive [Article 135.1 (g) PVD], services performed by a third-party manager in respect of the administrative management of the funds *must, viewed broadly, form a distinct whole, fulfilling in effect the specific, essential functions of a service described in that same point 6….*" (Emphasis added)

127. The Court continued at [71]:

> "The services supplied must therefore concern specific essential elements of the management of special investment funds. Mere material or technical supplies, such as the making available of a system of information technology, are not covered by [Article 135.1 (g) PVD]."

128. At [72] the Court summarised its conclusion as follows:

> "Therefore, it must be held that art 13B(d)(6) of the Sixth Directive [Article 135.1 (g) PVD] is to be interpreted as meaning that the services performed by a third-party manager in respect of the administrative management of the funds come within the concept of 'management of special investment funds' in that provision if, viewed broadly, they form a distinct whole, and are specific to, and essential for, the management of special investment funds."

129. The CJEU remitted to the national court (the UK VAT and Duties Tribunal) the question whether these criteria were fulfilled on the facts of the case.

130. In her opinion, Advocate General Kokott elaborated on whether services provided to the manager of a SIF constituted the "management of special investment funds". At [99]-[101] of her opinion, the Advocate General explained:

> "99. An argument in favour of the services forming a distinct whole in the present case is the fact that BNYE/BNY took on not just individual ancillary operations but so to speak an inclusive service, as follows from the description of the outsourced functions in para 24 above. The transferred functions constitute an essential part of the activities which are listed as management functions in Annex II to Directive 85/611 [the UCITS Directive]. BNYE/BNY is responsible in particular for valuing the units and making payments. It also takes over core functions of accounting and reporting.
>
> 100. Some of the outsourced functions may, taken individually, not have distinctive character. In that respect, it is not sufficient for exemption from VAT that a certain function is listed in Annex II to Directive 85/611. The necessary distinctiveness is attained, however, if the third party takes on a bundle of services which forms an essential part of all the functions arising in the management of the fund.
>
> 101. Distinctiveness derives in that case not only from the extent of the outsourced services but also from the inner coherence of the operations outsourced. Valuation, for instance, is an important element for drawing up settlement documents and reports."

131. The Advocate General continued by saying at [102]-[104] that there was "some indication" that the functions which had been outsourced to BoNY were properly to be regarded as specific and essential to the management of a SIF. She said at [102] that: "Closely connected with valuation is the keeping of the corresponding records for the purposes of rendering accounts to the present (and potential) unit-holders and to the supervisory authorities." She noted, however, at [103] that some outsourced functions, such as those connected with payments, were not specific to the management of a common fund, even though they were "just as essential." The mere fact that an element is essential for completing an exempt transaction did not warrant the conclusion that the service that element represents is exempt. The Advocate General concluded at [104] that the exemption was not precluded by the fact that some component activities were not specific to fund management: "it is precisely the bundling of numerous more or less specific operations that is typical of the management of a common fund."

132. *GfBk* involved a case where a third party, GfBk, provided investment advice and recommendations to an investment management company ("IMC") which managed a retail investment fund. IMC entered those recommendations into its purchase and sale order system and, after checking that they did not infringe any statutory investment restriction applicable to special investment funds, implemented them, often within a few minutes of receiving them. Although the IMC made no selection of its own in the management of the investment fund, the final decision and final responsibility continued thereby to lie with it. GfBk was informed of the action taken following its recommendations and received daily statements of the composition of the investment fund for which it provided advice.

133. The Court at [21] followed *Abbey National*, holding that, in order to fall within the investment management exemption, management services provided by a third party manager "must, viewed broadly, form a distinct whole and be specific to, and essential for, the management of special investment funds."

134. At [22] the Court considered that it was necessary:

> "…to examine whether the advisory service provided by a third party concerning investment in transferable securities is intrinsically connected to the activity characteristic of an IMC [investment management company], so that it has the effect of performing the specific and essential functions of management of a special investment fund."

135. The Court concluded at [24] that services consisting in giving recommendations to an investment management company to purchase and sell assets were intrinsically connected to the activity characteristic of investment management.

136. The Court continued:

> "27. The court held in *Abbey National*, paras 26, 63 and 64, that not only investment management involving the selection and disposal of the assets under management but also administration and accounting services—such as computing the amount of income and the price of units or shares, the valuation of assets, accounting, the preparation of statements for the distribution of income, the provision of information and documentation for periodic accounts and for tax, statistical and VAT returns, and the preparation of income forecasts—fall within the concept of 'management' of a special investment fund. It is therefore not important that, as in the case in the main proceedings, it was for the IMC in question to implement the recommendations provided by GfBk to purchase and sell assets, after checking that they complied with investment limits.
>
> 28. Furthermore, the wording of art 13B(d)(6) of the Sixth Directive [Article 135.1 (g) PVD] does not in principle preclude the management of special investment funds from being broken down into a number of separate services which may then fall within the meaning of 'management of special investment funds' in that provision, and may benefit from the exemption under it, even where they are provided by a

> third party manager (*Abbey National*, para 67), so long as each of those services has the effect of performing the specific and essential functions of management of a special investment fund. As has been pointed out in para 24 of the present judgment, that is so in the case of recommendations provided by a third party to an IMC to purchase and sell assets."

137. Noting at [30] that the purpose of the exemption was to ensure fiscal neutrality for small investors investing in SIFs, the Court considered at [31] that subjecting GfBk's services to VAT would give investment management companies that had their own investment advisory capability an advantage over those that had to outsource that service. This would infringe the principle that economic operators must be able to choose the form of organisation which, from the strictly commercial point of view, best suits them.

138. The Court therefore concluded that GfBk's services fell within the exemption.

139. In *GfBk*, Advocate General Cruz Villalon explained at [27] of his opinion that "the service provided by the third-party [to whom the provision of certain services had been outsourced] must be intrinsically connected to the service provided by the management or investment company, and also have a significant degree of autonomy as regards its content."

140. The Advocate General continued that [36] and [37]:

> "36. The case law test of specificity and distinctness at issue in this case is concerned with the autonomy of the service too, in other words, with the capacity to assume responsibility for services which are sufficiently defined so that they do not become blurred with other services provided by the recipient of the service. To a certain extent, this condition concerns the decisive character of the service and this is why the court has sometimes used the adjective 'essential' when referring to the requirement that 'viewed broadly' the service must form a 'distinct whole'.
>
> 37. Accordingly, a service that, 'viewed broadly', forms a 'distinct whole' is one that, first, cannot be confused with other services already performed by the recipient of the service. For example, if a management company already carries on accounting activities and that is evidenced by the fact that it has an internal accounts department which covers the whole of the service, it would be difficult to differentiate an accounting service provided by a third party from the one already performed internally by the company. That observation confirms how the service provided by the third party would lose autonomy because the recipient of the service already performs that service itself."

