[2017] UKFTT 700 (TC)

TC06119

Appeal number: TC//2016/02202

VALUE ADDED TAX – partial exemption – whether VAT on refurbishment of part of tennis club's premises wholly attributable to the making of taxable supplies – yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

THE QUEEN'S CLUB LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at Taylor House, Rosebery Avenue, London on 8 September 2017

Robert Maas of CBW Tax Limited for the Appellant

Susan Spence, Officer of HM Revenue & Customs, for the Respondents

DECISION

1. The appellant (the "Club") is a well-known members' tennis club. It makes exempt supplies of sporting services to its members and also makes taxable supplies (for example of food and drink in its bars and restaurants). It has incurred costs refurbishing bar, restaurant and café facilities on its premises. The Club considers that it is entitled to a full credit for input tax on those expenses as they were wholly attributable to taxable supplies. HMRC consider that input tax should be recovered under the Club's partial exemption method and the Club is appealing against that decision.

2. The parties are asking the Tribunal to determine, as a matter of principle, whether the input tax was attributable either solely to taxable supplies (as the Club argues), or to both taxable and exempt supplies (as HMRC argue). With the benefit of the Tribunal's decision in principle, they propose to agree matters of quantum between themselves. I am happy to give a decision on this basis.

Evidence

3. The Club relied on witness evidence from Tony Dhanoa, who is the Club's finance director. Officer Spence cross-examined him. I found Mr Dhanoa to be a reliable and honest witness and have accepted his evidence. HMRC did not rely on witness evidence.

4. Both parties made submissions by reference to a bundle of documents.

Facts

5. There was little dispute on most of the relevant background facts although the parties had very different perceptions as to the effect of those background facts on the Club's claim for input tax credit. I have made the findings set out at [6] to [17] below.

6. The Club is a limited company that carries on a sports club located in West London that was established in 1886. It provides its members with the opportunity to play lawn tennis, real tennis, rackets and squash. The Club's tennis facilities are world-class as is demonstrated by the fact that each year the Lawn Tennis Association hires the Club's courts to mount the Aegon Championship which is a precursor to the Wimbledon tournament and attracts many of the world's leading players.

7. At all times material to this appeal, the Club has been registered for VAT purposes.

8. The Club does not have a single clubhouse. Rather, its "clubhouse" consists of four adjacent buildings. One of these buildings is known as the "Pavilion". Until the renovation works described below, the first floor of the Pavilion included a café and two bars that were physically separated from the café and each other. In around 2011, the Club's Development Advisory Committee concluded that usage of the first floor of the Pavilion by members was poor and that a redesign would encourage greater usage and result in the Club obtaining more revenue. The Club therefore refurbished the first floor of the Pavilion by upgrading the café to a full-service restaurant and

easing access from the bars to the restaurant, so creating a continuous space that encourages people drinking at the bars also to eat at the restaurant.

9. I had little evidence as to whether the Club has elected to waive exemption from VAT in relation to the Pavilion. Officer Spence asked Mr Dhanoa in cross-examination whether such an election had been made but, not being a tax specialist, Mr Dhanoa did not understand the question and so could not answer it. However, Mr Dhanoa is the finance director of the Club and I have concluded that if an election to waive VAT exemption had been made in relation to the Pavilion, he would have known that such an election had been made, even if he did not understand fully what effect the election had. I have concluded that no option to waive VAT exemption has been made in relation to the Pavilion.

10. The Club has received goods and services connected with these renovations ("renovation goods and services") which can be summarised as follows:

(1) services of designers and consultants who advised on the appropriate design of the renovated restaurant and bars;

(2) the services of builders and surveyors involved with the necessary building works (which included moving existing entrances to the café/restaurant and the removal of internal walls);

(3) building materials used in the renovations;

(4) the services of project managers;

(5) kitchen equipment, tables and chairs for the upgraded restaurant; and

(6) goods and services used in the decoration of the renovated restaurant and bars.

Supplies of the renovation goods and services were subject to VAT and, accordingly, the Club incurred input tax on the acquisition of those goods and services.