141. Furthermore, at [41], the Advocate General concluded that it was not essential for there to be a change in the legal or financial situation in order for the exemption to apply, "but rather an outsourcing, in *substantive* terms, of the activity of 'management'".

142. More recently, in a case relating to services concerning payments into and disbursements from pension funds (*ATP PensionService A/S v Skatteminiseriet* Case C/12 [2014] STC 2145 at [65]), the CJEU has confirmed that the exemption contained in Article 135.1 (g) PVD "must, viewed broadly, form a distinct whole and be specific to, and essential for, the management of special investment funds." In other words, the CJEU reconfirmed the test first laid down by the Court in *Abbey National*.

The apportionment issue

143. Essentially, BlackRock argues that if the supply of Aladdin were to be classified as a supply of "management" services, there should be an apportionment between the supply of Aladdin for its use in relation to SIFs and non-SIFs. Thus, BlackRock argues, the single supply made by BFMI to BlackRock should be exempt to the extent that it is used by the Aladdin Recipients to manage special investment funds.

144. In *Talacre Beach Caravan Sales Ltd v Customs & Excise Commissioners* Case C-251/05 [2006] STC 1671 ("*Talacre Beach*") the CJEU considered a case concerning the supply of caravans and their contents. The taxpayer argued that the zero rating (exemption with the refund) applicable to the caravans also applied to its contents because the supply was a single indivisible supply which should therefore be subject to a single rate of VAT. HMRC argued, however, that under national law the zero rate applied only to the caravans themselves and that the standard rate of VAT applied to their contents.

145. The CJEU held that to allow the contents of the caravans to benefit from the zero rating would extend the scope of the exemption laid down for the supply of the caravans themselves and that such an interpretation would be inconsistent with the zero rating provisions of the Sixth Directive. National law specifically excluded some items supplied with the caravans from zero rating. Article 28(2)(a) of the Sixth Directive authorised member states to maintain exemptions that were in force on 1 January 1991 – this was effectively a "standstill" clause. To extend the exemption to the contents of caravans would extend the scope of the exemption laid down for the supply of the caravans themselves and this would run counter to the provision's wording and purpose. On this basis, therefore, the Court held that although there was a single supply the supply of contents of the caravans could not benefit from zero rating.

146. Advocate General Kokott stated the general rule at [31]-[32] of her opinion:

> " 31. The question of the scope of a transaction may be of particular importance, for VAT purposes, not only for identifying the place where the taxable transactions take place but also for applying the rate of tax or the exemptions provided for in the Sixth Directive. If an exemption is applicable to the principal element of a comprehensive supply, this exemption may, according to the principles set out above, also be extended to the subordinate elements that would be taxable as separate transactions.

32. Only *one* rate of taxation can be applied to *one* (composite) supply. If it were to be assumed that there was one supply, but the taxable amount were nevertheless to be split for the application of several rates of taxation, this would be contrary to the aim of the case law on composite supplies, namely to maintain the functioning of the VAT system."

147. The Advocate General, however, indicated at [35]-[45] that two different VAT rates could be applied to a single supply in circumstances where the main element was subject to a zero rate which constituted a national exception to the general principle that VAT should be charged at the standard rate to all suppliers of goods and services. The Advocate General continued at [38]-[40] that:

"38. When balancing these objectives, the interest in not undermining the harmonisation of law achieved by the Sixth Directive by extending national exceptions should be given priority over the objectives pursued by the Court with its rules [e.g. *Card Protection Plan Ltd v Customs and Excise Comrs* (Case C-349/96) [1999] STC 270 ("*CPP*")] determining the scope of a supply. In essence those rules have been developed only for reasons of practicality and do not claim absolute application.

39. Thus in *CPP*, para 27 the Court emphasises that the question of the correct method of proceeding when determining the scope of a supply cannot, in view of the diversity of commercial operations, be answered exhaustively for all cases. The rules laid down in *CPP* cannot therefore be applied systematically. Instead, when determining the scope of a supply all the circumstances must be taken into account, including the specific legal framework. In the present case, it is necessary to have regard to the particularity that the United Kingdom has established the exemption in a specific way in accordance with its socio-political evaluation and that national reliefs under the transitional regime of art 28 may continue to exist but may not be extended.

40. The application of a national exemption under art 28(2)(a) of the Sixth Directive is permissible only if it is—in the view of the member state—necessary for precisely defined social reasons for the benefit of the final consumer. In that regard the United Kingdom has determined that the zero rate should be applied only to the supply of caravans. It did not consider that the inclusion of the removable contents was justified on social grounds. This assessment of the national legislature cannot simply be overridden."

148. The CJEU expressly agreed with this analysis at [24]-[25], acknowledging at [24] that "a single supply is, as a rule, subject to a single rate of VAT…."

149. Advocate General Kokott concluded:

"42. Finally, although it must be conceded that the Court has accepted that tax exemptions for the principal element of a composite supply may be extended to ancillary supplies connected with it, nevertheless, as the United Kingdom Government rightly submits, those cases concerned exemptions under art 13 of the Sixth Directive, and

therefore exemptions enshrined in the scheme of the directive and in the application of which the right of deduction is excluded. In contrast, the national exceptions under art 28 lie outside the harmonised framework. They are not directed at the same objectives as the exemptions provided for in the directive itself and differ in form from those exemptions. Consequently, in those cases it is necessary to take particular care that the exceptions are not extended.

43. In summary, I reach the following conclusion: The rules on determining the scope of a transaction cannot be understood in such a way that they require a national exemption under art 28(2)(a) of the Sixth Directive to be extended to items which national law expressly excludes from the scope of the exception."

150. I note in relation to the comments at [42] that the Advocate General is referring to cases where the taxable element of a single supply was incidental or ancillary to an exempt dominant supply e.g. *Skatteministeriet v Morten Henriksen* [1989] EUECJ R-173/88.

151. In the later case of *Commission v France* Case C-94/09 [2012] STC 573 ("*the French Undertakers case*") the CJEU applied the same reasoning. In that case Article 96a PVD provided that the same rate of VAT, the standard rate, was applicable to supplies of goods and supplies of services. As an exception to that general principle, Article 98(1)b and (2) of the Directive granted member states the right to apply reduced rates of VAT to supplies of services by undertakers set out in Annex IIIc to that Directive. However, the national legislation of the French Republic on VAT provided that only the transportation of the body was subject to a reduced rate; all other services for funerals were subject to the standard rate. The Commission argued that the services supplied by undertakers constituted a single supply and therefore a single rate of VAT should be applied.

152. In other words, ordinarily the whole of the supply in question would have been standard rated but the member state had exercised its option to apply a reduced rate to part of the supply. Thus, *the French Undertakers case* was in effect the converse of *Talacre Beach* where the supply was predominantly zero rated but the member state had specifically decided to exclude an aspect of the supply from the zero rating.

153. The CJEU held that a member state was entitled to apply a national reduced rate of VAT which was limited to "concrete and specific aspects of the category of supply" ([29]) listed in the provisions of the PVD which provided certain national reduced rates (art 98 and Annex III). The French government could have subjected the entire supply by an undertaker to the reduced rate but it was at liberty to apply the reduced rate selectively. In those circumstances, the member state's choice had to prevail over the countervailing principle that a single supply was subject to a single rate of VAT.

154. The next decision of the CJEU concerned the provision of airport parking. In *Purple Parking Ltd v HMRC* Case C-117/11 [2012] STC 1680 the taxpayer provided airport parking in which a minibus took customers to and from the car park. The car parking service was standard rated and the issue was whether there were two separate

supplies i.e. the supply of transport (i.e. the minibus journey), which should be zero rated, and the supply of parking which should be standard rated. The costs incurred by the taxpayer in providing transport to the customers were included in a daily rate for parking.

155. The Upper Tribunal referred questions to the CJEU and, in particular, asked how it was to take account of the conclusions reached by the CJEU in the *French Undertakers case* in relation to the principle of fiscal neutrality and transport services in that case. The CJEU responded at [40] that that case:

> ".. concerns the possibility for a member state to apply, in a selective manner, on the basis of general and objective criteria, a reduced rate of VAT to certain aspects of a category of supplies that is listed in the Sixth Directive and, accordingly, concerns a different question from that raised by the first and second questions referred for a preliminary ruling. Indeed, the sole purpose of the latter is whether two services constituted, in the light of the specific circumstances of their supply at issue in the main proceedings, a single supply."

156. In other words, the CJEU appears to have taken the view that it was axiomatic that a single (standard) rate of tax applied in that case because there was a single composite supply of car parking and that this was different from the *French Undertakers case* where the member state had exercised its right to apply a lower rate of tax to a component of an overall supply.

157. Finally, the Court of Appeal in *Colaingrove Ltd v* HMRC [2017] STC 1287 ("*Colaingrove*") had to address an apportionment issue in respect of a single supply. In that case the taxpayer provided holiday accommodation in static caravans. It was a term of the holiday let that the customer would pay a sum for accommodation in the caravan and using its facilities, which included electricity. The supply of domestic power was subject to a reduced rate of VAT under UK domestic law. The taxpayer argued that, as regards the supply of electricity, it was only required to account for the reduced rate of VAT. Counsel for the taxpayer had argued that a failure to apportion would lead to an odd result which could be avoided by having a contract for two separate supplies. The Court of Appeal (Arden, Lindblom and Henderson LJJ) rejected these arguments.

158. Arden LJ held at [48] that it was only possible to carve out one aspect of a composite supply where there was a domestic legislative warrant for doing so. Within the relevant statutory Schedule there were a number of provisions which envisaged apportionment, but none of them applied where fuel was part of a composite supply:

> "…if it had been Parliament's intention that the reduced rate should apply to an element of the supply, it should have inserted some similar apportionment provision. This is not case (such as the exclusion of contents from caravans [a reference to *Talacre Beach*]) where the *CPP* principles need to be excluded since fuel forms a minor part of a composite supply and is subject to the limitation that it must be supplied for domestic use."

Submissions and discussion

The exemption issue - submissions

159. Mr Hitchmough examined the principles laid down in the *Abbey National* and *GfBk* decisions. He submitted that the Aladdin Services provided by BFMI to the Aladdin Recipients were *essential* to the Aladdin Recipients of fund management. Mr Kirby-Tibbits' evidence was clear that prior to the introduction of Aladdin the functions performed by Aladdin would have been performed by the PMs, the PMAs or other teams within BlackRock. The evidence was that the number of funds that can be managed by a PM had significantly increased with the advent of Aladdin and the number of PMAs required had fallen.

160. Secondly, Aladdin's functions were, Mr Hitchmough argued, *specific* to the business of fund management, e.g. analysis of the performance of the portfolio, identification of causes of tracking errors, real-time analysis of risks in the portfolio, monitoring corporate actions, monitoring compliance with Regulatory Rules and Product Rules and blocking trades potentially in breach of those rules, record-keeping and reconciliation of assets and cash balances). Viewed as a whole Aladdin's package of services was intrinsically connected to the business of fund management.

161. Thirdly, the Aladdin Services formed a *distinct whole*. They were not blurred with other services provided by the Aladdin Recipients. Mr Hitchmough contended that BFMI and the Aladdin Recipients had distinct roles. If, for example, Aladdin warned a PM about a compliance issue and blocked a proposed trade, it would then be for the PM to decide whether to accept that the trade had been correctly blocked or to seek approval from PCG. Although the roles were interactive they were distinct.

162. Mr Hitchmough referred to the *GfBk* decision and drew an analogy between the investment advice provided by GfBk to the IMC. In that case GfBk's role was to provide investment advice. The IMC received the advice to make investment decisions but retained the final authority over those decisions.

163. Mr Hitchmough argued that HMRC were wrong to contend that BFMI's Aladdin Services did not constitute a distinct whole on the basis that Aladdin's functions appeared to be only partial in respect of each function. HMRC seemed to argue that the Aladdin Recipients had to outsource to BFMI responsibility for the whole of trade execution, data control and operations, portfolio administration or portfolio and risk analysis.

164. The CJEU in *Abbey National* and *GfBk* had explicitly recognised that fund management could be broken down into a number of separate services. There was, argued Mr Hitchmough, no requirement that the third-party must perform the whole of any given function.

165. The Aladdin Services, Mr Hitchmough submitted, constituted a package of services and carried out different functions at the various stages of the fund management cycle. The bundle of services constituted an essential part of all the functions arising in the management of the fund and it was this bundling that gave the

Aladdin Services the necessary distinctiveness. Mr Hitchmough referred to the opinion of Advocate General Kokott in *Abbey National* at [104] that it was the bundling of numerous more or less specific operations that was typical of the management of a common fund.