11. The renovated restaurant is known as the "Grille" (and is named after a target in the game of real tennis). Like all of the Club's facilities, it can be used only by members of the Club and their guests. The Grille offers a range of dishes at prices that are comparable to similar restaurants in the Barons Court area of West London.

12. The Club's revenue comes primarily from membership fees that it charges. Members are required to renew their membership on 1 October each year. For the year 2012-13 the annual membership fee was £1,820 and the Club's policy has been to increase that fee only in line with inflation each year. By becoming a member of the Club, a person obtains the right to use both its sporting and non-sporting facilities, though an additional charge may be levied for the use of particular categories of tennis court. It was common ground that the membership fee was consideration for (and only for) an exempt supply of services closely linked with sport for the purposes of Item 10 of Schedule 9 of the Value Added Tax Act 1994 ("VATA 1994"). Members of the Club also obtain preferential rights to tickets to watch the Aegon Championship.

13. The Club has other sources of revenue as well:

(1) As noted above, it obtains a fee from the Lawn Tennis Association to use its courts for the Aegon Championship.

(2) It sells food and drink in its restaurant and bars. It was common ground that these sales consisted only of taxable supplies for VAT purposes. I have accepted Mr Dhanoa's unchallenged evidence that the revenue the Club raises from all of its bars and restaurants is not material to the Club's viability as a going concern.

(3) It sells sporting and other goods in shops on the Club's premises.

(4) It receives some rent from tenants who use some property (other than the Pavilion) that the Club owns which the Club does not need to use itself.

(5) It occasionally hires out its rooms (including the renovated bar and Grille restaurant) to members who want to use it for their own purposes, for example parties or receptions. I have accepted Mr Dhanoa's evidence that, whenever the refurbished bars or Grille restaurant, is hired out to members in this way, the Club also provides catering and refreshments. The Club does not provide the members only with access to the bars and Grille restaurants and nothing more. By contrast, when the Club hires function rooms to members (for example the President's Room on the second floor of the Pavilion), it may, depending on the members' requirements, provide the room alone with nothing more than tea or coffee.

14. The parties were not agreed as to whether the Club had a contractual obligation to its members to provide them with access to bars or restaurants. In this regard, Clause 2.6 of the Club's Rules provided as follows:

> 2.6 [The Club] will provide the Members with facilities for lawn tennis, real tennis, rackets, squash rackets, table tennis, a gymnasium, bridge, snooker and billiards and such other facilities as the Board may decide are in keeping with the aforementioned activities in a sociable environment with other advantages and facilities at the Club Premises from time to time.

15. I have accepted the submission of Mr Maas, who appeared for the Club, that this clause does <u>not</u> impose a contractual obligation on the Club to provide access to bars and restaurants. The natural reading of the clause is that there was an irreducible "core" of facilities that the Club had to provide (lawn tennis, real tennis etc.) which did not include access to bars and restaurants. The clause gives the Club a discretion to offer other facilities (provided the Board concludes they are in keeping with the "core" activities) but does not impose an obligation to do so.

16. Officer Spence suggested that, once the Board had decided, in its discretion, to make available particular bars or restaurants, it then had a contractual obligation to members to maintain them. I have not, however, accepted that submission as I was not shown any express contractual term to this effect and I was not satisfied that such

a term should be implied into Clause 2.6 in accordance with principles of contractual interpretation. Moreover, if Officer Spence's submission were correct, having decided to offer members a café at the Pavilion, the Club was under a contractual obligation to continue to offer that café and the Club could not have shut down that café (and converted it into the Grille Restaurant) without members' approval. Yet Mr Dhanoa's unchallenged evidence was that the decision to convert the café at the Pavilion into the Grille restaurant was taken by the Club's Development Committee alone. There was no suggestion in Mr Dhanoa's evidence that the consent of members was needed to convert the café into the Grille Restaurant, and Officer Spence did not suggest to him in cross-examination that there was any requirement to obtain members' consent. Therefore, the Club's conduct was entirely consistent with it having a discretion, but not an obligation, to continue to provide the café to its members.