166. Furthermore, distinctiveness for these purposes involved, according to Advocate General Kokott in *Abbey National* at [101], the extent and the coherence of the outsourced services. Mr Hitchmough drew attention to the comparison between the pre-Aladdin and the post-Aladdin positions of the Aladdin Recipients. He submitted that Mr Kirby-Tibbits' evidence concerning the number of funds that PM could now manage, the number of PMAs now required and the range of products could be offered was clear evidence of the extent and coherence of the services provided through Aladdin by BFMI. In addition, Mr Hitchmough referred to Mr Kirby-Tibbits' evidence that the range of funds with specific combinations of rules and investment aims that could be marketed was naturally inhibited by the monitoring capabilities that were available before Aladdin.

167. Mr Hitchmough submitted that the distinct character of the Aladdin Services was demonstrated by Mr Kirby-Tibbits' evidence of the specific tasks that the PM had to undertake before the introduction of Aladdin in connection with the management of a portfolio but which Aladdin now performed for the PM. Secondly, Mr Kirby-Tibbits' evidence of the tasks performed by Aladdin showed that these tasks were intrinsically connected with fund management and which Aladdin now performed in a manner, speed and with a level of accuracy that previously was not possible.

168. Mr Raymond Hill, for HMRC, argued that *Abbey National* and *GfBk* established that partial outsourcing of the management and administration of a SIF is only exempt provided that significant aspects of management and administration were outsourced and each of those aspects is sufficiently comprehensively outsourced. Mr Hill relied in particular on the comments of Advocate General Cruz Villalon in *GfBk* at [27] that the outsourced services needed to have "a significant degree of autonomy as regards its content". In addition Mr Hill relied on [36]-[37] of the Advocate General's opinion to the effect that the outsourced services should not "become blurred with other services provided by the recipient of the service" and that the service "cannot be confused with other services already performed by the recipient of the service."

169. Mr Hill submitted that the services outsourced must form a distinct whole in the sense of being an inclusive service forming a coherent part of the management of SIFs. This meant that the sub-contractor had to assume responsibility for those aspects of the management of SIFs – they should not simply be one aspect of a complete service otherwise performed by the recipient of the sub-contractor's service.

170. Mr Hill submitted that the Aladdin Agreement did not purport to outsource investment management or administrative management. Moreover, the Aladdin Agreement made it clear that BlackRock would be responsible for all decisions based on the pricing information using Aladdin. BFMI's sole responsibility was to provide the Aladdin system, not to serve as an investment adviser or to make any recommendations based on its risk management analyses. BFMI took no

responsibility in relation to its risk measurement analyses. Thus, Mr Hill submitted, BFMI undertook to provide analytic tools, but it was Aladdin Recipients who used those tools, whilst at the same time exercising their own judgement.

171. Mr Hill noted that Mr Kirby-Tibbits had accepted that until the Aladdin software was programmed by PCG, there was no difference in the generic Aladdin system as regards SIFs and non-SIFs. It was only when Aladdin was programmed by PCG that it became, so to speak, "bespoke" to the relevant fund.

172. There was, Mr Hill argued, a fundamental difference between obtaining a tool (like Aladdin) to enable one to perform a function and asking someone else to perform the function for you. When an Aladdin Recipient used Aladdin it was using software to interrogate a database and produce results. What BFMI was providing was intelligent and sophisticated software and access to databases containing a wide range of information relevant to securities and investment funds, but it was the Aladdin Recipients who customised Aladdin for their own purposes. Moreover, said Mr Hill, it was telling that Mr Kirby-Tibbits had accepted that Aladdin was a tool which the Aladdin Recipients interrogated and then took their own investment decisions on the basis of that information.

173. Mr Hill submitted that, on the evidence of Mr Kirby-Tibbits, approximately thousand BFMI staff who worked on Aladdin were not involved in assisting PMs to decide what to buy or sell nor were they applying the relevant Regulatory and Product Rules nor were they engaged in the administration of funds. They were simply checking and updating information held in Aladdin's database.

174. There was, therefore, no outsourcing in substantive terms of the investment management or the administration of the SIFs to BFMI. This was not a case like *Abbey National* where almost all of the administrative management of the fund was outsourced to BoNY or like *GfBk* where almost all of the investment management was outsourced to GfBk.

175. Next, Mr Hill submitted that, using the language of the Advocate General Cruz Villalon in *GfBk*, the services supplied by BFMI were not autonomous, because they largely overlapped with the activities which the PM was carrying out itself. Aladdin was enhancing tasks that the managers were doing or able to do themselves. The question was not whether Aladdin did things better than hitherto had been possible but rather whether the services formed a distinct whole and were autonomous. The only function which Aladdin performed which the PM did not perform was in relation to the transmission of trading orders.

176. In the course of Mr Hitchmough's reply, Mr Hill helpfully clarified HMRC's position which was that in order to fall within the exemption the third party had to take on a "significant part of the core functions" of the manager, when matters were viewed broadly. The requirements of the exemption that would then be satisfied if, in addition, the taxpayer could show that the service supplied by the third-party did not duplicate something already done by the PM, again viewed broadly.

177. Mr Hitchmough in reply argued that HMRC's submission (that BFMI had to take on a "significant part of the core functions" of the fund manager) had no basis in authority and was unnecessary.

The exemption issue –discussion

5 178. The case-law of the CJEU can be summarised in the following propositions:

(1) The exemption in in Article 135.1(g) PVD is defined according to the nature of the services provided and not according to the person supplying or receiving the service. (*Abbey National* [66]-[69] *GfBk* [20])

(2) The exemption was an exception to the general principle that VAT is to be 10 levied on all services supplied for consideration by a taxable person, and should therefore be interpreted strictly. (*Abbey National* [60])

(3) The exemption applied not only to investment management involving the selection and disposal of assets under management but also to administration and accounting services. (*Abbey National* [26], [63] and [64] and *GfBk* [27])

15 (4) Services falling within the exemption included those functions which related to administering the fund, such as those set out under the heading "administration", in Annex II to the UCITS Directive. Annex II was not exhaustive. (*GfBk* [25])

(5) To ensure fiscal neutrality, the transactions covered by that exemption are 20 those which are *specific* to the business of undertakings for collective investment. (*Abbey National* [62]-[63])

(6) There was nothing in principle which prevented the management of special investment funds from being broken down into a number of separate services. (*Abbey National* [67] *GfBk* [28])

25 (7) The services supplied fall within the exemption if, viewed broadly, they form a distinct whole, and are specific to, and essential for, the management of special investment funds. (*Abbey National* [72] *GfBk* [21])

(8) Mere material or technical supplies, such as the making available of a system of information technology, are not covered by the exemption. (*Abbey* 30 *National* [71])

(9) Services which were intrinsically connected to the activity characteristic of an investment management company would have the effect of performing the specific and essential functions of management of a SIF. (*GfBk* [23]) The service of giving recommendations to an investment management company to 35 purchase and sell assets was so intrinsically connected. (*GfBk* [24])

(10) The purpose of the exemption was to facilitate investment in securities by small investors by means of collective investment by excluding the cost of VAT in order to ensure fiscal neutrality when compared with direct investment. (*Abbey National* [62] and *GfBk* [30])

(11) It followed from the principle of fiscal neutrality that investment advice services provided by a third party should not be subject to a disadvantage when compared with funds which provided their own investment advice. Economic operators must be able to choose the form of organisation which, from the strictly commercial point of view, best suits them. (*Abbey National* [68] *GfBk* [31])

179. The key test, therefore, is whether the services supplied by BFMI to BlackRock form a distinct whole, and are specific to, and essential for, the management of special investment funds.

180. Taking the "specific" test first, there is no doubt in my mind that the services supplied by BFMI were specific to the Aladdin Recipients' businesses as fund managers. Aladdin was specifically designed and supplied for the purposes of fund management and its functions specifically related to various aspects of fund management. These functions, described earlier in this decision, were clearly intended to be used by a PM in managing an investment fund. They were not services or functions which had a generic nature so that they could be used in a variety of different types of businesses.

181. I reject Mr Hill's submission that in order to be "specific" the service needed to be "significant" or "substantial". Mr Hill relied on the statement in [99] of Advocate General Kokott's opinion in *Abbey National* where it was stated that BoNY took over the "core functions" of accounting and reporting. Similarly, as I understood it, Mr Hill relied on the observations of Advocate General Cruz Villalon in *GfBk* at [41] and, in particular, the reference to "an outsourcing" in *substantive* terms, of the activity of 'management'."

182. In my view, these references provide no support for Mr Hill's submission. I agree with Mr Hitchmough's submission that Advocate General Kokott was not attempting to lay down any legal principle but was, in context, seeking to relate the principles she had already explained to the facts of the case.

183. Likewise, Advocate General Cruz Villalon was not seeking to address the question of whether a service was "specific and essential" but rather was dealing with the separate issue of whether (as had been submitted by the German authorities and the Commission in that case) it was necessary for there to be a change in the legal and financial situation. Advocate General Cruz Villalon was not, in my view, placing a gloss on the concept of "specific and essential" but was addressing an entirely different issue. I should observe that Advocate General Cruz Villalon's actual interpretation of the "specific and essential" test was that [27] the services provided by the third-party had to be intrinsically connected to the activity carried out by a common fund (see also [31]).

184. Furthermore, I consider that the Aladdin Services were intrinsically connected(*GfBk* [23]) to the Aladdin Recipients' businesses as fund managers. The analytical and monitoring functions, for example, were clearly entirely directed towards efficient fund management.

185. I accept that Aladdin's function of transmitting trading instructions could be used in other types of financial business. This does not mean that the "specific" test is failed. As the CJEU has repeatedly said, the test is to be "viewed broadly" and that the services provided by the third party should therefore be looked at as a whole. Aladdin's functions spanned, as Mr Kirby Tibbits put it, the whole of the investment cycle. In other words, it provided a range or "bundle" of different but interconnected functions. As a whole, Aladdin was specific to the business of management of a common fund.

186. Furthermore, the fact that PCG customised ("coded") Aladdin for each particular fund does not, in my view, mean that the Aladdin Services were not "specific". Even in their generic form, Aladdin was clearly designed to be used for the specific purpose of investment fund management. That it was customised by PCG staff (i.e. staff not employed by BFMI) seems to me irrelevant. Many sophisticated pieces of software, which enable the user to access databases, allow user customisation. In any event, as regards making Aladdin a "bespoke" system suitable for SIFs, Mr Kirby-Tibbits' unchallenged evidence was that Aladdin contained a suite of documents which included the UCITS rules which PCG simply applied in the relevant case.

187. Similarly, I have concluded that BFMI's services supplied to BlackRock were also "essential" to BlackRock and the other Aladdin Recipients. In this connection, the evidence of Mr Kirby-Tibbits was clear. Whilst he accepted that it would in theory be possible for a PM to carry out manually some of Aladdin's functions, the clear thrust of his evidence was that it would be very difficult and, indeed, impractical for the PM to do so. For example, as regards cash management the evidence was that without Aladdin the PM would have to keep track of cash inflows and outflows, possibly in different currencies. I accept Mr Kirby-Tibbits evidence that it would be very difficult to do this. I also note that the use of Aladdin has enabled a PM to manage many more fund portfolios than was previously the case and has also reduced the need for PMAs. It would, in my judgment, be impractical to expect the Aladdin Recipients to manage the investment funds for which they are responsible by going back to pre-Aladdin analysis and monitoring.

188. The CJEU in *Abbey National* indicated at [71] that "mere material or technical supplies, such as the making available of a system of information technology" did not fall within the exemption. It was no part of HMRC's case, as I understood it, that this exclusion in respect of "technical supplies" and "information technology" applied in this case to exclude the Aladdin Services. In my judgment HMRC were correct to take this view. The CJEU made those comments in the context of considering whether services were specific and essential for the management of an investment fund. In other words, the point that the CJEU was making was that generic technical or information technology supplies (e.g. standard IT systems) were not specific to fund management and were common to many types of businesses. Certainly, there is clear authority that the manner in which the service is rendered is not relevant: an exempt service may be delivered electronically, automatically or manually (see, in relation to the exemption in Article 135.1(d) PVD, at [37] in *Sparekassernes Datacenter (SDC) v Skatteministeriet* [1997] EUECJ C-2/95).

189. I have therefore decided that the Aladdin Services were intrinsically connected to the activities characteristic an investment fund and were "specific and essential" to such management.

190. Although HMRC did not accept that the Aladdin Services were "specific and essential", it was clear that the main battleground, so to speak, in relation to the exemption issue was whether BFMI's services supplied to the Aladdin Recipients formed "a distinct whole" and I now turn to this issue.