17. The parties were also not agreed as to the importance that members placed on the presence of the refurbished Grille restaurant and bars on the Club's premises when they made their decision to renew their annual membership, or to become members in the first place. That issue goes to the heart of the dispute between the parties and I will consider it in detail in the "Discussion" section below. I regard the following facts (in addition to those I have already found) as relevant to that issue:

(1) Mr Dhanoa's unchallenged evidence, which I have accepted, was that most members use the Club to play sport only, without using other facilities that the Club provides.

(2) In 2011-12 the Club had a six-year waiting list for membership. As at the date of the hearing, that had increased to a ten-year waiting list.

(3) The Club did not reduce membership fees to reflect the inconvenience that members suffered while the refurbishment of the bars and the Grille restaurant was ongoing. On the contrary, membership fees rose in line with inflation during this time.

(4) The Club has a "clubhouse" that consists of four buildings. The Grille restaurant and the refurbished bars occupy just part of the first floor of one of those buildings and does not, therefore, comprise a large proportion of the communal and social space available to members.

(5) I have accepted Mr Dhanoa's unchallenged evidence that the Club does not seek to attract non-playing members and that applicants are not permitted to join the Club as a social member. The Club does have a "social membership" category. However, all social members are former playing members who are not able to participate in sport (for example because of their age, because they are pregnant or because they are injured). Restrictions are placed on the ability of social members to use sporting facilities and each switch from the playing membership category to the social membership category must be individually approved by the Club's chief executive.

The law

Statutory provisions

18. The exempt sporting services that the Club provides fall within Article 132(1)(m) of the Principal VAT Directive which provides for the following services to be exempt:

> the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education

19. Article 132(1)(m) has been enacted in VATA 1994. Item 3 of Group 10 of Schedule 9 of VATA 1994 provides that the following are exempt from VAT:

> The supply by an eligible body [broadly a non-profit-making organisation] to an individual of services closely linked with and essential to sport or physical education in which the individual is taking part.

20. Articles 167 and 168 of the Principal VAT Directive provide a right of deduction in respect of input tax. Article 167 provides for the right to arise when the input tax is incurred and Article 168 explains the nature of the right of deduction as follows:

> **Article 168**
>
> In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:
>
> (a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person…

21. Articles 173 to 175 of the Principal VAT Directive contain provisions for there to be a proportional deduction of input tax where that input tax relates to both taxable and exempt supplies.

22. Article 173 provides as follows:

> **Article 173**
>
> 1. In the case of goods or services used by a taxable person both for transactions in respect of which VAT is deductible pursuant to Articles 168, 169 and 170, and for transactions in respect of which VAT is not deductible, only such proportion of the VAT as is attributable to the former transactions shall be deductible.

23. I will not include the detailed apportionment mechanism that is set out in Articles 174 and 175 of the Principal VAT Directive given that the dispute between the parties is one of principle and does not relate to the precise operation of the apportionment mechanism.

24. The above provisions of the Principal VAT Directive have been enacted into UK law in VATA 1994 and the Value Added Tax Regulations 1995 (the "VAT Regulations"). Neither party suggested that domestic UK legislation failed properly to give effect to the Principal VAT Directive.

Section 25(2) of VATA 1994 is the basic provision that confers a credit for input tax. Section 26 of VATA 1994 specifies the input tax that is eligible for credit as follows:

> **26 Input tax allowable under section 25**
>
> (1) The amount of input tax for which a taxable person is entitled to credit at the end of any period shall be so much of the input tax for the period (that is input tax on supplies, acquisitions and importations in the period) as is allowable by or under regulations as being attributable to supplies within subsection (2) below.
>
> (2) The supplies within this subsection are the following supplies made or to be made by the taxable person in the course or furtherance of his business—
>
> (a) taxable supplies;
>
> …

25. The provisions conferring a proportional credit where input tax is incurred for the purposes of both taxable and exempt supplies are contained in Regulations 101(1) and (2) of the VAT Regulations. They provide, relevantly, as follows:

> **101 Attribution of input tax to taxable supplies**
>
> …
>
> (2) Subject to paragraph (8) below and regulation 107(1)(g)(ii) in respect of each prescribed accounting period—
>
> (a) goods imported or acquired by and goods or services supplied to, the taxable person in the period shall be identified,
>
> (b) there shall be attributed to taxable supplies the whole of the input tax on such of those goods or services as are used or to be used by him exclusively in making taxable supplies,

It was common ground that, in order for the Club's appeal to succeed, by virtue of Regulation 101(2)(b) of the VAT Regulations the Club must establish that the renovation goods and services were used by the Club exclusively in making taxable supplies.

Case law authorities

26. The Court of Justice of the European Union ("CJEU")[1] has determined how Article 168 is to be applied in a number of decisions. For example, in Case C-4/94 *BLP Group v Customs and Excise Commissioners* [1995] STC 424, the CJEU said:

[1] I will use this defined term to refer to the European Court of Justice as well.

> 19. … the goods or services in question must have a direct and immediate link with the taxable transactions, and that the ultimate aim pursued by the taxable person is irrelevant in this respect.

At paragraph 24 of its judgment, the CJEU emphasised that the question must be determined by reference to the objective character of the transactions in question and not by reference to the subjective intention of the taxable person in making them.

27. In *Midland Bank v Customs and Excise Commissioners* (Case C-98/8), the CJEU amplified on this guidance saying, at paragraph 30 of its judgment:

> 30. It follows from that principle as well as from the rule enshrined in the judgment of *BLP Group plc v Customs and Excise Comrs* (Case C-4/94) [1995] STC 424 at 437, [1995] ECR I-983 at 1009, para 19 according to which, in order to give rise to the right to deduct, the goods or services acquired must have a direct and immediate link with the taxable transactions, that the right to deduct the VAT charged on such goods or services presupposes that the expenditure incurred in obtaining them was part of the cost components of the taxable transactions. Such expenditure must therefore be part of the costs of the output transactions which utilise the goods and services acquired. That is why those cost components generally have arisen before the taxable person carried out the taxable transactions to which they relate.

28. The emphasis in the above decision was therefore on whether expenditure was a "cost component" of taxable supplies. However, the parties were agreed that, at least for the purposes of this appeal, there was no material distinction between a formulation of the test based on a "direct and immediate link" and a formulation that focused on the concept of "cost components".

29. In this appeal, there is no dispute that there was a direct and immediate link between the renovation goods and services that the Club received and taxable supplies that it made in the Grille restaurant and bars. The question that divides the parties is whether there was also a direct and immediate link between the renovation goods and services and exempt supplies that the Club made. Following the decision of the Upper Tribunal in *St Helen's School Northwood Limited v HMRC* [2006] EWHC 3306 (Ch), to answer this question, the Tribunal must not focus on the physical use of the refurbished areas. Therefore, the fact that those areas were physically used as a café/restaurant and as bars, and that the Club makes only taxable supplies in those areas, does not determine the issue. Rather, the Tribunal should seek to ascertain what Warren J described as the "economic use" of the renovation goods and services to ascertain whether the Club used them to make exempt supplies.

30. Moreover, following the decision of the Court of Appeal in *Dial-A-Phone Limited v Commissioners of Customs & Excise* [2004] EWCA Civ 603, it is possible for there to be a direct and immediate link between the renovation goods and services received and exempt supplies even if the link with taxable supplies is closer. The Tribunal's task is to consider whether there is a "sufficient" link, not to decide which link is "closest". Understandably, in her submissions, Officer Spence emphasised this point. However, I consider that Mr Maas was correct to stress that, for HMRC's calculation

of the Club's input tax recovery to be correct, there must still be a direct and immediate link between the renovation goods and services that the Club received and exempt supplies that it made. The decision in *Dial-a-Phone Limited* does not dilute that requirement.