191. In neither *Abbey National* nor *GfBk* did the CJEU elaborate on what was meant by the concept of "a distinct whole." *GfBk*, however, does contain one clue. In that case, the third-party supplied investment advice to the IMC. The investment management company, however, retained the ultimate authority on the question whether an investment should be made – it had the final decision. In practice, it appears that the investment management company simply followed the GfBk's advice, having first checked that the recommendations were in accordance with the relevant regulatory requirements. The fact that the investment management company also had a role to play in making investment decisions (albeit a relatively formal one) did not prevent the service of the third-party falling within the exemption.

192. The facts in this case are very different from those in *Abbey National* and *GfBk*. In those cases, the whole or substantially the whole of particular functions relating to investment fund management or administration were outsourced to a third-party. In this case, *part* of many aspects of investment fund management and administration was supplied via Aladdin. In cross-examination, Mr Kirby-Tibbits repeatedly acknowledged in respect of the various different functions of Aladdin that it did not take over the entirety of those functions and that, in most cases, the PM retained an important role. Thus the issue in this case did not squarely arise for consideration in *Abbey National* and *GfBk*.

193. In essence, Mr Hill argued that all or substantially all of the particular function of investment fund management or administration had to be carried out by BFMI through the provision of Aladdin, otherwise the requirement that the third-party services had to form "a distinct whole" was not satisfied. In my judgment that argument is incorrect, as I shall explain.

194. Although the CJEU did not elaborate on the "distinct whole" test, the Advocates General in *Abbey National* and *GfBk* did, as I have explained earlier, shed further light on this concept.

195. In *Abbey National* Advocate General Kokott noted at [67] that the service in question had to be "distinct in character" and at [100] that while some of the outsourced functions, taken individually, may not have a distinctive character, nonetheless the necessary distinctiveness is attained by the third-party taking on "a bundle of services which forms an essential part of all the functions arising in the management of the fund". The Advocate General continued at [101]:

> "Distinctiveness derives in that case not only from *the extent* of the outsourced services but also from *the inner coherence* of the operations

> outsourced. Valuation, for instance, is an important element for drawing up settlement documents and reports." (Emphasis added)

196. Thus, the extent of the services and their inner coherence are factors which give the necessary distinctiveness. In that case, the third-party provided an "inclusive" service but it was also one in which the individual elements had an inner coherence. In other words, the Advocate General was seeking to distinguish cases where the various services were interrelated ("inner coherence") from those where the services were an amalgam of unrelated and disparate services.

197. I have, however, more difficulty with the analysis of Advocate General Cruz Villalon in *GfBk* and, in particular, his view that the "distinctiveness" criterion required "a significant degree of autonomy" as regards the content of the service (see [27]). At [36] the Advocate General defined the "autonomy of the service" to be "the capacity to assume responsibility for services which are sufficiently defined so that they do not become blurred with other services provided by the recipient of the service." At [37] the Advocate General said that the "distinct whole" requirement was one that required that a service:

> "…cannot be confused with other services already performed by the recipient of the service. For example, if a management company already carries on accounting activities and that is evidenced by the fact that it has an internal accounts department which covers the whole of the service, it would be difficult to differentiate an accounting service provided by a third party from the one already performed internally by the company. That observation confirms how the service provided by the third party would lose autonomy because the recipient of the service already performs that service itself."

198. I confess that I have, with respect, some misgivings about Advocate General Cruz's concept of "autonomy". Unlike his explanation of "intrinsic connection" in the context of the "specific and essential" requirement, I note that the CJEU in *GfBk* did not adopt or refer to the Advocate General's analysis of distinctiveness or, in particular, his concept of "autonomy" nor can I discern any reference to this approach in the *Abbey National* decision. In my respectful view, the Advocate General focused too much on the nature of the activities of the recipient of the service rather than concentrating on the nature of the services themselves (see: *Abbey National* [66]-[69] *GfBk* [20]).This is the key difference in approach between the Advocates General: Advocate General Kokott addressed the distinctiveness issue by concentrating in the services themselves ("bundle of services", "extent of services" and "inner coherence") whereas Advocate General Cruz Vilallon addressed the relationship between the third party services and those provided by the recipient of the services ("blurred with other services", "confused with other services" and "difficult to differentiate"). In my judgment the approach of Advocate General Kokott in *Abbey National* on the distinctiveness issue is to be preferred.

199. Furthermore, in the example given by Advocate General Cruz Vilallon of an internal accounts department, with respect, I have some difficulty in seeing why a management company which already carries on some accounting activity should suffer VAT if it decides to outsource part of that activity. There may be any number

of entirely commercial reasons (e.g. staffing levels or pressure of work) why a management company might decide to outsource its accounting function in relation to some particular funds but not in relation to others. That does not, in my view, rob the outsourced accounting service of its distinctive character; were it to do so it would offend against the principle of fiscal neutrality and would also detract from the principle that economic operators must be able to choose the form of organisation which, from a strictly commercial point of view, best suits them.

200. Applying the principles outlined by Advocate General Kokott in *Abbey National*, the Aladdin Services were, in my judgment, interrelated and had an inner coherence. The Aladdin Services provided a sophisticated analytical and monitoring information service, giving access to the extensive data banks stored on BFMI's servers, which covered the full range of what Mr Kirby-Tibbits described as the investment management cycle. Indeed its sophistication and complexity is difficult to convey merely in words and the extent of Aladdin's capabilities only became fully apparent when Mr Kirby-Tibbits gave a practical demonstration of the system. For example, the Aladdin Services involved monitoring the fund, preparing the daily Green Package, identifying the cause of tracking errors, analysing risk, monitoring cash, Regulatory and Product Rule monitoring, monitoring corporate actions, communicating and tracking trading orders and post-trade portfolio administration. It seems to me that these varied functions were coherent in the sense that they were intended to and did cover almost all the aspects in the investment fund management cycle. Furthermore, the broad range of functions delivered by the Aladdin Service seems to me to satisfy the requirement of extensiveness referred to by Advocate General Kokott in *Abbey National* – Aladdin provided a bundle of different functions.

201. Even if I were to apply Advocate General Cruz Vilallon's concept of "autonomy" in *GfBk* in the present case, I would still reach the same conclusion. The activity of the computerised provision of analytical and monitoring information of investment funds was distinct from the activities which the Aladdin Recipients carried on. Thus, Aladdin might warn a PM that a proposed trade would breach a Product Rule but it would be for the PM to decide whether to carry out the trade. Again, Aladdin may identify that a particular investment was responsible for a tracking error, but it was for the PM to decide whether to retain or dispose of the investment. Aladdin would inform the PM of the cash position of a fund on a real-time basis, but the PM had to decide what to do with that information. These were distinct functions and roles albeit, as Mr Hitchmough put it, interactive. Aladdin's role was essentially the provision of analysis and information, but the role of the PM was to decide what action to take, if any based on that information. It seems to me that the provision of that information and analysis was a function which the PMs did not themselves carry out and that there was, to use the words of Advocate General Cruz Vilallon, no "blurring". In fact, "blurring" only arises if the functions are described with such a high degree of generality that the actual specific content of the services is ignored.

202. Thus, it seems to me that the requirement that the Aladdin Services should constitute "a distinctive whole" is met.

203. Mr Hill urged on me the proposition that the Aladdin Services could not constitute "management" for the purposes of the exemption because Aladdin was only "a tool" used by PMs in the management of the funds for which they were responsible. It is true that Aladdin is a tool – Mr Kirby-Tibbits accepted as much in cross-examination – albeit that it is an extremely sophisticated tool. But it seems to me that whether Aladdin is a tool or not is not the correct test. The test is whether the services in question, viewed broadly, form a distinct whole, and are specific to, and essential for, the management of special investment funds. In my view, for the reasons I have given, I consider that that test is satisfied on the facts of this appeal.

204. Furthermore, the fact that Aladdin is provided by BFMI but operated by the employees of the Aladdin Recipients (in the sense that those employees require Aladdin to perform analytical/monitoring functions or at least are able to view those functions on their computers) does not seem to me to alter the position. Aladdin will do a number of things automatically (e.g. net asset value updating) and other things it will do if prompted by employees of the Aladdin Recipients. The service provided by BFMI to BlackRock under the Aladdin Agreement is the provision of the software licence and the functionality of Aladdin, which includes allowing the Aladdin Recipients to access the data held on BFMI's servers. Thus, BFMI provides BlackRock with, amongst other matters, analytical and monitoring information which is specifically designed for investment fund management. If, as I have concluded, that service constitutes a "distinct whole" and is "specific and essential" to the business of fund management then the service fulfils the requirements for exemption.

205. I should add that it seems to me that my interpretation and application of the "distinct whole" and "specific and essential" requirements is consistent with the principle of fiscal neutrality. It means that the Aladdin Recipients are in no worse position than a fund manager which chose to use its own in-house analytical, monitoring and compliance systems or than a direct investor. In this context, I have borne in mind the comments of Advocate General Kokott in *Abbey National* at [66] of her opinion, with which I respectfully agree, where she said:

> "An excessively narrow understanding of the concept of management would… have the effect of making outsourcing of partial services unattractive and thus making an economic a sensible division of labour more difficult."

206. Accordingly, for the reasons given above, I decide the exemption issue in favour of BlackRock.

The apportionment issue – submissions

207. As I have already mentioned, it was common ground that the supply of the Aladdin Services constituted a single composite supply of services to BlackRock as a representative member of the VAT group comprising the Aladdin Recipients.

208. Proceeding on this basis, therefore, Mr Hitchmough accepted that as a general principle a single composite supply would usually be taxed at a single rate. Mr

Hitchmough also accepted that if that general principle were to be applied in this case, the single rate would be the standard rate of VAT.

209. The general principle (single rate for a single supply) was not, however, an absolute rule, according to Mr Hitchmough. It was, he submitted, a matter of interpretation of the relevant legislative provision, in this case Article 135.1(g) PVD. Mr Hitchmough argued that this was a case where multiple rates should apply.

210. First, Mr Hitchmough referred to the CJEU's decision in *Talacre Beach* and in particular to [24]-[26]. These passages showed that the CJEU recognised that there was no absolute rule that a single rate of tax must be applied to a single composite supply. Instead the Court indicated that all the circumstances, including the specific legal framework had to be taken into account. The Court looked at the objective of the Article [Article 28.2] in question and it also derived comfort at [26] from the fact that there was no evidence to suggest that apportionment of the consideration would lead to "insurmountable difficulties capable of affecting the proper working of the VAT system…."

211. In relation to the opinion of Advocate General Kokott in *Talacre Beach*, Mr Hitchmough drew attention to certain passages ([37]-[40]) which he submitted demonstrated that the rules in cases such as *Card Protection Plan Ltd v Customs and Excise Commissioners Case* C-349/96 [1999] STC 270 had been developed mainly for reasons of practicality and did not claim absolute application.

212. Secondly, Mr Hitchmough referred to *the French Undertakers case* and, in particular to [30]-[33]. He submitted that in deciding whether separate rates of tax should apply, it was not determinative that there was a single supply. The important question was giving effect to the legislative intention. This was particularly evident in the Court's conclusions in [33]. The question, therefore, was whether Article 135.1(g) PVD, properly construed, required apportionment or whether a single composite supply had to be taxed at a single rate. It was, Mr Hitchmough argued, essentially a question of statutory interpretation.

213. Finally, Mr Hitchmough referred to the decision of the Court of Appeal in *Colaingrove*. The judgment of Arden LJ (with whom Lindblom and Henderson LJJ concurred), particularly at [45]-[54], was based on the premise that a single supply was capable of having separate rates of VAT applied to it, if that was what the relevant legislation required. However, the meaning and scope of the domestic legislation was plain and it prohibited apportionment: other statutory provisions contemplated apportionment but the one in question in that case did not.

214. Mr Hitchmough submitted that, in the present case, a purposive construction of Article 135.1(g) required an apportionment to reflect the dual use of the Aladdin Services; the present appeal was not a case concerning an apportionment between different aspects of the supply made to the Aladdin Recipients. It was that latter approach that was rejected in *Colaingrove*. Mr Hitchmough therefore argued for a use-based apportionment.

215. Finally, in relation to *Colaingrove*, Mr Hitchmough noted that the construction of domestic legislation and, in particular, the provision for apportionment in other cases was not relevant in the present case. BlackRock's appeal concerned a provision of Community law which had direct effect: it was Article 135.1(g) which was to be interpreted and applied.