31. Finally, following the decision of the Court of Appeal in *Customs & Excise Commissioners v Southern Primary Housing Association Ltd* [2003] EWCA Civ 1662, the analysis of whether there is a "direct and immediate link" between the renovation goods and services received and exempt supplies is not the same as asking whether the Club would have been able to make the relevant exempt supplies "but for" receiving the renovation goods and services.

32. I was also referred to several decisions of this Tribunal which dealt with the recoverability of input tax associated with refurbishments of buildings, including some dealing with buildings owned by sports clubs. Those were helpful insofar as they demonstrated how the Tribunal had approached similar factual questions. However, since each case will turn on its own facts, and since I consider that I have summarised the applicable principles of law that are binding on me in the paragraphs above, I will not refer to these Tribunal decisions in any more detail.

Discussion

33. Officer Spence suggested that there was a sufficient direct and immediate link between the renovation goods and services and the following exempt supplies that the Club made:

> (1) exempt supplies consisting of supplies of membership that the Club made to its members; and
>
> (2) exempt supplies consisting of the Club's hire of the bars and restaurant to members set out at [13(5)] above.

34. Officer Spence's submission referred to at [33(2)] relies on the proposition that, when the Club hires the bars and restaurant to its members, it makes exempt supplies for VAT purposes. I have not accepted that submission. The Club has not waived VAT exemption in relation to the Pavilion and therefore any supplies of licences to occupy the Pavilion would be exempt supplies by virtue of Item 1 of Group 1 of Schedule 9 VATA 1994. However, given the finding I have made at [13(5)], I have concluded that, when the Club makes the Grille restaurant and the bars available to its members it does so as part of a supply of catering services which are standard rated and not exempt.[2]

35. That leaves Officer Spence's submission at [33(1)]. The burden is on the Club to demonstrate that the only direct and immediate link is between the goods and services received and taxable supplies that the Club makes. For reasons set out below, I consider the Club has discharged that burden.

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[2] I do not need to decide whether, when the Club makes function rooms such as the President's Room available to members on a "room only" basis (without providing associated supplies of catering), the Club makes a purely exempt supply of a right to occupy land and I will not do so.

36. The first point to note is that, following *Midland Bank*, there can only be a direct and immediate link between the renovation goods and services that the Club received and supplies that the Club made after receiving those goods and services. Therefore, given that Officer Spence made her case on the basis that there was a link with exempt supplies of membership, the question is not whether the Club refurbished the bars and restaurant to benefit members at the time of refurbishment. Rather, given that formulation of HMRC's case, the question is whether there was a direct and immediate link with exempt supplies of membership that the Club made (when members either renewed their membership or became members for the first time) after the Club received supplies of renovation goods and services.

37. Officer Spence in her submissions stressed the benefit that members of the Club receive consisting of the ability to enjoy food and drink at the bars and Grille restaurant without having to compete for tables with the general public. I accept that members of the Club obtain such a benefit and I am also prepared to accept that members who use the Grille restaurant and bars regard it as a desirable feature of membership of the Club[3]. However, that does not establish a direct and immediate link with the provision of exempt supplies consisting of membership of the Club. Rather, given the point at [36], the relevant question is whether there is a direct and immediate link between the renovation goods and services that the Club received and the decision of members either to become members, or to renew their membership. For the reasons set out below, I have concluded that there is no direct and immediate link in this sense.

38. I do not regard it as particularly relevant that income from the Club's bars and restaurants is not crucial to its viability since the threshold for a particular source of revenue to be "crucial to viability" for such a large club is presumably high. Moreover, it is possible for members to attach significance to matters that the Club does not regard as crucial to viability.

39. However, even if members as a whole did value the right of exclusive access to the Grille restaurant and bars, they had no contractual assurance, when renewing their membership, or becoming members, that that right of access would be provided. The Club had a six-year waiting list for membership even when the Pavilion was in its unaltered state. Moreover, while the refurbishment works were ongoing (which Mr Dhanoa acknowledged would have involved inconvenience to members and limitations on the dining and drinking facilities at the Pavilion), the waiting list increased and the Club increased its membership fees. All of those factors strongly point towards a conclusion that there was no direct and immediate link between the renovation goods and services and exempt supplies that the Club made to members who either renewed their membership or chose to become members for the first time.

40. Viewed objectively, the focus of the Club's offering to its members is on world-class sporting facilities. It does not seek to attract social members, although it does cater for people who, having been playing members, are not able to continue to play

[3] Although, as I have noted, Mr Dhanoa's unchallenged evidence was that most members of the Club do not actually use the Grille restaurant or the refurbished bars.

sport by admitting them to a social membership category. Nor, viewed objectively, are the Grille restaurant and the bars a means for members to enjoy the Club's world class sporting facilities. No doubt some degree of social space is necessary for members to enjoy the Club's sporting facilities fully. However, given Mr Dhanoa's evidence to the effect that most members simply leave the Club's premises after they have finished their game without using the bars or restaurants, and given that the refurbished bar and Grille restaurant take up just part of one floor of the Club's "clubhouse" which is spread over four buildings, I do not consider that, viewed objectively, the renovated bars and Grille restaurant are a means by which members are able enjoy the Club's sporting offering.

41. In short, viewed objectively, what members obtain when they join the Club is a right of access to world-class sporting facilities together with such additional facilities as the Club decides, in its discretion, to offer. The focus is on the sporting facilities (and no doubt it is for this reason that both the Club and HMRC agree that the membership fee is consideration only for an exempt supply). There is a limited number of social members who are not able to use those world-class sporting facilities. It may well be (though I saw little, if any, evidence to this effect) that some members, whether social or playing members, like the renovated Grille restaurant and bars so much that they influence their decision to renew their membership. But the presence or otherwise of a "direct and immediate link" must be determined by objective factors. Since the presence of the Grille restaurant and bars does not impact on members' ability to enjoy the Club's world-class sporting facilities, it follows that there is no direct and immediate link between the refurbishment works and the Club's exempt supply of membership.

42. By analogy with the decisions of this Tribunal in *Bridgnorth Golf Club v Revenue & Customs* [2009] UKFTT 126 (TC) and *Bedale Golf Club Limited v Revenue & Customs* [2015] UKFTT 446 (TC), Officer Spence urged me to a different conclusion. However, those decisions are both not binding on me and deal with completely different types of sports club. I can quite accept that someone purchasing membership of a small golf club with modest facilities and a single clubhouse is necessarily acquiring a right of access to the clubhouse. In such a case, the clubhouse is intrinsic to the supply of sporting services and the golf club should not obtain full input tax recovery when the clubhouse is renovated because there is a sufficient direct and immediate link between that input tax and exempt supplies of services closely linked to sport. However, the Club is different. It does not have a single clubhouse, but rather has four buildings which provide a variety of social facilities. Crucially, the Club is under no contractual obligation to provide its members with access to bars or restaurants and most members do not use its bars or restaurants. The Club's primary offering to its members consists of access to world-class sporting facilities and I am not satisfied that the Club's bars and restaurants are a means by which members can enjoy those world-class sporting facilities or indeed any other services "closely linked to sport" (within the meaning of Article 168 of the Principal VAT Directive). I therefore regard the Tribunal's decisions in *Bridgnorth Golf Club* and *Bedale Golf Club* as distinguishable.

Conclusion

43. My overall conclusion is that there was no direct and immediate link between the renovation goods and services and exempt supplies that the Club made. There was plainly a direct and immediate link between those goods and services and taxable supplies that the Club made and this was not in dispute.

44. I have therefore concluded that the Club is entitled to credit for the full amount of input tax that it incurred. Within 56 days of release of this decision, the parties must inform the Tribunal whether they have been able to agree matters of quantum, as they indicated that they could. If they are not able to agree on quantum, the Tribunal will issue directions to ensure that any remaining dispute is resolved at a further Tribunal hearing.

45. 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.

JONATHAN RICHARDS
TRIBUNAL JUDGE

RELEASE DATE: 22 SEPTEMBER 2017