216. That type of use-based apportionment would reflect a purposive construction of Article 135.1(g). Mr Hitchmough referred to [68] of Advocate General Kokott's opinion in *Abbey National* (referred to with approval by the Court) where she explained that the purpose of the Article 135.1(g) exemption was to facilitate investment in securities by small investors through the medium of investment funds and to ensure fiscal neutrality. Mr Hitchmough submitted that allowing apportionment would ensure that the small investor did not suffer an unintended VAT burden; "unintended" because, if the Aladdin Services qualified for the exemption, a VAT burden would arise purely as a result of the form in which the supply has been made by BFMI to BlackRock. In addition, Mr Hitchmough referred to the Advocate General's opinion in *Abbey National* at [66] where she cautioned against an "excessively narrow understanding of the concept of management [which would] have the effect of making outsourcing of partial services unattractive and thus making an economic the sensible division of labour more difficult."

217. Mr Hitchmough also referred to the comments of the CJEU in *GfBk* at [31] where the Court emphasised the fact that the principle of fiscal neutrality allowed economic operators to choose the form of organisation which, from a strictly commercial point of view, best suited them.

218. Therefore, Mr Hitchmough submitted that apportionment was required as a result of a purposive construction of Article 135.1(g).

219. Mr Hill submitted that the apportionment issue raised the question whether the general principle that a single supply should be taxed at a single rate applied in this case or whether an exception to that rule should apply instead. If the general rule applied, it was common ground that the supply of services in this appeal would be predominantly a supply of services in relation to non-SIFs and thus be standard rated.

220. Apportionment, Mr Hill argued, could only be permitted in very limited circumstances. *Talacre Beach* was an example of one of those exceptional circumstances. The effect of applying a single rate of VAT to the whole of a composite supply in that case would have been to extend the scope of zero rating after 1 January 1991, contrary to an express requirement of Community Law ([19]-[22]). Therefore, in that case it was necessary to have an apportionment because otherwise zero rating would have infringed Article 28(2)(a). Moreover, domestic law had specifically excluded the contents of a caravan from zero rating. The Court was not saying that, as a general matter, it was possible to apply two different rates of VAT to a single service.

221. Mr Hill also referred to the opinion of Advocate General Kokott in *Talacre Beach* at [28] where she noted that splitting a comprehensive supply into too many

separate classified individual supplies would overcomplicate the application of the VAT rules. Furthermore, the Advocate General stated at [32] that only one rate of taxation could be applied to one composite supply and that at [38] that the application of several rates of tax to a single supply would be contrary to the aim of the case law on composite supplies, namely to maintain the functioning of the VAT system.

222. As regards *the French Undertakers case*, the CJEU at [25]-[26] allowed tax to be charged at different rates in respect of the same supply because the reduced rate was an exemption which was specifically authorised by Community Law. Mr Hill submitted that in the present case there was no provision of Community law which authorised different rates of tax being charged in respect of a single supply.

223. If BlackRock's apportionment argument were to be accepted, Mr Hill warned that taxpayers would argue for apportionment on the basis of the purpose for every composite supply where an element consisted of an exempt supply.

224. Mr Hill referred to *Colaingrove* where Community Law authorised member states to apply a reduced rate. The issue in *Colaingrove* was whether the UK legislation, correctly construed, allowed part of a single supply to be charged at the reduced rate instead of the standard rate which would otherwise be applicable to the whole supply. The Court of Appeal decided at [48] that there was no domestic legislative authorisation for the apportionment of the consideration in respect of a single supply.

225. Mr Hill noted that in *Colaingrove*, Mr Cordara QC, for the taxpayer, had advanced the same argument now being put forward by Mr Hitchmough. Mr Cordara had argued at [31] that an apportionment of the consideration would accord with the social purpose behind the reduced rate for electricity and at [25]-[26] put forward similar arguments on fiscal neutrality. Neither of those arguments found favour with the Court of Appeal.

226. In this case, if the Aladdin Services were to be treated as "management" for the purposes of the exemption, the supply was one in which the management of non-SIFs predominated. The supply was, therefore, taxable and it was not possible to advance a fiscal neutrality argument to alter that result.

The apportionment issue – discussion

227. It is not in dispute that BFMI's supply to BlackRock in its capacity as the representative member of the VAT group comprising the Aladdin Recipients was a single supply. Moreover, it was accepted by both parties that the funds managed by the Aladdin Recipients were predominantly (whether calculated by the number of funds or by the amount of assets under management) non-SIFs.

228. On this basis, it seems inevitable to me that the correct rate of VAT is the standard rate and that it is not permissible to apportion the consideration between the use of the Aladdin Services for SIFs and non-SIFs.

229. The circumstances in *Talacre Beach* and *the French Undertakers case* were entirely different. In the former case, the application of a single rate of tax to a composite supply would have extended zero rating in a manner directly contrary to a provision of Community Law. It was for this reason that different rates of tax had to be applied to the same single supply. There is no parallel between the present case and the position in *Talacre Beach*.

230. Similarly, *the French Undertakers case* provides no authority for the argument advanced by Mr Hitchmough in favour of apportionment. In that case, the reduced rate of VAT applied by France was specifically authorised by Community Law and, moreover, France was entitled to apply that reduced rate to certain elements of the overall supply. Again, there is no proper comparison with the present appeal and that case.

231. As was made clear in *Talacre Beach*, the general rule is that a single rate of tax should be applied to a single composite supply. The only exceptions to that rule are found in cases where there is clear authority in EU legislation for a different treatment.

232. Mr Hitchmough argues that apportioning the consideration between standard rated and exempt supplies in this case would promote the purpose of the exemption. That is no doubt true, but it would also be true of every composite supply where the ancillary element was, viewed in isolation, an exempt supply. Mr Hill is correct, in my judgment, when he says that if apportionment were to be allowed in this case, it would have to be allowed in a wide variety of other situations and would be contrary to the aim of the case law on composite supplies, namely to maintain the functioning of the VAT system. That, in my view, would be a startling and novel proposition which, of itself, suggests that it cannot be right.

233. The need to ensure the proper an efficient functioning of the VAT system must, in my judgment, prevail over the furtherance of the purpose of specific exemptions, except where there is a clear Community Law warrant to the contrary.

234. I therefore decide the apportionment issue in favour of HMRC.

Conclusions

235. I have decided that the supply of the Aladdin Services by BFMI to BlackRock:

(1) would, when viewed in isolation, qualify for exemption from VAT in Article 135.1(g) PVD in so far as those services are used for the management of SIFs; and

(2) notwithstanding the above conclusion, the supply is subject to the reverse charge at the standard rate because no use-based apportionment of the consideration in respect of a single composite supply can be permitted in this case.

236. I therefore dismiss this appeal.

Rights of appeal

237. 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.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 15 AUGUST 2017